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INTERNATIONAL DEVELOPMENT ASSOCIATION

PROGRAM DOCUMENT

FOR A

PROPOSED CREDIT

IN THE AMOUNT OF USD 500 MILLION

TO

THE REPUBLIC OF UZBEKISTAN

FOR THE

UZBEKISTAN REFORMS FOR A SUSTAINABLE TRANSFORMATION
TOWARD A MARKET ECONOMY DEVELOPMENT POLICY OPERATION

May 29, 2018

Macroeconomics Trade and Investment Global Practice
Europe and Central Asia Region

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REPUBLIC OF UZBEKISTAN
FISCAL YEAR

January 1 – December 31

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(Exchange Rate Effective as of May 29, 2018)

UZS 7,982 = US\$1.00

ABBREVIATIONS AND ACRONYMS

ADB	Asian Development Bank	INDC	Intended Nationally Determined Contribution
CAR	Capital Adequacy Requirements	IPSAS	International Public-Sector Accounting Standards
CBU	Central Bank of Uzbekistan	ISA	International Standards on Auditing
CE	Citizen Engagement	LDP	Letter of Development Policy
CIS	Commonwealth of Independent States	MFD	Maximizing Financing for Development
CPF	Country Partnership Framework	MFTR	Memorandum on Foreign Trade Regime
CPI	Consumer Price Index	MOF	Ministry of Finance
CPSD	Country Private Sector Diagnostics	NPL	Non-Performing Loans
DPL	Development Policy Lending	PEFA	Public Expenditure and Financial Accountability
DPO	Development Policy Operation	PFM	Public Financial Management
DSA	Debt Sustainability Analysis	PI	Performance Indicator
EBRD	European Bank of Reconstruction and Development	PPG	Public and Publicly Guaranteed Debt
ESA	Environmental and Social Assessment	PPP	Public Private Partnership
EY	Ernst and Young LLP.	REER	Real Effective Exchange Rate
FDI	Foreign Direct Investment	SBA	Standards of Budget Accounting
FMIS	Financial Management Information Systems	SCD	Systematic Country Diagnostic
GDP	Gross Domestic Product	SOE	State Owned Enterprise
GEF	Global Environmental Facility	TA	Technical Assistance
GFS	Government Finance Statistics	TFA	Trade Facilitation Agreement
GNP	Gross National Product	TSA	Treasury Single Account
GOA	Government of Uzbekistan	UE	Uzbekenergo JSC
GRS	Grievance Redress Service	UFRD	Uzbekistan Fund of Reconstruction and Development
GUAS	Department of Architecture and Construction	UNDP	United Nations Development Programme
IA	Internal Auditing	UNFCCC	United Nations Framework Convention on Climate Change
IBRD	International Bank for Reconstruction and Development	UNG	Uzbekneftegaz JSC
ICT	Information Communication Technology	UNWTO	United Nations World Tourism Organization
IDA	International Development Association	UZS	Uzbek Som
IFI	International Financial Institution	VAT	Value Added Tax
IFRS	International Financial Reporting Standards	WTO	World Trade Organization
ILO	International Labor Organization		
IMF	International Monetary Fund		

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UZBEKISTAN DEVELOPMENT POLICY OPERATION

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SUMMARY OF PROPOSED LOAN AND PROGRAM

UZBEKISTAN REFORMS FOR A SUSTAINABLE TRANSFORMATION TOWARD A MARKET ECONOMY

Recipient	Republic of Uzbekistan
Implementation Agency	Ministry of Finance
Financing Data	IDA Credit Amount: US\$500 million
Operation Type	Stand-Alone Development Policy Lending Operation
Pillars of the Operation and Program Development Objective(s)	The development objective of the DPL is to support Uzbekistan’s economic transformation into a market economy. The DPL is structured around three pillars: (i) Foundations for Sustainable Economic Growth and a Resilient Macro-Financial Framework, (ii) Supporting Market Formation for Private Sector Development, and (iii) Enabling Job Creation and Managing Social Risks.
Result Indicators	<p>1. Foundations for Sustainable Economic Growth and Macro-Financial Resilience</p> <ul style="list-style-type: none"> • No surrender requirement on foreign exchange from export earnings [Baseline: 25 percent surrender requirement] • Improved data quality from banks is implemented and permits adoption of risk-based supervision plan for onsite inspections. [Baseline: No proper reflection of bank’s risks] • The CBU has developed guidelines for regular stress testing of commercial banks, and has conducted at least one round of stress tests on 4 commercial banks. [Baseline: no stress testing of banks] • 2018 augmented budget outturns on tax expenditures, current spending and net lending to UE and UNG amount to less than 0.8% of GDP, and IFRS compliant financial statements have been published for prior years (2015 and 2016). [Baseline: 2017 augmented budget outturns on tax expenditures, current spending and net lending to UE and UNG amount to 1.2% of GDP and no published IFRS consolidated financial statements]
	<p>2. Supporting Market Formation for Private Sector Development</p> <ul style="list-style-type: none"> • Annual total trading of products with deregulated prices (gasoline extraction, cathode copper, copper wire, secondary aluminum, metal zinc, technical kerosene, polypropylene, polyethylene, technical Sulphur, caustic ash, rolled ferrous metals, cement, cement clinker, construction glass, sugar, barley) in Commodity Exchange increases to UZS 16 tn. [Baseline: UZS 8 tn.] • Average custom tariff rate is less than 8% [Baseline: 15.3% average custom tariff] • Difference between domestic average price for cotton and international price is 10% or less. [Baseline: More than 20 percent] • Mandatory hectares for growing cotton reduced by 135,000 ha. and grain by 40,000 ha. [Baseline: 1,285,000 ha. for cotton; 1,329,500 ha. for grain]

	<p>3. Enabling Job Creation and Managing Social Risks</p> <ul style="list-style-type: none"> • Legal framework for employees with part-time and temporary formal contracts exists and the number of total employee contracts is 90,000 or more, including 30,000 female employees [Baseline: no formal framework exists] • Budget includes funding for 500,000 beneficiaries, including low-income families and families with dependent children. [Baseline: 435,500 covered families]
Overall risk rating	Substantial
Climate and disaster risks (required for IDA countries)	Are there short and long-term climate and disaster risks relevant to the operation (as identified as part of the SORT environmental and social risk rating)? YES
Operation ID	P166019

1. UZBEKISTAN'S TRANSFORMATION

1. **This program document describes the proposed Development Policy Operation (DPO) to the Republic of Uzbekistan in the amount of US\$500 million.** This operation is historic: it is the first DPO from the WBG to the country since its independence supporting Uzbekistan's first steps in its transformation towards a successful market economy. Unlike many planned economies that began this transition process in the early 1990s, Uzbekistan has been a latecomer to market reforms. Nearly 25 years after the collapse of the Soviet Union, the country remained a closed centrally-planned economy, with growth sustained by commodity export revenues that financed import-substitution industrialization. Despite the serious structural weaknesses of the model, it held over time—on the tailwinds of the commodities super-cycle and ongoing government interventions. Import barriers and capital controls, significant directed lending, as well as on- and off-budget subsidies supported a wide network of state-owned enterprises (SOEs) and a few private-sector participants. However, economic growth was not accompanied by productivity growth or sufficient high-quality job creation, leading to substantial outward labor migration. Following the commodity price shock in 2014, the lack of price flexibility (in exchange rates and domestic prices) led to the widening in relative price distortions, and it became evident that existing economic policies were incapable of providing sustained productivity growth and good-jobs creation to meet the needs of a growing and young population.

2. **With the weaknesses of the old growth model fully unmasked, and a pressing need for jobs, Uzbekistan launched a process of market-oriented reforms that have surprised observers by their breadth, depth and speed.** In late 2016, following the first leadership change since the country gained independence in 1991, newly-elected President Mirziyoyev embarked upon an ambitious economic modernization program to reinvigorate equitable growth for all of Uzbekistan's citizens. The Government announced a broad market-oriented reform program, which included five priority policy areas: (i) enhancing state and public institutions; (ii) securing the rule of law and reform of the judicial system; (iii) promoting economic development; (iv) fostering social development; and (v) ensuring personal and public security through inter-ethnic and religious tolerance and constructive foreign policy. The program also restated the authorities' commitment to macroeconomic stability and to improving the business climate.

3. **Following the issuance of its 2017-2021 Strategy, the Government of Uzbekistan has made rapid progress on its path toward social and economic transformation.** On September 5, 2017, the authorities allowed the local currency, the Uzbek som, to depreciate by over 50 percent, while abolishing the existing surrender requirements on exports; as a result, the large parallel foreign exchange rate premium was eliminated. This move not only reduced large economic distortions in the economy and avenues for corruption, but was also a key signal of the Government's reform commitment. There have also been important steps to reduce the state's large presence in the economy, liberalize prices and open the economy to greater foreign and domestic private-sector participation in job growth and investment. These actions, by themselves, represent a major first step for Uzbekistan's strategy to achieve equitable growth and jobs, and entail major structural changes that present both opportunities and challenges.

4. **Public expectations are high and demographic pressures are mounting.** The current process of social and economic opening has been receiving widespread support from the

population and has generated an upbeat mood in the country. Until now, citizens have responded positively to the changes, as they feel that they are finally starting to be heard and that the Government is genuinely interested in improving their economic situation. Given the high expectations, the administration is under pressure to deliver tangible results as soon as possible, especially as Uzbekistan is facing a major jobs challenge with a rapid rise of the working age population which has been increasing by some 50 percent since 2000, from 14 million to 22 million today. These demographic pressures also increase the risk of radicalization.

5. Uzbekistan is now at a critical juncture of its economic transition—and it must urgently tackle a legacy of stark microeconomic imbalances while sustaining macroeconomic stability.¹ Unlike other deep structural reform initiatives that were launched due to the presence of unsurmountable macroeconomic imbalances, Uzbekistan transformation is taking place in a context of a sustainable macroeconomic framework, and rests on comfortable buffers and low public and external liabilities. Rather, the reforms are motivated by the increasingly visible challenges posed by deep microeconomic imbalances—particularly given the lack of market institutions, and market-based price determination—which have imperiled the efficient reallocation of resources in the economy. This led to flagging productivity and faltering high-quality job creation. In this light, the country’s progress towards a market economy will entail three fundamental economic and societal shifts: (i) from a state-led to the private sector-led economy; (ii) from inward-looking to an outward-looking growth and job-creation drivers; and (iii) from general Government provision of all social services to a modern, targeted social protection system. The actions taken in this direction to date—and supported by this DPO—represent major initial steps toward Uzbekistan’s strategy of stimulating equitable growth and private-sector led job creation. At the same time, the transformation toward a market economy may also bring about transitional dislocations and possible adverse impacts for some vulnerable parts of the population—adverse impacts that this operation aims to mitigate.

6. The greatest priority for Uzbekistan is to make these reforms sustainable. This first DPO supports fundamental economic policy reforms—major “first steps”—which set Uzbekistan on a new development trajectory. Notwithstanding this effort, significant work is pending going forward in a wide number of areas to build the sound market-based institutions that would underpin Uzbekistan’s development going forward. In this light, while this DPO is a standalone operation, it anticipates a longer-term strategic engagement, including additional financing in subsequent years to support the next phase of the reform program which will have a stronger focus on sectoral and institutional reform. Moreover, this reform program will be supported by a cohesive and well-coordinated technical assistance program. Close coordination with other development partners is a priority for the WBG to maximize synergies and to avoid overburdening the country’s absorption capacity.

¹ Uzbekistan’s *Systematic Country Diagnostic* (SCD, WB report No. 106454), published in May 2016, highlighted the following key constraints to Uzbekistan’s inclusive growth and shared prosperity: (i) *market distortions* undermining allocative efficiency and competition; (ii) *regulatory barriers* to firm operations preventing firm growth and formalization; (iii) *inefficient allocation of resources* (land, labor, capital) depressing agricultural productivity and rural incomes; (iv) *insufficient and inefficient infrastructure*, particularly connectivity, depressing competitiveness.

7. **The DPO will support these reforms by providing an organizing framework based on three key pillars:**

- **Policy Area 1— Foundations for Sustainable Economic Growth and Macro-Financial Resilience.** The DPO is supporting a fundamental adjustment of macroeconomic policymaking, while helping mitigate near-term macro-fiscal and financial risks. These key reforms include making the exchange rate regime market-based (including by removing the surrender requirements), improved SOE governance and reforms to support cost recovery and financial stability, as well as a strengthening of financial sector systems through prudential regulations and stress testing.
- **Policy Area 2— Supporting Market Formation for Private Sector Development.** Through a combination of reforms and investments, Uzbekistan will be able to open markets. A number of key reforms have been enacted to help create the foundations for private sector-led growth. DPO-supported reforms include the market-based formation of key prices, liberalizing international trade, and expanding opportunities for the private sector in key sectors, including agriculture.
- **Policy Area 3— Enabling Job Creation and Managing Social Risks.** The DPO places special emphasis on mitigating possible negative impacts on vulnerable groups due to the economic reforms. To this end, it supports the scaling-up of social safety nets and reforms to facilitate the movement of workers from low value-added sectors to high value-added sectors.

8. **This proposed DPO has been developed jointly by the World Bank and IFC, and has been guided by the Maximizing Financing for Development (MFD) approach.** The DPO leverages an ongoing technical assistance program of IFC that covers key areas of this operation, and is benefitting from a Country Private Sector Diagnostics (CPSD) that has been developed in parallel. This joint approach should make it easier to attract private sector investment as market-enhancing reforms take hold. The World Bank and IFC will jointly monitor and support the implementation of the next phase of reforms. The IMF is monitoring macroeconomic developments under its Article IV program and the ADB is providing complementary budget support. All institutions are closely collaborating, sharing information, and monitoring Government reform progress (see section 4 D).

2. MACROECONOMIC POLICY FRAMEWORK

A. OVERVIEW – THE TRANSFORMATION OF THE MACROECONOMIC FRAMEWORK

9. **In 2017, Uzbekistan’s economic performance reflected an improved external environment, offset by a legacy of imbalances and structural rigidities.** Overall, the economy decelerated—by about 2 percentage points, to a still robust annual real GDP growth rate of just under 5½ percent. This followed almost a decade of robust economic activity of 7-8 percent growth supported by strong global commodity prices and a benign global and regional context.

10. **During the first three quarters of the year (prior to the exchange rate liberalization in September 2017 and additional reform initiatives) the economy struggled to maintain its momentum.** While the Government launched its vision for reform in February 2017, the specific

details—including the date and pace of the exchange rate liberalization—were uncertain. Earlier in the year, as a means to counter the growing strains in the economy, the Government pursued an expansionary fiscal policy and increased directed lending to back SOEs. However, unlike neighboring CIS countries—where growth picked up more quickly, in part thanks to earlier reform adjustments—Uzbekistan recorded a deceleration in growth while inflation edged up, and the existing gap between the official and unofficial/curb market exchange rate widened, reflecting growing pressures. In sum, despite supportive fiscal and financial policies geared towards lifting growth, the economy slowed as imbalances and rigidities intensified.

11. Recognizing the need to urgently invigorate the economy and set the stage for deeper structural changes, the authorities launched an ambitious strategy for reform at the end of the summer. A key measure to this process—the move towards an official market-determined exchange rate—required, among other things, the lifting of surrender requirements on export revenues. Starting in July, requirements by which firms were mandated to sell a portion of their export revenues to the Central Bank of Uzbekistan (CBU) at the official exchange rate were reduced. The authorities also started preparing with other measures. They abolished the export ban on 15 priority food products in May 2017 to boost production.² To avert an inflationary spiral that could emerge from the eventual exchange rate adjustment with the liberalization, the CBU tightened monetary policy in June, raising the policy rate from 9 percent to 14 percent, curbing credit growth sharply (from a monthly rate of 5 percent per month to just 0.5 percent). To enhance financial resilience and recognize the eventual fiscal costs of the reform, the Government preemptively recapitalized 12 banks through two separate injections for a total of around US\$700 million: US\$500 million provided by the Government’s wealth fund, the Uzbek Fund for Reconstruction and Development (UFRD), and UZS 1.0 trillion through the budget in the first semester of the year.

12. In early September, the exchange rate was liberalized through a one-step devaluation of the Uzbek som, shifting to a tightly managed-float using market mechanisms thereafter. On September 5, the Central Bank of Uzbekistan (CBU) allowed the official exchange rate to adjust from UZS 4,210 to UZS 8,100 per US dollar, helping to converge the official rate with the market exchange rate.³ The authorities announced the full removal of the remaining restrictions on exchange rate convertibility, including the export-revenue surrender requirements. The exchange rate correction has supported macroeconomic fundamentals under enhanced CBU independence. The CBU has since announced its intention to eventually move toward inflation targeting and an increasingly floating exchange rate regime.

13. The liberalization of the foreign exchange market had mixed implications for the balance sheets of various sectors. The balance sheets of the CBU, the Government (including the UFRD and the SOE complex) and the private sector were affected in different ways. The IMF has estimated the CBU and the UFRD—with its comfortable combined foreign reserve buffer—saw an increase its assets, valued in local currency, after the revaluation; private sector agents that were dollarized also saw a balance sheet improvement valued in local currency. Nonetheless, the balance sheets of key players (particularly, the SOEs that were previously benefitting from the implicitly subsidized official exchange rate and had large foreign denominated liabilities) saw net

² These included meats, wheat, other grains, sugar and vegetable oil.

³ As of end-2016, the official exchange rate was UZS 3,231 per dollar, and by end-2017 it was UZS 8,120 to the dollar—a depreciation of 60 percent for the year as a whole.

losses; their access to substantial directed credit from the banking sector helps explain the authorities' focus on strengthening the banks' capital prior to the adjustment.

14. **Following the currency depreciation, the Government continued with macro-fiscal policies to manage fiscal costs, contain inflationary pressures, and strengthen the economy.** In the aftermath of the exchange rate unification, import tariff rates for about 8,000 out of 10,800 items were reduced (for about 5,000 items tariffs were eliminated) to mitigate the adverse effect on import-intensive companies (and prices) and improve the competitiveness of the economy.⁴ The Government restructured a share of the foreign-currency denominated debt falling due for four important SOEs adversely affected by the exchange rate adjustment—electricity (Uzbekenergo), oil and gas (Uzbekneftegaz), and two enterprises in the chemical sector. The total cost was largely born by the UFRD, although some support was also provided through the budget, including through tax reductions.⁵ Other measures—such as an upward adjustment in hydrocarbon prices and electricity tariffs, as well as the introduction of differentiated tariffs—were implemented to help Uzbekneftegaz and Uzbekenergo move closer to cost recovery, and preempt fiscal pressures.

15. **In general, the authorities have promptly adjusted their macroeconomic framework to moderate risks (and secure benefits) of the reform.** As detailed in the following sections, growth remains sustainable, and monetary and fiscal policies have been strengthened to serve as an anchor for macroeconomic stability. However, important policy challenges remain—including securing low inflation in the wake of needed exchange rate liberalization and broad relative price adjustments taking place, as well as firmly establishing the appropriate market-based institutions to serve as a platform for a dynamic, private-sector led economic activity and job creation.

B. MACROECONOMIC PERFORMANCE IN 2017

16. **In 2017, the Uzbek economy expanded at a slower pace than in previous years.** Real GDP growth decelerated to an estimated 5.3 percent in 2017, down from the officially reported 7.8 percent in 2016, reflecting the growing strains of macroeconomic imbalances and a history of official policies that constrained private sector dynamism. The improving external environment, the announcement of the reform program, and the much-needed exchange rate adjustment in the last quarter helped net exports to recover as a growth driver. On the supply-side, services, construction and industry were sustained by ongoing Government programs, but agriculture growth decelerated to 2 percent in 2017 (compared to 6.6 percent in 2016), with cotton and cereal production falling as the Government reduced mandatory land area dedicated to these crops and enforced compliance on labor codes.

⁴ As a result, many tariffs on industrial inputs were lowered from about 30 to 10 percent, with the weighted average import tariff decreasing from 13.9 percent to 5.9 percent.

⁵ The cost born by the UFRD amounted to US\$380 million, or 0.8 percent of GDP.

Table 1: Uzbekistan: Key Macroeconomic Indicators and Projections, 2014-2020

	2014	2015	2016	2017e	2018f	2019f	2020f
Real GDP growth, %	8.1	7.9	7.8	5.3	5.0	5.1	5.5
GDP per capita (US\$)	2,050	2,124	2,094	1,491	1,239	1,449	1,526
CPI inflation (official eop), %	6.1	5.6	5.7	14.4	16.9	10.1	8.2
CPI inflation (IMF estimate, eop), %	9.3	8.4	7.9	18.9	16.9	10.1	8.2
Credit to private sector, % change	25.3	23.3	28.4	103.0	24.5	15.2	17.6
Broad money (M2), % change	16.0	24.2	23.5	40.3	19.0	17.9	17.9
Monetization ratio (M2/GDP), %	23.4	24.5	26.2	29.3	27.6	27.2	27.6
Augmented budget bal. % of GDP	2.0	-1.3	-0.6	-3.3	-1.3	-1.4	-1.4
Exports (% of GDP)	19.4	15.0	14.2	21.7	29.0	25.2	27.5
Imports (% of GDP)	19.4	16.2	16.7	22.6	33.5	30.1	33.2
Trade Balance (% of GDP)	0.0	-1.2	-1.5	-0.9	-4.5	-4.9	-5.2
Current account balance, % of GDP	1.7	0.7	0.7	3.7	0.2	-1.0	-2.7
FDI, net (% of GDP)	1.0	1.3	1.5	2.0	2.5	2.3	2.9
Gross official reserves (US\$ billion)	24.2	24.3	26.5	28.1	28.9	28.9	28.4
Gross official reserves, months of imports	18.0	21.0	22.1	18.8	18.0	16.4	15.3

Source: IMF and World Bank; e=estimate, f=forecast

17. **Uzbekistan's external position strengthened in 2017.** During 2014-16, the country compensated for the impact of lower commodity export prices by boosting export volumes. This trend continued in 2017, albeit at a decelerating rate as global commodity prices rose through the year. The pick-up in growth in Russia and China, Uzbekistan's key trade partners, also helped export growth. Exports rose by 9.5 percent in 2017 (to US\$10.4 billion), while imports grew by 3.2 percent (to US\$10.8 billion).⁶ Overall, the trade balance registered a deficit of 0.9 percent of GDP in 2017, while the current account surplus rose from 0.7 percent of GDP in 2016 to 3.7 percent of GDP thanks to the steep recovery in remittances as the recipients of Uzbek migrant labor (Russia and Kazakhstan) benefitted from the improvement in global hydrocarbon prices. Net foreign direct investment (FDI) as a share of GDP grew in 2017, .but this was primarily due to the fall in the dollar value of nominal GDP (as the exchange rate devalued) and not an increase in FDI stocks. Gross international reserves rose to US\$28.1 billion by end-2017 (from US\$26.5 billion in 2016), representing a comfortable buffer of nearly 19 months of imports of goods and services.

