



Report and Recommendation of the President to the Board of Directors

Project Number: 51350-001
May 2018

Proposed Programmatic Approach, Policy-Based Loan for Subprogram 1, and Technical Assistance Grant Republic of Uzbekistan: Economic Management Improvement Program

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Asian Development Bank

CURRENCY EQUIVALENTS

(as of 15 May 2018)

Currency unit – sum (SUM)

SUM1.00 = \$0.0001240
\$1.00 = SUM8,059.24

ABBREVIATIONS

| | | |
|--------|---|--|
| ADB | – | Asian Development Bank |
| CBU | – | Central Bank of Uzbekistan |
| CGR | – | corporate governance rule |
| e-GDDS | – | enhanced general data dissemination system |
| GDP | – | gross domestic product |
| IFRS | – | International Financial Reporting Standards |
| IMF | – | International Monetary Fund |
| MTBF | – | medium-term budget framework |
| MOF | – | Ministry of Finance |
| OECD | – | Organisation for Economic Co-operation and Development |
| PEFA | – | public expenditures and financial accountability |
| PPP | – | public–private partnership |
| SDDS | – | special data dissemination standard |
| SOE | – | state-owned enterprise |
| TA | – | technical assistance |

NOTE

In this report, "\$" refers to United States dollars.

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PROGRAM AT A GLANCE

| | | | |
|---|--|--|---------------------|
| 1. Basic Data | | Project Number: 51350-001 | |
| Project Name | Economic Management Improvement Program (Subprogram 1) | Department/Division | CWRD/CWPF |
| Country Borrower | Uzbekistan Republic of Uzbekistan | Executing Agency | Ministry of Finance |
| 2. Sector | Subsector(s) | ADB Financing (\$ million) | |
| ✓ Public sector management | Public expenditure and fiscal management | | 300.00 |
| | | Total | 300.00 |
| 3. Strategic Agenda | Subcomponents | Climate Change Information | |
| Inclusive economic growth (IEG) | Pillar 1: Economic opportunities, including jobs, created and expanded | Climate Change impact on the Project | Low |
| 4. Drivers of Change | Components | Gender Equity and Mainstreaming | |
| Governance and capacity development (GCD) Partnerships (PAR) Private sector development (PSD) | Institutional development Public financial governance Implementation International finance institutions (IFI) Promotion of private sector investment | No gender elements (NGE) | ✓ |
| 5. Poverty and SDG Targeting | | Location Impact | |
| Geographic Targeting Household Targeting SDG Targeting SDG Goals | No No Yes SDG8 | Nation-wide | High |
| 6. Risk Categorization: | Complex | | |
| 7. Safeguard Categorization | Environment: C Involuntary Resettlement: C Indigenous Peoples: C | | |
| 8. Financing | | | |
| Modality and Sources | | Amount (\$ million) | |
| ADB | | 300.00 | |
| Sovereign Program (Regular Loan): Ordinary capital resources | | 300.00 | |
| Cofinancing | | 500.00 | |
| World Bank - Program loan (Not ADB Administered) | | 500.00 | |
| Counterpart | | 0.00 | |
| None | | 0.00 | |
| Total | | 800.00 | |
| Note: An attached technical assistance will be financed on a grant basis by the Technical Assistance Special Fund (TASF-OTHERS) in the amount of \$1,000,000. | | | |

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on (i) a proposed programmatic approach for the Economic Management Improvement Program, and (ii) a proposed policy-based loan to the Republic of Uzbekistan for subprogram 1 of the Economic Management Improvement Program.¹ The report also describes proposed technical assistance (TA) for the Economic Management Improvement Program, and if the Board approves the proposed loan, I, acting under the authority delegated to me by the Board, approve the TA.

2. The proposed programmatic approach aims to strengthen economic management in Uzbekistan and thus support macroeconomic stability and sustained high growth. Sustained high growth is a prerequisite for job creation. The program will (i) introduce important fiscal reforms to ensure fiscal sustainability; (ii) improve governance in state-owned enterprises (SOEs) to make their operations financially viable; (iii) improve access to bank finance by strengthening bank supervision to facilitate competitive financing of private sector operations, especially small and medium-sized enterprises; and (iv) strengthen economic data collection, analysis, management, and dissemination systems to bolster economic decision-making. Programmatic budget support will finance two subprograms, each designated as a fully front-loaded single-tranche intervention to be implemented during 2018–2019. The attached TA will assist in implementing the program.

II. PROGRAM AND RATIONALE

A. Background and Development Constraints

3. Uzbekistan's economic growth has been strong in the past decade, which helped reduce poverty levels. Strong external demand and buoyant export performance of gas, gold, and copper, aided by high commodity prices, generated state budget revenues that financed large-scale public investment in infrastructure development and industrial modernization. The remittances, mainly from the Russian Federation, and consistent increases in public sector wages and pensions supported consumption growth. However, from 2013 onwards, declining global commodity prices, subdued growth in some export destination countries,² and more recently, an economic downturn in the Russian Federation successively affected Uzbek exports, budget revenues, and household incomes. In response, authorities implemented countercyclical fiscal and monetary policies to stimulate domestic demand. Consequently, gross domestic product (GDP) growth slowed only marginally from 8.0% in 2014 to 7.8% in 2016. However, growth declined further in 2017 to 5.3% as the economy adjusted to the adverse impacts of a significant devaluation of the local currency.³ Rising inflationary pressures with the official exchange rate depreciating by about 48% subdued construction and service activities. Agriculture also suffered as the prices of imported inputs nearly doubled in local currency.

4. In September 2017, the government initiated a comprehensive exchange rate reform to solve long-standing difficulties associated with limited access to foreign exchange and requirements to surrender foreign exchange, which brought parallel exchange markets and economic distortions. The lack of access to foreign exchange was, for years, a key deterrent to foreign investment and private sector development. Thus, the reform aimed to promote foreign investment, private sector development, and exports. It allowed free access to foreign currency

¹ The design and monitoring framework is in Appendix 1.

² These countries include Kazakhstan, the People's Republic of China, Russian Federation, and Turkey.

³ Uzbekistan: Selected Economic Indicators 2015–2019. IMF Press Release No. 18/168. 9 May 2018. (<http://www.imf.org/en/News/Articles/2018/05/09/pr18168-imf-executive-board-concludes-2018-article-iv-consultation-with-the-republic-of-uzbekistan>).

for private firms. However, liberalizing the foreign exchange market created many macroeconomic challenges because of weak governance structure in some areas. For one, high inflation and accelerated local currency depreciation inflated the credit risk of unhedged foreign currency borrowers, primarily large SOEs.⁴ In response, the government launched some complementary reforms, at a substantial cost, both additional expenditures and revenue losses, to facilitate a soft landing and minimum disorder in economic management.⁵ However, the costs associated with these reforms pose fiscal and debt sustainability risks.⁶ Without these complementary measures, foreign exchange market reforms would have been difficult to implement efficiently. Developments during late 2017 exposed areas that will require stronger governance structures to minimize vulnerabilities to shocks, as discussed below.

