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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
SUPPLEMENTAL FINANCING DOCUMENT FOR A PROPOSED

LOAN
IN THE AMOUNT OF US$200 MILLION TO

REPUBLIC OF UZBEKISTAN
FOR THE

Supplementary Development Policy Financing: Sustaining Market Reforms in Uzbekistan

April 17, 2020

Macroeconomics, Trade And Investment Global Practice
Europe And Central Asia Region

Republic of Uzbekistan

GOVERNMENT FISCAL YEAR

January 1, 2020 – December 31, 2020

CURRENCY EQUIVALENTS

(Exchange Rate Effective as of April 15, 2020)

UZS 10,121

US$1.00

ABBREVIATIONS AND ACRONYMS

ADB	Asian Development Bank
CBU	Central Bank of Uzbekistan
CPF	Country Partnership Framework
DPO	Development Policy Operation
DPL	Development Policy Loan
GDP	Gross Domestic Product
GFS	Government Financial Statistics
GRS	Grievance Redress Service
IBRD	International Bank for Reconstruction and Development
ICR	Implementation Completion Report
IDA	International Development Association
IFC	International Finance Corporation
IMF	International Monetary Fund
LDP	Letter of Development Policy
MTI	Macroeconomics Trade and Investment
OECD	Organization for Economic Cooperation and Development
PISA	Program for International Student Assessment
PDO	Program Development Objective
PFM	Public Financial Management
PPG	Public and Publicly Guaranteed
PPP	Public-Private Partnership
MOF	Ministry of Finance
RE	Renewable Energy
SCD	Systematic Country Diagnostic
SOB	State-owned Bank
SOE	State-owned Enterprise
UFRD	Uzbekistan Fund for Reconstruction and Development
UN	United Nations
US$	United States Dollar
UZS	Uzbekistan som
WB	World Bank
WBG	World Bank Group
WTO	World Trade Organization

Regional Vice President:	Cyril Muller
Country Director:	Lilia Burunciuc
Regional Director:	Lalita Moorty
Practice Manager:	Sandeep Mahajan
Task Team Leader:	Vinayakraj Nagaraj

REPUBLIC OF UZBEKISTAN

SUPPLEMENTARY DEVELOPMENT POLICY FINANCING: SUSTAINING MARKET REFORMS IN UZBEKISTAN

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This Supplementary Development Policy Financing Loan was prepared by an IBRD team led by Vinayak Nagaraj (EECM1), comprising Ivailo Izvorski and Eskender Trushin (EECM1); Davit Babasyan (EECFM); Gulnora Kamilova, Rakhymzhan Assangaziyev, Shakhnoza Ayupova, and Shoista Zakirova (ECCUZ); William Seitz (EECPV); Marina Novikova (HECSP); Sergiy Zorya (SCAAG); Eric Ranjeva and Ma Dessirie Kalinski (WFACS); Ruxandra Costache (LEGLE); Sophie Devnosadze (ECADE) and Jahongir Haitov, Mikhail Budnikov and Artur Ambartzumyan. The team wishes to thank Ezequiel Cabezon and Lawrence Dwight (IMF) for their advice and comments; Peter Milne for editorial assistance; and David Knight (EECM1), and Aurelien Kruse (ESAMU) for serving as peer reviewers. The team is also grateful for the excellent guidance and support from Cyril Muller and Sudharshan Canagarajah (ECAVP), Roumeen Islam (ECADE), Lilia Burunciuc and Sascha Djumena (ECCCA), Hideki Mori (ECCUZ), Lalita Moorty (GMTD2), and Sandeep Mahajan (GMTE2). The team expresses its profound gratitude to the many people involved—both in the Bank and on the side of the Government of Uzbekistan—in putting this operation together at short notice, going well beyond the call of duty under exceptional operational circumstances and personal hardship.

SUMMARY OF PROPOSED FINANCING AND PROGRAM

BASIC INFORMATION

Project ID	Parent Project
P173948	P168280

Proposed Development Objective(s)

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

Organizations

Borrower:	REPUBLIC OF UZBEKISTAN
Implementing Agency:	MINISTRY OF FINANCE OF THE REPUBLIC OF UZBEKISTAN

PROJECT FINANCING DATA (US$, Millions)

SUMMARY

Total Financing	**200.00**

DETAILS

International Bank for Reconstruction and Development (IBRD)	200.00

INSTITUTIONAL DATA

Climate Change and Disaster Screening

This operation has been screened for short and long-term climate change and disaster risks

Overall Risk Rating

Substantial

Results of the Parent Operation

Indicator Name	Baseline	Target
RI1: An increase in the value of horticultural exports.	US$875 million (2018)	US$960 million (2019)
RI2: Increase in the number of legal entities registered as wholesale trading businesses.	12,387 (2017)	13,000 (June 2020)
RI3: Banking sector legislation is in greater compliance with Basel Core Principles	Banking sector legislation is non-compliant with the following key Basel Core Principles for Effective Banking Supervision: BCP1, BCP2, BCP5, BCP8, BCP11, BCP19, BCP20 (December 2018)	Banking sector legislation is in increased compliance with Basel Core Principles for Effective Banking Supervision BCP1, BCP2, BCP5, BCP8, BCP11, BCP19, BCP20 (June 2020)
RI4: Competitive tendering of renewable energy projects under the new law.	0 (June 2018)	The government brings at least 1 RE project to the point of commercial tender announcement. (end-September 2020)
RI5: Number of end-user electricity and cold-water tariff changes made in accordance with new tariff methodology.	0 – Methodology did not exist (December 2018)	At least 1 electricity and 1 cold-water end-user tariff amendments are made in accordance with the new methodology. (June 2020)
RI6: A change in the ownership structure of (i) the national airline, (ii) all airports, (iii) air traffic control services.	All airports under the sole ownership of NAK (June 2018)	Airport ownership separated from NAK into a new entity, and a process is under way to concession at least one airport in Uzbekistan under PPP arrangements following a competitive tender process. (September 2020)
RI7: Number of independent financial valuations of State-Owned Enterprises conducted by the Agency for the Management of State Assets in accordance with International Financial Reporting Standards.	0 (December 2018)	Valuations for Uzbekenergo, Uzbekneftegaz, and at least 5 other SOEs have been completed (June 2020)
RI8: An increase in formal employment as evidenced by the number of private sector employees registered for payroll tax withholding, disaggregated by gender.	Male: 1,712,893 Female: 1,049,837 (end-December 2018)	Male: 1,952,698 Female: 1,207,315 (end-June 2020)
RI9: An increase in the roll out of standardized systematic national educational assessments.	No standardized and systematic national assessments in Uzbekistan (2018)	A new standardized and systematic national assessment is piloted in at least two regions (June 2020)
RI10: An increase in the utilization of the unified social registry system, as evidenced by the number of administrative units that have adopted the unified social registry to process applicants' registration, beneficiary selection, program enrolment, and payment orders.	0 - No Unified System in place (December 2018)	10 (September 2020)
RI11: Publication and availability of citizen budget documents.	A pilot Citizen Budget document for the 2018 Budget has been published and is available on the Ministry of Finance website (November 2018)	Citizen Budget documents for the 2019 and 2020 Budgets have been published and available on the Ministry of Finance website (June 2020)

IBRD SUPPLEMENTAL FINANCING DOCUMENT FOR A PROPOSED LOAN TO THE REPUBLIC OF UZBEKISTAN

1. INTRODUCTION AND COUNTRY CONTEXT

1. **The proposed supplemental financing loan of US$200 million supports the Government of Uzbekistan's response to an unanticipated tax revenue shortfall and expenditure surge resulting from the COVID-19 outbreak.** This financing is intended to augment the US$500 million already disbursed under the *Sustaining Market Reforms in Uzbekistan Development Policy Loan (DPL)*, which was approved by the World Bank Group's Board on June 14, 2019. The Program Development Objective (PDO) of the parent operation was to sustain Uzbekistan's economic reforms and its transition to a market economy by: (i) increasing the role of markets and the private sector in the economy; and (ii) enhancing social inclusion.

2. **Uzbekistan has made strong progress in implementing structural reforms.** Ten of the 11 result indicators in the parent operation have been met well in advance of their target dates. The remaining indicator on aviation reforms has been partially met and will be assessed after its target date of September 2020. In addition, the authorities have moved forward with several ambitious new reforms to modernize the agriculture sector, liberalize factor markets, reduce financial market distortions, strengthen fiscal transparency, and increase opportunities for women in the economy. Economic management has remained strong. Ambitious improvements in tax administration supported strong tax collection in 2019, despite a large reduction in corporate and individual tax rates. A well-timed program of gold sales resulted in a smaller-than-projected current account deficit in 2019. Prior to the onset of the COVID-19 crisis, Uzbekistan was on track for another strong year of economic performance in 2020.

