SECTOR ASSESSMENT (SUMMARY): AGRICULTURE, NATURAL RESOURCES, AND RURAL DEVELOPMENT[1]

A. Sector Performance, Problems, and Opportunities

1. Uzbekistan's economy grew consistently during 2010–2016, when gross domestic product (GDP) grew at an average annual rate of 8.0%, reaching $63.4 billion in 2016.[2] The economy has proved resilient to the downward pressures exerted from 2008 onwards on other economies by the global financial crisis. Despite an economic downturn in the Russian Federation (Uzbekistan's major trading partner and source of remittances), the Uzbek economy achieved GDP growth rates of 7.8% in 2016 and 5.3% in 2017. GDP growth is expected to be 7.3% in 2018.[3] Overall poverty, according to national poverty line estimates, declined from 27.5% of the population in 2001 to 12.8% in 2016 as a result of rapid economic growth.[4]

2. Along with overall economic growth, the agriculture sector's contribution to GDP in Uzbekistan grew at an average annual rate of 6.7% during 2012–2016. There was however, a slowdown in 2017 when the sector grew by only 2.0%. The higher rate of growth in other sectors resulted in a decline in the agriculture sector's contribution to GDP, from 34.4% in 2000 to 19.2% in 2017. Agriculture's contribution to GDP has traditionally derived from the production of cotton and wheat, which the government regarded as strategic crops and supported through preferential access to land, inputs, and finance. However, there has been a shift in the contribution of these crops to GDP since 2000. The share of cotton production in GDP declined from 3.6% in 2000 to 2.3% in 2016. Over the same period, the contribution of grains to GDP fell from 3.4% to 2.4%[5] while the combined share of fruit and vegetables increased from 5.2% to 10.6%.

3. Despite its declining share of GDP, agriculture remains an important sector. In 2017, it accounted for 27% of total employment. It is also a key income source in rural areas, where 49% of the population resides, and which account for 75% of people living below the poverty line. About 4.7 million rural households operating *dehkan* (small-scale) farms derive their income from agriculture. *Dehkan* farms, which operate independently of government support, account for the production of 66% of vegetables, 76% of potatoes, 54% of fruit, and 49% of grapes on farms of 0.35–0.50 hectares (ha).

4. The shift in production from cotton and wheat to horticulture is also reflected in exports. Agricultural exports grew at an annual average rate (in current dollar terms) of 12.5% during 2000–2013, while cotton exports grew by an annual rate of only 2.0%. During 2010–2017, cotton exports declined from $1.5 billion to $477.1 million, while the share of cotton exports in total exports fell from 27.5% in 2000 to 3.4% in 2017. By comparison, the share of food products in exports rose from 5.00% in 2000 to 6.35% in 2017.[6] Fruit and vegetable exports grew from $68.7 million in 2000 to $1.45 billion in 2016, equating to an average annual growth rate of 21%, while the share of fruit and vegetables in total exports increased from 2% to 9%. In 2016, the value of fruit and vegetable exports exceeded that of cotton exports by more than 30% ($600 million).

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[1] This summary is based on the detailed sector assessment accessible from the list of linked documents in Appendix 2 of the report and recommendation of the President.
[2] World Bank estimate in dollars. http://www.worldbank.org/en/country/uzbekistan (accessed 1 January 2018).
[3] Asian Development Bank (ADB). 2017. *Asian Development Outlook 2017*. Manila.
[4] On the basis of $1.90 purchasing power parity criterion, an estimated 68.1% of the population was below the poverty line in 2012. ADB. 2017. *Basic 2017 Statistics*. Manila.
[5] Uzbekistan State Committee on Statistics. 2017. *Statistical Report 2017*. Tashkent.
[6] Ministry of Foreign Economic Relations, Investment and Trade. http://www.mfer.uz (accessed 1 January 2018).

5. **Constraints**. Although continued growth is expected, the agriculture sector is characterized by low productivity and remains labor intensive. The horticulture subsector is constrained by limited access to quality land, specialized horticulture machinery, appropriate inputs, and, in particular, finance. Limited access to either equity or long-term debt financing for producers and enterprises throughout the value chain (as indicated by a disproportionately low level of credit disbursed in horticulture compared to its contribution to GDP) constrains the subsector's development.[7] The horticulture subsector does not receive preferential financing under government programs, as is the case for cotton and wheat production. Financial institutions have a largely negative perception of the profitability and creditworthiness of the agriculture sector. This is exacerbated by an undeveloped regulatory framework for the use of movable assets as loan collateral, and a lack of acceptable collateral among many small-scale producers or collateral with low realizable values among agribusiness enterprises. Further, access to information on potential borrowers is limited as the credit information system is not yet effective. Financial institutions have yet to develop credit policies and loan products appropriate to the needs of horticulture producers and enterprises, including cash-flow-based loan appraisal that considers the phasing of horticulture investment and seasonality.