5. Large public sector and inefficient fiscal management.⁷ The key deficiencies are (i) relatively weak oversight of aggregate fiscal risk from public sector entities; (ii) weak internal controls in large ministries; (iii) lack of public access to key fiscal information; (iv) lack of a medium-term fiscal framework to ensure a multiyear perspective in fiscal planning and expenditure policy and budgeting; (v) lack of competition, value for money, and controls in procurement; (vi) weak management of fiscal risks related to SOEs;⁸ and (vii) lack of coordination of development partners' aid. State and consolidated budgets are not based on long-term national and sector-specific strategic objectives and programs.⁹ SOEs dominate all the important segments of the economy, and thus leave little space for the private sector. These segments include energy (power generation and transmission; and oil and gas refining, transportation, and distribution); metallurgy; mining (nonferrous metals and uranium); telecommunication (fixed telephony and data transmission); agriculture (cotton processing); machinery (automotive industry, locomotive, and aircraft production and repair); and transport (airlines, railways, and municipal public transport). Moreover, inefficient upstream SOEs dealing with public utilities have an adverse impact on the downstream private companies. At present, Uzbekistan does not adhere to the Organization for Economic Co-operation and Development (OECD) Guidelines on Corporate Governance of SOEs.¹⁰ SOEs are subject to domestic accounting standards and rules, which are still not fully comparable with the International Financial Reporting Standards (IFRS).

6. Inefficient banking intermediation and supervision. The banking system in Uzbekistan is still closely controlled by the state through a complex set of regulatory actions. Most banking assets remain in state-owned or state-controlled banks,¹¹ and most loans are directed by the government to develop certain preselected programs or sectors. The banking system includes 2 state banks, 13 joint-stock commercial banks, 8 private banks, and 5 banks with foreign investments. Banks' corporate and retail deposits comprise only about 56% of their non-equity funding. Loans from the government and funding from international financial institutions are the two other important sources of non-equity funding. Moreover, state-owned banks have a strong influence over systemic loan growth and interest rates through their participation in state-run

⁴ The year-end consumer price inflation was 18.9% in 2017, compared to 7.9% in 2016 (source: footnote 3).

⁵ Moderating inflation without losing jobs is necessary for this purpose. Creating adequate jobs remains the main challenge for the government.

⁶ More on this in Section D (para. 16).

⁷ Sector Assessment (Summary): Multisector (accessible from the list of linked documents in Appendix 2).

⁸ Some of the important deficiencies in the governance structure of SOEs include weak controls of payroll and non-payroll expenditures, poor quality and timeliness in preparing financial statements and audits, poor legislative scrutiny and lack of follow-up of external audits, and non-transparency of relevant information.

⁹ When there are uncertainties about the state of the state's finances, investors demand higher-risk premiums on government debt, which affects private demand via the interest rate. Contingent liabilities of the government are an important source of uncertainties.

¹⁰ <http://www.oecd.org/corporate/guidelines-corporate-governance-SOEs.htm>

¹¹ The market share is about 80% in terms of assets. Also, state-controlled banks have large loan exposures to SOEs.

lending programs, and they enjoy the privilege of servicing the domestic blue-chip companies. Consequently, banks cannot play the role of effective financial intermediaries, which inhibits the ability of citizens or private companies to obtain credit and other banking services.¹² Therefore, Uzbekistan has low levels of corporate and personal indebtedness. The ratio of domestic credit to GDP was about 43.1% by the end of 2017. Banking supervision, including capital and liquidity assessments, remains irregular. Hence, more focus should be put on developing banks, enabling them to provide much cheaper and more efficient financing for private investments. Moreover, Uzbekistan's debt and capital markets remain extremely shallow. The domestic capital market is underdeveloped and does not help private entrepreneurs to raise funds. Similarly, the domestic private sector bond market transacts less than 0.5% of banks' liabilities.

7. **Lack of transparent and efficient data dissemination systems.** Timely flows of accurate socioeconomic data will remain an important driver of growth and change. Flows of data play a significant role in creating new economic paradigms, as envisaged by the government. Poor data quality and standards are detrimental to private investment decisions and for prioritization of public projects. The data collection, analysis, and dissemination systems are quite weak in Uzbekistan and amplify other macroeconomic challenges. Data systems require significant strengthening to enable the policy makers to make informed decisions in the areas of macroeconomic planning and management.¹³ This is equally important from the perspective of foreign investors willing to invest in Uzbekistan.

8. The loan, the first programmatic approach intervention in Uzbekistan, draws on lessons learned from related initiatives in Uzbekistan and in other countries in the Central and West Asia region.¹⁴ Strong government commitment and adequate support from all stakeholders are the two important prerequisites for a successful policy-based reform program.¹⁵ Thus, setting realistic policy actions is crucial to ensure the government's commitment. A programmatic approach, supported by adequate TA support, is appropriate for this purpose. Similar lessons were also identified for the World Bank's Banking Sector Restructuring and Privatization Project in Pakistan.

B. Policy Reform and the Asian Development Bank's Value Addition

9. The Government of Uzbekistan is committed to transform the economy into an open and diversified structure and improve resilience to macroeconomic shocks. The government recognizes that this will also require complete transparency in economic data collection and dissemination. In February 2017, after Uzbekistan's first change in leadership in 25 years, the government adopted a 5-year national development strategy, 2017–2021.¹⁶ It sets five priority areas for reform. These priority areas are essentially addressing the issues covering (i) governance and public administration; (ii) the rule of law and the judicial system; (iii) economic

¹² The World Bank's enterprise surveys in 2015 showed that almost 75% of firms did not avail themselves of bank loans, and the value of collateral was on average 176% of the loan amount.

¹³ The problem of planning and economic management without facts is well documented, including in World Bank. 1983. *World Development Report 1983*. New York: Oxford University Press (Chapter 7).

¹⁴ Asian Development Bank (ADB). 2007. *Report and Recommendation of the President to the Board of Directors: Proposed Loan and Technical Assistance Grant to the Republic of Uzbekistan for the Public Finance Management Reform Project*. Manila; and ADB. 2017. *Report and Recommendation of the President to the Board of Directors: Proposed Loan and Administration of Technical Assistance Grant to the Republic of Uzbekistan for the Power Generation Efficiency Improvement Project*. Manila.

¹⁵ This is also noted in IMF's 2018 Article IV consultation staff report for the Republic of Uzbekistan. (<http://www.imf.org/en/Publications/CR/Issues/2018/05/11/Republic-of-Uzbekistan-2018-Article-IV-Consultation-Press-Release-Staff-Report-and-Statement-45873>)

¹⁶ Government of Uzbekistan. 2017. Presidential Decree No. 4947: The Strategy of Actions on Further Development of Uzbekistan. Tashkent.

development and liberalization; (iv) social development; and (v) security, tolerance, and foreign policy. The strategy articulates the government's vision for the development of a conducive environment for private sector development, and recognizes the need to improve public sector management, the banking sector, and the financial performance of SOEs (including key SOEs in the power sector). One of the three priority strategies is to modernize the governance system, including greater ownership and transparency of the budget process, and a gradual transitioning to program budgeting, with the aim to increase the effectiveness of government operation and maintenance expenditures. The government also plans to make SOEs regionally competitive and use the market mechanism to distribute resources and manage government assets. The government is committed to end unproductive transfers and subsidies to SOEs from the budget and convert loss-making SOEs into profit-making entities.¹⁷ This is planned to be achieved through restructuring and, for smaller SOEs, through outright privatization. The government intends to gradually move to the International Public Sector Accounting Standards across all government agencies by 2020. There is an ambitious economic reform agenda to stabilize the balance of payments and put the country on a different, more sustainable growth path.

10. The Strategy of Actions on Further Development of Uzbekistan, 2017–2021 includes key policy reforms to address issues related to access to finance and foreign currencies.¹⁸ The banking sector's performance is critical for the macroeconomic policy measures of the Central Bank of Uzbekistan (CBU) to succeed. As such, the government plans to improve banking supervision by moving to a risk-based approach, improve the quality of bank assets, and attract additional investment. The government reiterated the need for consistent policies and interpretation of regulatory requirements to build confidence in the banking sector. In 2017, a series of government documents were adopted to reform the banking sector and make the CBU more independent. Recent activities include taking various actions to remove potential conflicts of interest, excluding CBU staff participation on the supervisory boards of state-owned and controlled banks, transferring management of CBU shares in two state-owned banks to the Ministry of Finance (MOF), eliminating barriers to accessing cash and foreign currency, and protecting commercial banks from administrative pressures. A systematic review of the entire legal framework applicable to banks was initiated in mid-2017 to identify and address inconsistencies and ambiguities.