3. **The authorities have prioritized reforms that support the vulnerable and introduced measures to mitigate the costs of transition.** As of early March 2020, nearly all respondents in World Bank monitoring[1] stated that they believed that the country was generally on the right track on political, social and economic reforms. Only about 6 percent responded that the government was not engaging in open dialogue with citizens on reform issues, and only 11 percent reported that their family's financial situation was worse than at the start of the reforms. In response to evaluations finding gaps in coverage, the authorities have increased the number of families receiving social assistance, in 2019 reaching 25 percent more vulnerable families than in 2016.

4. **The COVID-19 outbreak poses a significant threat to the sustainability of Uzbekistan's reform agenda and its transition to a competitive market economy.** Economic growth in 2020 is currently projected at 1.6 percent, significantly lower than the pre-crisis projection of 5.7 percent. Per capita GDP growth is expected to be nearly flat in 2020, compared with a pre-crisis projection of 4.1 percent. It is likely that conditions will deteriorate further, and that growth could be negative in 2020. Promising signs of private sector growth and job creation in 2019 in sectors such as tourism, horticulture and services are now at risk. The crisis has wiped out tourism and high-value horticulture exports in recent months. Social distancing restrictions and mandatory closures have brought most industrial output and commerce to a halt. Export-oriented sectors, such as natural gas, metals, horticulture, light manufacturing, chemicals and fertilizer have been severely affected due to lower global demand and disruptions in trade and transportation networks. Important reform measures such as planned energy tariff adjustments have been postponed. Horticultural operations have been interrupted due to weaker orders from export markets.

5. **A sharp fall in remittances and increased risks of rising unemployment and inflation as a result of the COVID-19 outbreak pose a significant threat to sustained poverty reduction.** Uzbekistan has made commendable progress

[1] The Listening to the Citizens of Uzbekistan survey collects views on the national reform program every month with a representative sample of 1,500 households.

in reducing poverty, with extreme poverty having almost entirely been eliminated. Pre-crisis, the World Bank projected that poverty would fall to 7.4 percent of the population in 2020.[2] The poverty gap—which measures the average distance of poor households from the poverty line—is expected to increase by nearly 24 percent. Remittances from the Russian Federation have played a significant role, with over 2 million migrant workers remitting money to some of the poorest households in the country. Remittances could fall by more than 40 percent this year compared with 2019 as a result of the COVID-19 crisis, as the Russian economy reels under the impact of the dual shocks of COVID-19 and lower oil prices. There is emerging evidence of rising unemployment, as sustained domestic disruption severely affects businesses. Production and import interruptions are also likely to elevate inflation risks. These factors could significantly increase the incidence and depth of poverty in the coming months.

6. **Recognizing this threat, the authorities have moved rapidly to contain the outbreak and respond to the economic effects of the crisis.** Soon after the first detected case of the virus in Uzbekistan, the authorities closed schools, implemented tighter controls on movement, required social distancing and activated emergency health protocols. These restrictions have been progressively tightened, leading to the suspension of most non-essential domestic economic activity across the country. The government has also moved quickly to provide additional health sector resources, including essential equipment and additional hospital bed capacity. In late March, the government announced a US$1 billion anti-crisis package to fund health expenditures and provide interim financial relief to the most affected households and enterprises. A second set of measures was announced on April 3 to provide further tax and debt relief to businesses.

7. **The authorities are seeking rapid assistance to meet the surge in immediate health and social expenditures during a period of seasonally low tax revenues.** The effects of economic disruption, alongside the costs of anti-crisis measures, have created a budget financing gap and a cash-flow deficit. World Bank staff currently estimate the budget financing gap will be about 2.7 percent of GDP in 2020. This is likely to grow if health restrictions are tightened or economic activity is disrupted for longer than currently anticipated. The increase in COVID-19-related expenditures has more than doubled the forecast cash flow deficit for the second quarter. Global financial and commodity market disruptions have restricted the government's ability to meet this increased deficit from other non-budget sources of finance, such as external sovereign debt or gold sales. These resources are likely to help partially fill the full-year budget financing gap, but only later in the year. To manage immediate expenditure pressures—including the provision of enough resources for the health response and for social safety net assistance—the authorities have requested that development partners front-load resources intended for disbursement later this calendar year.

8. **The proposed supplemental financing loan is an early component of a coordinated donor strategy to fill the budget financing gap in 2020 and meet immediate COVID-19-related spending needs.** The World Bank, the Asian Development Bank (ADB) and the International Monetary Fund (IMF) are coordinating closely to support the government's economic policy response. The proposed supplemental financing loan will provide US$200 million in initial liquidity, which will then be followed by a proposed ADB emergency operation of US$500 million in June 2020. A proposed US$500 million World Bank Development Policy Operation (DPO) that was scheduled for Board submission in November 2020 will be advanced to July 2020 to address the remaining financing gap. At the government's request, these operations are being prepared in close consultation with the IMF, which stands ready to provide additional support if worsening conditions create a balance of payments need. Further resources from all three institutions are likely to be available should conditions deteriorate even further.

[2] Using the lower middle-income poverty line (US$3.2/day 2011 PPP).

2. REFORM PROGRAM SUPPORTED BY THE ORIGINAL OPERATION: AN UPDATE

9. **The government has maintained a strong commitment in implementing the reforms supported under the first and second Development Policy Loan (DPL) engagements.** Before the crisis, reforms supported under the June 2019 DPL were being implemented effectively. Ten of the 11 result indicators in the June 2019 DPL have already been met or exceeded.. Result indicator 6, relating to aviation, has been partially met with the government announcing its intentions to concession Tashkent Airport through a competitively tendered Public-Private-Partnership (PPP) arrangement. Transaction advisers have been selected for the process. However, due to the COVID-19 crisis, a competitive tender process has been delayed. Result indicator 6 is likely to be met once global investment conditions improve. Of all policy actions supported under both operations, only one policy action from the first DPL was changed: average effective tariffs were raised slightly under a trade policy calibration exercise carried out as part of the preparations for WTO accession. To avoid policy reversal and remain within the agreed result indicator in the program, the average effective tariff was set at 8 percent.

10. **Since the approval of the June 2019 DPL, the government has enacted further structural reforms to accelerate the market transition.** Over the past eight months, the government has taken on a more complex and challenging phase of reforms to begin liberalizing factor markets, reduce the state's economic footprint and distortion of markets, modernize and market-orient the agriculture sector, strengthen the cost recovery of public utilities, and increase opportunities for women in the economy.

11. **There has been significant progress in reforming the agriculture sector.** In October 2019, the government adopted its Agricultural Strategy 2020–2030 to modernize agriculture. At its heart is a redefinition of the state's role and a shift to market-oriented, inclusive and private sector-led agriculture. The Agricultural Strategy 2020–2030 emphasizes reforms to: (i) strengthen the transparency of land allocation and land tenure security; (ii) eliminate the state production system for cotton and wheat, while attracting private investments in agriculture; (iii) shift agricultural public expenditures from subsidies to public goods; (iv) invest in agricultural knowledge and innovation systems; (v) enhance the management of soils and water; and (vi) collect and disseminate better data and information. It recognizes the structural and policy weaknesses of Uzbekistan's agriculture sector and prioritizes public investments in quality, reliability, safety and logistics, while creating space for the private sector to benefit from public investments, and generate profits and jobs.

12. **In February 2020, the government announced that it would dismantle the most binding constraint to the total elimination of forced and child labor: the state agricultural order system in cotton.** Starting from the 2020 harvest, the government has removed state production targets and ended mandatory state procurement of cotton. Historically, the historical state production system brought in more than 2 million forced workers—many of whom were children—to pick cotton by hand. This triggered an international boycott of Uzbek-sourced cotton and textiles. The announcement in February is the culmination of significant efforts by the authorities since 2017 to reform the cotton sector and eliminate forced and child labor. Similarly, the government has reduced state procurement of wheat in 2020, and has announced the end of state targets and procurement of wheat in 2021.

13. **A series of reforms is expected to improve financial sector efficiency in the economy.** In the fourth quarter of 2019, the government enacted measures to close the gap between preferential lending rates and the official market reference rates for almost all new lending. In December 2019, the government then transferred almost all commercial bank on-lending from the Uzbekistan Fund for Reconstruction and Development (UFRD)—the sovereign wealth fund—out of the banking sector and back to the UFRD's balance sheet. This will help pave the way for the reform and eventual privatization of state-owned commercial banks. Measures were also put in place to centralize ownership and

oversight of the banking sector in the Ministry of Finance (MoF) and restructure the largest state-owned bank—the National Bank of Uzbekistan—into a joint-stock company with increased transparency and reporting requirements.