6. On the supply side, the high cost of funds, perceived risks, and administrative costs associated with lending to individuals and small businesses, especially in rural areas, require banks to charge interest rates of 11%–25% for local currency loans and 6%–15% for foreign currency loans. Individuals and small businesses are required to borrow at the higher end of these ranges. Deposit mobilization is undermined by public mistrust in banks and this is compounded by administrative hurdles in withdrawing cash from bank accounts, with a fee of up to 20% of the transaction amount. A 2014 survey showed that 40% of adults had savings accounts but only 2% had saved with financial institutions.[8] Bank lending for investment is especially constrained by the predominantly short-term maturity of funding sources.

7. In rural areas in particular, access to finance for private individuals and enterprises is constrained by weak rural branch networks and limited mobile banking services. Eighty percent of small businesses are funded by family, friends, and informal sources.[9] In addition, farmers and agribusiness enterprises have poorly developed business and managerial skills and generally low financial literacy. Surveys indicate that small businesses overall lack access to information on market opportunities, suppliers, competitors, technology, and banking products.[10] The low income level of rural households, many of which are headed by women, also limits their access to financial services and ability to invest. Access to finance remains a constraint on private business growth.[11]

8. **Opportunities**. As a result of such constraints, the potential of a growing and more sophisticated consumer demand for both fresh and processed products in domestic and export markets is not being realized. Significantly larger volumes of produce with improved quality could be marketed if better post-harvest logistics, notably cold storage and transport, existed.[12] Only 15% of all horticultural production is processed. About 69.0% of fruit is consumed fresh, 20.0% is processed, and 11.0% exported, while 81.0% of vegetables is consumed fresh, 11.3% is

[7] An analysis of the portfolio of 10 major banks at the end of 2015 indicates that lending to horticulture accounted for only 0.3% of the banks' gross portfolios, while the horticulture subsector's contribution to GDP was 10.6% in 2015.

[8] World Bank. 2014. *Business Environment and Enterprise Performance Survey*. Washington, DC.

[9] World Bank. 2014. *Business Environment and Enterprise Performance Survey, 2012–2014.* Washington, DC.

[10] Center for Economic Research. 2014. *Entrepreneurs of Uzbekistan as a basis for formation of the middle class.* Tashkent.

[11] World Bank. 2016. *Doing Business 2016: Measuring Regulatory Quality and Efficiency.* Washington, DC.

[12] ADB staff estimates indicate that post-harvest losses are up to 45.0% of the harvested crop and that existing cold storage will be only able to store 2.3% of the forecast horticulture output by 2020.

processed, 4.3% is used for seeds, and 3.4% is exported. This indicates a significant opportunity for improved value addition from increased processing and exports of both fresh and processed products. ADB staff analysis of Uzbekistan's revealed comparative advantage suggests that Uzbekistan produces more specialized horticultural products than many other countries, indicating Uzbekistan's potential to expand its export market. The traditional market for Uzbek horticulture produce has been the Russian Federation, which accounts for 80% of all exports from Uzbekistan, though Uzbek imports only account for 3%–4% of the Russian Federation's fruit and vegetable imports. Uzbekistan could expand its exports significantly by capturing a larger share of the Russian Federation market. Beyond this market, there is also scope for exports to European markets, where fruit and vegetable consumption is relatively low based on nutritional requirements recommended by the World Health Organization. However, accessing European (and especially European Union) markets will require improvement in horticulture quality, safety standards, and certification systems. In this context, there is considerable scope to improve storage, processing, and marketing technologies.