11. The program will facilitate identification and implementation of key reforms to address the development challenges, as explained above (paras 5–7), and improve economic management in Uzbekistan. This is a prerequisite for diversification of the economy with improved participation of the private sector. This is expected to be achieved under the programmatic approach. The proposed reforms are grouped in three areas:¹⁹

- (i) **Macroeconomic data collection, analysis, and dissemination systems.** The loan will facilitate implementation of an enhanced general data dissemination system (e-GDDS) over two subprograms.²⁰ The necessary orders for the adoption of the e-GDDS issued under subprogram 1, and the e-GDDS will be fully implemented under subprogram 2. The government will also submit a plan for implementation of the special data dissemination standard (SDDS) under subprogram 2. Similarly, the CBU's data dissemination systems will be strengthened under both subprograms: (a) necessary instructions were issued for

¹⁷ As per the resolution of the Cabinet of Ministers (14 November 2017), the electricity tariff increased by 12% and the gas tariff by 10% from 1 April 2018.

¹⁸ See footnote 16 for reference.

¹⁹ See the Policy Matrix (Appendix 4) for sequencing of the proposed reforms under each reform area.

²⁰ The International Monetary Fund (IMF) is supporting this initiative with TA support. A dedicated website has already been operationalized for data dissemination.

regular publication of data on monetary aggregates, banking activities, foreign exchange reserves, and balance of payments on the CBU website under subprogram 1; and (b) the proposed data dissemination systems on the CBU website will be fully operationalized under subprogram 2.

- (ii) **Fiscal and financial management.** Many important fiscal reforms are proposed under the programmatic approach.²¹ Under subprogram 1, MOF disseminated the public expenditure and financial accountability (PEFA) prepared in 2012 on its website with an action-taken report; MOF will update the PEFA under subprogram 2. To improve budget preparation, MOF issued necessary guidance to use all 12 budget accounting standards (in line with the International Public Sector Accounting Standards) for the preparation of the 2020 budget. Actual implementation of these standards will begin under subprogram 2. Similar sequencing will be followed to introduce internal audits in key government departments to improve internal controls.²² Introducing discipline in budget allocation based on developmental priorities by adopting a medium-term budget framework (MTBF) is proposed under subprogram 2.²³ Several reforms are proposed to improve financial market supervision and reduce the cost of financial intermediation for the private sector. CBU prepared capital adequacy assessment statement for selected banks, and conducted stress testing under subprogram 1.²⁴ Based on these reports, the CBU will prepare an action plan to address shortfalls in loan-loss provisioning, capital shortfalls, and liquidity shortfalls for the selected banks under subprogram 2.²⁵ Two important initiatives under subprogram 2 are (i) finalizing the guidelines for implementation of risk-based bank supervision and (ii) designing the policies to reduce directed lending.
- (iii) **State-owned enterprise governance and private sector operations.** Several reforms are proposed to improve the functioning of SOEs—logically sequenced over two subprograms. These reforms are necessary to create fiscal space, facilitate private sector operations, and strengthen public service delivery. The corporate governance rules (CGRs) prepared under subprogram 1, based on the 2015 OECD Guidelines on Corporate Governance of SOEs (para. 5), and order issued for implementation of CGRs in selected SOEs. Implementation will be operationalized under subprogram 2. Public–private partnerships (PPPs) will be strengthened in Uzbekistan through the PPP law submitted to the Parliament for approval under subprogram 1. Based on this law, specific projects will be

²¹ The government is currently designing specific tax reform proposal covering (i) improvements in tax administration, (ii) enlargement of the tax base, (iii) simplification of the tax rules, and (iv) transparency in selection of the cases for tax incentives. ADB may also consider supporting selected tax reform initiatives under subprogram 2. IMF provided technical assistance support for this purpose.

²² Many reforms under this area, such as improving internal controls and updating PEFA, will improve public financial management and strengthen governance and anticorruption efforts.

²³ Effective budget management requires a medium-term perspective, as a single-year perspective does not provide adequate flexibility to implement a government's development priorities while ensuring allocative efficiency of scarce public resources. M. Cangiano, T. Curristine, and M. Lazare, eds. 2013. *Public Financial Management and Its Emerging Architecture*. Washington, DC: IMF. The OECD points to the importance of medium-term budgetary planning, particularly in cases where (i) capital projects with changing operational costs are implemented; (ii) programs come into effect toward the end of the year, and their full annual costs are not materializing in the initial year; and (iii) programs' spending implications are not visible in the given year but would become so in the following years. OECD. 2014. *Budgeting Practices and Procedures in OECD Countries*. Paris.

²⁴ These initiatives in the area of improved financial management will be supported by regular and quarterly stress tests of banks supported under the World Bank's Development Policy Operation in 2018.

²⁵ The banks' capital adequacy ratios are currently higher than the threshold level, but banks will require additional capital to support higher lending to the private sector.

developed by the government under subprogram 2.²⁶ Another related reform is the divestment of noncore assets of SOEs. The government approved noncore assets for two selected SOEs and will finalize its divestment by 2019 under subprogram 2. Several critical reforms are proposed to improve financial management of JSC Uzbekenergo,²⁷ including completion of fixed asset revaluation by 2019,²⁸ and finalization of an IFRS-compliant consolidated audited financial statement for 2017—both under subprogram 2.²⁹ Under subprogram 1, MOF also approved a sustainable debt management strategy for JSC Uzbekenergo.

12. The value addition of the Asian Development Bank (ADB) stems from its long experience in designing and implementing policy-based loans in the Central and West Asia region, covering similar areas. ADB's value addition can be categorized under four broad groups: (i) facilitating identification of key reforms and international best practices in several areas of economic management—as highlighted in the policy matrix; (ii) providing operational support to implement complex reforms (such as an MTBF, internal audit, corporate governance, risk-based banking supervision, etc.) with the help of the attached TA;³⁰ (iii) creating synergies with ADB's sector-specific support to facilitate timely implementation of selected policy actions under the program; and (iv) coordinating with other development partners to provide a unified reform package to the government. ADB's support for the policy-based loans in other countries in this region also highlights the importance of effective coordination among the development partners.

13. **Coordination among development partners.** The World Bank is currently processing a budget support program (development policy operation of \$500 million) for Uzbekistan. The proposed prior actions are divided across three pillars: (i) foundation for sustainable economic growth and macro-financial resilience, (ii) supporting market creation for private-sector development, and (iii) enabling jobs, and managing social risks. Both institutions are collaborating in dealing with identifying and implementing reforms to promote improved banking supervision, facilitate financial transparency in selected SOEs (such as introduction of IFRS-compliant financial statements), and private sector development.³¹ The main objective of this collaboration is to introduce complementary reforms and reinforce a concerted reform effort. ADB is also coordinating with the International Monetary Fund (IMF) and sharing TA resources for strengthening data collection, analysis, and dissemination (reform area 1). The Government of Switzerland is also providing TA resources to finalize the design and coverage of the national summary data page, with the support of ADB and the IMF. The proposed programmatic approach also addresses many reform proposals highlighted in the IMF's 2018 Article IV consultation staff report for the Republic of Uzbekistan. The important reforms include: (i) supporting implementation of e-GDDS and SDDS, with the help of capacity development support and targeted policy actions, to strengthen data dissemination; (ii) improving fiscal transparency; (iii)

²⁶ ADB will provide support under the attached TA.