14. The government is consulting on measures to significantly reduce its ownership of enterprises. Prior to the onset of the COVID-19 crisis, a government taskforce undertook a comprehensive exercise to identify and inventory over 2,800 SOEs in the economy. The government is now consulting on a draft strategy that establishes strict criteria for retained state ownership of these enterprises. Under this strategy about 2,275 enterprises will be liquidated, consolidated, or fully divested of state ownership over the next five years. The remaining SOEs will be evaluated further under international accounting and financial guidelines, and further divestiture decisions are expected. The proposal also requires that any SOEs retained by the state should be subject to internationally accepted corporate governance principles, and to competitive neutrality requirements enforced by the competition regulator.

15. Measures have also been enacted to increase fiscal transparency and strengthen economic management. In late 2019, a new budget law was enacted to give Parliament greater scrutiny over the budget process. As part of this law, operations of the UFRD—which since the Fund's establishment in 2006 have been managed separately from regular fiscal operations—have been integrated into the government's budget. Similar to the rest of the budget, proposed UFRD income and financial operations must be approved by Parliament as part of the annual budget process. The budget law also significantly expands the scope and coverage of public budget reporting, and for the first time requires local budgets (at the regional and district levels) to be prepared by the local administration and approved by local councils. In November 2019, a new Banking Law (supported under the parent operation) and Central Bank Law were approved by Parliament to significantly strengthen the Central Bank of Uzbekistan's (CBU) supervisory powers and operational autonomy on monetary policy. As part of the new Central Bank Law, CBU now provides transparent reporting of its foreign exchange market interventions and has announced a new inflation targeting framework to bring inflation to 5 percent by end-2023.

3. IMPACT OF THE CRISIS, ECONOMIC DEVELOPMENTS AND OUTLOOK

Impact of the crisis

16. Local transmission of the COVID-19 virus is yet to be contained. The first confirmed case of the virus was detected in Uzbekistan on March 15, 2020. As of April 15, 2020, there were 1195 confirmed cases[3] and four deaths. The authorities moved quickly to close learning centers, cancel all public gatherings, and initiate emergency measures to boost the health response. Subsequently, more restrictive social distancing policy measures have led to the closure of public transportation, non-essential businesses and public spaces. Uzbekistan has also closed its borders to non-trade entry or exit until at least April 20. Stay-at-home orders, reinforced by a ban on unauthorized vehicular traffic, are also in force until that date. Over 100,000 people are in various forms of formal or home-based (and community-enforced) quarantine.

17. The crisis has progressively disrupted the economy, to a point where considerable domestic activity is now at a standstill. Beginning with modest supply chain disruptions in February, the global spread of the crisis has had more acute effects on the economy as tighter transport and travel restrictions eroded trade and tourism. Current estimates suggest that about half of economic activity has been suspended. This may increase following further recent measures to suspend unauthorized vehicular traffic. Although these restrictions are currently scheduled to expire on April 20, it is likely that they will be extended.. Initial World Bank estimates are that GDP growth will fall sharply to 1.6

[3] Almost all new cases are emerging from within the quarantined population.

percent in 2020 compared with 5.7 percent projected in January. Exports are likely to fall by at least 10 percent and remittances by over 50 percent, compared with 2019. It is harder to estimate the effects of domestic disruption, but the World Bank's current projections are that the stoppage in domestic economic activity will contribute to a decline in growth of at least 2 percentage points this year, with a possibility that this could worsen further.

18. **Baseline projections are that per capita income growth will be flat, and that 1.3 percent of the population, or 448,000 people, may already have fallen into poverty as a result of the crisis.** Using the poverty line appropriate for lower middle-income countries (US$3.2 per person per day in PPP terms), poverty is expected to rise in 2020. World Bank staff estimate the share of people living in poverty will be 8.7 percent following the outbreak, compared with a projection of 7.4 percent pre-crisis. Relative to pre-crisis projections, this equates to an additional 448,000 people expected to be in poverty. This could quickly increase if the most disruptive restrictions to economic activity are extended. Many more risk falling into poverty or facing considerable hardship. In addition, the effect of domestic disruptions on the incomes of the poor and vulnerable will be compounded by rapidly falling remittances, which predominantly accrue to low-income households in Uzbekistan.[4] Low-income households in Uzbekistan receive the bulk of remittances and migrants. In addition to weaker economic conditions in Russia and Kazakhstan, and a sharply depreciated ruble and tenge, both of which will reduce remittances, many seasonal workers—estimated to be in the hundreds of thousands—have not been able to return to work due to travel restrictions.

19. **Measures to contain and eradicate the virus, and provide rapid assistance to firms and households, have led to an unexpected surge in spending at a time when revenues are seasonally low.** The health costs of the crisis are increasing rapidly as hospitalization cases rise and as over 0.3 percent of Uzbekistan's population is being quarantined, isolated, or monitored. Increased procurement of supplies and equipment, compensation for frontline medical workers, and the need for additional health infrastructure to provide hospital beds have significantly increased health spending. At the same time, economic disruptions have begun to affect poor and vulnerable households, prompting an immediate expansion of the social safety net for low-income families and dependents of people who are infected or quarantined. This spending surge was not anticipated by the government, and comes at a time of seasonally low revenue collections and high expenditures from usual budget activity. The near-total disruption in global financial markets has severely constrained the government's ability to liquidate its asset positions to raise cash. Any drawdown on these positions could risk market losses, which the government is seeking to avoid.

Economic developments since the approval of the June 2019 DPL

20. **Macroeconomic performance since the June 2019 DPL was approved has been strong, in part due to the gains from structural reforms.** Real GDP growth in 2019 was 5.6 percent, slightly higher than the 5.5 projected at the time of the June DPL. A surge in government-led investment to expand public infrastructure and modernize SOE assets was the most significant driver of growth. However, growth was also supported by a record increase in tourist arrivals, a rebound in agricultural growth supported by record horticultural exports, a strong expansion of private manufacturing and construction activity, and the continuation of strong service sector growth. Growth in these sectors can be attributed, in part, to structural reforms enacted since 2017: sweeping visa liberalization measures; a reduction in import tariffs; the removal of almost all horticultural export barriers; a large investment program to improve the reliability, supply, and cost-recovery of energy and other intermediate inputs that have created bottlenecks in the

[4] World Bank simulations suggest that without remittance income Uzbekistan's poverty rate in 2018 would have increased from 9.6 to 16.9 percent of the population.

past; border efficiency reforms; and a transformation in the tax and regulatory business environment to reduce costs and compliance burdens on smaller firms.

21. Significantly higher exports and a sharp increase in foreign investments helped increase external buffers in 2019, despite a modest current account deficit. Record horticulture exports, a sharp increase in gold prices, and increased manufacturing exports contributed to a 4.0-percentage-point increase in exports relative to projections in the June 2019 DPL. This helped compensate for a higher-than-projected increase in imports of capital and machinery equipment funded by state-directed investments in SOEs. The current account deficit was about 1 percentage point lower than projected, at 5.6 percent in the June 2019 DPL. The deficit was more than financed by a large increase in foreign direct and portfolio investments, and through increased borrowing by the government in the form of sovereign bonds and loans from international financial institutions. As a result, reserves grew by 13 percent in 2019 (relative to a projected 2 percent in June 2019), increasing end-2019 import cover from 12 to 14 months of imports.

22. Inflation declined consistently during first three quarters of 2019 but increased following additional devaluation of the som and price liberalization measures later in the year. Average annual consumer price inflation was 14.5 percent—significantly lower than 17.5 percent in 2018 and close to projections in the June 2019 DPL. Lower food prices from a strong harvest contributed to falling inflation for the first half of 2019. However, inflation rebounded in the third and fourth quarters of 2019 as a result of wheat and flour price liberalization, a higher-than-expected increase in energy utility prices, and pass-through effects of the depreciation of the som against the US dollar. Consumer price inflation at the end of 2019 was 15.2 percent, marginally lower than June 2019 projections.

23. Monetary policy in 2019 remained tight but was undermined by a significant expansion of state directed lending to SOEs. Since 2017, the CBU has maintained a tight and anti-inflationary monetary policy stance. It has maintained its benchmark refinancing rate at 16 percent following an increase from 14 percent in September 2018, and has tightly controlled the expansion of non-government-directed credit. However, since 2017, a large expansion of state-directed credit via the UFRD and at highly subsidized interest rates—about half of the central bank reference rate—has undermined monetary policy transmission and created large distortions in the banking sector. Annual growth in credit to the economy was 64[5] percent in 2019, against projections of 25 percent in the June 2019 DPL. This followed annual growth of 51 and 103 percent in 2018 and 2017, respectively. About 40 percentage points of credit growth in 2019 was through an expansion of state-directed investment project on-lending (via commercial banks) to SOEs via the UFRD. The significant increase in lending in 2019 was due to the advancement of several investment modernization plans in the energy and public utilities sectors to address input constraints affecting domestic producers and services for households.