9. Continued diversification from cotton and wheat production towards horticulture also offers significant environmental benefits regarding water usage. Climate change projections for Uzbekistan from 2005 to 2050 indicate that (i) water demand will increase from 59 billion cubic meters (m^3) to 62–63 billion m^3, (ii) supply will decrease from 57 billion m^3 to 52–54 billion m^3, and (iii) the water deficit will increase by more than 500% from about 2 billion m^3 to 11–13 billion m^3.[13] Horticultural crops typically use less water than cotton and are more efficient in water use than grain crops. In Uzbekistan, 4,426 m^3 of water are required to grow 1 ton of cotton and 2,068 m^3 are required for 1 ton of wheat.[14] By comparison, grapes require about 2,400 m^3 and apples about 820 m^3 per ton produced.

B. Government's Sector Strategy

10. The government's welfare improvement strategy aimed to reduce poverty through improved rural productivity and the creation of income-earning activities. Strategy elements included (i) further structural reforms in agriculture and the diversification of agricultural production; (ii) mechanization of agriculture, improvement of infrastructure, and development of agribusiness; (iii) more productive use of land and water; (iv) greater financial stability of farm entities; and (v) more market-oriented agricultural policies. These approaches continue to form the basis of the government's welfare strategy. For agriculture, the government's development plan to 2020 includes further reductions in cotton and wheat production and increased horticulture production. A strategy for further land reform will result in increased production areas as follows: potatoes 36,000 ha, vegetables 91,000 ha, fruit orchards 18,000 ha, and vineyards 11,200 ha.[15] The strategy will also aim at improving logistics and processing to boost exports of key agricultural products, including horticulture.[16] A further policy initiative established a state procurement system for fruit and vegetables.[17] It is intended that fruit and vegetable product procurement—for delivery to processors and for storage to ensure adequate off-season supply for consumers—and the export of fresh fruit and vegetables will be entrusted to two state entities (namely, UzAgroexport and Uzmevasanoatholding).

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[13] World Bank. 2010. *Climate Change and Agriculture Country Note*. Washington, DC.

[14] M. M. Aldaya, A. Y. Hoekstra, and G. Munoz. 2010. Water footprint of cotton, wheat and rice production in Central Asia. *Value of Water Research Report Series*. No 41. Delft, Netherlands.

[15] Approved by the Cabinet of Ministers on 29 December 2015.

[16] Presidential Decree PP-2505 of 5 March 2016. *On measures to further develop the raw material base, expansion in processing of horticulture, meat and dairy products, increasing foodstuffs production and export within 2016–2020*. Tashkent.

[17] Government of Uzbekistan. 2016. *President's Resolution No. 2520*. Tashkent.

11. In the finance sector, the government has implemented programs to support small business and banking growth and has increased access to finance. To improve the banks' ability to assess borrower creditworthiness, the Law on Credit Information, which was promulgated in 2011, helped establish a public credit bureau. To facilitate registration of movable assets as loan collateral, the 2013 Law on Collateral Registry supported establishing an electronic secured transactions registry. Laws enacted in the late 1990s need to be improved to facilitate the use of movable property as collateral. Assisted by the International Finance Corporation, the government prepared draft legal amendments for enactment in 2017.