18. **Consumer price inflation accelerated in 2017, reflecting both a credit expansion early in the year, as well as the sharp currency depreciation and the initial adjustments in relative prices brought by the reform.** The effect on consumer prices of the sharp depreciation of the Uzbek som in September was partially mitigated by the fact that a significant share of consumer goods had reflected the rising curb/unofficial exchange rate months in advance. In contrast, a larger contribution on consumer price increases was the result of price adjustments of key goods and services that have begun to be liberalized (toward market costs, including electricity, natural gas, fuels, metals and grains).⁷ Annual CPI inflation (using the IMF's methodology, which was

⁶ Exports of most goods and services increased in 2017, especially gold (27.8 percent), machinery (60 percent), energy (12 percent), and horticulture products (26 percent). However, cotton-fiber exports declined by 25.1 percent due to stagnant output, and higher consumption by the domestic textile industry.

⁷ Many of these goods were previously subject to implicit or explicit subsidies; and in some cases, part of their fiscal cost may have been observed in the emergence of shortages.

officially adopted in the first quarter of 2018) was 18.9 percent by end-2017, compared with 7.9 percent by end-2016.

19. **The central bank tightened monetary policy to help reduce inflation.** As noted earlier, the CBU tightened monetary policy in June, raising the policy rate from 9 percent to 14 percent, while keeping the reserve requirement ratio unchanged (at 15 percent for demand deposits and deposits with maturity of up to one year, 12 percent for time deposits with maturity of 1-3 years, and 10.5 percent for longer-term deposits). While nominal money and credit growth rates fell after June due to tighter policies; the earlier credit expansion to the private sector generated a year-on-year growth of 103 percent for 2017. Overall, the liquidity remaining in the economy, combined with the near-term relative price adjustments on previously regulated goods, have kept CPI inflation relatively high.⁸

20. **Overall fiscal policy became more expansionary since 2017, helping to mitigate the impact of the exchange rate adjustment.** In Uzbekistan, fiscal policy has been largely characterized by on-budget activities that are disciplined and rules-bound, coupled with off-budget activities—mainly financed by the UFRD—to support Government priority sectors and/or SOEs, including through directed (often subsidized) lending. Together, the on-budget and off-budget activities form an “augmented” fiscal balance that captures the aggregate fiscal stance in the economy (Table 2). Overall fiscal policies became expansionary (moving from an augmented fiscal deficit of 0.6 percent of GDP in 2016 to a deficit of 3.3 percent of GDP). The expansion had two components:

- *First, off-budget operations, largely financed by the UFRD, helped soften the adjustment from the exchange rate unification on the balance sheets*, both for the banking sector (through preemptive recapitalization earlier in the year) and the SOEs (through the restructuring of foreign-exchange denominated debt). The total widening of the UFRD deficit from 2016 to 2017 reached 3.4 percent of GDP, reflecting the impact cost of the transition cushioned through the authorities’ assets.
- *Second, the state budget was prudent; demand-boosting fiscal measures implemented through the year were financed within-budget via tax increases and expenditure-savings.* To boost consumption and help promote private business development, the authorities raised public spending on salaries, pensions and social allowances (by a nominal 15 percent in December 2017, vis-à-vis 15 percent in 2016 and 10 percent in 2015, and an average overall increase of 33 percent in the period 2008-14), and further reduced direct income taxes on SMEs in services, farms and the low-income households. This was financed on-budget through hikes in indirect taxes,⁹ and a reduction of subsidies through adjustments in the prices of energy, bread and utilities towards cost-recovery levels.

21. **Price liberalization in 2017 helped reduce the fiscal risks stemming from SOEs’ balance sheets.** In addition to the financial assistance to banks and SOEs, the Government raised fuel prices by about 40 percent in November 2017; on April 1, 2018 the price of natural gas was

⁸ The IMF has also noted that an estimated large but not quantifiable amount of foreign exchange cash circulating in the economy may have tripled its domestic currency equivalent over the past few years. This could potentially result in future inflationary pressures to the extent that forex cash holdings are transferred to domestic currency.

⁹ Increases included excises on petrol and water, as well as taxes on property, pollution, and alcohol and tobacco.

increased by 10 percent and electricity by 12 percent. All these measures helped to further improve the financial position of SOEs and reduced the burden on the state budget. Moreover, the Government eliminated deregulated the price on various commodities, which have been traded on the commodities exchange since January 1, 2018, as a means of removing price distortions and transitioning to international prices.¹⁰

Table 2: Uzbekistan: Key Fiscal Indicators and Projections (% of GDP)

	2014	2015	2016	2017e	2018f	2019f	2020f
Budget revenue	33.1	33.0	30.5	30.1	30.1	30.0	30.5
o/w Tax revenue	20.3	19.9	19.0	18.8	19.4	19.6	19.4
Grants	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Budget expenditure	32.7	34.1	31.3	30.1	31.3	31.4	30.4
o/w Current expenditure	28.4	29.8	27.9	25.8	26.9	26.3	27.3
o/w wages and salaries	10.4	10.3	10.3	10.3	9.8	9.2	10.0
interest expenditure	0.1	0.1	0.1	0.2	0.2	0.2	0.2
Capital expenditure	3.7	2.6	2.4	2.6	2.4	2.5	2.6
Fiscal balance	0.4	-1.2	-0.8	-0.1	-1.3	-1.4	-0.2
Primary balance	0.4	-1.2	-0.8	-0.1	-1.1	-1.2	0.6
Resource fund (UFRD), balance	1.6	-0.1	0.2	-3.2	0.0	0.0	0.0
Own revenue and grants	2.5	1.3	1.7	1.6	1.7	1.5	1.5
Expenditure and net lending	0.9	1.4	1.4	4.8	1.7	1.5	1.5
Gov. revenue incl. UFRD	35.6	34.3	32.2	31.7	31.8	31.5	32.0
Gov. expenditure, incl. UFRD	33.6	35.5	32.7	35.0	33.1	32.9	33.4
Capital expenditure, incl. UFRD	4.6	4.0	3.8	7.4	4.1	4.0	4.1
Augmented fiscal balance	2.0	-1.3	-0.6	-3.3	-1.3	-1.4	-1.4
Financing	-2.0	1.3	0.6	3.3	1.3	1.4	1.4
Domestic	-3.3	-0.4	-0.3	1.7	-0.5	-1.0	-1.1
External	1.3	1.7	0.9	1.5	1.8	2.4	2.5

Source: IMF and World Bank.

C. MACROECONOMIC OUTLOOK AND RISKS

22. **Uzbekistan's growth prospects are expected to remain broadly favorable, but there are risks related to this phase of economic transformation.** The baseline scenario projects a slight deceleration of growth to 5.0 percent for 2018 and 2019 as reforms are implemented, while support of private-sector investment and export-oriented growth will slowly strengthen economic growth in 2020 and 2021 to 5.5 and 6 percent, as transitional adjustments stabilize.

23. **External accounts would remain stable over the medium term, including as the structure of the balance of payments changes in the context of a more open, dynamic domestic economy.** While the current account surplus improved significantly last year, under a successful reform scenario, this surplus should moderate over the medium term as imports of capital and intermediate goods pick up, mirroring a solid capital and financial account backed by

¹⁰ These include, among others, gasoline extraction, cathode copper, copper wire, secondary aluminum, metal zinc, technical kerosene, polypropylene, polyethylene, technical Sulphur, caustic ash, rolled ferrous metals, cement, cement clinker, construction glass, sugar, barley.

growing FDI (and lending from IFIs), among other sources of foreign finance. On balance, Uzbekistan should be able to maintain its already comfortable external buffers.¹¹

24. **Fiscal policy will be critical in stabilizing the economy over the medium term.** With financial markets and the CBU's stabilization capacity still developing, fiscal policy will shape aggregate demand. Given high uncertainty about the short-term path of real growth as reforms seek to free and reallocate resources across the economy, a prudent fiscal stance—including on- and off-budget operations—is key in stabilizing future inflation. The projected fiscal stance in 2018 is broadly neutral, as presented in the recent Article IV Consultation with the IMF; and the authorities are committed to keeping a prudent fiscal stance, measured by the augmented balance that captures UFRD's operations.¹² Risks still stem mainly from the off-budget activities, which may not be fully transparent nor entirely predictable; the Government plans to improve transparency by bringing all its operations on-budget in 2019. The authorities are also committed to tax reform—which is needed to stimulate job creation and to preempt the future decline in revenue collections from SOEs—but it should be revenue-neutral and gradual, to avoid undermining the fiscal stance.¹³ While public debt has edged up somewhat in recent years, it remains on a sustainable path; debt vulnerabilities are also ameliorated by the Government's ample reserves.

25. **Inflation remains an important risk and underscores the need to build a strong monetary policy framework.** In 2018, with the full effects of the September 2017 exchange rate devaluation materializing, and a broad price liberalization more generally, inflation may persist. While the baseline assumes sustained prudent monetary policy that allows for gradual return to lower inflation, risks include not only external shocks that may make this process more protracted, but the reliance on ad-hoc tools (such as discretionary price ceilings to soften price impacts on consumers) that do not provide sustainable anchors to avoid inflation and may prevent the needed relative price adjustments from taking place. These measures may also be incompatible with ensuring the financial viability of both SOEs and private companies. Going forward, anticipated price increases in several sectors of the economy (including energy) may fuel inflation expectations; in this context, the credibility of both fiscal and monetary policy will be the main countervailing factor.

26. **With many sectors still ill-prepared to respond adequately to market price signals, there is an urgent need to remove key constraints so that concrete gains can be achieved.** The latter will be tantamount to providing the process with anchors for social (and political and environmental) sustainability. Tackling the lack of responsiveness of the economy to price signals will require shrinking the large state footprint in the supply of most goods and services in the economy, as well as ensuring that the nascent institutional frameworks being developed are designed to enable the operation of market-based mechanisms. A lack of understanding and confidence in of how a market economy works and what it can deliver could prevent key decision-

¹¹ International reserves currently stand at over US\$28 billion, corresponding to nearly two years of imports in goods and services. External debt outstanding is well contained at about 32 percent of GDP.

¹² Following a fiscal deficit of 3¼ percent of GDP in 2017, reducing on-lending operations should curb the deficit to 1¼ percent of GDP in 2018.

¹³ The World Bank is already providing technical assistance in this area, in close coordination with the IMF. The related reforms to the tax system and its administration will be a key area of focus under a potential second DPO.

makers from permitting market mechanisms to work. Fostering a change in culture that brings trust and greater comprehension will also be an important challenge to resolve.

27. **Additional risks to the outlook include the banking sector balance sheets.** Reported NPLs are only about 1 percent of bank assets and several banks report having none, raising questions about the accuracy of loan classification. While banks' capital-asset ratios (CARs) reportedly remain above the regulatory minimum, credit and foreign exchange risks on the asset side could appear on the banks' balance sheets, particularly under a scenario with downside risks to growth were to materialize.

28. **A sound, market-based financial sector with the capacity to allocate domestic savings in the economy to support private sector activity remains to be developed.** The banking sector is predominantly state-owned, with its funding base largely built on public resources, while domestic deposits by the private sector are small. Moreover, credit allocation is mostly reliant on directed lending practices (a form of off-budget fiscal activity). Existing exposures to large SOEs further complicate the picture. Transforming the banking sector into an open, competitive, market-based financial intermediary that does not require (nor provides) subsidies and allocates credit based on commercial decisions will be essential in establishing a solid platform for the healthy development of the private sector more generally. Putting in place the pillars for the development of a domestic capital market is also a pending task.

D. DEBT SUSTAINABILITY

29. **Debt levels in Uzbekistan are moderate for a low middle-income country.** The Government holds almost no domestic debt, and public debt consists entirely of external debt.¹⁴ Public and Publicly-Guaranteed debt rose in absolute terms in 2017, from US\$7 billion in 2016 to US\$11.7 billion; due to the decline in nominal GDP measured in US dollar terms—given the devaluation of the national currency on September 5, 2017—this represented an increase from 10.5 percent of GDP in 2016 to 24.5 percent of GDP in 2017 (Table 3). Total external debt, which includes PPG and commercially non-guaranteed external obligations, is also comfortable at just above 40 percent of GDP.

30. **The risk of debt unsustainability is low.** The joint Bank-Fund DSA for Uzbekistan (published with the IMF's Article IV Consultation in May 2018) suggests the following results:

- **Public debt.** The PPG-to-GDP ratio is expected to remain comfortably below 30 percent of GDP for the next 10 years under a baseline scenario. This debt level is relatively low by international standards for a lower-middle income country with a medium level of Government capacity in macroeconomic and debt management.
- **Total external debt.** The overall stock of external obligations (including PPG) is also envisaged to remain sustainable. The DSA shows that total external debt will be well-contained at under 40 percent of GDP over the next decade under the baseline. While the exchange rate devaluation triggered an increase in the external debt service-to-exports ratio in 2017, the external debt service payments are expected to hover at under

¹⁴ Historically, the Government has issued only a small amount of treasury bills.

20 percent of export revenues, and well-covered by the projected overall reserve buffers.¹⁵

31. **Continued prudence will be key to preserving Uzbekistan’s debt sustainability over the long term.** The risk of sovereign default is low given Uzbekistan's explicit commitment to fiscal restraint, low external debt stock and high international reserves relative to its external financing requirements, which far exceed total liabilities (not just public liabilities). All solvency and liquidity indicators are projected to remain below their respective thresholds under both the baseline and stress scenarios. Uzbekistan faces a moderately low risk of external debt distress and low risk of overall debt distress.

32. **Fiscal risks from contingent liabilities associated with SOE debt are closely monitored by the Ministry of Finance (MoF), and corrective actions are taken quickly every year to mitigate such risks.** Uzbek public companies and banks have access to external borrowing without explicit Government guarantees, and their financial performance is monitored by the MoF. As a result, risks associated with contingent liabilities appear to be limited and manageable, including thanks to Uzbekistan’s large fiscal buffers. Over the longer term, bringing large SOEs into cost recovery and financial sustainability will be critical to enhance fiscal and debt resilience.

Table 3: Uzbekistan: Debt Sustainability

	2014	2015	2016	2017e	2018f	2019f	2020f
Total Public and Guaranteed (PPG) Debt, US\$ billion	6.9	6.2	7.0	11.7	8.1	10.1	11.2
Total PPG Debt, % of GDP	10.9	9.3	10.5	24.5	20.1	21.0	21.9
o/w: External Debt (PPG), % of GDP	10.9	9.3	10.5	24.5	20.1	20.9	21.7
Domestic Debt (PPG), % of GDP	0.0	0.0	0.0	0.0	0.0	0.1	0.2
Total External Debt (PPG + Private), US\$ billion	13.8	12.3	13.5	19.8	15.4	16.8	17.4
Total External Debt (PPG + Private), % of GDP	21.8	18.5	20.3	41.3	38.1	35.2	34.3
Private External Debt (% of GDP)	10.9	9.2	9.8	16.8	18.0	14.2	12.4
External Debt Service Payments (% of Exports)	3.7	4.7	5.2	13.6	15.6	13.9	13.2
Gross International Reserves (US\$ billion)	24.1	24.3	26.5	28.1	28.9	28.9	28.4

Source: IMF and World Bank.

E. ADEQUACY OF THE MACROECONOMIC FRAMEWORK

33. **Uzbekistan’s macroeconomic policy framework is adequate for the proposed operation.** As highlighted in the preceding discussion, economic growth is expected to remain strong over the medium term, while inflation is expected to moderate based on prudent macroeconomic policies. Large international reserve buffers and sustainable external balances are also expected to maintain public and private external debt at moderate levels.

34. **Over the medium term, the macroeconomic framework should serve as a strong platform for private sector export-led growth to be unleashed.** Implementing well-coordinated, prudent monetary and fiscal policies will be critical to this end, as it will be maintaining a sound exchange rate regime that helps to avoid any re-emergence of an overvalued real exchange rate. The IMF projects an end-of-year CPI increase of 16.9 percent in 2018, somewhat lower than in

¹⁵ External public and PPG debt has been serviced fully and there are no external arrears, including by SOEs.

2017 (18.9 percent), which would be consistent with sustaining a robust rate of economic growth. Ongoing IMF monitoring and technical assistance, including on tax policy and administration, public financial management (PFM), financial supervision, and data standards improvement will assist with macroeconomic stability.

F. IMF RELATIONS

35. **The Government maintains an ongoing dialogue with the IMF on macroeconomic policy in Uzbekistan.** An Article IV Mission took place from February 27 to March 13, 2018, and compliance with Article VIII obligations was assessed by a mission in early April. A joint IMF-World Bank Mission on Tax Policy Reform visited Tashkent on February 19 to 28; the Government has published the tax policy mission's technical assistance report on its official website. The World Bank and the IMF have a very strong and productive dialogue on macroeconomic issues. At the conclusion of the Article IV Consultation (presented to the IMF's Executive Board on May 4, 2018), the IMF highlighted the authorities' commitment to reform, noting that one of the key challenges lying ahead will remain generating sufficient domestic jobs as the transition towards a market economy takes hold. The IMF has observed that Uzbekistan must continue working to enhance the coordination of its stabilization policies, reform its financial sector, and press ahead with the implementation of the wide array of structural policies (see the IMF Relations Note in Annex 3). Uzbekistan does not have a financing program with the IMF.

3. THE GOVERNMENT'S PROGRAM

36. **In February of 2017 the Government of Uzbekistan approved a five-year Development Strategy for 2017-2021.** At the core of the Strategy is a broad market-oriented reform policy. The Strategy, to be implemented over five years, is guided by an annual state program that is approved every year. The Development Strategy covers five priority areas: (i) enhancing state and public institutions; (ii) securing the rule of law and reform of the judicial system; (iii) promoting economic development; (iv) fostering social development; and (v) ensuring personal and public security through inter-ethnic and religious tolerance and constructive foreign policy.

37. **Under the first priority area, the Government's Strategy aims at enhancing the role of the Parliament and building a competitive political system.** It also aims at reforming the public administration and public service through decentralization, skills enhancing and the gradual reduction of the state regulation of the economy. The first priority area also addresses the issue of public-private partnerships, transparency and e-Government. Finally, it aims at guaranteeing participation of civil society, including through enhancing the role of the media, and the effective dialogue with ordinary people.

38. **The second priority area, on the rule of law and the judicial system,** includes issues such as independence of the judiciary, strengthening of judicial control, and specialization of the courts. The area also covers the provision of guarantees and protection of rights, improving administrative, criminal, civil and commercial law. Other proposed reforms include crime prevention, strengthening the rule of law and judicial system, and improving the system of legal aid and legal service.

39. **The third priority area, on economic development and liberalization, aims at strengthening macroeconomic stability and achieving high rates of economic growth.** This envisages the strengthening of fiscal and monetary policies, reducing the tax burden, developing market mechanisms for monetary policy and strengthening and developing the banking and financial sector. It also aims at improving the competitiveness of the economy through structural reforms, fostering industrial diversification and encouraging private production, reducing energy consumption and resource intensity, including through the development of free economic zones, and liberalizing and fostering export sector. The area covers also the modernization of agriculture to help ensure food security and increase exports, as well as encourage the use of more climate-adapted crops (reduce water consumption), developing markets and institutional reform. The priority area aims also at developing the private sector and reducing the role of the state to foster growth across different regions.

40. **The fourth priority area on social development aims at increasing real income, creating employment, improving the social security system, healthcare and improving the role of women in society.** In addition, this area envisages improving infrastructure and housing development, education, and research and development.

41. **Finally, the fifth priority area seeks to strengthen civil, religious and inter-ethnic peace and tolerance.** This includes the issues of security and defense, but also environmental concerns and improvement of foreign relations at the regional and world levels.

42. **Uzbekistan's development strategy to increase energy efficiency and reduce fossil fuel use intensity is also consistent with its commitment to climate change mitigation.** Uzbekistan's voluntary commitments on climate change mitigation and adaptation under its INDC (Intended Nationally Determined Contribution, submitted to the United Nations Framework Convention on Climate Change, on April 18, 2017). These commitments focus on energy efficiency and reducing the fossil fuel intensity of the economy, including: (1) decrease specific emissions of greenhouse gases per unit of GDP by 10% by 2030 from level of 2010. Achievement of the INDC long-term objective envisages support from the international organizations and financial institutions, ensuring access to the advanced energy saving and environmentally sound technologies, resources for climate financing; and (2) Uzbekistan will also continue its efforts for adaptation capacity building to reduce risk of climate change adverse impact on various sectors of economy, social sector, and the Aral Sea coastal zone.