24. Although the banking sector was well-capitalized in 2019, a strong increase in bank lending substantially degraded liquidity buffers. Credit to the private sector and non-UFRD lending to the state sector grew by about 23 percent in 2019, backed by an expansion in bank deposits and external funding. Regulatory capital to risk-weighted assets was about 23.5 percent at the end of 2019.[6] Aggressive credit growth in 2019 reduced bank liquidity buffers (mostly at the state-owned banks), making banks more vulnerable to liquidity shocks. The ratio of liquid assets to total banking sector assets decreased from 13 percent at end-2018 to 11 percent at end-2019.

5 In December 2019, almost all UFRD on-lending via commercial banks was transferred out of the banking system and to the accounts of the UFRD. As a result, end-2019 credit growth – net of UFRD activities – was about 24 percent. For comparison with 2018 and 2017 credit growth, UFRD on-lending is included in this paragraph.

[6] The ratio increased from 16 percent in October to 23.5 percent in December largely due to a policy decision to move UFRD debt in the banking system back to the UFRD balance sheet, and to convert some debt positions into bank equity.

Table 1: Uzbekistan: Key Macroeconomic Indicators

	2017	2018	2019	*2020*	2020	2021	2022
				*PC**		(Projected)	
National Income and Prices							
Real GDP growth (annual percent change)	4.5	5.4	5.6	*5.9*	1.6	7.0	6.0
Real per capita GDP growth (annual percent change)	3.2	4.1	4.4	*4.5*	0.0	5.4	4.4
Consumer price inflation (end of period)	18.8	14.3	15.2	*12.4*	15.8	9.1	8.0
External Accounts							
Export of goods, of which	10,162	11,386	13,899	*15,690*	12,517	14,265	16,286
Gold	3,260	2,910	4,918	*5,162*	5,801	5,896	5,957
Merchandise imports, of which	12,377	18,252	21,207	*22,758*	18,693	22,815	25,340
Machinery and Equipment	4,497	7,529	9,572	*10,053*	7,595	10,382	11,541
Remittances and other transfers	4,323	4,208	5,455	*4,971*	2,409	5,679	6,122
Services Balance	-1,842	-2,442	-2,266	*-2,258*	-1,431	-2,098	-1950
Current account balance (percent of GDP)	2.5	-7.1	-5.6	*-4.7*	-8.5	-6.4	-5.4
Foreign direct investment, net	1,788	623	2,284	*1,534*	995	1,848	1,825
Gross international reserves (US$ billion)	28.1	27.1	29.2	*29.0*	26.7	25.1	24.5
Gross international reserves (months of import cover)	14.4	12.2	14.0	*11.7*	11.0	9.5	8.4
Gross external debt (percent of GDP)	34.1	34.3	43.5	*37.0*	44.7	45.1	45.1
Consolidated Fiscal Accounts							
Revenues	24.7	27.8	28.2	*24.0*	23.2	26.1	26.1
Expenditures	23.4	26.0	28.2	*25.3*	27.2	26.1	26.1
Budget Fiscal Balance	1.3	1.8	0.0	*-1.3*	-4.0	-1.3	-0.9
Policy-lending	3.1	4.0	3.9	*1.5*	1.5	1.8	1.6
Overall fiscal balance	-1.8	-2.2	-3.9	*-2.8*	-5.5	-3.1	-2.5
Total public debt	20.2	20.4	29.2	*25.0*	32.7	33.1	33.3
Monetary Accounts							
Broad money growth	41.0	13.2	13.8	*27.6*	13.8	21.5	22.0
Credit to the economy	103.0	50.8	63.5	*28.3*	24.0	17.2	13.1
Memorandum Items							
Nominal GDP (som trillion)	303	407	512	*642*	603	708	833

**PC = Pre-Crisis*

Sources: World Bank and IMF staff calculations/estimates based on official data provided by the authorities.

25. **Tax revenues in 2019 were significantly higher than projections as a result of a record expansion in the personal and corporate tax base, despite a large reduction in corporate and income tax rates.** Large reductions in payroll, turnover and income tax rates, and reforms to remove perverse incentives[7] that encouraged firms to remain small and underreport employment and turnover, contributed to a surge in income and corporate taxpayer registrations. Increased tax collections from the reforms, and significant efforts to streamline and improve value-added-tax compliance, contributed to a 4-percentage-point increase in tax revenues relative to the June 2019 projections.

26. **The higher revenues helped finance a substantial expansion in social and investment budget spending and eliminate the projected fiscal deficit.** Using Government Financial Statistics (GFS)-based classifications, the government's budget deficit was zero in 2019, relative to the small deficit of 0.6 percent of GDP projected in June

[7] This reform was a prior action in the June 2019 DPL.

2019 (Table 2). Higher-than-expected revenues were used to advance centralized budget investment initiatives and increase wages for teachers and medical workers. Investment spending was directed toward expanding and improving water and sanitation services, constructing and rehabilitating roads, strengthening irrigation systems, and improving urban and village infrastructure. Resources were also used to expand access to social housing. However, relative to June 2019 projections, a substantial increase in UFRD lending contributed to a 2.3 percent increase in the overall fiscal deficit, which better measures the impact of the general government fiscal footprint on the economy.

27. Revisions were made to the macroeconomic framework as a result of end-2019 outcomes. In January 2020, revisions were made to update the macroeconomic and fiscal framework used to prepare the June 2019 DPL (Annex 4). The updated frameworks are presented as pre-crisis projections for 2020 in Tables 1 and 2.

Macroeconomic outlook

28. As a result of the COVID-19 crisis, growth is likely to fall sharply in 2020 (or possibly turn negative in a severe downside case) before recovering back to about 6 percent over the medium term. A fall in external trade, sharply lower remittance income and severe domestic economic disruptions are likely to lower growth to 1.6 percent in 2020, relative to pre-crisis projections of 5.9 percent. Initial estimates from March 2020 are that about 475,000, or 85 percent of small businesses, have been temporarily closed. Tax collection data for March and early-April 2020 show that revenues are about 20 percent lower than budget projections. Early trade data for the first quarter suggest that imports have fallen by around 10 percent and exports by about 18 percent compared with the first quarter of 2019. Remittances this March were estimated to be about 25 percent lower than in March 2019. If conditions improve in the coming months, modest growth may still be achievable through strong gold and food exports, and via some additional productivity to make up for losses earlier in the year. However, under a downside scenario, with deeper and more prolonged domestic economic disruption, the economy is likely to contract in 2020. Assuming conditions improve by the end of the year, the government's anti-crisis policy measures and investment buffers are likely to help support a rapid recovery, with modest overshooting in 2021 and a reversion to the medium-term trend of 6 percent projected before the crisis.

29. Due to the crisis, the current account deficit is expected to increase in 2020 before narrowing over the medium term as exports and migrant remittances recover. Despite a large increase in gold exports, a substantial decline in exports of natural gas, manufacturing and tourism will sharply lower total exports in 2020. Although imports are unlikely to fall by the same proportion, capital goods (machinery parts and intermediate goods) and consumer imports, which were projected to be high this year, are likely to fall in response to supply disruptions, and postponements of investment and public works activity. Remittances are likely to see their sharpest fall since independence as: (i) border closures have stopped seasonal migrants from returning to work; (ii) the Russian economy—where most migrants work—is expected to contract in 2020; and (iii) the sharp depreciation of the ruble against the som by nearly 20 percent since 1 January has reduced the purchasing power of migrants. These factors are likely to increase the current account deficit to 8.5 percent of GDP in 2020 relative to pre-crisis projections of 4.7 percent. The deficit is projected to narrow over the medium term to between 5.0 and 6.5 percent as exports and remittances pick up. With a significant slowdown in portfolio and direct investments projected in 2020, the current account deficit is projected to be financed through a combination of increased development partner assistance in response to the COVID-19 crisis and a drawdown of reserves (Table 3). The resumption of investment flows is projected to finance the deficit in the medium term, based on the strong increases recorded prior to the crisis.