²⁷ JSC Uzbekenergo has been selected to complement ADB's interventions in the energy sector.

²⁸ Asset revaluation allows firms to take into account changes in the fair value of some assets when determining their carrying amounts in financial statements. Fixed asset revaluation of energy companies is usually needed under two sets of circumstances: when there are (i) regulatory issues where higher asset values will require higher tariffs set by the regulatory commission; and (ii) restructuring issues where knowledge about the true value of fixed assets is critical before embarking on a major restructuring, including unbundling of electricity operation.

²⁹ JSC Uzbekenergo has already completed an IFRS-compliant financial statement for 2015. Moreover, JSC Uzbekenergo has already operationalized the Center for Financial Management and International Financial Standards with 28 qualified staff to facilitate preparation of the financial statements. ADB is taking the lead in this area and provided technical assistance support.

³⁰ Attached Technical Assistance (accessible from the list of linked documents in Appendix 2).

³¹ In addition to providing cross-references in their respective program documentation, ADB and the World Bank issued a joint letter, addressed to the Government of Uzbekistan, highlighting the government's critical role in addressing important issues related to improved public financial management and delivery of their respective programs.

strengthening supervisory capacity of CBU using the risk-based supervision system; (iv) allowing banks to function in line with the international best practices to facilitate private sector development; and (v) implementing comprehensive corporate governance rules in SOEs. Thus, ADB's collaboration spans both program design and policy implementation.

C. Impacts of the Reform

14. Uzbekistan's overarching development objective is the facilitation of macroeconomic stability and sustainable high growth. The effect of the reforms will be an improved environment conducive to private sector investment. The program will help achieve the government's development objectives through the proposed reforms, which will help strengthen economic management, facilitate better public financial management, support improved performance of SOEs,³² and create effective financial intermediation facilities. These reforms will primarily work through two channels: (i) there will be additional fiscal space to augment public investment with a medium-term focus and better outcome orientation, and the improving efficiency of public investment will have a crowding-in impact on private investment;³³ and (ii) proposed policy reforms under the program will also make additional financial resources available for private investment. Improved economic management, and consequent macroeconomic stability, is an important driver of foreign direct investment. Augmenting private investment is essential to sustain high growth with additional job opportunities.

15. A programmatic approach is needed because the structural reforms require a long-term horizon to be implemented effectively. Implementation of most of the proposed reforms must begin with necessary changes in legal, institutional, and human resource structures. Judging capacity constraints while designing the reforms is also important. Therefore, sequencing of reforms will remain critical. For example, introduction of an MTBF requires sufficient preparatory and implementation time. Similarly, introduction of an internal audit or CGRs will require a gradual approach starting with necessary changes in the business process. Thus, it is critical that the reforms are properly identified and sequenced over two subprograms. A programmatic approach is ideal for chronologically sequencing the reforms in a multiyear framework. It also enables alignment of policy actions with unavoidable realities and exogenous shocks. Moreover, the proposed modality plays a leveraging and catalyzing role in coordinating TA provided by the development partners.

D. Development Financing Needs and Budget Support

16. While devaluations in 2017 probably increased some revenue receipts, such as value-added tax, their overall impact on budget revenues was negative. At the same time, as indicated in para. 4, burden on the state exchequer increased as the government aimed to (i) mitigate the adverse impact of reforms on vulnerable groups; and (ii) ensure smooth functioning of strategic industries, including SOEs, banks, and financial institutions. These additional expenditures and revenue losses are summarized in Table 1. However, this resulted in a huge budget deficit of almost 3.3% of GDP in 2017 (as against a deficit of 0.6% in 2016),³⁴ including the balance of the Fund for Reconstruction and Development of Uzbekistan. The augmented fiscal deficit is expected to be at around 1.3% of GDP in 2018.³⁵ This signifies large development financing

³² Better service delivery by SOEs will also improve in parallel.

³³ Additional fiscal space will critically depend on, among others, the proposed MTBF-based budget allocations under subprogram 2, supported by improved tax efforts. The program's support for PPP will also help to support private sector development.

³⁴ Table 1 in Sector Assessment (Summary): Multisector (accessible from the list of linked documents in Appendix 2).

³⁵ Approximately \$1.5 billion combining 2017 and 2018 together.

needs at the aggregate level. The government is currently in the midst of a comprehensive fiscal consolidation exercise that aims at (i) additional revenue generation, and (ii) downsizing of public administration while safeguarding macroeconomic stability and setting the stage for sustainable and higher growth. However, given the sluggish nature of revenue improvements over the short to medium term, the burden of fiscal consolidation will primarily fall on expenditure rationalization, especially development expenditure. This is a clear illustration of a hard budget constraint and its impact on development financing, given the downward rigidity in nondiscretionary items of recurrent expenditure (salary, pensions, and interest). Thus, it will be extremely difficult for the government to incur additional costs to carry out its reform agenda, unless expenditures on specific items are protected and partly financed by development partners. The program is expected to finance a portion of Uzbekistan's development financing needs.³⁶ Thus, the program will help the government to pursue its macroeconomic reform agenda without jeopardizing expenditure on essential items.

Table 1: Summary of Increases in Budget Expenditure Items and Revenue Losses (2017–2018)

| Item | Cost (\$ million) |
|--|----------------------|
| Support to banks for capital enhancement | 643.7 |
| Support for price stabilization (including creation of a price stabilization fund) | 542.6 |
| Loss of revenue due to tax rationalization (including customs duties) | 358.8 |
| Moratorium on interest and principal payments during September 2017 and December 2018 in foreign currency loans of state-owned enterprises | 221.6 |
| One-time support to state-owned enterprises because of exchange rate liberalization | 393.4 |
| Total | 2,160.1 |

Source: Government of Uzbekistan, Ministry of Finance.

17. Based on the development financing requirements of the program, ADB will provide policy-based loans (with a total amount of \$600 million) to finance subprograms of \$300 million each under the programmatic approach. The ordinary capital resources loan will have a 15-year term, including a grace period of 3 years, an annual interest rate determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility, a commitment charge of 0.15% per year, and such other terms and conditions as set forth in the draft loan agreement (ordinary operations). Based on the straight-line method, the average loan maturity is 9.25 years, and there is no maturity premium payable to ADB.

E. Implementation Arrangements

18. The MOF will be the executing agency of the program. The CBU, the State Committee on Statistics, the State Committee for Assistance to Privatized Enterprises and Development of Competition, JSC Uzbekenergo, Ministry of Economy, and MOF are proposed to be the implementing agencies. The program director from MOF will supervise overall implementation coordination across the various implementing agencies. The policy-based loan will be disbursed in accordance with ADB's *Loan Disbursement Handbook* (2017, as amended from time to time). The entire program will be implemented over 30 months (June 2017–December 2019). Subprogram 1 completion is expected by July 2018 and that of subprogram 2 by December 2019.

³⁶ The government will also mobilize resources from domestic sources and use financial support from other development partners to finance its development financing needs (para. 13).

III. ATTACHED TECHNICAL ASSISTANCE

19. An assessment of the institutional capacity was carried out for the program. It was agreed between the government and ADB that the TA for the Economic Management Improvement Program will enhance capacity in the following areas to support implementation of proposed reforms under the programmatic approach:³⁷

- (i) **Medium-term budget framework.** Support will be provided to prepare MTBF and improve budget preparation and dissemination.
- (ii) **Public-private partnership.** Technical support will be provided to develop, select, and monitor PPP projects. Comprehensive training will be provided to the selected staff.
- (iii) **Internal audit.** The TA will help to strengthen the internal audit departments within the selected ministries, including introduction of a risk-based audit manual.
- (iv) **Risk-based supervision and capital adequacy assessment.** The TA will help the CBU with improved monetary management, especially to carry out risk-based supervision, capital adequacy assessments, and stress testing at regular intervals.
- (v) **JSC Uzbekenergo investment plan and fixed asset revaluation.** The TA will help JSC Uzbekenergo to prepare a master plan for investment financing and fixed asset revaluation.
- (vi) **Gender sensitivity analysis.** The TA will support an analysis of gender sensitivity of public expenditure programs and creation of a specialized sex-disaggregated database for private enterprises.
- (vii) **Training and workshops.** The TA will provide support for trainings and workshops in various departments (including the State Committee on Statistics).