43. **The Government strategy includes steps to improve the quality and availability of economic data.** In September 2017, the government committed to improving data quality and availability, starting with the Presidential decree mandating the dissemination of economic and financial data. In January 2018, the Statistics Committee began publishing a new consumer price index based on an updated methodology, consistent with that of the IMF. The government has also agreed to participate in the IMF's enhanced General Data Dissemination System (e-GDDS), posting a National Summary Data Page with key economic, financial, and social statistics starting in May 2018. Ongoing work includes efforts to improve balance of payments statistics, monetary reporting and financial soundness indicators, and to compile Uzbekistan's International Investment Position. Moreover, the CBU, Ministry of Finance, and the Statistics Committee are preparing a roadmap for improvement of statistics that is scheduled for release in November 2018. The Statistics Committee is working to improve the quality and range of national accounts data.

Going forward, the Government is planning to upgrade labor market statistics, including the collection of household survey data.

4. THE PROPOSED OPERATION

A. LINK TO THE GOVERNMENT OPERATION AND DESCRIPTION

44. **The DPO will support the Government of Uzbekistan’s efforts in:** (i) fostering sustainable growth through resilient macro-fiscal and financial policies by mitigating potential risks as the economy undergoes its adjustment to a more market-based economy; (ii) opening markets for the private sector, especially in the tradable sectors; and (iii) establishing a social protection system that effectively protects the vulnerable during the transition.

- **Policy Area 1—Foundations for Sustainable Economic Growth and Macro-Financial Resilience.** The DPO is supporting a fundamental adjustment of macroeconomic policymaking, while mitigating near-term macro-fiscal and financial risks. These key reforms include the liberalization of the foreign exchange market, improved SOE governance and utility tariff reforms, as well as a strengthening of financial sector system through prudential regulations and stress-testing.
- **Policy Area 2—Supporting Market Formation for Private Sector Development.** Through a combination of reforms and institutional enhancements, Uzbekistan will be able to open markets. A number of key reforms have been enacted to create the foundations for private sector-led growth. DPO-supported reforms include the market-based formation of key prices, liberalizing trade, and expanding opportunities for the private sector in sectors that reflect the country’s comparative advantage, including agriculture.
- **Policy Area 3—Enabling Job Creation and Managing Social Risks.** The DPO places special emphasis on mitigating possible negative impacts on vulnerable groups due to the economic transition. This includes the scaling-up of social safety nets and facilitating the movement of workers from low value-added sectors to high value-added sectors.

45. **The policies supported in the DPO are fully aligned with the Government’s program.** The program supports the five-year Development Strategy for 2017-2021 approved by the Government in February 2017. All three pillars of the DPO broadly address the contents of the Development Strategy, and goals of each pillar interlink with all five priority areas specified in the Government program. More specifically, the highly ambitious third priority area on economic development and liberalization in the Government’s program is linked with the first two pillars of the DPO. In addition, the operation backs the core of the fourth priority area, improving the social security system and the role of women in society (by formalizing temporary and part-time work) under the third pillar of the DPO.

46. **In the past, Uzbekistan, through a state-driven approach to economic management managed to sustain stable growth, but lacked dynamism and flexibility.** This model—which was highly reliant on state-directed investment—lost its ability to generate growth and generated scant productivity gains. Prior commodity-driven growth came at a significant opportunity cost

(by supporting non-competitive sectors) such that Uzbekistan’s vast potential was underleveraged (for example, in the horticultural sector).

47. **While Uzbekistan has been able to reduce poverty in recent years, it remains among the poorest countries in ECA.** The national poverty rate fell only slightly between 2016 and 2017, from 12.5 percent to 12.4 percent. Nearly 4 million people were estimated to live below the national poverty line in 2017.¹⁶

48. **The proposed DPO builds on challenges identified and lessons learned from Uzbekistan’s 2016 Systematic Country Diagnostic and the WB’s experience in similar transition economies.** Key lessons include: (i) the need to secure the improvement of the business climate to attract private foreign direct and domestic investment, (ii) the need to develop market mechanisms required for the transition toward an efficiency-driven economy (including SOE governance, macroeconomic management, foreign exchange convertibility), and (iii) the need to promote private sector led growth, diversification, and modernization.

B. PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS

49. **The development objective of this DPO is to support Uzbekistan’s economic transformation to a market economy.** The DPO backs 10 critical reforms under three policy pillars as defined in the previous section. The Government has demonstrated strong ownership and reform commitment under the three pillars and the design of the DPO, along with the corresponding advisory services, are helping the Government to embark upon a consistent medium-term strategy. The areas of the Government’s Strategy underpinned by World Bank Group’s support are closely linked to analytical findings of prior studies and technical assistance support provided to Uzbekistan (Table 4).

50. **Under the first pillar, the DPO supports vital reforms to rebalance Uzbekistan’s macroeconomic management.** A critical reform has been the liberalization of the foreign exchange market, through a large devaluation of the foreign exchange rate, a move to a managed exchange rate float, and the elimination of surrender requirements. These actions eliminated the very large parallel exchange rate premium on foreign currency in early September 2017, as the exchange rate became market-determined.¹⁷ The Government has also taken decisive steps to reform the SOE sector, especially the two largest energy SOEs, Uzbekenergo (UE) and Uzbekneftegaz (UNG), which used to benefit from the (subsidized) official exchange rate, as well as from directed lending and other implicit and explicit subsidies. These reforms also have important implications for the exposure the financial sector to underlying credit risks, explaining why the operation supports the upgrading of prudential regulations and stress-testing to help mitigate potential financial risks arising from needed structural adjustments.

51. **The second pillar of the operation aims to open previously closed markets and to create the foundations for private sector-led growth.** The Government has undertaken several major reforms to establish functioning markets for key goods and services in the economy, and has started to eliminate subsidies to allow for relative price adjustments critical for the transition.

¹⁶ These are national official poverty estimates have not been independently validated by World Bank experts.

¹⁷ Just prior to the reform, the premium was as elevated as 100 percent.

The Government has taken important steps to empower farmers so that they can run their farms as private businesses and liberalized trade by reducing tariffs. Moreover, to signal Uzbekistan’s new openness to the world and desire to benefit from economic integration the Government has liberalized and streamlined its visa regime and re-initiated its WTO accession process.¹⁸

52. **In the third pillar, the DPO focuses on the social sustainability of the ongoing reforms.** This operation specifically supports the enlargement of the social safety net to help individuals that suffer potential job losses during the structural change, which has already been reflected in the new state budget. In addition, the WBG has been supporting the Government to reform its Labor Code to make it easier to hire employees and encourages the transition from informal to the formal sector by formalizing contracts for temporary and part-time workers.

53. **The WBG is coordinating closely with other development partners.** The IMF has also actively reengaged in Uzbekistan and has been providing assurances of the adequacy of the macroeconomic framework to anchor the operation (see also Annex 3). The Asian Development Bank (ADB) is preparing a parallel budget support operation; staff in both institutions are coordinating the development of the policy matrices to ensure that they are complementary. For example, there is a strong alignment and synergies in ADB and World Bank support to the Government in reforming energy sector SOEs.

Table 4: Prior Actions and Analytical Underpinnings

Policy Objective	Prior Actions	Analytical Underpinnings
1. Foundations for Sustainable Economic Growth and Macro-Financial Resilience		
Enhanced economic growth is stimulated through reducing exchange rate and monetary distortions, and greater private sector access to foreign exchange	PA1. The Recipient, through the Central Bank of Uzbekistan (CBU) has eliminated all foreign exchange surrender requirements on all export earnings.	Uzbekistan Systematic Country Diagnostic (P152958); Uzbekistan Foreign Exchange Convertibility (P163859); Technical and Analytical Support to Uzbekistan in the Transition to a Market Economy (P167074).
Financial sector stability is enhanced to improve the environment for stable economic growth	PA2. The Recipient, through the CBU has issued revised prudential regulations on banking capital adequacy, liquidity, and asset classification to improve compliance with international financial regulatory standards in line with the Basel Core Principles.	Uzbekistan Financial Sector Technical Assistance (P165372); Uzbekistan Strengthening Banking Regulations (P167070).
	PA3. The Recipient has adopted measures requiring the CBU to conduct annual stress tests on commercial banks in line with international best practices.	Uzbekistan Financial Sector Technical Assistance (P165372); Uzbekistan Strengthening Banking Regulations (P167070).

¹⁸ Although Uzbekistan initiated discussion to join WTO in 1994, it has not held a meeting with WTO since 2005. The Government announced in 2017 its desire to start the process of accession to the WTO, and has formally communicated this decision to the WTO Secretary General. The Bank, in coordination with other development partners including USAID, is providing technical assistance to Uzbekistan as it prepares for WTO accession.

Policy Objective	Prior Actions	Analytical Underpinnings
Fiscal sustainability is strengthened through tariff reforms and financial transparency of SOEs	PA4. The Recipient has adopted key measures to promote financial recovery and transparency of Uzbekenergo and Uzbekneftegaz, through: (i) approval of fuel and electricity tariff adjustments; (ii) introduction of differentiated electricity tariffs to improve efficiency; and (iii) adoption of policy requirements for Uzbekenergo and Uzbekneftegaz on financial statement audits' compliance with the international financial reporting standards.	Uzbekistan Systematic Country Diagnostic (P152958); Energy Subsidies in Uzbekistan: Impact and the Way Forward (P153801); Industrial Energy Efficiency Program (P156670); Strategic Advisory for Improving Corporate Governance (P165740).
2. Supporting Market Formation for Private Sector Development		
Greater flexibility in domestic relative prices, along with a transparent business environment	PA5. The Recipient has (i) removed regulatory price controls for a list of key products, in particular production inputs and raw materials and; (ii) adopted requirements for a set of products to be transacted through commodity exchanges, in order to develop market institutions and to liberalize prices.	Uzbekistan Systematic Country Diagnostic (P152958); Uzbekistan Investment Climate Reform and Entrepreneurship Support (P164631); Technical and Analytical Support to Uzbekistan in the Transition to a Market Economy (P167074).
External trade to foster investment, growth and jobs, and market-based prices	PA6. The Recipient has reduced average custom tariff rates.	Uzbekistan Systematic Country Diagnostic (P152958); Uzbekistan Investment Climate Reform and Entrepreneurship Support (P164631); Technical and Analytical Support to Uzbekistan in the Transition to a Market Economy (P167074).
Agricultural productivity and efficiency increases to promote job growth, and wages	PA7. The Recipient has increased the regulated purchase price paid for cotton closer to the international market price aimed to increase cotton productivity and to promote a more efficient use of resources (including land, water and fertilizer).	Uzbekistan Systematic Country Diagnostic (P152958); Agricultural Modernization TA (P162303); Third Party Monitoring in Cotton Sector (P156962); Horticulture Development Project; GEF Sustainable Agriculture and Climate Change Mitigation Project; Jobs and Skills for Modern Economy Project.
	PA8. The Recipient has reduced the land area mandatorily assigned to grow cotton and grain in order to support the raise of productivity and to promote a more efficient use of resources (including land, water and fertilizer).	Agricultural Modernization TA (P162303); Third Party Monitoring in Cotton Sector (P156962).
3. Enabling Job Creation and Managing Social Risks		
Facilitating employment through greater options in	PA9. The Recipient, through its Executive branch, has submitted to its Parliament, for approval thereof, the draft	Uzbekistan Vision 2030 (P143449); Jobs and Skills Development in Central Asia (P143516);

Policy Objective	Prior Actions	Analytical Underpinnings
contracting formal workers	amendments to the Labor Code to expand formal contracts to part-time and temporary workers.	Uzbekistan Systematic Country Diagnostics (P106454).
Effective social safety nets	PA10. The Recipient has increased the social safety nets financial support for vulnerable groups, including low-income families and families with dependent children.	Supporting Uzbekistan’s Inclusive Economic Reform Through Strengthening Its Social Protection System (P166665); Uzbekistan Support Towards Developing National Citizen Engagement Framework (P166817).

Pillar 1 –Foundations for Sustainable Economic Growth and Macro-Financial Resilience

54. **The reforms supported under this pillar help address the major economic imbalances and risks at the outset of the authorities’ ambitious reform program.** The Pillar’s interrelated objectives include: a) enhancing economic growth through greater openness, b) improving macro-fiscal sustainability, governance, and private sector participation through reform of public enterprises, and c) strengthening financial sector stability. They attend to the macro-fiscal and financial areas that represent the greatest short-term vulnerabilities which, if not resolved, would constitute a major impediment for sustainable economic growth and job creation over the near and medium term.

Prior Action 1: *The Recipient, through the Central Bank of Uzbekistan (CBU) has eliminated all foreign exchange surrender requirements on all export earnings.*

55. **The reform of the foreign exchange regime was the first reform—and one of the most important—implemented by the Government in its ambitious program.** The foreign exchange (forex) regime was characterized by a growing gap between the official and the unofficial/curb market exchange rates, with a significant cost to the central bank and with large distortions in the economy that resulted in a sub-optimal allocation of resources, including the development of an export sector with negative value-added. In addition, the private sector was seriously limited in accessing foreign exchange and instead developed multiple, and expensive, mechanisms to access forex.¹⁹ On September 5, 2017, the authorities liberalized the forex market by allowing the domestic currency, the Uzbek som, to depreciate by over 50 percent and abolished the existing surrender requirements on export revenues. This move was important from an economic perspective, but also significant as it signaled a change in strategy: in addition to improving access for the private sector to forex transactions, it also made explicit the large costs incurred by SOEs—which previously benefited from the implicit subsidy provided by the overvalued official exchange rate—as well as the risks they posed for the banking sector through its (directed) lending portfolio.

56. **Despite its considerable cost to previously protected sectors, the net economic impact of the exchange rate liberalization has been positive and its benefits are expected to grow over the medium and longer term.** After the CBU allowed the official exchange rate to move

¹⁹ Prior to the reform, many observers, including the World Bank and the IFC, stressed to the authorities in the past that the lack of foreign exchange convertibility, as well as the presence of surrender requirements, very seriously hampered the prospects for private sector activity in Uzbekistan.

from UZS 4,210 to UZS 8,100 per US dollar, it eliminated the gap between official and market exchange rates, and established a framework to allow a managed-float regime thereafter. As noted earlier, the forex market liberalization has improved the country's aggregate balance sheet, which was buffered by the presence of large net forex assets—including foreign reserves held by the CBU, by the Government at the UFRD, and by at least some private sector agents. Data suggest that forex reserves rose as a result of the devaluation and output increased in some of the less-regulated export sectors (such as horticulture), aided by the adjustment in relative prices linked to the exchange rate depreciation.

57. **The elimination of the surrender requirements is fully aligned with the broader elimination of exchange rate restrictions in Uzbekistan, attesting to the depth of this reform effort.** During its 2018 Article IV Consultation, the IMF also conducted a review under Article VIII, which confirmed that the reforms implemented by the Uzbek authorities since September 2017 have eliminated all relevant exchange restrictions and the multiple currency practice subject to IMF jurisdiction that had been identified in earlier assessments. The IMF has noted that market participants indicate that they are now able to make payments and transfers for current transactions without impediment; the IMF staff will continue to monitor the ongoing implementation of the new liberalized FX regime.

Prior Action 2: *The Recipient, through the CBU has issued revised prudential regulations on banking capital adequacy, liquidity, and asset classification to improve compliance with international financial regulatory standards in line with the Basel Core Principles.*

58. **The process of modernization and strengthening of the banking sector in Uzbekistan will require a significant and sustained effort by the authorities in the coming years.** This process will require, *inter alia*, a critical revision of the prudential regulations to align them with the minimum international requirements and standards. Considering the significant number of prudential regulations (reportedly over 300) currently in force, the CBU, together with the World Bank team, agreed to focus first on the most important prudential regulations covering capital, liquidity and asset classification.

59. **The proposed amendments will ensure a more risk-focused prudential framework for capital, liquidity and asset classification:**

- ***Amendments to the Regulation on Capital Adequacy Requirements (CARs)*** will improve banks' capital ratios by ensuring a better reflection of risks to capital, particularly credit risk. The risk-weighted buckets have been adjusted for different credit risk exposures, including cross-border transactions, to ensure that risks generated by these transactions are properly reflected in banks' capital requirements.
- ***Amendments to the Regulation on Liquidity*** will ensure better quality of banks' liquid assets, with the aim of absorbing potential shocks without requiring the emergency injection of liquidity into the banking system or triggering a systemic crisis. These amendments will also reduce the possibility of manipulating the liquidity ratio by using interbank transactions.
- ***Amendments to the Regulation on Assets Classification*** will improve the capacity of banks to identify, at an early stage, potential losses generated by credit risk. To this end, the number of quantitative and qualitative indicators that have to be considered by

banks for the credit risk assessment were increased. Also, risk indicators were recalibrated for different types of assets to ensure a more accurate assessment of the credit-risk level, depending on the type of debtor or collateral, and financial situation.

60. **The revision to these three regulations is only a first step in what must be a sustained effort, both by the CBU and the banking sector, to modernize the regulatory framework for banking in Uzbekistan.** Drafting new regulations on corporate governance and risk management is the next priority, as the current regulations do not cover many important provisions needed by a modern, market-based banking system. Revision of the prudential reporting framework is also needed to ensure that the CBU has proper information for the transition to the risk-based supervision model; and the CBU's internal process of analyzing prudential reporting will need to be improved and supported with modern analytical tools to automatize technical and validation processes.

Prior Action 3: *The Recipient has adopted measures requiring the CBU to conduct annual stress tests on commercial banks in line with international best practices.*

61. **This prior action supports the CBU's efforts to apply an improved stress test methodology to the Uzbek banking sector.** The CBU has recognized the importance of regularly implementing stress tests as a complementary tool for good supervisory practices, especially given the vision of developing a sound, market-based banking system. The new methodology used will allow the projection of bank-by-bank balance sheets and the identification of potential vulnerabilities on an individual basis—and for the sector as a whole—to shocks stemming from the macroeconomic environment. The results of the stress tests will guide supervisory intensity vis-à-vis certain banks and will allow the CBU to discuss potential measures that the banks could take in advance to mitigate the impact of potential shocks.

62. **The CBU has collected comprehensive data on four banks to allow for a preliminary assessment of vulnerabilities and to help guide the calibration of the impact of potential shocks.** The sample was selected to be representative of three different types of financial institutions operating in Uzbekistan. The CBU, together with World Bank staff, analyzed the balance sheets of two large state-owned banks, a joint-stock bank, and a private bank. The CBU and World Bank staff discussed together a shock scenario for the Uzbek economy to include the effects of a slowdown of growth in China and Russia, together with a softening of global oil and gas prices. The scenario included the projections of the effects of a significant depreciation of the local currency, a slowdown of industrial production and economic activity, and of the CBU's policy reaction to a significant depreciation in the form of an increase of the CBU's reference rate. The tests showed that the two state banks are most vulnerable to such a structure of shocks, given their high share of lending in foreign exchange and high off-balance-sheet commitments, suggesting that the banks would require state guarantees for future solvency if such a scenario were to materialize. The commercial banks were relatively more resilient due to the currency composition of their portfolios. However, the relatively higher share of deposits at floating rate vis-à-vis fix rate longer-term credits constitutes a significant vulnerability.

Prior Action 4: *The Recipient has adopted key measures to promote financial recovery and transparency of Uzbekenergo and Uzbekneftegaz, through: i) approval of fuel and electricity tariff adjustments; ii) introduction of differentiated electricity tariffs to improve efficiency; and*

iii) adoption of policy requirements for Uzbekenergo and Uzbekneftegaz on financial statement audits' compliance with the international financial reporting standards.

63. **SOEs in Uzbekistan are widespread, account for sizable shares in GDP and employment, and exert disproportionate influence in economic activities.** Uzbekneftegaz (UNG) and Uzbekenergo (UE) are among the largest SOEs in the country, have extensive forward and backward economic linkages, and collectively employ about 170,000 people (close to 20 percent of the estimated employment in SOEs). They are both large holding companies which comprise a very broad range of core and non-core businesses. As other companies in the SOE complex, UE and UNG benefitted from the subsidized official exchange rate prior to the exchange rate reform, as well as from (also subsidized) directed lending.

64. **Reforming UE and UNG is critical—not only their balance sheets experienced significant valuation losses with the exchange rate reform, but they must become financially sustainable more generally.** As noted earlier, the authorities absorbed some of the adjustment cost of UE and UNG through stop-gap measures following the exchange rate adjustment. At the same time, the Government also moved forcefully to help convergence towards cost-recovery; in 2017-18, domestic currency prices of electricity, natural gas, and petroleum were raised by 17-43 percent, helping realign revenues and costs in both UE and UNG, reducing inefficient energy subsidies, including through associated reductions in fuel and electricity usage.²⁰ Going forward, both SOEs must continue to move decisively to secure financial sustainability and improved governance, to help avoid the accumulation of fiscal costs.²¹ Not only these firms face a potential financial gap as they have yet to achieve full cost-recovery, and become subject to hard budget constraints, including by becoming independent from subsidized lending. The authorities foresee the removal/divestiture of UE and UNG's non-core businesses, and both SOEs will be increasingly subject to competition from the private sector.

65. **This prior action supports strengthening macro fiscal sustainability, improving public services, enhancing the financial sustainability and accountability of UE and UNG, and creating a space for private investments.** The prior action aims to bring UE and UNG back on a financially sustainability path, also helping enhance the country's energy security and future growth prospects. The proposed actions constitute a substantive first step that: (i) constitutes an integral component to comprehensive medium-term packages of financial recovery actions for SOEs; (ii) allows a greater role for the price mechanisms to adjust resource allocation and consumption in certain areas (e.g. time-of-use, and through commodity exchanges); and (iii) pioneers IFRS-based consolidated financial reporting among SOEs, a practice still rarely adopted in the country, for greater transparency and accountability. These actions also pave the way for further development including improved corporate governance and decision-making in the SOEs, private sector participation in the sector including in renewable energy development (with potential climate change mitigation co-benefits), and more accountable public services.