Table 2: Uzbekistan: Fiscal Operations (percent of GDP)

	2017	2018	2019e	*2020pc*	2020p	2021p	2022p
			(e)stimate (pc) pre-crisis (p)rojected				
Total Revenues, of which:	**24.7**	**27.8**	**28.2**	***24.0***	**23.2**	**26.1**	**26.1**
Tax revenues, of which	15.2	17.4	19.1	*18.3*	15.8	19.0	19.1
Income and profit taxes	4.3	4.2	6.2	*6.2*	5.3	6.8	7.1
Value-added taxes	4.9	6.9	6.6	*6.8*	5.9	6.8	6.8
Excise taxes	2.5	2.4	2.0	*1.7*	1.4	2.0	1.9
Mining Taxes	1.1	2.1	2.9	*2.4*	2.1	2.1	2.0
Taxes on international trade	0.7	0.4	0.4	*0.4*	0.2	0.4	0.4
Other revenues (tax and non-tax)	**2.2**	**3.2**	**4.2**	***2.1***	**3.5**	**3.2**	**3.2**
Extra-budgetary Funds	**7.3**	**7.2**	**4.9**	***3.9***	**3.9**	**3.9**	**3.8**
Pension fund[8]	5.9	5.9	4.8	*3.6*	3.6	3.9	3.8
Road fund	1.0	0.9		Fund closed			
Other extra-budgetary expenditure	0.4	0.4	0.1	*0.3*	0.3	0.0	0.0
Total expenditures, of which:	**23.4**	**26.0**	**28.2**	***25.3***	**27.2**	**26.1**	**26.1**
Social safety nets	5.5	5.1	5.2	*5.0*	6.0	5.3	5.2
Social and cultural expenditure	9.2	10.9	10.8	*8.7*	8.8	9.3	9.2
Public investment	1.1	1.3	4.0	*2.1*	1.9	3.1	3.1
Public administration	0.9	1.0	1.2	*1.0*	1.1	1.1	1.1
Economy	1.7	1.9	2.6	*2.1*	3.1	2.7	2.7
Interest expenditure	0.0	0.1	0.2	*0.2*	0.1	0.3	0.3
Other expenditure	5.0	5.7	4.2	*6.2*	6.2	4.3	4.5
Budget Fiscal Balance	**1.3**	**1.8**	**0.0**	***-1.3***	**-4.0**	**-1.3**	**-0.9**
Policy-based lending	**3.1**	**4.0**	**3.9**	***1.5***	**1.5**	**1.8**	**1.6**
Overall fiscal balance	**-1.8**	**-2.2**	**-3.9**	***-2.8***	**-5.5**	**-3.1**	**-2.5**
Statistical discrepancy	**-0.2**	**0.7**	**-0.2**	-	-	-	-
Financing, of which	**1.6**	**2.9**	**3.7**	***2.8***	**5.5**	**3.1**	**2.5**
Domestic	0.2	-1.2	-2.3	*-1.2*	0.1	1.5	1.2
External	1.4	4.1	6.0	*4.0*	5.4	1.6	1.4

Note: Aggregate fiscal data and the Budget Fiscal Balance presented in this table adjusts official budget data for UFRD financing operations, equity injections, externally financed expenditures and policy lending.
Sources: Ministry of Finance, IMF and World Bank staff estimates.

30. **Higher inflation in 2020 is projected to moderate over the medium term with easing supply bottlenecks and lower food prices.** Wheat has a high weight in the consumer price food basket, and Uzbekistan depends on imports from Kazakhstan to meet its wheat and flour requirements. As a result, the recent imposition of binding wheat and

[8] The reduction in pension fund revenues is due to a reduction in pension-ringfenced payroll taxes. Pension expenditure however, will not be affected under a Presidential Decree committing to funding ringfenced pension fund revenue shortfalls from the general budget.

flour export quotas in Kazakhstan is expected to increase food prices in Uzbekistan in the second quarter of 2020. The local wheat harvest in May-June will partially ease market pressures. Although the exchange rate has remained relatively stable since the start of the crisis, any sharp devaluation that may occur also heightens inflationary risks in 2020. This increase, combined with supply and trade disruptions, is expected to drive up average inflation in 2020 to 16 percent, compared with projections of 14.1 percent in June 2019. Inflation is expected to moderate to single digits over the medium term as constraints on monetary policy effectiveness are removed, and as remaining administrative price and tariff controls are liberalized.

31. The economic impact of the crisis and the cost of anti-crisis measures have created an unanticipated budget financing gap in 2020 and have widened the medium-term deficit. Based on preliminary estimates, the government faces a budget financing gap of US$1.6 billion (2.7 percent of GDP) in 2020. Budget revenues are currently estimated to be 0.8 of a percentage point of GDP lower in 2020 than the government's budget projections. Tax revenues are projected to fall by 2.5 percentage points of GDP, but higher gold dividends and a decision to forego new accumulations to the UFRD in 2020 will help contain the revenue loss. About two-thirds of tax revenue losses are estimated to be from the direct economic impacts of the COVID-19 crisis, and the rest from announced tax relief measures. VAT and non-gold mining taxes are expected to be hardest hit. Budget spending is currently projected to increase by 1.9 percent of GDP to finance the unanticipated surge in health expenditure and economic anti-crisis policies. As a result, the budget balance is now projected to be in deficit by 4 percent of GDP. This is 2.7 percentage points of GDP higher than the deficit projected in the approved government budget, and 4.4 percent higher than projected in June 2019. These estimates are based on the COVID-19 containment measures announced so far but could significantly worsen with further and more prolonged disruption. The budget balance is projected to remain in deficit over the medium-term as some anti-crisis measures, such as public works projects that would only commence after social distancing rules are eased, are expected to continue for a few years.

32. Constraints to monetary policy effectiveness are being lifted. Annual UFRD lending projections are assumed to remain at similar levels. As a result, the overall fiscal deficit is expected to narrow from 5.5 percent of GDP in 2020 to 2.5 percent in 2023. UFRD lending will no longer be conducted via the banking system, and lending activities will be approved annually through the government budget process. At the end of 2019, measures were enacted to end almost all preferential lending below the CBU market reference rate, and to fully liberalize interest-rate setting on loans from January 1, 2021. These measures also set out the government's intentions to move from directed lending to explicit interest rate subsidies from the government budget. The effective implementation of these measures is expected to improve the effectiveness of monetary policy over the medium-term.

33. A joint World Bank-IMF Debt Sustainability Analysis (DSA) conducted in May 2019 assessed risks to debt sustainability as low. The DSA noted that the risk of sovereign default remains 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). The May 2019 DSA found that:

- ***Public and publicly guaranteed (PPG) debt.*** The PPG-to-GDP ratio is expected to remain at around 25 percent of GDP for the next 10 years under a baseline scenario. This is relatively low by international standards for a lower middle-income country with a strong level of debt carrying capacity.
- ***Total external debt.*** The overall stock of external obligations (including PPG) is also envisaged to remain sustainable. The DSA showed that total external debt will be well-contained at around 30 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 be just under 12 percent of export revenues, and well-covered by the projected overall reserve buffers.

34. **Scaling up investment project disbursements and external budget financing led to a large increase in external debt in 2019.** Public and publicly guaranteed debt rose by about 9 percentage points to about 29 percent of GDP at end-2019. A sharply higher pace of international financial institution (IFI) and commercial project disbursements, and an increase in external budget financing from IFIs and the issuance of debut Eurobonds, contributed to this increase. The large increase in IFI project disbursement rates is linked to new measures adopted in 2019 to reduce bureaucracy and process steps to enable slow-moving donor-financed projects to advance more quickly. About half of the increase in PPG debt in 2019 is attributable to IFIs, another quarter to disbursements linked to the new gas-to-liquid energy project, and the remainder to Eurobond issuances and other project disbursements. Despite the increase in PPG debt, preliminary assessments of debt sustainability suggest that risks to debt sustainability remain low. A follow-up DSA, scheduled for March 2020, has been postponed until later in the year following the COVID-19 crisis.

35. **A limit on sovereign external debt was established in 2020 to strengthen Uzbekistan's long-term debt sustainability.** As part of a major budget reform package, the authorities established a debt ceiling in 2020 to limit sovereign external debt accumulation. The ceiling will be agreed annually with Parliament and be based on a reconciliation between financing needs and macroeconomic sustainability assessments. In 2020, the ceiling was set at US$4 billion. Subsequently, the government has adopted further measures to determine how projects will be selected as part of the debt ceiling establishment process, in order to prioritize projects with high economic returns or that align strongly with reform priorities. Prior to the crisis, the ceiling and the implementation of the project prioritization process had significantly reduced the government's intentions to borrow externally in 2020. With the onset of the COVID-19 crisis, the government may seek authorization from Parliament to expand the ceiling to meet its budget financing gap. A new ceiling will be developed for the 2021 Budget.

36. **Adjusting for anticipated impacts from the COVID-19 crisis, a preliminary assessment suggests that risks to Uzbekistan's debt sustainability remain low.** Using updated debt information and revised 2020 and medium-term macroeconomic projections, a preliminary debt sustainability analysis indicates that risks remain low to Uzbekistan's debt sustainability. A formal joint IMF and World Bank DSA will be conducted in the coming months, which will incorporate more accurate projections of the COVID-19 outbreak impact on the economy in 2020.