20. The TA is estimated to cost \$1,300,000, of which \$1,000,000 will be financed on a grant basis by ADB's Technical Assistance Special Fund (TASF-other sources). The government will provide counterpart support in the form of counterpart staff remuneration, office accommodation and supplies, other logistical support, and other in-kind contributions.³⁸

21. The implementation arrangements for the TA will be aligned to those of the programmatic approach. ADB's Central and West Asia Department will select, supervise, and evaluate consultants; and procure goods (if necessary). The TA components will be monitored by the program director from MOF. A total of 65 person-months of consultancy services (international and national) will be required intermittently. Both individual consultants and a consulting firm will be engaged. The consulting firm will be engaged using the quality- and cost-based selection method with a standard quality-cost ratio of 90:10, to be selected and engaged by ADB in accordance with the ADB's *Procurement Policy* (2017, as amended from time to time) and the associated project administration instructions and/or TA staff instructions. Output-based lump sum consulting contracts will be preferred for the firm and for the individual consultants. All disbursements under the TA will be made in accordance with ADB's *Technical Assistance Disbursement Handbook* (2010, as amended from time to time).

³⁷ The TA will help implement the policy actions proposed under subprogram 2, including those that are logically sequenced over two subprograms.

³⁸ Attached Technical Assistance Report (accessible from the list of linked documents in Appendix 2).

IV. DUE DILIGENCE

A. Technical

22. Several outputs of the program have technical components at their core. Preparation, selection, and monitoring of PPP projects, to be supported under the program, will require strong financial and project management skills. Preparation of MTBF and linking them with actual budget allocations will require sound technical knowledge. Capacity building support under the program will assist the relevant government departments to better manage these technical operations.

B. Economic

23. The program was subject to economic analysis, the results of which demonstrate that its benefits considerably outweigh the costs. The key direct benefits considered are classified into three groups:

- (i) Higher public investment because of additional fiscal space attributed to (a) MTBF-based budget making and improved internal controls, (b) reduced fiscal transfers to large SOEs over the medium term, and (c) savings from greater efficiency and cessation of systemic leakages. Fiscal space created under the program helps to enhance public investment.³⁹
- (ii) Higher private investment because of improved financial intermediations, and crowding-in attributed to higher public investment on infrastructure. Improved private investment in the state, in turn, will lead to higher growth and more employment opportunities.
- (iii) Better service delivery because of improved performance of SOEs.

C. Governance

24. ADB's *Anticorruption Policy* (1998, as amended to date) was also explained to and discussed with the government. A governance risk assessment was conducted along the lines prescribed by the implementation guidelines of ADB's Second Governance and Anticorruption Action Plan.⁴⁰ This assessment was complemented by a review of areas of possible risk and vulnerability in state financial management. The assessment found some risks that could affect the proposed programmatic approach. They include risks related to (i) political support for reforms and ownership of the government, especially for sensitive reforms; and (ii) institutional dimensions of the proposed programmatic approach (e.g., weak capacity in the relevant institutions). The financial assessment found several areas of concern: (i) integration of capital and current budgets through proper planning, (ii) lack of alignment between sector goals and resource allocation, and (iii) fund-flow arrangements between MOF and off-budget funds for carrying out development programs.⁴¹ While no major risks of mismanagement of resources at the executing level can be discerned, issues identified in internal controls, medium-term budget framework, institutional capacity, and financial sustainability (especially for the PPP projects) are targeted for capacity development under the TA and policy changes under the loan.

³⁹ Economic Analysis (accessible from the list of linked documents in Appendix 2).

⁴⁰ Consistent with its commitment to good governance, the implementation of the program will adhere to ADB's Anticorruption Policy.

⁴¹ On 18 December 2017, the government set up the Fund for Financing State Development Programs through Resolution No. PP-3437.

D. Poverty, Social, and Gender

25. The poverty reduction and social impacts of the program are positive. The support for augmenting and sustaining development financing will have an impact on income poverty, especially in a situation of rising inflation. The program's special emphasis on better expenditure targeting through linking the MTBF with actual budget allocations is clearly geared toward protecting the poor and other vulnerable groups. The program will aim to sustain macroeconomic stability and growth during the initial phase of the medium-term reforms through improvements made to (i) funding of public and private activities, (ii) fiscal and financial management, and (iii) management of SOEs and private sector participation. While these outcomes do not have a direct impact on poverty reduction, the successful implementation of the policy actions under the proposed programmatic approach will facilitate higher productive public investment and higher budget allocations for the social programs. Higher private investment, in turn, will create additional jobs. Thus, it is expected that the program will have significant indirect benefits for the poor and vulnerable. The program will help maximize the benefits that improved corporate and sector governance can bring to SOEs in terms of economic efficiency and financial feasibility. This is expected to improve access to public utilities. The program will also help the government to improve its 2016 Gender Inequality Index ranking of 57, which was low in relation to some neighboring countries.⁴² The labor force participation rate is also low for females (48.3%) compared to males (76.2%).⁴³ Thus, targeted expenditure on health under the MTBF and higher employment opportunities in the private sector are expected to lift Uzbekistan's Gender Inequality Index ranking. Rectifying these problems becomes more challenging if the government is unable to invest effectively (with improved targeting) and adequately in economic and social infrastructure, either directly or through partnerships with the private sector.⁴⁴ Private investment is also expected, through the PPP projects, in areas covering school education and health service delivery. This will also improve education and health indicators for women and children. The attached TA will analyze gender sensitivity of government expenditure programs and create a sex-disaggregated database of private enterprises (primarily small and medium-sized enterprises). This gender analysis of the public expenditure programs will facilitate the introduction of an appropriate composition structure of the MTBF, which is a prerequisite for significantly improved gender targeting under subprogram 2.

E. Safeguards

26. Given the nature of the program, all three safeguard categories (environment, involuntary resettlement, and indigenous peoples) are categorized as C under the policy-based loan.

F. Risks and Mitigating Measures

27. Major risks and mitigating measures are summarized in Table 2 and described in detail in the risk assessment and risk management plan.⁴⁵

⁴² The Gender Inequality Index reflects gender-based inequalities in three dimensions: reproductive health, empowerment, and economic activity. United Nations Development Programme. *Human Development Report 2016: Human Development for Everyone—Briefing note for countries on the 2016 Human Development Report: Uzbekistan*. http://hdr.undp.org/sites/all/themes/hdr_theme/country-notes/UZB.pdf.

⁴³ The labor market exhibits distinct gender patterns, with women overly represented in public sector jobs (health care and education), which carry lower salaries, and men predominating in technical and other more profitable fields (construction, transport and communications, and industry).

⁴⁴ Summary Poverty Reduction and Social Strategy (accessible from the list of linked documents in Appendix 2).

⁴⁵ Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

Table 2: Summary of Risks and Mitigating Measures

| Risks | Mitigation Measures |
|--|---|
| Trained staff are not retained in relevant departments during the entire period of the program, affecting successful completion of various policy actions. | Consistent and sustained engagement with the Government of Uzbekistan and ensuring to create adequate staff with technical skills to prevent this. The attached TA will play an important role in this direction. |
| Adequate and financially viable public-private partnership projects are not identified and developed. | Effective and planned support under the attached capacity development TA. Repeated trainings are necessary for the selected staff. |

ADB = Asian Development Bank, TA = technical assistance.