²⁰ The related Bank projects and technical assistance to support energy efficiency will complement these measures.

²¹ As noted earlier, resources from the UFRD were dedicated by the Government in 2017 to restructure foreign-exchange rate denominated debts by these companies to the domestic financial system (falling due in 2017-18), to ease their pressure. In addition, the authorities reduced their tax liabilities. The direct cost of these measures approximated 1 percent of GDP in 2017 for UE and UNG.

Pillar 2: Supporting Market Formation for Private Sector Development

66. **The reforms supported under this pillar will help Uzbekistan to shift from a state-led economy to a market-based system in which the private sector will become the main engine of growth.** The Pillar’s interrelated objectives include: a) creating greater flexibility in domestic relative prices, b) fostering external trade to generate opportunities for investment, growth and jobs, and c) expanding jobs through growth of trade opportunities, particularly in agriculture.

Prior Action 5: *The Recipient has (i) removed regulatory price controls for a list of key products, in particular production inputs and raw materials, and (ii) adopted requirements for a set of products to be transacted through commodity exchanges, in order to develop market institutions and to liberalize prices.*

67. **This action supports the Government’s efforts to redefine the role of the state in the economy and promote private sector development in Uzbekistan.** Price controls have been widely applied in the Uzbek economy, from sectors that are usually considered natural monopolies—such as electricity, gas and water—to sectors where prices are not usually regulated—food staples, fuel, cement, metals, cotton, wheat and glass among others. Prior to the launch of the reforms, a wide group of goods was subject to regulated prices; moreover, many goods (such as key production inputs) were acquired by certain groups of economic agents (such as SOEs) under direct, non-market allocation mechanisms. Both types of policies (the undue price controls for certain products as well as the direct, non-market allocation of a significant share of goods across a selected group of economic agents) distort opportunities for other economic agents to enter the market, compete, and provide better quality of goods and services.

68. **The authorities have started to build market institutions and liberalizing prices.**²² To this end, the Government is adopting policy that allows for an increasing number of goods and services, particularly production inputs and raw materials, to be subject to liberalized (deregulated) prices, and by allowing an increased number of goods and services to be transacted through market conditions, particularly in commodity exchanges. The commitment of the Government to limit the power of public bodies to approve price, production and/or distribution mechanisms for products and raw materials is needed to unleash market forces and level the playing field in Uzbek markets. However, the Council of Ministers still defines a “list” of socially and strategically important goods for which prices, production and distribution can be controlled (and hence prices are either regulated and/or the allocation of the goods is not market-based).²³

²² The authorities have also progressed by eliminating the so-called “**localization program**”. Since the early 2000’s the Government implemented this import-substitution program by granting individually-calibrated, non-transparent incentives to selected firms only. The program has been removed.

²³ Not all goods, however, are treated the same way; the Council of Minister can decide whether to regulate prices and/or control the distribution/allocation of goods and services. As a result of the reforms, various key goods have now fully deregulated prices and are always transacted in commodity exchanges and/or under market conditions (e.g., cathode copper, copper wire, secondary aluminum, metal zinc, extraction of gasoline). A second group of goods has deregulated prices but do not always have to be transacted in the commodity exchanges (that is, other non-market practices of allocation may be allowed), as with goods such as technical kerosene, cement, polypropylene, polyethylene and others. A third group is always transacted in the market/commodity exchanges, but at regulated prices (e.g., fodder grade wheat and technical seeds). Finally, a number of “sensitive” goods continue to be reserved (with regulated prices, and do not need to be transacted in commodity exchanges—including flour, bread, key medicines, liquid and natural gas for the population, ethanol, and various others).

69. **This Prior Action, while significant, is only the beginning of a critical agenda that must be decisively implemented to develop market institutions in Uzbekistan.** Progress is gradual as firms trading in the commodity exchange are still subject to specific quotas of the supply left over after selling to SOEs; these remaining restrictions will need to be removed to help secure the establishment of solid market institutions in Uzbekistan. In this context, it will be important to narrow the list of goods and services subject to regulated prices and/or non-market allocation practices to a concise “negative list” of exemptions to otherwise deregulated prices determined by the market. More generally, the elimination of any remaining non-market based policy instruments limiting competition will be essential to complement the Government’s reform efforts.

Prior Action 6: The Recipient has reduced average custom tariff rates.

70. **As Uzbekistan moves toward a market economy, it is increasingly important that the relative prices of goods are anchored on international market prices.** The further lowering of tariffs, especially reducing the dispersion of tariffs by reducing peak rates, will help to achieve this goal, increasing competition and helping benchmark the needed relative price adjustments in the economy.

71. **Following the exchange rate reform, Uzbekistan significantly cut its import tariffs, to attenuate the ensuing inflation and enhance competitiveness.** As observed earlier, import tariff rates for about 8,000 out of 10,800 items were reduced (for about 5,000 items, tariffs were eliminated) to mitigate the adverse effect on import-intensive companies (and prices) and improve the competitiveness of the economy.²⁴ As a result, the simple average tariff was reduced from 15.2 to 6.3 percent, whereas the trade-weighted average went from 13.9 to 5.9 percent, as not all groups saw their tariffs reduced homogeneously.²⁵ This broad reduction in tariffs has provided a strong stepping stone for an ambitious agenda on trade liberalization; the authorities are taking initial steps to broaden their reach and reinitiate their WTO accession process, supported by the Bank’s technical assistance.

72. **Going forward, there is a rich pending agenda to enhance trade policy and trade facilitation, including in the context of a potential WTO accession.** Next steps will need to focus on enhancing trade policy and bringing it in line with international standards; the still complex design of many of the remaining tariffs needs to be simplified, including to enhance transparency. Moreover, as there is still superimposition between the trade tariffs and domestic excises, a reform of excise taxes along similar lines should be taken simultaneously, especially since excise taxes at present reportedly differ between imported and domestic goods.²⁶

²⁴ The fiscal cost of this measure, however, is likely to be negligible in the short-run, as imports by major firms (and SOEs) have benefited from special exemptions. Over the medium and long-term, however, its comparative effects will be slightly larger as less-discretionary policies are expected.

²⁵ For agricultural products, deeper-than-average cuts were registered in animal products, cotton, fruit and vegetables, and sugars and confectionaries; whereas those in non-agriculture products were registered in electrical machinery, mineral products, petroleum, textiles, and other manufactures.

²⁶ However, these averages should be taken as lower bounds, since nearly 700 tariff lines are legally written in such a manner as to make the rates that importers have to pay non-transparent. These include conditional tariffs (e.g., “10 percent, but not less than US\$0.9 per kilo”), as well as compound tariffs for motor vehicles (e.g., “x percent plus an additional amount calculated based on engine displacement”).

Prior Action 7: *The Recipient has increased the regulated purchase price paid for cotton closer to the international market price aimed to increase cotton productivity and to promote a more efficient use of resources (including land, water and fertilizer).*

73. **The current state procurement system in agriculture relies on a complex array of Government's support** that aims at ensuring export earnings from cotton and food security from wheat. It represents a significant fiscal burden on the Government's budget, entailing a wide range of subsidies for input production and distribution, farmers' credit, irrigation, power, and post-harvest processing (ginning and milling). This system is creating significant market distortions and misallocation of resources. Fixed procurement prices offered to farmers are well below market prices and do not provide the right incentives to increase productivity, generate incentives for an efficient resource and improve quality.

74. **The Government announced key measures to provide better incentives to cotton producers at the start of the 2018 cotton campaign.** These included a significant increase of the cotton procurement price from 1,700 to 3,200 soms per kilogram. According to President Resolution #3386 (Nov 14, 2017), import tariffs on agricultural inputs have been reduced. Going forward, further liberalization of input (included land) and output markets will allow farmers to have a broader choice of inputs, farming equipment, service providers and marketing channels to help improve productivity and quality. This is also expected to allow and facilitate the adoption of new climate smart agriculture technologies and practices, that will result in adaptation as well as mitigation co-benefits. In addition, a more rational use of fertilizers coupled with increased energy efficiency of agricultural processes are expected to yield mitigation co-benefits as well. Facilitating the creation of a wide range of private agro-entrepreneurs offering different services to farmers will also generate off-farm employment.

75. **The authorities are also fostering the creation of cotton clusters, with the intention of moving away from state-intervention and to help liberalize the cotton sector.** These clusters, three in 2017 and thirteen in 2018, will cover 700,000 hectares in the near future (around 65 percent of the total cotton area), and are intended to facilitate market- and private-sector driven production and marketing arrangements. The clusters, which are led by private textile companies that serve as anchors, will enter in direct contract farming arrangements with producers. They will be free to organize input supply and cotton ginning on their own, and negotiate cotton price above the state-procurement price.

Prior Action 8: *The Recipient has reduced the land area mandatorily assigned to grow cotton and grain in order to support the raise of productivity and to promote a more efficient use of resources (including land, water and fertilizer).*

76. **Under the current area-based quota system of production, farmers must allocate a large share of their land to the production of cotton and wheat without having any flexibility to make independent farming decisions.** More than 60 percent of the irrigated land is mandatorily assigned to cotton and grain productions, representing a significant misallocation of resources. In 2016, the Government initiated a five-year plan to remove less productive land from the mandatory production of cotton and wheat. By June 2019, at least 135,000 hectares of cotton and 40,000 hectares of wheat will have been removed from mandatory assignment, representing over 7 percent of the total cotton/wheat area.

77. **In line with the Government’s strategy to encourage agricultural diversification the “released” areas are being reassigned to the cultivation of less water-demanding and higher value crops.** This is expected to allow and facilitate the adoption of new climate smart agriculture technologies and practices, that will result in adaptation as well as mitigation co-benefits.²⁷ Besides, a more rational use of fertilizers coupled with increased energy efficiency of agricultural processes are expected to yield mitigation co-benefits as well. Recent Government’s decisions²⁸ instruct *Hokimiyats* to now hold quarterly consultations with private farms and smallholder farmers (through the Farmers’ Council) and local representatives of the Senate (*Kengashi*) on crop production planning and land allocation.

78. **The agricultural system has maintained low prices and many administrative and institutional constraints that dis-incentivize farmers and encourage land sub-leasing (which provides higher earning than the cotton/wheat returns).** To efficiently respond to market signals, farmers will need to become real private agroentrepreneurs with full autonomy in farming decisions, including crop choice, land use and crop and animal husbandry practices. As a pending agenda for the future, assigning cotton and wheat production targets in volumes only, and not in sown area and location, will provide a strong and immediate incentive to farmers to increase cotton/wheat productivity to reallocate land freed from cotton/wheat to other higher value crops. This would give farmers the opportunity to grow other food and cash crops—better adapted to the growing conditions in the country and the anticipated future climate conditions in which Uzbekistan has comparative advantage—and for which there may also be consumption shortages and imports, as well as fodder crops (and trees) which are badly needed by livestock farmers, producing climate change adaptation and mitigation co-benefits.

Pillar III: Enabling Job Creation and Managing Social Risks

79. **The reforms supported under this pillar complement the previous two pillars by focusing on the social sustainability of the ongoing reform process.** The Pillar’s objectives include: a) facilitating the movement of workers from low value-added sectors to high value-added sectors, b) improving social safety nets to mitigate negative impacts on vulnerable groups due to economic liberalization.

Prior Action 9: *The Recipient, through its Executive branch has submitted to its Parliament, for approval thereof, the draft amendments to the Labor Code to expand formal contracts to part-time and temporary workers.*

80. **This operation supports the Government’s reform of the 1996 Labor Code to expand formal contracts to part-time and temporary workers, and facilitate workers’ movements between sectors.** The Government, through the Ministry of Employment, has submitted a proposal to reform the Labor Code and is currently under consideration by the Cabinet of Ministers. The reform introduces the notions of seasonal and temporary work, and specifies corresponding contracts; provides options for formal employment to also be extended to home-based work, employment at a distance; and professional sportspersons and coaches, to facilitate formal employment. Importantly, the revised Labor Code simplifies employers’ hiring and firing

²⁷ This is also in line with Uzbekistan’s adaptation measures for the period up to 2030, listed in its NDC.

²⁸ President Resolution #3281 (Sept 15, 2017), Decree #5199 (Oct 9, 2017) and Resolution #3318 (Oct 10, 2017)

procedures to enhance the mobility of workers, the flexibility of the labor market, and improve women's formal entry into the labor market.

81. Flexible labor legislation, including through part-time and temporary contracts, can promote formal job creation. For firms, part-time and temporary contracts can be appropriate to cope with unexpected fluctuations in demand; replace permanent staff on holiday, maternity, or sick leave; hire workers with specialized skills to carry out specific time-bound projects; or launch start-up ventures with risky and uncertain returns. For workers, particularly women and youth, formal part-time and temporary contracts can provide opportunities for those people who might not have been able to access employment under a permanent contract, aid employees' desire for variable (flexible) contractual arrangements, and working conditions to varying employee private needs, while also being protected by social security benefits. For example, employees who are studying, raising children, or generally managing other duties, value part-time and temporary contracts. Part-time arrangements can have a particularly important and positive impact on low-skilled workers, women and young workers. Female labor market participation is a particular challenge. According to the World Development Indicators, female labor force participation in Uzbekistan was 53% compared to men's participation rate of nearly 78% in 2017. For female workers, these flexible formal contracts can provide a pathway into permanent employment and an opportunity to gain experience and skills.

Prior Action 10: *The Recipient has increased the social safety nets financial support for vulnerable groups, including low-income families and families with dependent children.*

82. This operation supports the Government's efforts to develop a comprehensive and effective social safety net to support low-income and vulnerable households that might be negatively impacted by the implementation of economic reforms.²⁹ The Government is in the process of strengthening its social safety nets system by improving the effectiveness of social benefits through an adequate non-contributory cash allowance. The ultimate objective of the social benefits reform is to ensure that an adequate level of cash allowance reaches poor and vulnerable families for a sufficient period time. Therefore, the reform involves increasing the coverage of social benefits, reviewing and adjusting as necessary the size and structure of the cash allowance, and improving poverty targeting to reduce inclusion and exclusion errors.

83. The Government has started the implementation of the social benefits reform by allocating more budget to expand the coverage of the family allowance. The first step is to increase the coverage of social benefits for low-income families, as well as families with dependent children. The Government is committed to increasing the coverage of social benefits by 30 percent, from about 435,000 beneficiaries in 2017 to over 500,000 in 2018. Improving the effectiveness of social benefits is a medium-term process that will require a broader set of reforms on the targeting,

²⁹ In addition to the social assistance system covered under this prior action, Uzbekistan's social security system (contributory) has substantial coverage and is more effective than the average of MICs and LICs in preventing certain groups to fall into poverty. There is also a non-contributory unemployment benefit, which is small; the Government seems to have no plans to expand it in the immediate future. There is also a non-contributory unemployment benefit, which is small; the Government seems to have no plans to expand increase it in the immediate future. Instead the Government is in the process of reforming the social benefits system and scaling up a registry of beneficiaries to better reach poor and vulnerable individuals (including those negatively affected by the economic reforms) and facilitate their placement in adequate interventions.

administration, implementation arrangements and consolidation of social benefits in a coherent system.³⁰

84. **The reform of social benefits will be gradually implemented.** For many years, Uzbekistan has relied on its *Mahalla* system, a local government based institution providing targeted assistance to poor families, which remains in place; there are no plans to fully replace it. However, the Government is aware of key issues with the *Mahalla* system requiring improvement, including the lack of transparency, monitoring and information verification, and is in the process of complementing this community-based approach with more formal processes and accurate mechanisms to reduce inclusion and exclusion errors. Among the complementary formal processes and mechanisms put in place, subsequent improvements will be related to: (i) adjusting the system to identify eligible households through objective targeting mechanisms and efficient processes; (ii) developing and implementing a social registry to facilitate policy and program coordination, and better support the poor and vulnerable; (ii) reforming the benefit system by merging various means tested benefits into a single well targeted cash allowance (following existing practices in several EU countries); and (iii) adjusting the size of the benefit and its structure to better tailor benefits to specific conditions of beneficiary families

C. LINK TO THE CPF, WORLD BANK OPERATIONS AND WBG STRATEGY

85. **The proposed DPO is being prepared jointly with Performance and Learning Review (PLR) of the 2016-2020 Country Partnership Framework (CPF), recognizing the significant changes that Uzbekistan is undergoing since the latest CPF was approved.** While the diagnostic outlined in the SCD remains valid, significant changes in the country's reform strategy warrant rebalancing the program to support economic transformation. The new program's focal areas include: (i) sustainable transformation towards a market economy, (ii) reform of state institutions and service delivery, and (iii) building human capital and citizen participation. The DPO contributes to the Government's efforts in its transformation to a market-oriented economy by supporting growth and macro-financial resilience, private sector development, as well as social protection for vulnerable groups.

86. **The proposed DPO is fully consistent with the WBG's strategy aimed at eradicating extreme poverty and promoting shared prosperity.** The program pillars are set to ensure long-term macroeconomic stability and safeguard the social safety nets—which are key preconditions for sustained poverty reduction. The specific attention of the proposed DPO to support the Government of Uzbekistan in market creation for private sector development allows for improvements in the business climate, higher productivity, and subsequently a boost in shared prosperity.

87. **The proposed DPO complements the ongoing WB operations aimed at supporting sustainable growth and creation of markets.** Specifically, the program's Pillar 1 goes in line with activities supported by the IFC in the financial sector under the *Technical and Analytical Support to Uzbekistan in the Transition to a Market Economy* (P167074), the *Financial Sector Technical Assistance* (P165372), and the *Uzbekistan Strengthening Banking Regulations* (P167070). The WB's ongoing operations in the country's energy sector include the development

³⁰ Given the large prevalence of male labor emigration in Uzbekistan, a non-negligible share of the beneficiaries are likely to be female-headed households.

strategy, a comprehensive gas-sector master plan, tariff study for natural gas, and support in corporate governance improvements through *Energy Subsidies in Uzbekistan: Impact and the Way Forward* (P153801) and others. The proposed DPO is also consistent with the *ECA Regional Climate Action Plan* (endorsed in June 2017), which aims to support countries in the transformation toward greener, cleaner, and more resilient economies, and contributes to the WBG targets and commitments on climate action by increasing climate-related financing in ECA.

88. **The program’s second and third pillars are consistent with a range of project and technical advice.** The program’s Pillar 2 is accompanied by the support of WBG TA on trade facilitation and WTO accession including *Technical and Analytical Support to Uzbekistan in the Transition to a Market Economy* (P167074), *Uzbekistan Investment Climate and Competition Reform* (P164631) and *Uzbekistan: Supporting the Transition to an Export-Oriented Market Economy*. WB operations aimed at supporting the agriculture include *Agricultural Modernization TA* (P162303) and *Third-Party Monitoring in Cotton Sector* (P156962); as well as credit lines through *Horticulture Development Project*, the *GEF Sustainable Agriculture and Change Adaptation and Mitigation for Aras Sea Basin (CAMP4ASB)*, and the *Jobs and Skills for Modern Economy Project*. Finally, the DPO’s Pillar 3 is backed by *Supporting Uzbekistan’s Inclusive Economic Reform Through Strengthening Its Social Protection System* (P166665) and *Uzbekistan Support Towards Developing National Citizen Engagement Framework* (P166817).

D. CONSULTATIONS AND COLLABORATION WITH DEVELOPMENT PARTNERS

89. **The proposed DPO is built upon consultation processes—initiated by the Government of Uzbekistan—with various sectors of the Uzbek society.** The measures supported by the operation conform to a broad market-oriented reform program initiated by the current Uzbek administration in February 2017. One of the key aspects of the Uzbek transition reform agenda, unlike the one under previous administration, is to consult with key stakeholders as well as with the general public, thus evaluating their specific complaints and recommendations, addressing a wider range of problems in the economy, and developing a more thoughtful set of policies to include in the reform program. The Government prioritized listening to the needs and concerns of its citizens by declaring 2017 the “Year of Dialogue with Citizens” and, among other things, launching the Virtual Reception, a mechanism to receive direct communications from citizens. The Virtual Reception has been used so far by more than one and half million citizens and the Government is currently working on ways to distill and analyze the data that is emerging as well as to systematize and further develop its approach to communicate with stakeholders in moving forward. Based on discussions with the Government on the country’s development priorities and challenges, such as the successful transformation of the Uzbek economy toward a market-oriented system driven by the private sector development, the proposed program builds upon a wide range of issues, touching as much aspects of the economy as possible. The Government’s reforms which are supported by the WB as part of this and potentially subsequent DPO series aim at reducing poverty and boosting shared prosperity.

90. **The proposed DPO has been prepared in close collaboration with the IMF, the Asian Development Bank (ADB), EBRD, and other international organizations as part of a coordinated effort to support macroeconomic and structural reforms that will provide a smooth economic transition with minimum social costs.** Jointly with the IMF, the WB provides assurances of the adequacy of the macroeconomic framework to anchor the operation; additionally,

the technical assistance in complementary areas will be closely coordinated between the two organizations. For instance, the Bank participated in a joint WB-IMF mission on Tax Policy Reform. The ADB is preparing a parallel budget support operation, and the staff of both the ADB and the WB are coordinating the development of the Policy Matrices to ensure that they are complementary (for example, ADB and WB are collaborating to support the financial recovery of Uzbekenergo). Also, the ADB has expressed its interest in having the second tranche of their Policy-based Loan join a potential second budget support operation with the WB. The engagement of the EBRD, the UNDP, the European Union and bilateral development agencies also continues in several areas. The WB is in cooperation with the EBRD on the development of the PPP Legal Framework, and with USAID on the process of WTO accession. There is also close collaboration with the International Labor Organization (ILO) on eradicating forced labor and improving labor market outcomes.