37. **Despite the significant shocks from the COVID-19 crisis, Uzbekistan's macroeconomic policy framework remains supportive of the major economic transition that is currently underway and is adequate for the proposed supplemental operation.** Economic growth is expected to rebound and remain strong over the medium term, although this outcome also depends on the success of global efforts to combat the COVID-19 crisis. Sustainable twin (external and fiscal) balances with identified deficit financing, judicious debt management and greater flexibility in exchange rate management will help maintain sufficient reserve cover, and moderate levels of public and private external debt. Although inflation remains high, in large part reflecting significant increases in administered prices, it is expected to gradually moderate over the medium term as policy-based lending is scaled back and as monetary policy transmission improves. The post-COVID-19 outlook, however, remains vulnerable to downside risks, including: (i) deeper and more prolonged (than anticipated) health and economic crises from the COVID-19 outbreak; (ii) continued government-directed credit at current levels; (iii) external economic shocks (e.g., from slowdowns in trading partners) impacting domestic economic performance and financial sector stability; (iv) large increases in contingent liabilities arising from a number of planned PPP transactions if contractually linked economic conditions do not materialize; (v) adverse weather conditions; and (vi) the occurrence of a major natural disaster.

Table 3: External Financing Requirements and Sources (percent of GDP)

	2018	2019	2020	2021	2022
		Est.	Projected		
Financing Requirements	**5.8**	**7.6**	**5.7**	**5.0**	**3.5**
Current Account Deficit	7.1	5.6	8.5	6.4	5.4
Repayment of commercial debt	0.7	-1.6	1.3	0.2	-1.2
Change in reserves	-2.0	3.6	-4.1	-1.6	-0.7
Financing Sources	**6.9**	**7.6**	**5.7**	**5.0**	**3.5**
FDI and portfolio investments	1.2	6.2	1.8	4.8	2.4
Public / Public Guaranteed Debt	4.7	8.8	4.7	3.2	4.0
Other flows (net)	-1.0	-1.9	-1.1	-1.6	-1.5
Gold sales and revaluations	1.1	1.2	0.3	-1.4	-1.4
Errors and omissions	0.9	-6.7	0	0	0

Sources: World Bank and IMF staff calculations.

38. **The World Bank's support to Uzbekistan is being carried out in close consultation and coordination with the IMF and the ADB, which also have extensive ongoing monitoring and technical assistance programs.** In addition to increased staff monitoring, the IMF is providing technical assistance in the areas of central bank legal reform, monetary operations and policy, external statistics, national accounts, GFS, fiscal transparency, tax policy, tax administration, and public financial management. Meanwhile, the ADB is providing support to strengthen public financial and macroeconomic management and improve the corporate governance of SOEs.

3. RESPONSE TO THE CRISIS

3.1. THE GOVERNMENT'S RESPONSE

39. **A Republican Anti-Crisis Commission, led by the Prime Minister, is managing the government policy response to the crisis.** The Commission has been given four objectives: (i) to safeguard the health and productivity of citizens through an effective medical response; (ii) to preserve income and livelihoods, especially for the poorest and most vulnerable; (iii) to prevent long-term damage to the economy; and (iv) to safeguard the economic transition and reform program. Development partners, especially the World Health Organization (WHO), are providing analytical and advisory support to the Commission. The Commission is also being supported by health policy experts from the Republic of Korea, China and the United States.

40. **The overarching objective of the initial health policy response is to minimize the transmission of the virus within the borders of Uzbekistan.** Through aggressive measures to "flatten the curve" through restrictive social distancing measures, the authorities believe they can allow enough time to rapidly increase testing and identification in order to quarantine infected citizens and prevent the virus from spreading. The government then intends to widely deploy rapid testing kits to gradually open its borders to increased people transit. Over time, and as further research into the virus provides enhanced treatment and management options, these measures may be further relaxed.

41. **The authorities have so far announced two large anti-crisis packages, comprising financial and regulatory measures, to support the health and economic policy responses.** A first anti-crisis package, budgeted at about US$1 billion, was announced on March 20. Health spending is targeted toward a large scale-up in testing (and acquisition of domestic test-kit production capability), purchasing new health equipment, boosting frontline worker salaries and creating temporary health infrastructure facilities. Social measures include an expansion in the level of low-income

allowances and the number of beneficiaries, unilateral extensions of targeted social assistance eligibility periods, measures to expand disability payments for people who are quarantined or infected, regulations to safeguard parents and other caregivers of infected people, provisions to expand unemployment insurance payments, and measures to simplify application and eligibility assessment procedures. Economic measures include a range of tax and expenditure measures to provide both relief and regulatory forbearance for tax and debt payments, and measures to ease cash-flow constraints for businesses. Measures will also provide debt relief and financial support for key SOEs, such as the national airline and the main gas exporter. A second anti-crisis package, announced on April 3, seeks to support the economy with a range of tax exemptions, a reduction in import tariffs for medical supplies and food, an extension of deadlines for loan repayments and additional social safety net payments. A list of key initiatives from both packages is provided in Annex 3.

42. **The anti-crisis measures are largely in line with emerging international best practice.** The government's health sector response has received strong endorsement from the WHO and other partners. Its economic policy measures are largely consistent with emerging guidance from international organizations on how countries can best respond to the dual demand and supply shocks to the economy, while safeguarding vulnerable households and economically important firms from the worst effects of the COVID-19 disruption. Some measures, such as the ambitious program of expanded public works, may be more difficult to implement with continued social distancing requirements, but the authorities have expressed a willingness to reallocate resources to other areas to ensure that the anti-crisis measures are supporting a rapid economic recovery post-crisis.

43. **To address risks of reform reversal, the authorities have committed to transparency in how anti-crisis spending is utilized.** Some measures, particularly the use of fiscal support for SOEs and the significant allocations for subsidized lending and credit to firms and households, are both consistent with emerging international practice but are also measures that the government is trying to curtail as part of the reform program. To balance the need for these measures with the risks, the government has committed to the transparent reporting of its anti-crisis expenditure policies. For example, the government intends to provide transparent fiscal subsidies to SOEs from the anti-crisis package, instead of its historical approach of drawing down resources from the UFRD.

44. **The stronger social contract that has emerged due to the popularity of the reforms has reinforced the government's efforts; a shared citizen-government effort to slow transmission shows early but promising results.** Although testing capacity is still low, initial estimates suggest that Uzbekistan is making substantial progress to sharply "flatten the curve" in an accelerated timeframe. The strong policy response has been reinforced by an effective communications strategy to establish official social media channels that provide hourly updates, and dispel rumors and fake information. Citizen engagement—via formal communication channels and via community institutions—has been critical to the response. Volunteer citizen groups have teamed up with the armed forces and security personnel to provide logistical support and care for vulnerable households. In a break from its past misgivings, the government has openly asked for help from religious and community leaders to help reinforce social distancing policies, and support the detection and identification of cases. Increased transparency and openness from the government—a principal objective of the 2017–1 Development Strategy—has helped strengthen efforts to contain viral transmission.

45. **In addition to the budget financing gap in 2020, the crisis has created an unanticipated near-term cash-flow constraint.** The unexpected surge in expenditures has come at a time where revenue collections are seasonally low. Alternative funding sources are scarce as a result of global financial disruption, and Uzbekistan's buffers are not well designed to cater to fast-moving fiscal shocks. For example, resources in the UFRD serve two policy objectives: (i) to provide long-term investment debt-financing for investment projects; and (ii) to supplement the government's external financing (UFRD cash balances form part of the international reserves). The UFRD's charter constrains the ability of government to use UFRD balances to meet short-term fiscal stabilization needs. Thin domestic financial markets and legal restrictions that prohibit the central bank from financing the budget limit other domestic sources

of finance. Low liquidity in the banking sector limits the amount the government can raise from local bond issuances: the government's entire domestic bond issuance program in 2019 represented just over one-quarter of the amount proposed in this supplemental operation. Most of the lending in the banking sector originates from UFRD project financing, an option that cannot be used to fund the budget shortfall. Easing restrictions on the UFRD and the central bank would require considerable time. The near-total disruption in global debt markets also limits Uzbekistan's ability to seek offshore financing. As a result of these constraints, the government has asked IFIs to provide additional financial support to address its immediate cash constraint and fill the budget financing gap. If external conditions ease, the authorities intend to tap the sovereign bond market toward the end of the year. As a strong reformer with good macroeconomic buffers, this may be an effective and competitive financing strategy should this option become feasible.