Source: ADB.

V. ASSURANCES

28. The Government of Uzbekistan and MOF have assured ADB that implementation of the program shall conform to all applicable ADB policies including those concerning anticorruption measures,⁴⁶ safeguards, gender, procurement, consulting services, and disbursement as described in detail in the loan documents.

VI. RECOMMENDATION

29. I am satisfied that the proposed programmatic approach and policy-based loan would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve

- (i) the programmatic approach for the Economic Management Improvement Program; and
- (ii) the loan of \$300,000,000 to the Republic of Uzbekistan for subprogram 1 of the Economic Management Improvement Program, from ADB's ordinary capital resources, in regular terms, with interest to be determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility; for a term of 15 years, including a grace period of 3 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft loan and program agreements presented to the Board.

Takehiko Nakao
President

31 May 2018

⁴⁶ ADB. 2006. *Second Governance and Anticorruption Action Plan*. Manila.

DESIGN AND MONITORING FRAMEWORK

| Country's Overarching Development Objective | | | |
|---|---|---|--|
| Macroeconomic stability and sustainable high growth facilitated (Strategy of Actions on Further Development of Uzbekistan) ^a | | | |
| Results Chain | Performance Indicators with Targets and Baselines | Data Sources and Reporting Mechanisms | Risks |
| Effect of the Reform Environment conducive to private investment improved | To be accomplished by 2020: a. Local currency bank credit to private sector increased by at least 15% (2017 baseline: \$8 billion) b. Ratio of operating revenue to operating cost of JSC Uzbekenergo should be higher than or equal to 1 (2017 baseline: 0.8) | a. Annual report of the CBU b. Annual financial statement of JSC Uzbekenergo | Subdued improvement in external outlook may delay upward revision in tariffs of state-owned utilities leading to continued support to SOEs from banks and the government. |
| Reform Areas (under Subprogram 1) 1. Macroeconomic data collection, analysis, and dissemination systems | Key Policy Actions To be accomplished by 2018: 1.1 The government approved adoption of the International Monetary Fund's enhanced general data dissemination system (2017 baseline: system not implemented) 1.2 The CBU published data on monetary aggregates, banking activities, and foreign exchange reserves on its website starting from the first quarter of 2018; and balance-of-payments data from the third quarter of 2018 (2017 baseline: data not available on the CBU website) | 1.1 Annual reports of the State Committee on Statistics 1.2 Annual report of the CBU | Continued commitment of the government toward reform momentum is not sustained, causing delays in meeting targeted policy actions. Trained staff are not retained in relevant departments during the entire period of the program, affecting successful completion of various policy actions. |
| 2. Fiscal and financial management | 2.1 MOF issued an order for the adoption of 12 budget accounting standards, which are in line with the International Public Sector Accounting Standards, starting 1 January 2019 (2017 baseline: standards not adopted, except the first standard on accounting policy) 2.2 The government started implementing internal audit activities by newly created units | 2.1–2.2 MOF annual reports | |

| Results Chain | Performance Indicators with Targets and Baselines | Data Sources and Reporting Mechanisms | Risks |
|--|---|---|-------|
| | <p>within the Ministry of Public Education and the Ministry of Health (2017 baseline: internal audit activities not carried out)</p> <p>2.3 The CBU prepared recommendations based on the capital adequacy assessments for the National Bank of Uzbekistan for foreign economic activities, and for Xalq Bank, Asaka Bank, Promstoybank, Microcredit Bank, Ipoteka Bank, Agrobank, Qishloq Qurilish Bank, Turon Bank, and Aloqabank (2017 baseline: assessments were not prepared)</p> | <p>2.3 CBU annual report</p> | |
| <p>3. SOE governance and private sector operations</p> | <p>3.1 The government issued an order to implement approved CGRs in (i) Uzbekistan Railways, (ii) JSC Uzbekenergo, (iii) Uzneftegas, (iv) Uzavtosanoat, (v) Uzkimyosanoat, (vi) AGMK, and (vii) Uzagrotehsanoat holding (2017 baseline no approved CGR)</p> <p>3.2 The government submitted the draft law on public-private partnerships to Parliament (2017 baseline: draft law was not approved by the Cabinet of Ministers for submission to the Parliament)</p> <p>3.3 The government approved a list of noncore assets of JSC Uzbekenergo, Uzneftegas, and Uzkimyosanoat for divestment and transfers to local bodies (2017 baseline: list not available)</p> <p>3.4 JSC Uzbekenergo issued an order to disclose audited financial statements on the company's website (2017 baseline: audited financial statement not available on the website)</p> | <p>3.1–3.3 Annual reports of the State Committee for Assistance to Privatized Enterprises and Development of Competition)</p> <p>3.4 Annual report of JSC Uzbekenergo</p> | |

Budget Support

Asian Development Bank: \$300,000,000 (regular ordinary capital resources loan)

Transaction Technical Assistance

Asian Development Bank: \$1,000,000 (Technical Assistance Special Fund-other sources)

CBU = Central Bank of Uzbekistan, CGR = corporate governance rule, MOF = Ministry of Finance, NA = not applicable, SOE = state-owned enterprise.

^a Government of Uzbekistan. 2017. *Presidential Decree No. 4947: The Strategy of Actions on Further Development of Uzbekistan*. Tashkent.

Source: Asian Development Bank.

LIST OF LINKED DOCUMENTS

<http://www.adb.org/Documents/RRPs/?id=51350-001-3>

1. Loan Agreement
2. Sector Assessment (Summary): Multisector
3. Contribution to the ADB Results Framework
4. Development Coordination
5. Country Economic Indicators
6. International Monetary Fund Assessment Letter
7. Summary Poverty Reduction and Social Strategy
8. Risk Assessment and Risk Management Plan
9. List of Ineligible Items
10. Attached Technical Assistance Report

Supplementary Document

11. Economic Analysis

DEVELOPMENT POLICY LETTER

O'ZBEKISTON RESPUBLIKASI

VAZIRLAR MAHKAMASI



CABINET OF MINISTERS

REPUBLIC OF UZBEKISTAN

100008, Toshkent shahri, Hukumat uyi
Government House, Tashkent, 100008

No. 02/L-747 „11“ May 2018 y.

To: Mr. Takehiko Nakao
The President of ADB

DEVELOPMENT POLICY LETTER

Dear Mr. Nakao,

I would like to express appreciation to Asian Development Bank (ADB) for its strong and continued support recent initiatives on carrying out reforms in Uzbekistan. As you may know, in February, 2017, the President of Uzbekistan adopted the Strategy of Actions in five priority development areas for 2017–2021. The Strategy sets five priority areas for reforms: (i) improvements in the system of state and public administration; (ii) ensuring the rule of law and further reform of the judicial system; (iii) development and liberalization of the economy; (iv) development of the social areas; and (v) ensuring security, religious tolerance, inter-ethnic harmony, and constructive foreign policy. The inclusive growth and continued economic diversification are defined as the key reform objectives.

The Government of Uzbekistan (GOU), in conjunction with international financial institutions, private sector and academia is currently formulating comprehensive measures to implement the reforms in key areas, including public finance management, tax policy and administration, reforming the state-owned enterprises (SOE) and financial sector governance.

These specific reform areas are prioritized in government's long-term development agenda to achieve higher growth and adequate employment opportunities. Poor performance of many SOEs also has a profound financial displacement effect on private enterprises. Public

sector alone cannot cover employment requirements of all new job seekers. On the other hand, for its prosperity the private sector needs on access to finance, technologies, skills, and proper economic infrastructure. More importantly the private sector requires prioritized market-based allocation of resources.