E. MAINTAINING THE REFORM MOMENTUM: FUTURE SUPPORT

91. **The Government of Uzbekistan has requested a long-term engagement of the WBG to assist in the transformation of the economy.** This first DPO is a critical part of the Bank's re-engagement strategy as it supports fundamental social and economic reforms which attempt to Uzbekistan reorientation of its social and economic model of development, for example in unifying the exchange rate and in the partial liberalization of the visa regime as well as in an expansion of the social protection program to mitigate the social costs of the transition.

92. **In a next phase, the Government will need ongoing support to make the reforms sustainable.** Future operations will need to play an important role in assisting the Government maintain reform momentum to secure gains from well-targeted reforms that open up the private sector space, and enhance the functioning of institutions. It will be equally important to protect vulnerable groups affected by the reform process and to maintain macroeconomic stability, especially by controlling inflation. Future development policy lending can play an important role in supporting the Government's reform process. Against this backdrop, should a request be made, the WBG stands ready to provide ongoing support, assuming successful continuation of the reform program. Any future development policy operation would aim to solidify the gains achieved through this initial operation, foster sound market-based activities, and deepen the development of modern institutions for public policy.

93. **It is expected that a future DPO program would maintain the current pillars, while deepening the specific reforms.** In broad terms, a follow-up DPO would seek to achieve the following objectives:

- **Pillar 1. Foundations for Sustainable Growth and Macro-Financial Resilience.** In the next phase of the reform effort it will be critical to deepen SOE reform, particularly to consolidate the move towards financial sustainability and enhanced governance in remaining SOEs, including to mitigate macro-fiscal risks. Building sustainable fiscal institutions in line with best practices will also be critical. This includes bringing the existing off-budget operations on budget, and increasing transparency in Government's public finances. A modern, revenue-neutral tax policy reform will also need to be developed, and anchor not only the needed prudent macro-fiscal stance, but set the basis for an enhanced and friendlier business climate. After securing stabilizing sound

and stable financial sector, Uzbekistan is expected to enhance access to finance, another critical pre-condition for private sector development.

- **Pillar 2. Supporting Market Formation for Private Sector Development.** The program will need to focus on continuing establishing market-based institutions, including through securing a broad liberalization of prices and use of market-based mechanisms for their allocation, limiting the exemptions to a narrow list. Also, following the first steps already taken to connect Uzbekistan with the rest of the world (through the recent visa liberalization and re-initiation of WTO accession), the second phase of the private sector reform process will extend these achievements while opening new key sectors. There will also be new opportunities to enhance Uzbekistan air connectivity, which remains one of the country's economic Achilles' heels and will entail structural reform in the airline sector. A major sectoral priority is agriculture—particularly to further liberalize the use of land and inputs related to the sector to empower farmers to grow their preferred crops, and thus generate important productivity gains. Enhancements to the institutional frameworks that set the stage for private sector participation—on investment, competition and public private partnerships (PPPs) will also be critical.
- **Pillar 3. Enabling Job Creation and Managing Social Risks.** During this first DPO, the Uzbekistan Government created more labor market flexibility and expanded the social protection budget to mitigate the impact of the economic liberalization. In the next phase, Uzbekistan would have the opportunity to establish a more modern social protection system, which would allow the Government to manage its fiscal resources prudently while targeting those in need.

5. OTHER DESIGN AND APPRAISAL ISSUES

A. POVERTY AND SOCIAL IMPACT

94. **Overall, the reforms supported by this DPO are expected to be pro-poor.**³¹ The exchange rate unification and the reduction in the dispersion of tariff rates between imported and domestically produced goods will reduce market distortions. This, in turn, should lead to both more competitive export-oriented sectors and broadened product variety in the medium term. Few poor households directly benefited from the prevailing dual exchange rate regime (state support allowed exchange at the official rate for advantaged importers of equipment, machinery and technology), which came at the expense of exports and private consumption. Improving the business environment through the elimination of support for favored firms would be expected, overall, to

³¹ The 2016 SCD reflects on the ADePT analysis done using CALISS data (a 2013 household survey). The analysis based on that survey shows that social benefits are progressive (more benefits are accruing to poorest quintiles) hence the social benefit system is certainly a policy instrument with the potential to reduce poverty and inequality. Currently, the poverty impacts of the reform are small due to the low coverage and generosity of benefits. However, as explained above, the Government is in the process of reforming the social assistance system; *their poverty-reducing effects is expected to increase* should more households from the poorest quintiles receive social cash benefits and the benefit amount be adjusted to the family needs.

contribute to job creation in the long term, albeit with the potential for short-term job losses in firms that previously enjoyed preferential treatment.

95. **Reforms in the agriculture sector are expected to benefit the poor.** Agriculture is the largest source of employment in the economy, and in 2013 provided livelihoods for 49 percent of Uzbekistan's rural population, where pockets of poverty are concentrated. More flexible land use is expected to improve the allocative efficiency of productive capacity in the sector, potentially driving rising incomes for agricultural workers. Greater diversity in food production would also be expected to increase resilience for farmers and reduce the risk from market shocks, such as in cotton or wheat, producing climate change adaptation co-benefits. Diversifying to fruit trees, and increasing energy efficiency of agricultural processes coupled with more rational use of fertilizers, are also expected to have significant mitigation co-benefits as well. Allowing entry into the agriculture sector would likewise be expected to be pro-poor, as farmers and agricultural workers are likely to increasingly produce higher-value crops, increasing the competitiveness of the sector. Benefits of expanding smallholder (*dehqan*) agricultural production also include potentially increasing the food produced for own consumption available to poorer farmers. Increasing the availability of more diverse agricultural production would also be expected to reduce the cost of foods intended for local consumption, with beneficial implications for poorer households for whom food comprises the largest budget share. Reducing tariffs on food imports is expected to reduce the cost of living for citizens, and particularly for the poorest households. However, lower tariff barriers may also expose the agriculture sector to additional competition and could potentially result in lower employment in highly protected goods in the short term. Improving the governance code is expected to be neutral in the short term and beneficial for the poor in the long term

96. **Reforms to the banking system will have a positive impact.** Prudential regulations on capital, liquidity and asset classification are similarly expected to have a more immediate impact on firms than on households, including by enhancing their tools for making investment, savings and consumption decisions. Continued negotiation for WTO accession may imply long-term changes in the cost of some goods and employment in currently protected sectors, but a net benefit may be expected from the increase competition and diversity of goods and services. Reforms to the regulatory environment would reduce macroeconomic risks, lowering the probability of negative shocks adversely impacting the prospects of poor and vulnerable households. Implementing comprehensive stress tests would be indirectly beneficial for the poor by lowering the risk of shocks that could reduce economic growth.³²

97. **However, the exchange rate unification and reduced support to favored firms and sectors may have short-term adverse impacts on some poor and vulnerable groups.** The exchange rate depreciation, and the relative price adjustments that have ensured, have risen the risk of inflation in consumer prices which could increase poverty among vulnerable households and disproportionately affect poor households. Reducing subsidies to SOEs may lead to job losses in those sectors. This may, in turn, result in modest increases in poverty rates if social protection or social insurance is not available to mitigate the impact of the loss in income suffered by those who lose their jobs. Moderately negative impacts from rising utility tariffs are expected for poor and vulnerable households, which may be partially offset by strengthening the social protection

³² Improving resilience of the rural poor would further reduce their vulnerability to climate change-induced shocks.

system. Reductions in agricultural subsidies may reduce incomes for workers in the affected products and operations, and potentially lead to job losses among some agricultural workers. Agricultural workers who lack access to land to support production for their own consumption are at greater risk of falling into poverty in the event of job loss. However, the potential for entry into agricultural production, greater export opportunities, and product diversification should help to mitigate these risks, especially in the longer term.

98. **Expanding the coverage of the social protection system, coupled with labor market reforms, is pro-poor and can mitigate potential negative impacts from other proposed reforms.** The modest risk of rapidly rising prices can be reduced for poor households with social protection payments that account for price increases. Expansion of the social protection system, as a last resort safety net, can also reduce the risk of job losses resulting in extreme poverty. Social protection payments can further partially offset potential increases in utilities prices for vulnerable households. Expanding the types of contracts available would also potentially increase formality in the labor market and the number of formal jobs available. The informal sector accounted for 54 percent of total employment in 2013. This reform is expected to benefit poor workers, who are substantially more likely to lack the benefits of formal contracts. However, these reforms should proceed with caution so as not to unduly incentivize employers to recategorize currently full-time formal workers into less secure contract types.

99. ***Citizen engagement:* Public information campaigns and broader information campaigns about possible short-term adverse impact on poor and vulnerable groups and anticipated long-term benefits would be essential for building public consensus for reforms and generate the broad political support and public ownership that is necessary to sustain them.** Consulting with citizens and actively engaging them in decision-making regarding socio-economic priorities and necessary trade-offs allows due consideration of the views and perspectives of various social groups and results in more informed, inclusive and thoughtful decision-making processes. The Government has already prioritized such measures in 2017, by declaring the “Year of Dialogue with Citizens,” launching Virtual reception office, a mechanism to receive direct communications from citizens, which has processed over one and half million comments. National Development Strategy also includes actions to promote feedback on service delivery and improve data sharing with public and consultative policy-making bodies. It lays out steps to increase civil society participation and strengthening citizens’ self-governing bodies using press and media to raise issues related to public service provision. An advisory council for civil society organizations was created in May 2018 and a decree on public advisory councils, to be established with an oversight function for every Ministry and state-funded organization, is currently being finalized. The Government’s reforms supported by the World Bank are part of this wider engagement strategy. Regular consultations on the implementation of these reforms would be organized in the context of broader consultations on implementation of National Development Strategy. The World Bank will be supporting these consultations by cooperating with Development Strategy Center on “Listening to the Citizens of Uzbekistan” research project.

100. **Targeting lagging districts and vulnerable populations, especially in the rural areas.** To ensure that smallholder (*dehqan*) farmers benefit from the reforms in the agricultural sector, targeted measures to promote cooperation formats and employment creation in rural areas would be necessary, with particular focus on women and youth. These measures also need to be combined with improvement of basic infrastructure, increasing access to finance. Recent steps taken in this

direction include - “*Obod qishloq*” (developed villages) State Program initiated by 29 of March Presidential; Presidential decree of March 23 on “*Additional measures to increase accessibility of banking services*” etc. Capacity building efforts targeting local Governments and local self-governing bodies on the community level are essential for ensuring sustainability of reform efforts and ensuring transformational change on the ground.

101. **Labor rights and working conditions: Reforms in the agricultural sector are expected to lead to greater crop diversification and higher productivity.** This transformation will also support the ongoing full elimination of child and forced labor in the cotton harvest in Uzbekistan. The Government has expressed its high level commitment to monitor and prevent child and forced labor, including with the assistance of development partners. Continued focus on improving labor rights and working conditions is embedded in reforms to the Labor Code along with the increase in the variety of formal labor market contracts.

B. ENVIRONMENTAL AND CLIMATE CHANGE LINKAGES

102. **The environmental and climate mitigation/adaptation co-benefit impacts of the Program are anticipated to be mostly positive or neutral (see Annex 4).** Attracting businesses into the formal sector (Pillar 2) may have positive environmental outcomes, as environmental policies will be more readily applied. As the Government will bring the price of cotton more in line with international price to help increase productivity (Prior Action 7) and reduce the area mandatorily assigned to grow grain and cotton (Prior Action 8), this will lead to a decrease in air, soil and water pollution and provide opportunities for sustainable agriculture, as well as water usage and facilitate a shift towards climate adapted (and climate smart) agriculture. Both prior actions have important mitigation co-benefits resulting from the expected increase in agricultural productivity, as this has the potential to reduce energy use, irrigation and production inputs, as well as reduce non-CO₂ nitrous oxide emissions, including through improved access to higher quality fertilizers.³³ Reducing the land area mandatorily assigned to cotton and grain should help diversify crops, lowering the vulnerabilities of the sector to climate change.

103. **Going forward, it will remain critical to continue guarding against adverse risks linked to agriculture, which is one of the most climate- and environmentally-sensitive of all economic sectors.** In countries such as Uzbekistan, the risks of climate change for the agricultural sector are a particularly immediate and important problem since much of the rural population depends either directly or indirectly on agriculture for their livelihoods. Recent and projected trends in water availability under a changing climate and the increasing incidence of drought events in Uzbekistan have underscored these risks, as has the presence of agricultural pests that may not have previously been found in Uzbekistan. Risks to be closely monitored are those associated with the excessive use of agricultural inputs (mainly of fertilizers and pesticides) due to the non-observance of the necessary safety rules and procedures and in order to reduce GHG emissions.

104. **Several other prior actions in the DPO also produce climate change co-benefits.** As noted in Section 3 of this document, the need to adapt to climate change in all sectors is firmly entrenched on the National Development Strategy of the Government of Uzbekistan, and deeply supported by the country’s development partners. Along these lines, Prior Action 4, which foresees the adjustment of fuel and electricity tariffs towards cost recovery (jointly with the introduction of

³³ GWP 265–298 times that of CO₂ for a 100-year timescale.

differentiated electricity tariffs, and efforts to improve the financial sustainability and governance of key SOEs in the energy sector) should have positive impacts due to its anticipated result: a reduction in energy consumption. The reduction in average import tariff rates (Prior Action 6) is likely to increase the availability and lower the cost of environmentally-friendly goods, services and technologies, including efficient alternative energy solutions. In addition, the reform in Labor Code (PA 10) may introduce additional requirements for ensuring that higher occupational health and safety standards are implemented with respect to part-time and temporary workers.

105. **It will remain important to mitigate potential environmental and climate-related risks of economic reforms.** Possible environmental concerns might relate to private sector growth, should Uzbek production become biased towards pollution-intensive industries. Thus, in supporting private sector and freer markets, emphasis should be given to ensuring an efficient process of Environmental and Social Assessment (ESA), adequate monitoring and enforcement of the regulatory framework including in the field of environment and natural resources.

106. **Uzbekistan has its own system of environmental screening and assessment aimed at assessing and reducing adverse environmental impacts.** There are about 120 laws and regulations that cover the field of environment and natural resources. Few most important laws such as The Law of the Republic of Uzbekistan "On Environmental Protection" (1992) and Law on the State Environmental Expertise (2001) outline an environmental assessment procedure and define four categories of investment projects based on the level of environmental risks with 1 Category being the highest risk. Nevertheless, strategic environmental assessment, which might provide necessary information on environmental and social safeguards implications of the policy documents, has not been promoted in Uzbekistan. Furthermore, the existing regulatory system is not fully harmonized with the WB and best international ESA practices and needs improvement, mainly in terms of preparing environmental and management plans and ensuring their supervision and monitoring during project implementation. This is an important and urgent task, taking into account increased interest of IFIs and various donors to the country and forthcoming large-scale financing.

C. PFM, DISBURSEMENT AND AUDITING ASPECTS

107. **The latest PEFA assessment conducted in 2012 indicates strong performance in many PFM subsystems with 19 (out of 28) performance indicators (PIs) rated B and above.** Despite comparably good performance in several areas, some of the critical PFM downstream elements (internal audit, accounting and financial reporting, external audit) were weak with the Government efforts to improve its PFM system. In particular, the Effectiveness of Internal Audit (PI-21), Competition, Value for Money and controls in Procurement (PI-19), Quality and Timeliness of Annual Financial Statements (PI-25), Scope, Nature and Follow up of external audit (PI-26), Multi-year perspective in Fiscal Planning, Expenditure Policy and Budgeting (PI-12) as well as Public Access to Key Information (PI-10) were low-rated.

108. **The Government is taking steps to progress with the action plan outlined in the PFM Reforms Strategy for 2007-2018 (with the draft update for 2017-2021).** This MoF-led strategy covers a range of measures aimed at strengthening budget preparation and execution, public sector accounting, treasury systems as well as improving legislative base for PFM reforms. The Treasury Single Account has been introduced and made functional. In addition, the Government made a

progress on implementation GFS-2001 compliant Chart of Accounts, and interim FMIS. The Government also introduced eProcurement system, with an internal portal established to post information related to tendering processes.

109. **The Government also took initial steps to improve Public Access to key fiscal information by publishing the state budget main parameters and execution reports on the MoF website to provide budget transparency required by the Budget Code.** In 2017, a pilot Medium Term Budget for 2018-2020 has been developed and adopted at a municipality level. In 2013-2014 the Government implemented "Budget system reform in Uzbekistan" project aiming also at public sector accounting and reporting reforms. Namely, twelve draft Standards of the Budget Accounting (SBA), based on IPSAS, have been prepared, while implementation of IPSAS still remains a challenge due to capacity constraints and substantial resources required in staff training and rolling out of the standards. Overall PFM reforms have been proceeding slowly during last few years.

110. **The Chamber of Accounts (CoA - the country's Supreme Audit Institution) is still in the initial phases of its development.** Currently a new law on Chamber of Accounts is being developed, further there is a need for developing and aligning auditing practices with International Standards of Supreme Audit Institutions, starting with introduction of the compliance and financial audits.

111. **The public sector internal audit (IA) function is still at its embryonic stage with a need to focus on the legislative framework and operational model.** IA standards, quality assurance arrangements, IA system for conducting, documenting, and concluding IA workflow should be developed. A system for training, education, continuing professional development and possibly certification of internal auditors needs to be established.

112. **Foreign Exchange Control Environment at the Central Bank of the Republic of Uzbekistan (CBU) is assessed to maintain overall adequate operational control over its exchange reserve management. The CBU has been audited regularly by internationally recognized audit firms and received satisfactory audit reports.** In particular, the 2016 audit of CBU's consolidated financial statements was conducted by an international audit firm, which issued an unmodified opinion on the financial statements, however financial statements are not prepared in accordance with IFRS but rather in accordance with internal accounting and reporting procedures issued by CBU. The audit was conducted in accordance with International Standards on Auditing (ISA). The audited financial statements of CBU are not made publicly available.

113. **Meanwhile, considering that no IMF safeguards assessment for the CBU has been conducted yet, and that there were recommendations in the management letter provided by the auditor relating to controls and accounting over foreign exchange reserve, to secure acceptable fiduciary arrangements over the operation, the Bank will apply additional mitigation measures to mitigate fiduciary risks.** This will involve opening a dedicated foreign currency account for the operation. The Bank will also require that the dedicated foreign exchange account is audited by an auditor acceptable to the Bank, on terms of reference acceptable to the Bank. The audit report will be submitted to the Bank within five months after fiscal year ending in December 31.

114. **The DPO funding would be made available to the Republic of Uzbekistan upon the effectiveness of the Financing Agreement and the submission of withdrawal application for the credit.** The proceeds of the Credit will be disbursed into a dedicated foreign currency bank account that will form part of the country's official foreign exchange reserves held by the CBU and will be opened in the name of the Ministry of Finance. The Recipient shall open, prior to furnishing to the Association the first request for withdrawal from the Financing Account, and thereafter maintain a dedicated account in USD ("Foreign Currency Dedicated Account") at the CBU; and all withdrawals from the Financing Account shall be deposited by the Association into the Foreign Currency Dedicated Account. Within 30 days following the deposit of the amount of the Financing into the Foreign Currency Dedicated Account, the Recipient shall transfer the Financing amount into the Treasury Single Account (USD and/or UZS). The Recipient, within thirty (30) days after the withdrawal of the Financing from the Financing Account, shall report to the Association: (a) the exact sum received into the Foreign Currency Dedicated Account; (b) the details of the account to which the equivalent of the Financing proceeds will be credited; (c) the record that an equivalent amount has been accounted for in the Recipient's budget management systems; and (d) the statement of receipts and disbursement of the Foreign Currency Dedicated Account.

115. **The MoF will be responsible for the operation's administration and for preparing the withdrawal application, maintaining the dedicated foreign currency bank account as well as the local currency bank account.** The MoF, with the assistance of the CBU, will maintain records of all transactions under the DPO in accordance with sound accounting practices, and the proceeds of the DPO will be promptly accounted in the country's budget management system using the country's regular procedures for such accounting.

116. **If after depositing funds in the dedicated foreign currency bank account, the proceeds of the credit are used for ineligible purposes as defined in the General Conditions, these proceeds will be refunded to the World Bank.** As stipulated by the General Conditions, amounts refunded to the Bank in respect of ineligible expenditures will be cancelled from the credit.

D. MONITORING, EVALUATION AND ACCOUNTABILITY

117. **The Ministry of Finance is responsible for the implementation of the program supported by the DPO.** As the main implementing agency, the Ministry of Finance will coordinate with other Government agencies involved in the implementation of the DPO, including the Central Bank, the Ministry of Economy, the Ministry of Agriculture, the Ministry of International Trade, the Ministry of Tourism and the Ministry of Labor and Social Protection. Together with the Ministry of Finance and the State Committed on Statistics, these institutions will 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 show in the monitoring and results framework of the policy matrix (Annex 1).

118. **Grievance Redress.** Communities and individuals who believe that they are adversely affected by specific country policies supported as prior actions or tranche release conditions under a World Bank Development Policy Operation may submit complaints to the responsible country authorities, appropriate local/national grievance redress mechanisms, or the WB's Grievance

Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address pertinent concerns. Affected communities and individuals may submit their complaint to the WB’s independent Inspection Panel which determines whether harm occurred, or could occur, as a result of WB non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank’s attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank’s corporate Grievance Redress Service (GRS), please visit <http://www.worldbank.org/GRS>. or information on how to submit complaints to the World Bank Inspection Panel, please visit www.inspectionpanel.org.