3.2. THE BANK'S RESPONSE, STRATEGY AND COLLABORATION WITH DEVELOPMENT PARTNERS

46. To help address the budget financing gap, the government has requested the World Bank to provide US$200 million in supplemental budget financing and bring forward US$500 million in budget support originally scheduled for Board submission in November. The US$200 million will help the government finance the immediate health and social expenditure surge. Proposed development policy financing of US$500 million that was already in the pipeline this year is being brought forward to July in anticipation of the growing financing need.

47. To support the government's immediate policy challenges, a proposed US$95 million[9] World Bank emergency project will provide financial and technical support to strengthen the government's health and social protection measures. The project will (a) increase health sector procurement; (b) provide expert assistance in the pandemic response; and (c) expand access to the social safety net, with a focus on low-income families and those either unemployed or furloughed.

48. The proposed emergency response project will help reinforce the quality and efficiency of additional expenditure that this proposed supplementary financing operation is supporting. Resources from the proposed US$95 million project will help strengthen the government's pandemic response systems. They will also be used to trial and test new measures to quickly expand social protection coverage in response to the anticipated surge in the number of vulnerable households. As an investment project, implementation will be backstopped by strong World Bank staff supervision to ensure effectiveness. Successful measures will then be quickly increased in scale by the government using budget resources, including this proposed operation. This proposed operation will also help government expand existing safety net systems, such as pensions, which are not part of the proposed emergency project but are still critical to the government's social response.

49. The World Bank's response strategy in Uzbekistan is part of a coordinated engagement between the government and development partners. The World Bank is working closely with government and the development partner community to respond to the challenges emerging from the COVID-19 outbreak. The proposed emergency response project is being delivered in close consultation with the WHO, the United Nations Development Program, the United Nations Children's Fund, and the International Labour Organization.

50. This proposed operation is part of a coordinated partner response strategy, involving the World Bank, the ADB and the IMF, to cover the domestic financing gap. All three partners are working closely to assess economic conditions and impact, advise the government on its macroeconomic and budget policy responses, and provide financial support as required. Uzbekistan currently does not have a large balance of payments need but could seek rapid IMF support should external conditions worsen. To cover the domestic financing gap, the government has asked

[9] Of which $30 million is expected to be from the COVID-19 facility.

the World Bank and ADB to provide about US$1.2 billion of the estimated US$1.7 billion financing gap. It has sought US$700 million in support from the World Bank, up to US$1 billion from the ADB, and intends to raise about US$500 million in external sovereign financing should conditions improve (Table 4).

Table 4: Unanticipated Budget Financing Needs Associated with COVID-19

	som million	US$ million	% of GDP
Lower revenues from the crisis (net of gold income increase)	**-4,824**	**-503**	**-0.8**
Additional budget expenditures	**12,957**	**1,350**	**2.2**
***Less* Budget reprioritization**	**1,538**	**160**	**0.3**
Net unfinanced budget expenditures	**11,419**	**1,189**	**1.9**
Increase in Budget Deficit	**16,243**	**1,692**	**2.7**
Proposed Additional Budget Financing, of which:	**16,243**	**1,692**	**2.7**
Anticipated GOU External Financing*	**4,723**	**492**	**0.7**
Proposed Additional Partner support	**11,520**	**1,200**	**2.0**
World Bank supplemental DPO financing (April 2019)	1,920	200	0.3
Asian Development Bank emergency financing (May 2019)[10]	4,800	500	0.8
World Bank full DPO (likely July 2019)	4,800	500	0.8

** The authorities intend to issue external sovereign debt toward the end of 2020*

Source: Authorities, World Bank Estimates

51. **Across both the health and economic policy responses, the World Bank is working closely with other partners to support the government's policy response.** The United Nations, especially the WHO, is coordinating the development partners' response to the crisis. A range of bilateral and multilateral partners is providing financial and non-financial assistance to support the health response and the work of the Republican Commission. The World Bank is an active member of all donor support groups assisting the Republican Commission, and co-chairs the group on socioeconomic impact management. It is also closely engaged with other bilateral partners that have expressed interest in, but are not yet in a position to commit to, providing additional financial support to the government.

52. **The World Bank is well-placed to support the government's request for advisory and financial assistance through new and existing activities, with limited impact on the Bank's longer-term ability to sustain the ambitious reform agenda.** Several Bank projects, covering emergency health care, social protection, agriculture modernization, rural development, and horticulture and livestock development, have space to provide targeted support to reinforce and amplify efforts by the government and other partners to respond to the crisis. The additionality in budget financing relative to the anticipated pipeline is relatively small, ensuring that further resources remain available to support recovery efforts in 2021 and 2022. An ongoing Systematic Country Diagnostic (SCD; for Board submission at end-2QFY21), and a new Country Partnership Framework (CPF; for submission at end-FY21) provide an opportunity for further analytical work to develop options for a fast recovery that sustains the reform momentum. While the SCD

[10] The government has requested US$1 billion in assistance from the ADB (budget and project support), and the request is still under consideration. This estimate of US$500 million has been prepared by World Bank staff based on initial discussions with the ADB. A final decision has not yet been made by the ADB management or its Board of Directors.

may be delayed by a short period to better ascertain the economic fallout of the crisis, both products are expected to be delivered to the Board within existing timeframes.

4. RATIONALE FOR PROPOSED SUPPLEMENTAL FINANCING

53. **In asking for additional financing from the World Bank and other partners, the authorities wish to avoid alternative strategies that could potentially jeopardize the gains Uzbekistan achieved since 2017.** While more advanced economies are relaxing constraints to direct central bank financing of fiscal deficits, authorities in Uzbekistan are reluctant to do so having recently implemented measures (in November 2019) to strengthen the powers and autonomy of the CBU. The authorities are also intent on preserving measures to curtail UFRD on-lending in the economy and strengthen the transparency of UFRD financing. While one-off measures to rely on these institutions for financing may be convenient, the authorities have rightly prioritized longer-term benefits that these reforms could provide in supporting fiscal management and a smooth economic transition.

54. **The large and unanticipated expenditure surge and the significant constraints caused by the global economic and financial disruptions justify the need for accelerated financial support.** Uzbekistan's external position has not yet weakened to a point where a clear balance of payments need has arisen. Should this change, the authorities are in close and regular contact with the IMF to discuss support options. In view of the timeframe for when resources are needed and the currently available externally financing sources, supplemental development policy financing from the World Bank will go a long way in covering the fiscal needs of the government, and providing it the fiscal space to carry out exceptional emergency responses to the health and economic crises that have emerged because of COVID-19. The fiscal space will also be useful to safeguard the longer-term structural reforms that are necessary for Uzbekistan's successful transition to becoming a market economy and that are being supported by the June 2019 DPL to which this supplement is attached.

55. **The strong and early measures enacted by the authorities to contain the health crisis are contributing to the economic costs.** Uzbekistan's strong health policy measures are contributing significantly to the higher economic costs. These measures will help contain viral transmission. They are being complemented by measures to support firms and workers to help them tide over the restrictions associated with the containment of viral transmission. The World Bank's support to the government's anti-crisis response, with emphasis on immediate relief measures, will ensure that the government can contain and mitigate the impact of the crisis. It will also position the economy for a strong recovery once the pandemic is over. **The government's reform program is being implemented in compliance with the provisions of the legal agreement with the World Bank.** The government has remained on-track in implementing reforms, as evidenced by the initial results assessment. It has also made good progress with all reform intentions set out in the Letter of Development Policy under the June 2019 DPL. Finally, Uzbekistan remains committed to advancing the reform program, as evidenced by the strong progress made by the agencies implementing the June 2019 DPL.

56. **The authorities have requested resources to be disbursed by end-April.** This limits the available time to process a free-standing DPL to meet the budget gap. However, a proposed free-standing Development Policy Operation (DPO) of US$500 million will be submitted to the Board for consideration, likely in July. This operation will help reinforce the reform program and ensure that the significant achievements that the government had made prior

to the crisis, and the ongoing achievements in a few areas where the reform program continues despite the crisis, form part of the Bank's ongoing engagement in Uzbekistan.

5. OTHER DESIGN AND APPRAISAL ISSUES

Poverty and Social Impact

57. **Actions taken since the approval of the June 2019 DPL continue to sustain poverty reduction and provide support to the vulnerable.** In addition to expanding social safety net coverage both prior to, and since, the COVID-19 crisis, piloting of a new social registry, supported under the parent operation (result indicator 10), is in its advanced stages and is expected to further improve targeting and reduce errors of both exclusion and inclusion in the country's transfer programs to low-income households. Officials have also worked closely with the World Bank team to conduct poverty and social impact evaluations of utility tariff increases. Tariff adjustments have consistently been accompanied by increased social assistance support and other transfers. These changes have narrowed regressive energy subsidies while moving the sector to near-cost recovery levels. Reforms to employment regulations pursued under the parent operation (result indicator 8) allowed those seeking work to apply to openings outside of their region of propiska registration, significantly reducing barriers to employment in Tashkent and other high-demand areas. Going beyond the actions specified in the operation, the authorities further simplified temporary registration renewal in Tashkent, increasing permit periods from 6 to 12 months, and reduced renewal processing time to as little as 10 minutes for those with the appropriate documentation (though significant administrative burden remains in many cases).