The government has also embarked on fundamental tax reform program. In February, 2018, the President of Uzbekistan instructed the government to formulate comprehensive tax reform proposal, emphasizing (i) enlargement of the tax base; (ii) introduction of international tax standards in the context of market economy; (iii) restructuring of tax administration; (iv) reduction of tax burden to the entrepreneurs and individuals; (v) simplification of tax filing procedures; (vi) introduction of transparent rules and the selection procedures for tax incentives.

Uzbekistan also prioritized an efficient and timely distribution of economic and social data to enhance economic planning on the basis of reliable data and make public management more accountable. The government further initiated reform in national income accounting and Consumer Price Index (CPI) methodology. Since February 2018, a revised CPI methodology that correspondent with international standards is used for measuring inflation. Between official and alternative inflation estimates there are no more substantial differences. The government lifted nondisclosure requirements and declassified such key economic data as the volume and composition of international reserves. Uzbekistan formally joined the IMF's Enhanced General Data Dissemination Standard and announced plans to join the Special Data Dissemination Standard in the near future, which also noted in official statement of IMF on 3 May 2018. At the same time, the government introduced broad institutional changes in the national statistics committee to improve its capacity to collect, analyze and disseminate data efficiently. We have pledged to ADB's technical assistance support of our efforts to improve the data quality.

Development Finance Reform Program

The proposed Economic Management Improvement Program that we are eager to implement jointly with ADB will help the government to identify key reform areas and consolidate various transformations that have been planned and initiated since September, 2017. As you may know, our initiatives jump-started with foreign exchange market liberalization in September 2017.

We had to mitigate negative impacts on our economy and protect the vulnerable groups of our population. Uzbekistan's significant reform package of 2017, has exposed many economic management challenges, raised living costs, reduced credibility of private sector, and weakened the viability of many large SOEs, which were poorly prepared for a market-based exchange rate. Mobilizing additional resources to finance various new initiatives without detriment to normal government activities also remains a critical challenge. Various reforms, by their nature, have a long-term implementation period. These reforms will need to be carried out during 2-3 years. A sequel of assistance to such reforms would consolidate and stabilize achievement of improvement the economic management in Uzbekistan. Particularly, ADB's support will be utilized to implement key reforms to strengthen following areas:

- I. **Macroeconomic data collection, analysis, and dissemination systems.** Data collection and dissemination are important for planning, monitoring and evaluation of the government's development initiatives. Our main targets are to (i) facilitate implementation of enhanced general data dissemination system (e-GDDS), (ii) initialize a system of regular publication of data on balance of payments, monetary aggregates, external debt, interest rates, and foreign exchange reserves in CBU's website starting from the first quarter of 2018.
- II. **Fiscal and financial management.** Significant reforms in this area are planned to create fiscal space and improve financial intermediation for the private sector. The reforms will cover (i) introducing discipline of budget allocation based on developmental priorities by adopting a medium-term budget framework; (ii) designing an action plan based on an updated Public Expenditures Framework Assessment (PEFA); (iii) strengthening transparency in budget planning by adopting the approved standards of budget accounting; (iv) introducing internal audits in selected ministries to improve efficiency of allocation limited public resources; and (v) reducing the cost of financial intermediation for the private sector and improving banks' performance by introducing capital adequacy assessments, risk-based supervision and discipline in directed lending.
- III. **SOE governance and private sector operations.** Improving functioning of SOEs is an important pillar in the government's reform agenda. Several reforms are identified to improve performance of SOEs and creation of economic space for the private sector. The reforms are covering (i) introduction of corporate governance principles, (ii) divestment of non-core

assets, (iii) initiating the public-private partnerships (PPP). There are special reforms for Uzbekenergo, including: (i) fixed asset revaluation, (ii) preparation of the debt management strategy and master plan for financing investment, and (iii) conduct IFRS compliant consolidated audited financial statement annually.

The proposed program, as presented, is the right approach to ensure sustainability of government reform efforts. At the same time, the government is fully aware of the challenges standing ahead. Many proposed reforms will require acquiring new skills by the certain officials. We, therefore, request comprehensive long-term support from ADB for capacity development and training. Without such support, it will be difficult for us to sustain the dynamic of reforms.

Let me reassure that we remain committed to the implementation of the reforms. We also confirm that the policy actions proposed under this program are reflective and fully in consonance with the reform agenda of GOU.

We would like to thank ADB for working closely with GOU in developing this program and would like to reiterate our full support for it. We hope to continue our cooperation with ADB to initiate other reforms to provide a favorable legal and institutional infrastructure for improved economic management, leading to higher growth and employment opportunities.

Yours sincerely,



Djamshid Kuchkarov

Deputy Prime Minister,
Minister of Finance of the Republic of Uzbekistan

POLICY MATRIX

| First Subprogram: 2018 | Second Subprogram (Indicative): 2019 |
|---|---|
| Output Area 1: Macroeconomic Data Collection, Analysis, and Dissemination Systems | |
| <p>1. Government of Uzbekistan (the government) adopts accession to the IMF's Enhanced General Data Dissemination System (e-GDDS). (Document required: Order of the President of the Republic of Uzbekistan)</p> | <p>1. The government submits an Action Taken Report to justify full compliance to the e-GDDS requirements covering the following areas: (i) disseminate the data required by e-GDDS punctually; (ii) provide an advance release calendar; (iii) provide detailed information on statistical practices; (iv) certify the accuracy of the metadata on an annual basis; and (v) use of standardized electronic reporting procedures. (Document required: e-GDDS Implementation Report by the State Committee on Statistics)</p> |
| | <p>2. The government approves a plan with clear timelines for the adoption of IMF's SDDS. (Document Required: Approved Action Plan by the State Committee on Statistics)</p> |
| <p>2. For improved dissemination of monetary and financial data, the government approves regular publication of data on monetary aggregates, banking activities, and foreign exchange reserves by CBU on its website starting from the first quarter of 2018, and the balance of payments data from the third quarter of 2018. (Document required: (i) Order of the President of the Republic of Uzbekistan; (ii) Screenshot of the Summary Data Release Calendar of the State Committee on Statistics to show the timeline for BOP data publication; and (iii) screenshot of the data pertaining to monetary aggregates, banking activities, and foreign exchange reserves)</p> | <p>3. CBU submits a plan with clear timelines to strengthen coverage and frequency of data dissemination in the CBU website to be completed by December 2019. (Document required: The plan approved by CBU)</p> |
| Output Area 2: Fiscal and financial management | |
| | <p>4. The government (i) approves a MTBF to facilitate improved distributive efficiency of scarce public resources; and gender responsiveness; and (ii) notifies adoption of MTBF for budget making beginning 2020. (Document required: (i) MOF approved MTBF and the Decision of the President of the Republic of Uzbekistan on the adoption of MTBF for budget making)</p> |