6. SUMMARY OF RISKS AND MITIGATION

119. **The overall risk to the operation is substantial.** Uzbekistan has embarked on an ambitious reform process transforming the economy from a state-controlled and centrally planned to a market economy, the core of which this operation is supporting. The risks are therefore not only on the economic, but also political, institutional and social. The World Bank has mobilized, together with other international financial institutions and bilateral partners, significant technical assistance to support the transition. However, the speed and comprehensiveness of the reform process create substantial risks that need to be addressed. The most relevant risks for this operation are macroeconomic, technical design of program, and implementation capacity. Risks associated with the political and governance areas, sector strategies and policies (agriculture, banking and energy sectors) and fiduciary risks are considered moderate.

Table 5: Risk Assessment

Risk Categories	Rating (H, S, M or L) *
1. Political and governance	M
2. Macroeconomic	S
3. Sector strategies and policies	M
4. Technical design of project or program	S
5. Implementation capacity	S
6. Fiduciary	M
7. Environment, climate and social	M
8. Stakeholders	M
Overall	S

*H- High, S - Substantial, M – Moderate, L – Low.

120. **Macroeconomic risks are substantial, and stem from both external and domestic factors.** On the external side, the uncertainties related to both nominal and real demand shocks for Uzbek exports may have a strong negative impact on growth, exaggerated by the high concentration of exports in China and Russia. On the domestic side, they are linked to the potential pressures that SOEs and the banking sector may exert on growth, jobs and inflation –and their linkages to commitment to policy implementation. Following the sharp devaluation, SOEs—which still represent the largest share of the economy—and the banking sector suffered valuation losses on their balance sheets. Given that banks and SOEs had enjoyed Government support, the change raises risks for this sector (as well as potential contingent liabilities). The banking sector could be affected by weak growth and SOE performance, particularly in view of the sizeable amount of directed lending in their portfolios. Price and exchange rate liberalization may lead to high inflation in the medium run which, in turn, may require larger than expected contractionary fiscal and

monetary policies that could hamper growth in the short term. While the country is comfortably buffered by a large stock of foreign reserves, any excessive pressures on inflation or hampered growth and job creation would compound with other risks, particularly that of stalling or reversing the much-needed reform process. These risks are considered substantial; however, the Government's commitment with the reform and macroeconomic prudence in general, as well as measures to (i) strengthen fiscal sustainability through reductions in transfers and preferential lending, (ii) issue (via the CBU) prudential regulations and regular stress tests, (iii) trade liberalization, and (iv) enhance the investment climate are expected to support the success of this DPO and the Government's broader reform agenda.

121. The risks of implementation capacity, as well as the technical design of the program, are rated as *substantial* due to the constraints both in implementing agencies as well as the challenges on the technical design of the reform program, which may undermine progress despite of strong political commitment for reform. The presence of inadequate institutions, weak market transmission mechanisms, rent-seeking behavior, and lack of transparency and data availability can hamper the successful implementation of the reform program, thus posing substantial risks. The technical limitations (including in coordination at the intra-government level) to support the ambitious reform program also impose a substantial risk to the success of the program. The failure to transform into a market-oriented economy, secure relative price adjustment and the efficient allocation of resources in the economy can undermine the Government's ability to sustain growth and enhance job creation over the long term after the program. The Government is partnering with the World Bank, the IMF, the ADB, and the EBRD, among others, to receive technical assistance in policy design and capacity building. This is resulting in a coordinated outcome tailored to achieve the program's longer-term objectives. With the Government's demonstrated commitment to transformation reforms, the program may help control the risks through its pillars.

122. Political and governance risks are moderate. The transformation of the Uzbek economy from a centrally planned economy to a market economy imposes potential political shifts that could threaten the transition. Following the devaluation, for instance, SOEs—especially large ones in the energy sector—need transformation to become sustainable, with the added political and governance risks due to potential layoffs and loss in credibility. On the program pillars, the risks are also relevant for (i) the social protection of the vulnerable groups who are likely to suffer the most in the first stages of the reforms, and (ii) supporting market creation by ceasing subsidies to selected firms. The authorities, however, are aware of these risks and are utilizing a continuous consultation process and raising awareness on key policy measures. The political leadership in the reform process, however, contributes to the moderation of the implicit risks of the reform, as the Government is seen as spearheading the major reforms and has obtained popular support. The Government's commitment to the reform program through several prior actions including foreign exchange rate liberalization, increased coverage of safety nets, and SOE reforms can also help to control the political and governance risks by increasing the safety net of the vulnerable groups.

123. Sector strategies and policies risks are considered moderate. The 2nd pillar of this operation—supporting market creation for private sector development—covers Uzbekistan's key growth sectors, especially agriculture, and addresses cross-cutting trade and competition reforms which affect all economic sectors. This creates potential risks due to the infancy of basic market institutions or incomplete implementation of the reform program specifically related to these

sectors. For example, in the agriculture sector, risks of not accompanying the needed elimination of subsidies with key institutional measures such as enhancing property rights, liberalizing land use and providing technical assistance, may impose threats to productivity, climate change mitigation co-benefits, job outcomes, and wage growth. The sector strategies and policies risks are considered moderate as the Government has made some steps to boost productivity through (i) allowing Government procurement price to rise toward market levels, (ii) liberalizing prices through commodity exchanges, (iii) reducing import barriers, and (iv) establishing privately-owned clusters to allow farmers to enter into direct private contractual arrangements. Overall, the policies and strategies are generally adequate for the purposes of the program and consistent with the Government's development objectives.

124. **Financial management risk is rated moderate based on the stand-alone assessment of this operation.** There is a moderate risk that the program's funds will not be used to achieve value for money with integrity in generating sustainable development outcomes. To mitigate this risk, the Government will need to safeguard Central Bank and treasury operations with appropriate financial management.

Annex 1: Policy and Results Matrix

Policy Objectives	DPO Prior Actions (PAs)	Results Indicators
Pillar 1: Foundations for Sustainable Economic Growth and Macro-Financial Resilience <i>Enhancing economic growth through greater openness—Improving macro-fiscal sustainability, governance, and private sector participation through reform of public enterprises—Strengthening financial sector stability.</i>		
Enhanced economic growth is stimulated through reducing exchange rate and monetary distortions, and greater private sector access to foreign exchange	1. The Recipient, through the Central Bank of Uzbekistan (CBU) has eliminated all foreign exchange surrender requirements on all export earnings.	Baseline: 25 percent surrender requirement on foreign exchange from export earnings. (September 2017) Target: No surrender requirement on foreign exchange from export earnings. (June 2019)
Financial Sector Stability is enhanced to improve environment for stable economic growth	2. The Recipient, through the CBU has issued revised prudential regulations on banking capital adequacy, liquidity, and asset classification to improve compliance with international financial regulatory standards in line with the Basel Core Principles.	Baseline: Current reporting framework on capital, asset classification, and liquidity does not ensure a proper reflection of banks' risks. (September 2017) Target: Improved data quality from banks is implemented and permits adoption of risk-based supervision plan for onsite inspections (June 2019)
	3. The Recipient has adopted measures requiring the CBU to conduct annual stress tests on commercial banks in line with international best practices.	Baseline: No stress testing of Banks (September 2017) Target. The CBU has developed guidelines for regular stress testing of commercial banks, and has conducted at least one round of stress tests on 4 representative commercial banks. (June 2019).
Fiscal sustainability is strengthened through tariff reforms and financial transparency of SOEs	4. The Recipient has adopted key measures to promote financial recovery and transparency of Uzbekenergo and Uzbekneftegaz, through: i) approval of fuel and electricity tariff adjustments; ii) introduction of differentiated electricity tariffs to improve efficiency; and iii) adoption of policy requirements for Uzbekenergo and Uzbekneftegaz on financial statement audits' compliance with the international financial reporting standards.	Baseline: 2017 augmented budget outturns on tax expenditures, current spending and net lending to Uzbekenergo and Uzbekneftegaz amount to 1.2% of GDP, and no IFRS-compliant financial statements have been published. (December 2017) Target: 2018 augmented budget outturns on tax expenditures, current spending and net lending to Uzbekenergo and Uzbekneftegaz amount to less than 0.8% of GDP, and IFRS-compliant financial statements have been published for prior years (2015 and 2016). (December 2018)

Policy Objectives	DPO Prior Actions (PAs)	Results Indicators
<p align="center">Pillar 2 – Supporting Market Formation for Private Sector Development</p> <p align="center"><i>Creating greater flexibility in domestic relative prices—Fostering external trade to generate opportunities for investment, growth and jobs—Expanding jobs through growth of trade opportunities, particularly in agriculture.</i></p>		
<p>Greater flexibility in domestic relative prices, along with a simple and transparent business environment</p>	<p>5. The Recipient has (i) removed regulatory price controls for a list of key products, in particular, production inputs and raw materials, and; (ii) adopted requirements for a set of products to be transacted through commodity exchanges, in order to develop market institutions and to liberalize prices.</p>	<p>Baseline: Annual total trading of products with deregulated prices (gasoline extraction, cathode copper, copper wire, secondary aluminum, metal zinc, technical kerosene, polypropylene, polyethylene, technical Sulphur, caustic ash, rolled ferrous metals, cement, cement clinker, construction glass, sugar, barley) in Commodity Exchange amounts to UZS 8 trillion. (2017)</p> <p>Target: Annual total trading of products with deregulated prices (gasoline extraction, cathode copper, copper wire, secondary aluminum, metal zinc, technical kerosene, polypropylene, polyethylene, technical Sulphur, caustic ash, rolled ferrous metals, cement, cement clinker, construction glass, sugar, barley) in Commodity Exchange increases to UZS 16 trillion. (2018).</p>
<p>External trade to foster investment, growth and jobs, and market-based prices</p>	<p>6. The Recipient has reduced average custom tariff rates.</p>	<p>Baseline: Average custom tariff rate is 15.3%. (September 2017)</p> <p>Target: Average custom tariff rate is less than 8%. (June 2019).</p>
<p>Agricultural productivity and efficiency increases to promote job growth, and wages</p>	<p>7. The Recipient has increased the regulated purchase price paid for cotton closer to the international market price aimed to increase cotton productivity and to promote a more efficient use of resources (including land, water and fertilizer).</p>	<p>Baseline: Difference between domestic average price for cotton and international price is more than 20 percent. (September 2017)</p> <p>Target: Difference between domestic average price for cotton and international price is 10 percent or less. (June 2019)</p>
	<p>8. The Recipient has reduced the land area mandatorily assigned to grow cotton and grain in order to support the raise of productivity and to promote a more efficient use of resources (including land, water and fertilizer).</p>	<p>Baseline: Mandatory hectares for growing is 1,285,500 ha. for cotton; 1,329,500 ha. for grain. (September 2017)</p> <p>Target: Mandatory hectares for growing cotton is reduced by 135,000 ha. and grain by 40,000 ha. (June 2019)</p>

Policy Objectives	DPO Prior Actions (PAs)	Results Indicators
<p>Pillar 3 – Enabling Job Creation and Managing Social Risks</p> <p><i>Facilitating the movement of workers from low value-added sectors to high value-added sectors – Improving social safety nets to mitigate negative impacts on vulnerable groups due to economic liberalization</i></p>		
<p>Facilitating employment through greater options in contracting formal workers</p>	<p>9. The Recipient, through its Executive branch, has submitted to its Parliament, for approval thereof, the draft amendments to the Labor Code to expand formal contracts to part-time and temporary workers.</p>	<p>Baseline: No framework exists for employees with part-time and temporary formal employment contracts. (September 2017)</p> <p>Target: Legal framework exists for employees with part-time and temporary formal employment contracts and the number of total employees with these contracts is 90,000 or more, including participation of female workers of 30,000 or more. (June 2019).</p>
<p>Effective social safety nets</p>	<p>10. The Recipient has increased the social safety nets financial support for vulnerable groups, including low-income families and families with dependent children.</p>	<p>Baseline: Budget includes funding for 435,500 beneficiaries, including low-income families and families with dependent children. (March 2017)</p> <p>Target: Budget includes funding for 500,000 beneficiaries, including low-income families and families with dependent children. (June 2019).</p>

Annex 2: Fund Relations Annex

IMF Executive Board Concludes 2018 Article IV Consultation with the Republic of Uzbekistan

May 9, 2018

- Creating more and better jobs is the government's overarching policy priority.
- Comprehensive tax reform is needed, foremost to stimulate job creation, but the reform should be implemented gradually and in line with maintaining a stability-oriented fiscal policy.
- To bring inflation to single digits over the next two years, it will be important to tighten fiscal and monetary policies.

On May 4, 2018, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation [1] with the Republic of Uzbekistan.

External shocks which began in 2014, lowered exports, commodity prices, and remittances and contributed to a decline in growth from about 8 to 5 percent in 2017. At the same time, growth of domestic employment remained below one percent. A loosening of fiscal and monetary policies, along with price and foreign exchange liberalization, caused inflation to pick up in late 2017 and was close to 20 percent in early 2018. Uzbekistan's external position remains strong. International reserves were equivalent to 19 months of imports of goods and services at end-2017 and debt is low. Public and total external debt were 24½ and 41 percent of GDP, respectively, at end-2017.

The fiscal deficit, including the Fund for Reconstruction and Development (FRD), rose from ½ percent of GDP in 2016 to 3¼ percent of GDP in 2017. While the government's fiscal position was close to balance, the FRD deficit was larger than expected due to on-lending activities and recapitalization of state banks.

Monetary policy was loose early in 2017 and reserve money and credit to the economy had grown by more than 50 percent in August compared with a year earlier. Monetary policy tightened prior to the foreign exchange liberalization in September 2017, including by increasing the refinancing rate from 9 to 14 percent. Reported financial indicators suggest the banking system is sound. Banks capital adequacy ratio stood at 19 percent and non-performing loan ratio was 1.2 percent at end-2017. However, credit markets are segmented with state enterprises having preferential access to credit, including foreign exchange loans, at concessional rates.

In 2017, Uzbekistan embarked on a series of reforms to boost its economy. These included liberalizing prices, cutting tariffs, initiating structural reforms of state enterprises, granting the central bank greater independence, expanding the social safety net, and improving the quality and availability of economic statistics. Particularly significant was liberalization of access to foreign exchange and depreciation and unification of exchange rates in September 2017. The authorities are considering additional actions in 2018 including steps to restructure state enterprises and reform the tax system.

Executive Board Assessment [2]

They welcomed that Uzbekistan has initiated a comprehensive reform program to open and liberalize the economy, stimulate job creation, and promote inclusive growth. Noting the internal and external risks to the outlook, Directors encouraged the authorities to maintain prudent macroeconomic policies and the momentum of structural reforms. In this regard, they underscored the need for tighter fiscal and monetary policies to gradually bring inflation to single digits.

Directors commended the authorities for their prudent fiscal policies, which have kept public debt low. They supported the plans to reduce the overall fiscal deficit in 2018, mainly by reducing on lending operations by the Fund for Reconstruction and Development. Directors emphasized the importance of ensuring that all fiscal operations are brought on budget. They also underscored that a comprehensive reform of the tax system is essential to foster job creation and to insure against the risk of a sharp future decline of tax collections from state enterprises. They advised that reform should be introduced gradually and should be revenue neutral to preserve a stability oriented fiscal policy.

Directors agreed that the central bank should use a range of indicators, including the refinancing rate, bank liquidity, money, and the exchange rate, to gauge the appropriate stance of monetary policy. They noted that it will be important to enhance the independence of the central bank to support the adoption of inflation targeting over the medium term.

Directors noted that reported financial sector indicators are strong, but the concentration of credit in state enterprises is a vulnerability. They welcomed plans to further upgrade the central bank's supervisory capacity and intervention tools. Directors underlined the importance of policies fostering a banking system that is inclusive and supports growth over the medium term.

Directors commended liberalization of the foreign exchange market, including the elimination of exchange restrictions. They noted that while Uzbekistan's external position is strong, it could be impacted by changes arising from the economic transition and Uzbekistan's dependence on remittances and commodity exports. Directors welcomed the authorities' intention to allow the exchange rate to adjust in line with fundamentals to help safeguard external stability and maintain scope for an independent monetary policy.

Directors welcomed the significant structural reforms underway. They emphasized that priorities ahead should focus on restructuring state enterprises and further trade and price liberalization, especially by raising energy prices to cost recovery levels, and promoting competition. Directors also welcomed the recent governance reforms and encouraged continued efforts to fight corruption and enhance the rule of law. They underscored that economic diversification, especially into sectors with higher human capital content would support the country's fast paced demographic transition.

Directors commended recent steps to improve the availability and quality of economic statistics and welcomed Uzbekistan's participating in the IMF's enhanced General Data Dissemination System (e GDDS). They looked forward to further improvements towards subscribing to the Special Data Dissemination Standard (SDDS) as part of their participation in the e GDDS.

Uzbekistan: Selected Economic Indicators, 2015-19

	2015	2016	2017	2018	2019
			Est	Proj	Proj
National income					
Real GDP growth (percent change)	7.9	7.8	5.3	5.0	5.0
GDP per capita (in U.S. dollars)	2,124	2,094	1,491	1,238	1,455
Population (in millions)	31.3	31.8	32.1	32.5	32.9
Prices					
			(percent change)		
Consumer price inflation (eop)	8.4	7.9	18.9	16.9	10.1
GDP deflator	9.2	7.4	19.0	20.3	13.8
External sector					
Current account balance (percent of GDP)	0.7	0.7	3.7	0.4	-1.0
Gross official reserves (in billions of U.S. dollars)	24.3	26.5	28.1	29.2	29.5
External debt (in billions of U.S. dollars)	11.8	13.0	15.6	15.7	16.2
Exchange rate (in Sums per U.S. dollar; eop)	2,810	3,231	8,120
Real effective exchange rate (in levels, - = depreciation)	100	93	63	51	58
Government finance					
			(percent change)		
Consolidated budget balance	-1.2	-0.8	-0.1	-1.3	-1.3
Fund for Reconstruction & Development balance	-0.1	0.2	-3.2	0.0	0.0
Augmented fiscal balance	-1.3	-0.6	-3.3	-1.3	-1.3
Augmented revenues & grants	34.3	32.1	31.6	31.7	31.6
Augmented expenditures & net lending	35.6	32.7	34.9	33.0	32.9
Public debt	9.2	10.5	24.5	20.6	21.3
Money and credit					
			(percent change)		
Reserve money	20.0	22.2	84.8	15.4	14.5
Broad money	24.2	23.5	40.3	19.0	17.8
Credit to the economy	23.3	28.4	103.0	22.3	13.6

Sources: Uzbek authorities; and IMF staff estimates and projections.

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Annex 3: Letter of Development Policy

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MAY 17 2018



O'ZBEKISTON RESPUBLIKASI **CABINET OF MINISTERS**
VAZIRLAR MAHKAMASI **REPUBLIC OF UZBEKISTAN**

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

№ 02/1-248 15 .. мая 8
201 у.

**Президенту
Группы Всемирного банка
Доктору Джим Ким**

ЗАПИСКА ПО ПОЛИТИКЕ РАЗВИТИЯ

Уважаемый доктор Ким,

Правительство Узбекистана и Группа Всемирного банка осуществляют тесное и эффективное сотрудничество в проведении глубоких социально-экономических преобразований, происходящих в Узбекистане. В этом письме представлены концептуальные основы Стратегии действий по дальнейшему развитию Республики Узбекистан на период 2017-2021 гг., а также важнейшие аспекты реформирования, которые согласуются с мерами поддержки Группы Всемирного банка в Узбекистане.

Справочная информация

В феврале 2017 года Президент Республики Узбекистан утвердил Стратегию действий по пяти приоритетным направлениям развития Республики Узбекистан в 2017-2021 годах. Это решительные моменты в нашей истории, свидетельствующий о приверженности Правительства Республики Узбекистан к проведению глубоких социально-экономических преобразований, на основе повышения конкурентоспособности

национальной экономики, развития предпринимательства, создания качественных рабочих мест и улучшения благосостояния для всех наших граждан.

Реализация Стратегии действий станет мощным импульсом для поступательного движения Республики Узбекистан по пути реформирования и модернизации страны, построения правового и демократического государства с развитой рыночной экономикой, сильного гражданского общества, обеспечения верховенства закона.

Стратегия действий охватывает пять важнейших приоритетных направлений: 1) совершенствование системы государственного и общественного строительства, 2) обеспечение верховенства закона и дальнейшее реформирование судебно-правовой системы, 3) развитие и либерализация экономики, 4) развитие социальной сферы и 5) обеспечение безопасности, межнационального согласия и религиозной толерантности, а также осуществление взвешенной, взаимовыгодной и конструктивной внешней политики.

В соответствии с *первым направлением* (совершенствования системы государственного и общественного строительства), реализуются меры по совершенствованию государственного управления и государственной службы посредством децентрализации государственного управления, повышения уровня профессиональной подготовки, материального и социального обеспечения государственных служащих, а также поэтапного сокращения государственного регулирования экономики; внедрению современных механизмов государственно-частного партнерства, направленных на повышение эффективности взаимовыгодного сотрудничества в реализации задач общественно-политического и социально-экономического развития страны; внедрению эффективных механизмов диалога с народом; развитию институтов гражданского общества, повышение их общественной и политической активности; усилению роли средств массовой информации, защита профессиональной деятельности журналистов.

Второе направление сосредоточено на укрепление верховенства закона и судебной системы. Это включает в себя

повышение статуса, уровня материального стимулирования и социального обеспечения судей и работников аппарата суда, укрепление материально-технической базы судов; всемерная реализация принципов независимости и беспристрастности суда, состязательности и равноправия сторон судебного процесса; обеспечение гарантий надежной защиты прав и свобод граждан в деятельности судебных, правоохранительных и контролирующих органов; совершенствование и либерализация норм уголовного и уголовно-процессуального законодательства, декриминализация отдельных уголовных деяний, гуманизация уголовных наказаний и порядка их исполнения; совершенствование и либерализация норм уголовного и уголовно-процессуального законодательства; совершенствование организационно-правовых механизмов противодействия коррупции и повышение эффективности антикоррупционных мер; повышение правовой культуры и правосознания населения, организация эффективного взаимодействия в данном направлении государственных структур с институтами гражданского общества, средствами массовой информации.