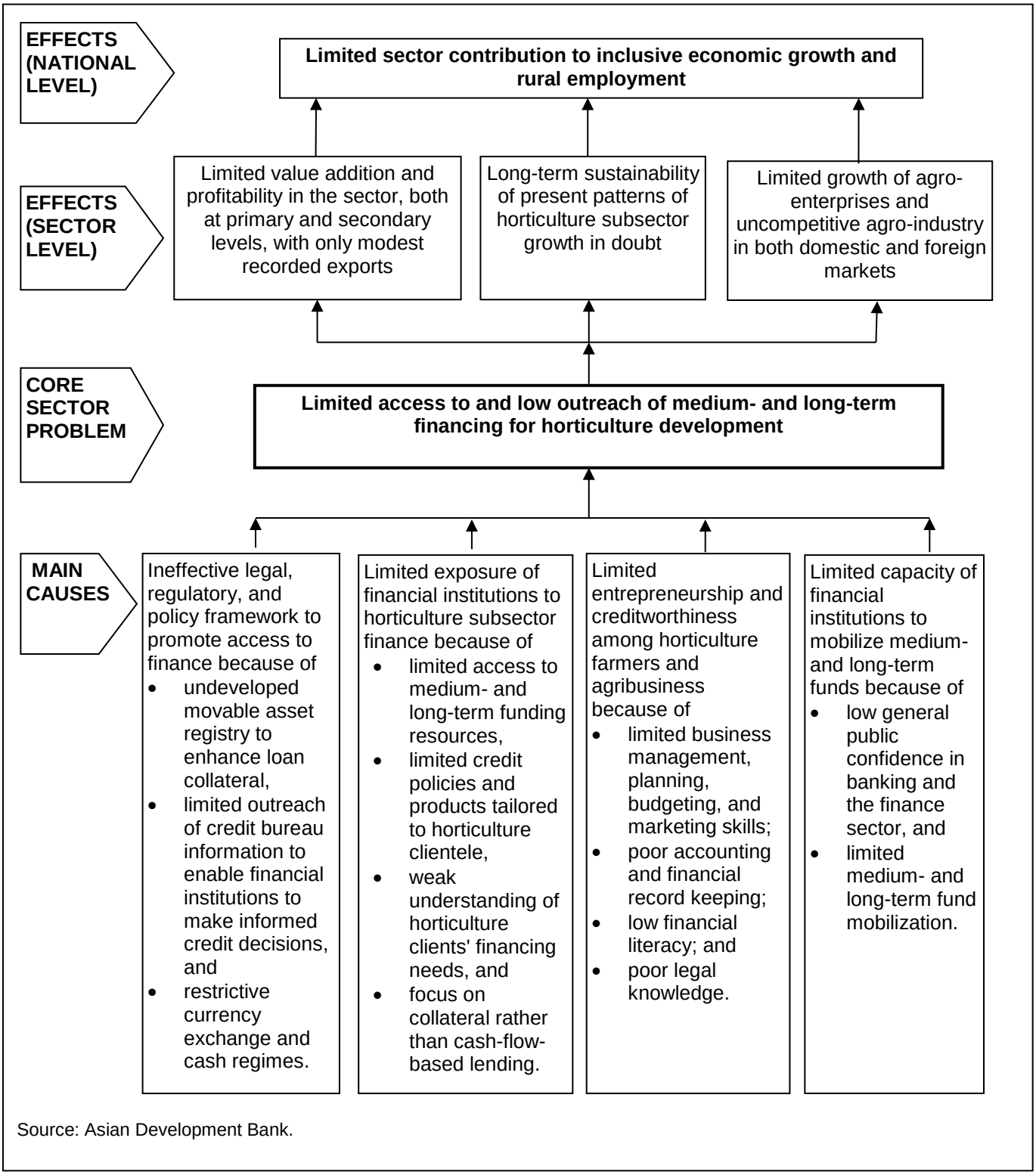
C. ADB Sector Experience and Assistance Program

12. Since 1996, the Asian Development Bank (ADB) has supported agriculture and enterprise development in Uzbekistan. In agriculture, ADB has supported irrigation rehabilitation and land improvement that have enhanced water supplies for cotton and wheat production to improve soil management and support farm enterprises. In the finance sector, ADB has supported enterprise development through six financial intermediation loans, six capacity building technical assistance projects, and an equity investment in Ipak Yuli Bank. ADB has (i) helped develop agro-processing to increase rural employment, (ii) provided funds for working capital and fixed asset financing, and (iii) improved the capacity of participating financial institutions. Lessons from ADB's support include the need to (i) engage in policy dialogue on regulatory and other impediments to enterprise development; and (ii) build capacity in participating financial institutions to support sound appraisal and supervision of subprojects, credit risk management policies, and corporate governance and financial disclosure policies. ADB has not previously provided support specifically to the horticulture subsector. The ongoing Horticulture Value Chain Development Project supports the government agriculture sector objectives while enhancing agricultural productivity and supporting the sustainable financial and economic viability of horticulture producers and agribusiness enterprises. The proposed additional financing project will help scale up the existing project's support to horticulture value chain development.

13. ADB's country partnership strategy (CPS) defined ADB's approach in Uzbekistan for 2012–2016 and is aligned with the government's development strategy.[18] The CPS supports Uzbekistan's transformation into a modern industrial and service economy through sustained and inclusive growth, reduced poverty, and expanded regional cooperation. Strategic assistance to be provided under the CPS will catalyze industrial development, accelerate economic diversification, promote private sector development, ensure climate-resilient investment, and create new employment opportunities.

[18] ADB. 2012. *Country Partnership Strategy: Uzbekistan, 2012–2016.* Manila; and ADB. 2015. The new country partnership strategy for Uzbekistan is under preparation as of April 2018.

Problem Tree for Agriculture, Natural Resources, and Rural Development



Source: Asian Development Bank.