| First Subprogram: 2018 | Second Subprogram (Indicative): 2019 |
|--|---|
| 3. MOF sets the direction of reforms in the areas covering public financial management, revenue mobilization, internal controls by publishing PEFA, developed in 2012, on its website with information on the progress achieved over the period 2012 to 2017 to facilitate updating of PEFA. (Document required: PEFA 2012 with information on the progress over 2012–2017 in the MOF website) | 5. MOF (i) updates 2012 PEFA based on the progress achieved between 2012 and 2017 and publishes in its website; and (ii) adopts an action plan to address the issues highlighted in the updated PEFA. (Document required: PEFA published in MOF website and Action Plan adopted by MOF) |
| 4. To improve budget preparation for 2020 and the adoption of budget standards, MOF (i) adopts 12 budget accounting standards in line with IPSAS ¹ which must be completed by December 2018, and (ii) issues order on implementation of all 12 standards starting 1 January 2019. (Document requirement: MOF order on the adoption of all the 12 standards with clear timeline) | 6. MOF uses 12 standards in preparation of 2020 budget and submits an Action Taken Report. (Document requirement: Action Taken Report by MOF). |
| 5. To enhance internal control and improved distribution of scarce public resources across all government ministries and agencies, the government initiates internal audit by (i) issuing order to pilot internal audit activities within the systems of MOPE and MOH; and (ii) approving the guidelines of internal audit covering, among others, general rules, rights and responsibilities of the Internal Audit Unit, reporting, professional qualifications and trainings etc. (Document required: (i) Order of the President of Uzbekistan on the establishment of internal audit units in MOPE and MOH; (ii) Internal Audit Guidelines approved by MOPE and MOH agreed with MOF) | 7. Based on the experience of internal audit activities in MOPE and MOH, the government operationalizes internal audit cells in three additional Ministries. (Document required: (i) copy of MOPE and MOH reports on the results of integration; and (ii) Government decision on setting up and organization of activities of internal audit in the additional Ministries) |
| 6. To improve financial market supervision covering (i) shortfalls in loan-loss provisioning, (ii) capital short falls; and (iii) liquidity shortfalls in the selected banks, CBU (i) prepares capital adequacy assessments in the format acceptable to ADB for National Bank of Uzbekistan for Foreign Economic Activities, Xalq bank, Asaka bank, Promstoybank, Microcredit bank, Ipoteka | 8. Based on the capital adequacy assessments and the stress testing results, CBU approves an action plan to address, as needed, (i) shortfalls in loan-loss provisioning, (ii) capital short falls; and (iii) liquidity shortfalls for the National Bank of Uzbekistan for Foreign Economic Activities, Xalq bank, Asaka bank, Promstoybank, |

¹ These standards are (i) Accounting policy, (ii) Budget reporting, (iii) Chart of Accounts; (iv) Accounting for foreign currency assets and liabilities; (v) Accounting for agriculture activities; (vi) Accounting for rent; (vii) Inventory; (viii) Fixed assets; (ix) Intangibles; (x) Revenues and dedicated funding; (xi) Accounting for loans; and (xii) Turnkey contracts for capital construction.

| First Subprogram: 2018 | Second Subprogram (Indicative): 2019 |
|---|---|
| bank, Agrobank and Qishloq Qurilish bank; Turon bank, and Aloqabank; and (ii) develops necessary recommendations based on these reports. (Document Required: CBU provides (i) capital adequacy assessment reports approved by CBU, and (ii) bank-wide recommendations) | Microcredit bank, Ipoteka bank, Agrobank and Qishloq Qurilish bank; Turon bank, and Aloqabank. (Document required: CBU approval for the Action Plan) |
| | 9. CBU (i) finalizes and approves the guidelines for introduction of Risk Based Bank Supervision Process; and (ii) initiates its implementation. (Document required: (i) CBU approved guidelines; and (ii) a status report by CBU on implementation of the guidelines). |
| | 10. MOF (i) submits a Status Report on directed lending detailing the amount across all programs and SOEs; and (ii) designs and approves policies to reduce the share of directed lending in total bank loans (covering all banks) in a phased manner to improve access to bank loans by the private sector. (Document required: the status report by MOF and Cabinet of Ministers' approved policies on reductions in directed lending) |
| Output Area3: SOE governance and private sector operations | |
| | 11. The government (i) implements the CGRs in specified SOEs, and (ii) submits a timebound action plan to implement it in all other SOEs. (Document Requirement: Status report and the time bound Action Plan by the State Committee on Corporate Governance) |
| 7. The government (i) approves Corporate Governance Rules (CGRs) based on <i>2015 OECD Corporate Governance Guidelines for SOEs</i> covering the following areas: (a) equitable treatment of shareholders and other investors, (b) stakeholder relations and responsible business, (c) disclosure and transparency, (d) the responsibilities of the boards of SOEs; and (ii) issues Order to implement CGRs in Uzbekistan Railways, JSC Uzbekenergo, Uzneftgas, Uzavtosanoat, Uzkimyosanoat, AGMK, and Uzagrotehsanoat holding. | |

| First Subprogram: 2018 | Second Subprogram (Indicative): 2019 |
|--|---|
| <p>(Document Requirement: (i) Minutes of the meeting, approving the corporate governance rules and its implementation in specified SOEs, of the Commission on the Improving Efficiency of Activities of the Joint Stock Companies and Enhancement of the System of Corporate Governance as approved by the Chairman of the Commission; and (ii) the approved corporate governance rules)</p> | |
| <p>8. The government through MOF approve a sustainable debt management strategy developed by JSC Uzbekenergo to protect credit standing by promoting sound financial assessment in the issuance and management of debt. (Document required: MOF approved debt management strategy)</p> | <p>12. JSC Uzbekenergo completes revaluation of fixed assets to improve its financial position and submit the report. (Document Required: Copy of the Report by JSC Uzbekenergo)</p> |
| <p>9. The government submits to the Parliament the draft law on public-private partnerships (PPPs) to promote private sector participation in economic activities. (Document required: Submission of the draft PPP Law by the Cabinet of Ministers of the Republic of Uzbekistan)</p> | <p>13. The government selects at least 2 financially viable PPP projects under the new law and taken up to the bidding stage. (Document required: MOF clearance for the selected projects)</p> |
| <p>10. The government (i) approves a list of non-core assets of JSC Uzbekenergo, Uzneftegas and Uzkimyosanoat for divestment and transfers to local bodies to improve financial performance of these SOEs. (Document required: List of non-core assets approved by the Cabinet of Ministers)</p> | <p>14. The government submits a status report on the completion of the divestment process for the selected non-core assets of SOEs and income earned from this process. (Document Required: MOF letter endorsing the report on the completion of the divestment process and income earned from this process)</p> |
| | <p>15. The government approves a Master Plan for the financing of JSC Uzbekenergo's investment during 2018–2022. (Document Required: MOF approval letter)</p> |
| <p>11. To facilitate improved financial management and transparency in the dissemination of financial accounts, JSC Uzbekenergo issues order to annually (i) prepare consolidated financial statements in accordance with IFRS, (ii) conduct the audit of these consolidated financial statements as per ISA and (iii) disclose these audited financial statements on the official</p> | <p>16. JSC Uzbekenergo completes IFRS compliant consolidated audited financial statements for 2017 with relevant disclosure notes and audit opinion and publishes it on its website. (Document required: IFRS compliant consolidated audited financial statements of JSC</p> |

| First Subprogram: 2018 | Second Subprogram (Indicative): 2019 |
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| <p>website of JSC Uzbekenergo. (Document required: Approved minutes of the Supervisory Board's decision on (i) conduct IFRS compliant consolidated audited financial statement annually, and (ii) publication of the audited financial statement in the website of JSC Uzbekenergo))</p> | <p>Uzbekenergo for 2017 with relevant disclosure notes and audit opinion)</p> |

CBU = Central Bank of Uzbekistan, CGR = corporate governance rule, e-GDDS = enhanced general data dissemination system, ISA = International Standard of Audit, IFRS = international financial reporting system, IMF = International Monetary Fund, IPSAS = international public-sector accounting system, MTBF = medium-term budget framework, MOF = Ministry of Finance, MOH = Ministry of Health, MOPE = Ministry of Public Education, OECD = Organization for Economic Co-operation and Development, PEFA = Public Expenditures and Financial Accountability, PPP = public-private partnership, SDDS = Special Data Dissemination Standards, SOE = state-owned enterprises