Третье направление предусматривает меры по укреплению макроэкономической стабильности в целях достижения высоких темпов инклюзивного экономического роста и создания рабочих мест. Реформы в этой области включают обеспечение устойчиво высоких темпов роста валового внутреннего продукта за счет сохранения макроэкономической сбалансированности, углубления структурных и институциональных преобразований на основе реализации принятых среднесрочных программ; обеспечение сбалансированности Государственного бюджета на всех уровнях с сохранением социальной направленности расходов, совершенствование межбюджетных отношений, направленное на укрепление доходной части местных бюджетов; продолжение курса на снижение налогового бремени и упрощения системы налогообложения, совершенствование налогового администрирования и расширение мер соответствующего стимулирования; углубление реформирования и обеспечение устойчивости банковской системы, уровня капитализации и депозитной базы банков, укрепление их финансовой устойчивости и надежности, дальнейшее расширение

кредитования перспективных инвестиционных проектов, а также субъектов малого бизнеса и частного предпринимательства; обеспечение сбалансированности и устойчивости национальной экономики, увеличение в ее структуре доли промышленности, сферы услуг, малого бизнеса и частного предпринимательства; проведение активной инвестиционной политики, направленной на модернизацию, техническое и технологическое обновление производства, реализацию проектов производственной, транспортно-коммуникационной и социальной инфраструктуры; дальнейшая модернизация и диверсификация промышленности путем перевода ее на качественно новый уровень, направленный на опережающее развитие высокотехнологичных обрабатывающих отраслей, прежде всего по производству готовой продукции с высокой добавленной стоимостью на базе глубокой переработки местных сырьевых ресурсов; углубление структурных реформ и динамичное развитие сельскохозяйственного производства, дальнейшее укрепление продовольственной безопасности страны, расширение производства экологически чистой продукции, значительное повышение экспортного потенциала аграрного сектора; дальнейшая оптимизация посевных площадей, направленная на сокращение посевных площадей под хлопчатник и зерновые колосовые культуры, с размещением на высвобождаемых землях картофеля, овощей, кормовых и масличных культур, а также новых интенсивных садов и виноградников; принятие системных мер по смягчению негативного воздействия глобального изменения климата и высыхания Аральского моря на развитие сельского хозяйства и жизнедеятельности населения.

Четвертое направление предусматривает реализацию мер по повышению реальных денежных доходов и покупательской способности населения, дальнейшее сокращение количества малообеспеченных семей и уровня дифференциации населения по доходам; созданию новых рабочих мест и обеспечение рациональной занятости населения, прежде всего выпускников средних специальных и высших учебных заведений, обеспечение сбалансированности и развитие инфраструктуры рынка труда, сокращение уровня безработицы; обеспечению обязательных социальных гарантий населению, усиление социальной защиты

уязвимых слоев населения и государственной поддержки пожилым людям и лицам с ограниченными возможностями, улучшение социального обслуживания, развитие государственно-частного партнерства в предоставлении социальных услуг населению; дальнейшая реализация комплексных мер по укреплению здоровья семьи, охране материнства и детства, расширению доступа матерей и детей к качественным медицинским услугам, оказанию им специализированной и высокотехнологичной медицинской помощи, снижению младенческой и детской смертности; повышению социально-политической активности женщин, усиление их роли в управлении государством и обществом, обеспечение занятости женщин, выпускниц профессиональных колледжей, широкое привлечение их к предпринимательской деятельности, дальнейшее усиление основ семьи; дальнейшее улучшение жилищных условий населения, прежде всего молодых семей, жителей ветхих жилых домов и других граждан, нуждающихся в улучшении жилищных условий, путем предоставления им ипотечных кредитов на льготных условиях и строительства доступного жилья в городах и сельской местности; обеспечению экологической безопасности проживания людей, строительство и модернизация комплексов переработки бытовых отходов, укрепление их материально-технической базы, обеспечение населения современными объектами утилизации отходов; продолжению курса дальнейшего совершенствования системы непрерывного образования, повышения доступности качественных образовательных услуг, подготовки высококвалифицированных кадров в соответствии с современными потребностями рынка труда; кардинальному повышению качества общего среднего образования, углубленное изучение иностранных языков, информатики, других важных и востребованных предметов, включая математику, физику, химию, биологию; воспитанию физически здоровой, духовно и интеллектуально развитой, самостоятельно мыслящей, преданной Родине молодежи с твердыми жизненными взглядами, повышение ее социальной активности в процессе углубления демократических реформ и развития гражданского общества; социальной защите молодежи, создание для молодых семей достойных жилищных и социально-бытовых условий; организации

эффективной деятельности органов государственной власти и управления, образовательных учреждений, молодежных и иных организаций в реализации государственной молодежной политики.

Наконец, в рамках *пятого направления*, предусматриваются меры по обеспечению защиты конституционного строя, суверенитета, территориальной целостности Республики Узбекистан; укреплению гражданского, межнационального, межконфессионального мира и согласия; предотвращению экологических проблем, наносящих урон состоянию окружающей среды, здоровью и генофонду населения; укреплению независимости и суверенитета государства, дальнейшее укрепление места и роли страны в качестве полноправного субъекта международных отношений, вхождение в число развитых демократических государств, создание вокруг Узбекистана пояса безопасности, стабильности и добрососедства; укреплению международного имиджа Республики Узбекистан, доведение до мирового сообщества объективной информации о проводимых в стране реформах.

Большинство мер реформирования полностью соответствует направлениям деятельности, поддерживаемых Группой Всемирного банка. Ниже приводится краткая информация о достигнутом прогрессе к настоящему времени в конкретных сферах сотрудничества, по которым деятельность тесно согласована обеими сторонами.

1. Создание основы для устойчивого экономического роста

Правительство Узбекистана, в рамках повестки дня реформ, стремится к достижению устойчивого экономического роста за счет либерализации валютного рынка, улучшения стабильности финансового сектора и повышения финансовой прозрачности и устойчивости.

Экономические данные: Правительство предприняло важные шаги, направленные на повышение качества и доступности экономических данных, но при этом имеется

признание того, что в наличии по-прежнему имеются недостатки, которые препятствуют мониторингу ключевых экономических, финансовых и социальных показателей. В сентябре 2017 года Указом Президента предусмотрено принятие мер по распространению экономических и финансовых данных. В январе 2018 года Государственный комитет Республики Узбекистан по статистике (далее - Госкомстат) начал публиковать новый индекс потребительских цен на основе обновленной методологии, соответствующей методологии МВФ. Правительство также согласилось принять участие в Расширенной общей системе распространения данных МВФ (РОСРД), в соответствии с которой в мае 2018 года опубликована Национальная сводная страница данных с ключевыми экономическими, финансовыми и социальными статистическими данными. Текущая работа включает в себя усилия по улучшению статистики платежного баланса, финансовой отчетности и показателей финансовой устойчивости, а также составление международной инвестиционной позиции Узбекистана. Кроме того, ЦБУ, Министерство финансов и Госкомстат готовят «дорожную карту» для улучшения статистики, которая должна быть принята в ноябре 2018 года. Госкомстат также работает над улучшением качества и объема данных национальных счетов. В будущем правительство обязуется обновлять статистику рынка труда, включая сбор данных и обследования занятости и домашних хозяйств.

Либерализация валютного рынка. До сентября 2017 года в Узбекистане поддерживался официальный обменный курс, основанный на строгом контроле над конвертируемыми валютами и требованиями к обязательной продаже. В результате имелись большие искажения в относительных ценах на внутренние и международные товары, что сдерживало экономическую деятельность, создание рабочих мест и благосостояние.

В сентябре 2017 года правительство предприняло решительные действия, чтобы уменьшить значительную нагрузку, которую эта политика оказывала на предприятия и население. Правительство объявило о немедленной корректировке официального обменного курса между национальной валютой

и долларом США с 4,210 сумов до 8 100 сумов за доллар США. Это мера устранила параллельную рыночную премию фактически за одну ночь. В то же время, с принятием этого решения, Центральный банк Узбекистана (ЦБУ) получил большую независимость для управления регулируемым курсом валют, определяемого рыночными инструментами. Кроме того, Правительство также объявило о полном снятии ограничений на конвертацию, включая требования об обязательной продаже иностранной валюты от экспортных поступлений.

Хотя проведение этих реформ потребует период корректировки для экономики Узбекистана, я уверен, что они будут поддерживать большую макроэкономическую стабильность и прямые иностранные инвестиции. Несмотря на первоначальные опасения по поводу бегства капитала, международные резервы увеличились, и ожидается, что уровень общего государственного долга останется стабильным на уровне не более 25 процентов к ВВП. Эти реформы также создадут условия для того, чтобы ЦБУ в конечном итоге перешел на таргетирование инфляции и гибкий режим плавающего валютного курса.

Повышение стабильности финансового сектора. Для модернизации экономики требуется стабильный и надежный финансовый сектор для удовлетворения потребностей растущего частного сектора Узбекистана. В последнее время ЦБУ принял меры по укреплению безопасности и стабильности финансовой системы посредством принятия расширенных нормативных документов и проведение стресс-тестирования. ЦБУ также выпустил пересмотренные пруденциальные нормативы относительно достаточности и ликвидности банковского капитала для улучшения соответствия международным стандартам финансового регулирования. В качестве первоначальной меры внедрения ЦБУ провел системные стресс-тесты балансов четырех крупнейших коммерческих банков и планирует ежегодно проводить стресс-тесты всей банковской системы. Результаты стресс-тестов укрепят диалог ЦБУ с банками и поддержат потенциальные меры, которые могут быть приняты заранее, чтобы минимизировать риски для финансовой системы. Эти усилия являются лишь первыми шагами по созданию надежной рыночной

системы, которая будет служить двигателем коммерческих финансов для деятельности частного сектора в Узбекистане.

Расширение финансовой прозрачности и устойчивости. Государственные предприятия (ГП) играют большую роль в экономике Узбекистана и являются важным источником обеспечения занятости. Хотя со временем они будут занимать меньшую долю в экономике, в ближайшей перспективе правительство Узбекистана намерено улучшить свои финансовые показатели и эффективность. Два государственных предприятия, «Узбекнефтегаз» (УНГ) и «Узбекэнерго» (УЭ) входят в число крупнейших государственных предприятий в стране и в совокупности на них занято около 170 000 человек.

Правительство признает, что обеспечение финансовой устойчивости УЭ и УНГ имеет решающее значение по многим причинам. Результаты деятельности этих крупных компаний не только имеют решающее значение для фискальной и финансовой стабильности Узбекистана, но компании обеспечивают важные ресурсы для других секторов экономики. Их способность действовать эффективно и устойчиво является ключом к долгосрочному росту и энергетической безопасности Узбекистана.

Эти реформы представляют собой первый этап действий правительства по повышению эффективности государственных предприятий и улучшению финансовой прозрачности. Правительство осуществляет комплексный план по обеспечению финансового оздоровления этих и других государственных предприятий в среднесрочной перспективе. Со временем Правительство Республики Узбекистан планирует обеспечить эффективное управление государственными предприятиями Узбекистана без необходимости больших субсидий, специальных налоговых процедур или льготных механизмов заимствований. В этом контексте мы предпринимаем решительные шаги, которые включают внедрение международных стандартов финансовой отчетности, оптимизация тарифов на электроэнергию и природный газ для возмещения затрат в среднесрочной перспективе

и использование дифференцированных тарифов для содействия более эффективному использованию энергии для смягчения последствий изменения климата.

Эти усилия дополняют те шаги, что мы делаем в нашей фискальной политике по мере её дальнейшего развития. Наши намерения в этой области включают планы по включению всех государственных расходов, таких как расходов внебюджетных фондов, в регулярный государственный бюджет. Это значительно улучшит прозрачность государственных финансов и улучшит управление экономическими и фискальными рисками. Это важно, поскольку Узбекистан уже начинает привлекать более пристальное внимание со стороны международных инвесторов, которые вносят свои средства в развитие деловых отношений с Узбекистаном. Правительство также рассматривает пути модернизации своей налоговой политики для поддержки лучшего финансового управления и создания более благоприятной среды для бизнеса и налогоплательщиков. Мы уверены, что эти реформы могут быть выполнены таким образом, чтобы повысить эффективность, оставаясь при этом нейтральными с точки зрения получения доходов, для защиты макроэкономической устойчивости Узбекистана.

2. Создание рынка для развития частного сектора

Правительство твердо намерено отказаться от экономической модели, в которой главную роль играет государство, приняв другую модель, где основным двигателем роста является частный сектор. Для достижения этого правительство намерено провести целый ряд реформ, которые повышают гибкость внутренних относительных цен, улучшат деловую среду и совершенствуют экономическую и социальную инфраструктуру. Реформы также будут способствовать усилению внешней торговли и откроют двери Узбекистана для международного бизнеса и туристов. Важно отметить, что правительство также инициировало реформы для повышения

производительности и эффективности сельского хозяйства, повышения эффективности и создания новых рабочих мест.

Улучшение страновой бизнес-среды. Правительство намерено уменьшить контроль над механизмами ценообразования, производства и распределения продуктов и сырья. Мы прилагаем усилия по дерегулированию цен и разрешению торговли сырьевыми товарами на сырьевых биржах, где их цена будет определяться рыночными принципами. Мы планируем дальнейшие меры по либерализации цен и расширению количества товаров и услуг, которые торгуются на рынке. Со временем будет проведена почти полная либерализации цен, за исключением лишь узкого перечня основных товаров и услуг, для которых будет сохранено регулирование цен.

Эти действия являются началом важного пути переориентации экономики Узбекистана и позиционирования ее в будущем. Они также подтверждают приверженность правительства поддерживать динамичную экономику, с лидирующей ролью частного сектора.

Создание возможностей в Узбекистане для расширения торговли, инвестиций и туризма. Правительство намерено создать возможности для расширения международной торговли как способа содействия экономическому росту и созданию рабочих мест. Правительство в одностороннем порядке снизило импортные пошлины на 8000 из 10 800 позиций, из которых около 5000 были исключены. Эти меры улучшат внешнюю конкурентоспособность Узбекистана, защищая импортоориентированные компании от непосредственных последствий реформ обменного курса. В результате данных мер в среднем ставки тарифов по торговле был снижен больше чем в два раза.

Правительство намерено продолжить дальнейшую либерализацию торговой политики и привести ее в соответствие с международными стандартами. Чтобы продвинуться в реализации данных планов, Узбекистан официально уведомил ВТО о своих намерениях возобновить процесс присоединения

к этой организации. Подготавливается дорожная карта, ведущая к вступлению в ВТО.

Наряду с готовностью улучшить условия торговли, правительство принимает меры по повышению людской мобильности, что в равной степени имеет решающее значение, как для увеличения иностранных инвестиций, так и развития туризма. В феврале 2018 года Правительство отменило требования по визам дополнительно для семи стран, в результате чего общее число таких стран достигло 16.

Правительство также расширило перечень стран, которые могут воспользоваться значительно упрощенным процессом выдачи виз, с 15 до 51 стран. Упрощенные визовые процедуры исключают требования для получения приглашений и сокращают время обработки до двух рабочих дней. Это важный шаг к сокращению барьеров для увеличения числа туристов, прибывающих в Узбекистан. Правительство также разработало план внедрения электронных виз, начиная с 1 июля 2018 года.

Рост производительности и эффективности сельского хозяйства в целях содействия повышения занятости и заработной платы. Правительство намерено сократить сложность государственных закупок в сельском хозяйстве. Нынешний подход накладывает существенное бремя на бюджет правительства, поскольку он предусматривает широкий спектр субсидий для производства и распределения сырья, кредитования фермеров, ирригации, энергетики и послеуборочной обработки. Кроме того, закупочные цены, предлагаемые фермерам, ниже рыночных цен не обеспечивали правильных стимулов для повышения производительности и повышения качества. Чтобы решить эти проблемы, правительство объявило о мерах по улучшению стимулирования для производителей хлопка. К ним относятся значительное увеличение закупочной цены хлопка с 1 700 до 3 250 сум за килограмм для урожая 2018 года. Правительство привержено дальнейшей либерализации (включая землю), чтобы позволить фермерам иметь более широкий выбор материалов, сельскохозяйственного оборудования, поставщиков услуг и каналов сбыта. Ожидается,

что эти реформы значительно повысят производительность и качество, будут способствовать более активному предпринимательству в сельскохозяйственном секторе. Самое главное, что эти реформы также создают основу для большей занятости в фермерских хозяйствах и связанных с ними сферах.

В рамках системы государственного заказа, учитывающей посевные площади, фермеры должны выделять значительную долю своей земли на производство хлопка и пшеницы без какой-либо гибкости в принятии независимых решений в сфере сельского хозяйства. Более 60 процентов орошаемых земель закреплено за хлопковыми и зерновыми производствами, что представляет собой значительное нерациональное использование ресурсов. В 2016 году правительство инициировало пятилетний план по сокращению площади земель, предназначенных для обязательного производства хлопка и пшеницы. По завершении этого процесса в 2021 году из состава земель по выращиванию хлопчатника и пшеницы будут выведено 170 000 и 50 000 гектаров, что составляет 8,5 процента от общей площади земель под хлопком и пшеницей. В соответствии с решениями правительства по поощрению диверсификации сельского хозяйства, «высвобождаемые» земли используются для выращивания высокоценных и менее требовательных к орошению культур. Правительство поручило местным органам власти проводить ежеквартальные консультации с частными фермерами и фермерами мелких фермеров (через Совет фермеров) и местными представителями сената (кенгаш) по планированию земледелия и распределению земли. Это направлено на поддержание постоянного диалога между правительством и фермерами.

3. Управление социальными рисками и стимулирование создания рабочих мест

Правительство твердо намерено обеспечивать адекватные меры социальной защиты и создавать рабочие места в официальном секторе.

Расширение системы официальных контрактов для занятых на неполный рабочий день и временных

работников. Правительство вносит поправки в Трудовой кодекс от 1996 года, чтобы расширить использование официальных контрактов для занятых неполный рабочий день и временных работников и повысить мобильность работников. Важно отметить, что пересмотренный Трудовой кодекс упрощает процедуры заключения контрактов для повышения мобильности работников, гибкости рынка труда и улучшения формального вступления женщин в рынок труда.

Расширение системы социального обеспечения. Правительство разработало комплексную систему социальной защиты для поддержки малообеспеченных и уязвимых семей, на которые может оказать негативное влияние осуществление экономических реформ. Правительство также занимается повышением эффективности системы социальной защиты и других социальных пособий за счет адекватного денежного пособия, не связанного с выплатой взносов. Конечной целью реформы социальных пособий является обеспечение таких условий, чтобы адекватный уровень денежной поддержки доходил до бедных и уязвимых семей в течение достаточного периода времени. Реформы также предусматривают расширение охвата социальными пособиями, а также, чтобы размеры и структура денежного довольствия пересматривались регулярно и корректировались по мере необходимости. Реформы позволят улучшить процесс таргетирования бедности, чтобы уменьшить ошибки в обеспечении инклюзивности и недопущения социальной исключенности.

Реформа социальных льгот осуществляется поэтапно. Первым шагом в этом направлении стало увеличение охвата социальными пособиями семей с низким доходом, а также семей с детьми-иждивенцами. Правительство выделило ресурсы для увеличения охвата социальных пособий на 30%, примерно от 435 000 бенефициаров в 2017 году до более чем 560 000 в 2018 году. Повышение эффективности социальных пособий - это среднесрочный процесс, требующий более широкого набора реформ по таргетированию, администрированию, реализации и консолидации социальных пособий в рамках логически выстроенной системы. Последующие улучшения будут связаны

с: (i) корректировкой системы для определения правомочных домохозяйств посредством объективных механизмов целевого охвата и эффективных процессов; (ii) разработкой и внедрением социального реестра для содействия координации политики и программ, более эффективной поддержки бедных и уязвимых слоев населения; и (iii) рассмотрением структуры льгот и критериев правомочности для улучшения адаптации конкретных условий для семей бенефициаров.

В целом, широкомасштабные реформы, реализуемые в рамках Стратегии действий по дальнейшему развитию Республики Узбекистан, опираются на твердую приверженность правительства делу улучшения жизни граждан Республики Узбекистан. Успешная реализация реформ также потребует дальнейшего развития прочных партнерских отношений страны с мировым сообществом. Мы надеемся на продолжение нашего высококачественного партнерства с Группой Всемирного банка и тесное сотрудничество с Вами, чтобы обеспечить воплощение в жизнь твердых намерений правительства для повышения благосостояния и благополучия всех граждан Узбекистана.

С уважением,



Джамшид Кучкаров

**Заместитель Премьер-министра,
Министр финансов Республики Узбекистан**

On the letterhead of the Cabinet of Ministers of the Republic of Uzbekistan

[Unofficial translation from Russian]

May 15, 2018
#2/1-248

Dr. Jim Kim
President
The World Bank Group
Washington, D.C. USA

Dear Dr. Kim,

The Government of Uzbekistan and the World Bank Group share a close and efficient partnership in conducting the profound socio-economic transformation that is under way in Uzbekistan. This letter presents the conceptual foundation of our Development Strategy for 2017-2021 and critical reform aspects that are aligned with the World Bank Group's support to Uzbekistan.

Background

In February 2017, the Government of Uzbekistan approved its five-year Development Strategy for 2017-2021. This is a critical juncture in our history confirming the commitment of the Government to conduct profound socio-economic transformations underpinned by improved competitiveness of the national economy, foster business development, add new high-quality jobs and improve living standards for all our citizens.

The implementation of our Development Strategy would provide a strong impetus for the progressive transformation of Uzbekistan through reforms and modernization, building a law-governed and democratic state with a developed market economy, a strong civil society, and ensuring the rule of law.

The Development Strategy covers five critical areas: 1) enhancing the state and public institutions, 2) securing the rule of law and reform of the judicial system, 3) promoting and liberalizing the economy, 4) fostering social development, and 5) ensuring security, inter-ethnic concord, and religious tolerance as well as pursuing mutually beneficial and constructive foreign policy.

Under *the first area*, enhancing state and public institutions, measures are taken to improve the public administration and public service through decentralization of governance, enhance public sector skills and financial and social support for public employees, and gradually reduce government regulatory barriers to the economy; introduce modern public-private partnership mechanisms aimed at improved efficiency of mutually beneficial cooperation in ensuring the socio-political and socio-economic development of the country; introduce the efficient

mechanisms of dialogue with all citizens; develop civil society organizations and improve their public and political engagement; and empower the mass media and protect the professional activity of journalists.

The second area focuses on strengthening the rule of law and the judicial system. It includes raising the status, incentives and social support for judges and court employees, strengthening the infrastructure of courts; full implementation of the principles of judicial independence and impartiality, adversary and equal rights of the parties in the judicial process; guarantees for reliable protection of citizens' rights and freedoms in the activities of judicial, law enforcement, and controlling bodies; improvement and liberalization of criminal and criminal procedural legislation, decriminalization of certain acts that current legislation perceives as criminal, humanization of criminal penalties and execution procedures thereof; improvement of administrative and legal mechanisms for countering corruption and improving the effectiveness of anti-corruption measures; increasing the legal culture and awareness of the general public, organizing effective interaction of government bodies with civil society and media in this area.

The third area provides for strengthened macroeconomic stability to achieving high rates of inclusive economic growth and job creation. The reforms in this area include ensuring a sustained high growth rate of gross domestic product by maintaining macroeconomic balance, deepening structural and institutional transformations based on the implementation of adopted medium-term programs; ensuring the balanced State Budget at all levels while preserving the mostly social nature of expenditures, improving inter-budgetary relations aimed at strengthening the revenue side of local budgets; further reduction of tax burden and simplification of taxation, improvement of tax administration and expansion of appropriate incentives; deepening the reform in the banking system and ensuring its stability, the level of capitalization and deposit base of banks, strengthening their financial stability and reliability, further expansion of lending to promising investment projects as well as small businesses and entrepreneurs; ensuring the balance and stability of the national economy with higher share of industry, services, small businesses, and private entrepreneurship; proactive investment policy aimed at modernization and technical and technological renovation of production, implementation of industrial, transport, communication and social infrastructure projects; further modernization and diversification of the industry with advancement thereof to a qualitatively new level by achieving fast development of high-tech manufacturing industries, primarily for finished products with high value added, based on the efficient processing of local raw materials; deepening of structural reforms and dynamic development of agricultural production, further strengthening of national food security, expanded production of environmentally friendly products, significant increase in the export potential of the agricultural sector; further optimization of crop areas aimed at reducing the acreage under cotton and grain crops by producing potatoes, vegetables, fodder and oil crops on newly released lands including new intensive orchards and vineyards; and systemic measures to mitigate the negative impact of global climate change and the drying up of the Aral Sea on the development of agriculture and livelihoods of the population.

The fourth area provides for the implementation of measures to raise real income and the purchasing power of the population, further reduce the number of low-income families and income

differentiation among the population; create new jobs and ensure adequate employment, first of all for graduates of secondary specialized and higher educational institutions, ensure the balance and development of the labor market infrastructure, reduce unemployment; provide mandatory social guarantees to the public, strengthen the social protection of vulnerable segments and state support for elder persons and persons with disabilities, improvement of social services, development of public-private partnership in providing social services to the public; further implementation of comprehensive measures to strengthen family health, protect mother and child, improve access of mothers and children to high-quality medical services, provide specialized and high-tech medical care, reduce infant and child mortality; increase the social and political involvement of women, strengthen their role in government and society management, ensure employment of women, graduating from vocational colleges, widely involve them in entrepreneurial activities, further strengthen the foundations of the family; further improvement of living conditions for the people, especially young families, residents of old houses and other citizens in need of better housing conditions, by providing them with mortgage loans on preferential terms and building affordable housing in cities and rural areas; ensuring the ecological safety of living conditions, construction and modernization of waste recycling facilities, strengthening their infrastructure, providing the public with modern facilities for waste disposal; further improvement of the continuous education system, improving the availability of high-quality educational services, training of highly qualified specialists in accordance with the current needs of the labor market; dramatic quality improvement of general secondary education, in-depth study of foreign languages, informatics, and other important and demanded subjects, including mathematics, physics, chemistry, and biology; education of physically healthy, morally and intellectually developed, self-conceiving, dedicated youth with strong life views, increasing the social involvement of the youth in deepening democratic reforms and developing civil society; social support to the youth, creation of decent housing and social conditions for young families; organizing efficient activities of government bodies, educational institutions, and youth and other organizations in the implementation of state youth policy.

Finally, *the fifth area*, includes measures to ensure the protection of the constitutional system, sovereignty, and territorial integrity of the Republic of Uzbekistan; strengthening of civil, interethnic, inter-confessional peace and harmony; prevention of environmental problems, which damage the environment, health and diversity of the population; strengthening the independence and sovereignty of the state, further strengthening of the position and role of the country as full-fledged subject of international relations, joining the community of developed democracies, creation of security, stability and good neighborhood belt around Uzbekistan; and strengthening of the international image of the Republic of Uzbekistan, objectively informing the world community about the ongoing reforms in the country.

Many of these reforms are fully aligned with the areas supported by the World Bank Group. The following is a summary of the progress achieved to date in specific areas where there is strong alignment.

1. Building Foundations for Sustainable Economic Growth

The Government of Uzbekistan, under its reform agenda, is committed to achieving sustainable economic growth by liberalizing foreign exchange market, improving financial sector stability, and enhancing fiscal transparency and sustainability.

Economic Data: The Government has taken important steps improving the quality and availability of economic data, but it is recognized that data availability still has shortcomings that hamper monitoring of key economic, financial, and social indicators. In September 2017, the Presidential decree mandated the dissemination of economic and financial data. In January 2018, the State Statistics Committee (further SSC) began publishing a new consumer price index based on the IMF methodology. The government has also agreed to participate in the IMF's enhanced General Data Dissemination System (e-GDDS), committing to post a National Summary Data Page with key economic, financial, and social statistics starting in May 2018. Ongoing work includes efforts to improve balance of payments statistics, monetary reporting and financial soundness indicators, and to compile Uzbekistan's International Investment Position. Moreover, the CBU, Ministry of Finance, and the SSC are preparing a roadmap for improvement of statistics which is scheduled for release in November 2018. The State Statistics Committee is also working to improve the quality and range of national accounts data. Going forward, the Government commits to upgrading labor market statistics, including the collection of labor and household survey data.

Exchange rate liberalization. Prior to September 2017, Uzbekistan maintained an official exchange rate underpinned by strict controls on foreign exchange convertibility and surrender requirements. As a result, there were large distortions in relative prices of domestic and international goods, which were constraining economic activity, job creation, and well-being.

In September 2017, the Government acted decisively to reduce the significant burden that this policy had placed on businesses and citizens. The Government announced an immediate adjustment of the official exchange rate between the Uzbekistan Sum and the US Dollar from UZS 4,210 to UZS 8,100 per US dollar. This action virtually eliminated the parallel market premium overnight. At the same time as this announcement, the Central Bank of Uzbekistan (CBU) was given greater independence to operate a managed exchange rate float, determined by market instruments. In addition, the Government also announced the full removal of restrictions on exchange rate convertibility on current account operations, including foreign exchange surrender requirements for export earnings.

While these reforms will require a period of adjustment for the Uzbekistan economy, I am confident that it will support greater macroeconomic stability and foreign direct investment. Despite initial concerns of capital flight, international reserves have increased, and total public and public guaranteed debt is expected to remain stable at less than 25 percent of GDP. These reforms will also provide the foundations for CBU to eventually move toward inflation targeting and a flexible floating exchange rate regime.

Improving financial sector stability. The modernization of the economy requires a stable and robust financial sector to meet the needs of Uzbekistan's growing private sector. Recently, the CBU has taken measures to strengthen the safety and stability of the financial system through

enhanced regulations and stress-testing. The CBU has also issued revised prudential regulations on banking capital adequacy and liquidity to improve compliance with international financial regulatory standards. As an initial implementation measure, the CBU has conducted systemic stress-tests of the balance sheets of four of the largest commercial banks, and plans to introduce annual stress-tests of the entire banking system. The results of the stress tests will strengthen the CBU's dialogue with banks, and support potential measures that could be taken in advance to minimize risks to the financial system. These efforts are just the first steps to creating a sound, market-based banking system that will serve as an engine of commercial finance for private sector activity in Uzbekistan.

Enhancing fiscal transparency and sustainability. State-owned enterprises (SOEs) play a large role in the Uzbekistan economy and are an important source of employment. While, over time, they will account for a smaller share of the economy, in the near-term the Government of Uzbekistan is committed to improve their financial performance and efficiency. Two SOEs, Uzbekneftegaz (UNG) and Uzbekenergo (UE), are among the largest SOEs in the country and collectively employ about 170,000 people.

The Government recognizes that putting UE and UNG on a financially sustainable footing is critical for many reasons. Not only is the health of these large firms critical to Uzbekistan's fiscal and financial stability, but these firms provide critical inputs to other sectors of the economy. Their ability to act efficiently and sustainably is key for Uzbekistan's long-term growth and energy security.

These reforms represent the first phase of actions by the Government to strengthen the performance of SOEs and improve fiscal transparency. The Government is implementing a comprehensive plan to secure the financial recovery of these, and other, SOEs over the medium-term. Over time, we are committed to ensuring that Uzbekistan's SOEs must be run efficiently, without the need for large subsidies, special tax treatments, or preferential borrowing arrangements. In this context, we are taking decisive steps that include the introduction of international financial reporting standards, increases to the electricity and natural gas tariffs to achieve cost recovery over the medium term, and the use of differentiated tariffs to promote more efficient energy use to mitigate the effects of climate change.

These efforts complement those we are doing on our fiscal policy going forward. Our intentions in this area include plans to bring all government expenditures, including off-budget funds, into the regular government budget. This will significantly improve the transparency of government finances, and improve the management of economic and fiscal risks. This is important as Uzbekistan is already beginning to attract greater market scrutiny by international investors with interests in doing business with Uzbekistan. The government is also considering ways of modernizing its tax policy to support better fiscal management and create a friendlier environment for businesses and taxpayers. We are confident that these reforms can be done in a way that improves efficiency while still remaining revenue neutral to safeguard Uzbekistan's macroeconomic resilience.

2. Market Creation for Private Sector Development

The Government is strongly committed to moving away from a state-led economy to one where the private sector is the main engine of growth. To achieve this, the Government is committed to a range of reforms that increase the flexibility of domestic relative prices, improve the business environment, and improve economic and social infrastructure. Reforms will also support enhanced external trade, and open Uzbekistan's doors further to tourists and international businesses. Importantly, the Government has also initiated reforms to improve agricultural productivity and efficiency, to promote efficiency and further job creation.

Improving the domestic business environment. The Government is committed to reducing controls over price setting, production and distribution for outputs and raw materials. We have initiated efforts to deregulate prices and allow a greater number of inputs and raw materials to be traded on commodity exchanges, where their price will be determined by market forces. We plan to further liberalize prices, and broaden the number of goods and services that are traded in the market. Over time, we expect to fully liberalize almost all prices, maintaining only a narrow list of essential goods and services that will be price regulated.

These actions are the beginning of an important journey to reorient Uzbekistan's economy and position it for the future. They also reiterate the Government's commitment to supporting a vibrant economy led by the private sector.

Opening Uzbekistan's doors to more trade, investment and tourism. The Government is committed to opening its doors to greater international trade as a way of promoting economic growth and jobs. The Government has unilaterally reduced import tariffs for about 8,000 out of 10,800 items, of which about 5,000 were eliminated (i.e. reduced to zero). These measures will improve Uzbekistan's external competitiveness, while buffering import-intensive companies from the immediate effects of the exchange rate reforms. Because of these measures, the average trade-weighted tariff was reduced by more than two times.

The Government is committed to further liberalizing trade policy and bringing it in line with international standards. To advance this commitment, Uzbekistan has formally communicated its intentions to the WTO to resume the process of accession. A roadmap leading to WTO accession is being prepared.

Accompanying the commitment to opening trade, the Government is improving greater mobility of people, which is equally critical to greater foreign investment and the development of tourism. In February 2018, the Government eliminated visa requirements for seven additional countries, bringing the total number of such countries to 16.

The Government has also expanded the number of countries that can take advantage of a significantly simplified visa issuance process, from 15 to 51. Simplified visa procedures eliminate requirements to obtain letters of invitation, and reduces processing times to two business days. This is an important step, to reducing barriers to increased tourist arrivals to Uzbekistan. The Government has also put in place a plan to introduce the issuance of electronic visas starting on July 1, 2018

Agricultural productivity and efficiency increases to promote job growth, and wages. The Government is committed to reducing the complexity of state procurement in agriculture. The current approach places a significant burden on the Government’s budget, as it provides a wide range of subsidies for inputs in production and distribution, farmers’ credit, irrigation, power, and post-harvest processing. In addition, fixed purchase prices on state orders that have been offered to farmers are below market prices and do not provide the right incentives to increase productivity and improve quality.

To address these issues, the Government has announced measures to provide better incentives to cotton producers. These include a significant increase of the cotton procurement price from 1,700 to 3,200 soms per kilogram for the 2018 harvest season. The Government is committed to further liberalization (including land) to allow farmers to have a broader choice of inputs, farming equipment, service providers and marketing channels. These reforms are expected to significantly improve productivity and quality, and facilitate greater entrepreneurship in the agriculture sector. Most importantly, these reforms also create the foundations for greater employment, on and off the farm.

Under the area-based quota system of production, farmers are required to allocate a large share of their land to the production of cotton and wheat without having any flexibility to make independent farming decisions. More than 60 percent of the irrigated land is mandatorily assigned to cotton and grain productions, representing a significant misallocation of resources. In 2016, the Government initiated a five-year plan to reduce the area of land subject to the mandatory production of cotton and wheat. When completed in 2021, 170,000 and 50,000 hectares will have been removed from cotton and wheat respectively, representing 8.5 percent of the total cotton/wheat area.

In line with the Government’s pledge to encourage agricultural diversification, the “freed-up” areas are being reassigned to the cultivation of less water-demanding and higher value crops. The Government has instructed Hokimiyats (local authorities) to hold quarterly consultations with private farms and smallholder farmers (through the Farmers’ Council) and local representatives of the Senate (Kengashi) on crop production planning and land allocation. This will help maintain an ongoing dialogue between Government and farmers.

3. Managing Social Risks and Enabling Jobs

The Government has a strong commitment to providing adequate social safety nets and creating job opportunities in the formal sector.

Expanding formal contracts to part-time and temporary workers. The Government is reforming the 1996 Labor Code to expand the use of formal contracts for part-time and temporary workers, and to facilitate worker mobility. Importantly, the revised Labor Code simplifies contracting procedures to enhance the mobility of workers, the flexibility of the labor market, and improve women’s formal entry into the labor market.

Enhancing social safety-nets. The Government had developed a comprehensive social safety-net to support low-income and vulnerable households that might be negatively impacted by the implementation of economic reforms. The Government is also in the process of strengthening the

effectiveness of the safety-net system and other social benefits through an adequate non-contributory cash allowance. The ultimate objective of the social benefits reform is to ensure that an adequate level of cash support reaches poor and vulnerable families for a sufficient period time. The reforms also involve increasing the coverage of social benefits, and ensuring that the size and structure of the cash allowance is regularly reviewed and adjusted as necessary. Reforms will also improve poverty targeting to reduce inclusion and exclusion errors.

The reform of social benefits is being implemented in steps. The first step of these reforms has been to increase the coverage of social benefits for low-income families, as well as families with dependent children. The Government committed resources to increasing the coverage of social benefits by 30 percent, from about 435,000 beneficiaries in 2017 to over 560,000 in 2018. Improving the effectiveness of social benefits is a medium-term process that requires a broader set of reforms on the targeting, administration, implementation arrangements and consolidation of social benefits in a coherent system.

Subsequent improvements will be related to: (i) adjusting the system to identify eligible households through objective targeting mechanisms and efficient processes; (ii) developing and implementing a social registry to facilitate policy and program coordination, and better support the poor and vulnerable; and (iii) reviewing benefit structure and eligibility criteria to better tailor benefits to specific conditions of beneficiary families.

By and large, the wide-ranging reforms implemented within the framework of the Strategy of Actions for the Further Development of the Republic of Uzbekistan are backed by a strong commitment from the Government to improve the lives of the citizens of Uzbekistan. Achieving these reforms will also require the continuation of our strong partnerships with the international community. We look forward to continuing our excellent partnership with the World Bank Group, and to working closely with you to deliver the Government's firm commitment to greater prosperity and well-being for all citizens of Uzbekistan.

Yours sincerely,

[/Signed]

Djamshid Kuchkarov
Deputy Prime Minister,
Minister of Finance
Republic of Uzbekistan

**Annex 4: Environment, Climate Change And
Poverty/Social Analysis Table**

Prior Actions	Significant positive or negative environment effects and climate change mitigation co-benefits	Significant poverty, social or distributional effects positive or negative
Pillar 1: Foundations for Sustainable Economic Growth and Macro-Financial Resilience		
<p>Prior Action 1: The Recipient, through the Central Bank of Uzbekistan (CBU) has eliminated all foreign exchange surrender requirements on all export earnings.</p>	Neutral	<p>Negative distributional impact from rising prices on consumer goods.</p> <p>Potential negative impacts for individuals directly tied to sectors previously allowed advantaged exchange rates.</p> <p>Positive medium-term distributional impact from greater competitiveness of exports and allocative efficiency from reduced distortions.</p>
<p>Prior Action 2: The Recipient, through the CBU has issued revised prudential regulations on banking capital adequacy, liquidity, and asset classification to improve compliance with international financial regulatory standards in line with the Basel Core Principles.</p>	Neutral	Positive medium-term distributional impact by increasing economic stability and resilience.
<p>Prior Action 3: The Recipient has adopted measures requiring the CBU to conduct annual stress tests on commercial banks in line with international best practices.</p>	Neutral	Positive medium-term distributional impact by increasing economic stability and resilience.
<p>Prior Action 4: The Recipient has adopted key measures to promote financial recovery and transparency of Uzbekenergo and Uzbekneftegaz, through: i) approval of fuel and electricity tariff adjustments; ii) introduction of differentiated electricity tariffs to improve efficiency; and iii) adoption of policy requirements for Uzbekenergo and Uzbekneftegaz on financial statement audits' compliance with the international financial reporting standards.</p>	Positive impacts due to increased tariffs and reduction in energy consumption with climate change mitigation co-benefits	Negative distributional impact from rising tariffs on utilities.
Pillar 2: Supporting Market Formation for Private Sector Development		
<p>Prior Action 5: The Recipient has (i) removed regulatory price controls for a list of key products, in particular production inputs and raw materials and; (ii) adopted requirements for a set of products to be transacted through commodity exchanges, in order to develop market-based institutions and liberalize prices.</p>	Positive impacts as environmental policies are more readily applied with climate change mitigation co-benefits.	<p>Positive distributional impact in supporting competition and better allocative efficiency.</p> <p>Negative impact on individuals directly tied to subsidized firms.</p>

Prior Actions	Significant positive or negative environment effects and climate change mitigation co-benefits	Significant poverty, social or distributional effects positive or negative
Prior Action 6: The Recipient has reduced average custom tariff rates.	Neutral	Positive distributional impact in medium term from increasing product choice and cost. Negative impact on local producers of goods formerly attracting a high-tariff.
Prior Action 7: The Recipient has increased the regulated purchase price paid for cotton closer to the international market price aimed to increase cotton productivity and to promote a more efficient use of resources (including land, water and fertilizer).	Increase in efficiency of agriculture, reduction in pollution, access to international markets of fertilizers leading to better quality and sustainable agriculture practices. Negative impacts to environment and farmers' health due to increased usage of fertilizers and pesticides and non-observance of safety rules and procedures. Potential mitigation co-benefits resulting from the expected increase in agricultural productivity, if this also reduces energy use, irrigation and other inputs to production and/or if this reduces non-CO2 GHG emissions from the use of less (or better quality) fertilizers.	Positive distributional impact from increasing compensation to farmers/agricultural workers and improving productivity
Prior Action 8: The Recipient has reduced the land area mandatorily assigned to grow cotton and grain in order to support the raise of productivity and to promote a more efficient use of resources (including land, water and fertilizer).	Positive impacts, less pressure on environment, more sustainable agriculture practices. Potential climate adaptation co-benefits because reducing the land area mandatorily assigned to grow grain and cotton supports efforts to diversify agricultural crops, which would help reduce vulnerability of the sector to climate change (by introducing more crop variety and by shifting to less water-intense crops).	Positive poverty/distributional impact from allowing greater choice in allocation of farming land
Pillar 3: Enabling Job Creation and Managing Social Risks		
Prior Action 9: The Recipient, through its Executive branch, submitted to its Parliament, for approval thereof, the draft amendments to the Labor Code to expand formal contracts to part-time and temporary workers.	Positive impacts due to better enforcement of the occupational health and safety standards for temporary and part-time workers.	Significant positive effect for part-time/temporary workers who are currently informal. Potential negative impact if contract type diversity induces full-time contracts to become part-time/temporary
Prior Action 10: The Recipient has increased the social safety nets financial support for vulnerable groups, including low-income families and families with dependent children.	Neutral	Significant positive effect for poor and vulnerable families now eligible.