58. **This proposed operation will have a positive poverty and social impact through its support for anti-crisis measures that limit the anticipated increase in poverty.** The government has outlined an ambitious set of social protection measures to contain the expected increase in poverty levels this year. This operation provides financial support toward those measures and will reinforce work to adapt and strengthen the safety net system under the World Bank's US$100 million emergency COVID-19 response facility project.

Environment

59. **Since the approval of the June 2019 DPL, further measures have been enacted to strengthen environmental management.** In 2019, authorities initiated a wide-scale program to afforest about 700,000 hectares (ha) of dry Aral Seabed with drought-resistant plants, representing about a 40 percent increase from the previous year. A new National Biodiversity Strategy and Action Plan was adopted in June 2019 to expand protected areas to 12 percent of Uzbekistan's territory by 2028, increase forestation of the Aral Seabed to 1.2 million ha by 2028 and integrate biodiversity conservation issues into all sectors of the economy. The authorities have also outlined a conceptual framework and medium-term roadmap of actions to strengthen environmental protection. Two further policy initiatives are currently being developed: a comprehensive state program on forestry and a national plan to combat desertification and droughts.

Public Financial Management and Disbursement

60. **A new loan agreement will be required to incorporate the supplemental development financing.** As no new prior actions are needed, the loan agreement will relate to the volume and cost of new lending.

61. **DPO funding would be made available to the Government of Uzbekistan upon the effectiveness of the Loan Agreement and the submission of withdrawal application for the loan.** The proceeds of the loan 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 (MoF). The Borrower will open, prior to furnishing to the Bank the first request for withdrawal from the Loan Account, and thereafter maintain, a dedicated account in US dollars ("Foreign Currency Dedicated Account") at the CBU; and all withdrawals from the Loan Account will be deposited by the Bank into the Foreign Currency Dedicated Account. Within 30 days following the deposit of the amount of the Loan into the Foreign Currency Dedicated Account, the Borrower will transfer the Loan amount into the Treasury Single Account (US dollars and/or Uzbekistan som). The Borrower, within 30 days after the withdrawal of the Loan from the Loan Account, will report to the Bank: (i) the exact sum received into the Foreign Currency Dedicated Account; (ii) the details of the account to which the equivalent of the Loan proceeds will be credited; (iii) the record that an equivalent amount has been accounted for in the Borrower's budget management systems; and (iv) the statement of receipts and disbursement of the Foreign Currency Dedicated Account.

62. The MoF will be responsible for the operation's administration and for preparing the withdrawal application, maintaining the Foreign Currency Dedicated 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 DPL in accordance with sound accounting practices, and the proceeds of the DPL will be promptly accounted for in the country's budget management system using the country's regular procedures for such accounting.

63. If after depositing funds in the Foreign Currency Dedicated Account the proceeds of the loan 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 loan.

64. The foreign exchange control environment at the Central Bank of Uzbekistan 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 2018 audit11 of the 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 the CBU. The audit was conducted in accordance with International Standards on Auditing (ISA). The audited financial statements of the CBU are not made publicly available and the Audit Report is of restricted use.

65. An IMF safeguards assessment for the CBU has not yet been conducted, this the World Bank will therefore apply additional mitigation measures to mitigate fiduciary risks. This will involve opening a Foreign Currency Dedicated Account for the operation. The Bank will also require that the Foreign Currency Dedicated Account is audited by an auditor acceptable to the World Bank, on terms of reference acceptable to the World Bank. The Audit Report will be submitted to the World Bank within six months after fiscal year ending on December 31.

66. There are no changes to the monitoring and evaluative framework set out in the June 2019 DPL. The MoF and a range of line agencies remain actively engaged in measuring and monitoring progress with the results set out in the June 2019 and June 2018 DPLs. Data availability and transparency has improved since the June 2019 DPL as a result of reforms to strengthen fiscal transparency and statistics institutions.

67. 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's Development Policy Operation may submit complaints to the responsible country authorities, appropriate local/national grievance redress mechanisms, or the World Bank'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

[11] Reviewed on April 6, 2020.

complaint to the World Bank's independent Inspection Panel, which determines whether harm occurred, or could occur, as a result of World Bank 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. For information on how to submit complaints to the World Bank Inspection Panel, please visit www.inspectionpanel.org.

6. SUMMARY OF RISKS AND MITIGATION

68. **Relative to the June 2019 DPL, macroeconomic risks are assessed as high.** Globally, the COVID-19 outbreak has severely affected economic and financial sector conditions. The health and economic effects of the outbreak have already affected Uzbekistan. Initial data show a sharp decline in Uzbekistan's export volumes, and recent measures to curtail the spread of the virus have severely disrupted domestic commerce and production. Growth is projected to be sharply lower in 2020 at 1.6 percent against a forecast of 5.7 percent in January. Under an increasingly likely downside scenario where global and domestic economic disruption is deeper and more prolonged, the economy may contract in 2020. The current account is projected to widen sharply in 2020 on the back of lower exports and remittances. Despite the significant commitment and determination of the authorities, the COVID-19 crisis poses a significant risk to Uzbekistan's ambitious economic and social transition, especially if poor outcomes caused by the crisis are mistakenly attributed by the population to the effects of the reform agenda. Increased risks of rising unemployment, a sharp fall in remittances and inflationary risks from a sustained COVID-19 outbreak pose a significant threat to poverty reduction. As the crisis passes, the macroeconomic risks environment is likely to moderate quickly as prospects from the economic transition remain strong. Meanwhile, Uzbekistan's strong macroeconomic buffers, safety nets and community institutions, as well as the announced anti-crisis package, will partially mitigate macroeconomic risks and the impact of the crisis on the poor.

69. **All other risks remain unchanged from the June 2019 DPL program document.** Since the approval of the June 2019 DPL, and prior to the COVID-19 crisis, none of the major risks identified in the original program document has materialized. Some institutional risks, such as the ability of the government to deliver public services (e.g., regular payments to vulnerable households and pensioners), are elevated as a result of social distancing policies, but the authorities have a clear strategy in place to adapt existing approaches in order to maintain the reliability and quality of public services during the crisis.

Table 5: Summary Risk Ratings

Risk Categories	Rating
1. Political and Governance	Substantial
2. Macroeconomic	High
3. Sector Strategies and Policies	Substantial
4. Technical Design of Project or Program	Low
5. Institutional Capacity for Implementation and Sustainability	Substantial
6. Fiduciary	Moderate
7. Environment and Social	Substantial
8. Stakeholders	Low
9. Other	
Overall	Substantial

ANNEX 1: PARENT PROJECT POLICY AND RESULTS MATRIX

Prior actions and Triggers		Results	
Prior Actions under DPO	**Indicator Name**	**Baseline**	**Target**
Pillar 1: Increasing the role of markets and the private sector in the economy			
Prior Action 1: To increase agricultural exports and incomes for farmers, the Borrower has (i) removed mandatory pre-payment and minimum export price requirements for horticultural exports, (ii) removed controls on the sale price of shaped bread, and (iii) increased the state farmgate procurement price offered to farmers for the 2019 wheat harvest.	**Results Indicator #1**: An increase in the value of horticultural exports.	US$875 million (2018)	US$960 million (2019)
Prior Action 2: To reduce market entry barriers and increase competition in domestic trading activity, the Borrower has removed (i) licensing requirements to start and operate wholesale domestic trading and itinerant trading businesses, and (ii) mandatory advance payment requirements for commercial trading transactions between entities whose government ownership is less than 50 percent.	**Results Indicator #2**: Increase in the number of legal entities registered as wholesale trading businesses.	12,387 (2017)	13,000 (June 2020)
Prior Action 3: To improve financial sector efficiency and stability, the Borrower has submitted a new banking law for Parliamentary approval that gives sufficient powers to the Central Bank of Uzbekistan to conduct effective oversight and enforcement, establishes a comprehensive and transparent licensing framework, and strengthens corporate governance and transparency requirements for commercial banks.	**Results Indicator #3**: Banking sector legislation is in greater compliance with Basel Core Principles	Banking sector legislation is non-compliant with the following key Basel Core Principles for Effective Banking Supervision: BCP1, BCP2, BCP5, BCP8, BCP11, BCP19, BCP20 (December 2018)	Banking sector legislation is in increased compliance with Basel Core Principles for Effective Banking Supervision BCP1, BCP2, BCP5, BCP8, BCP11, BCP19, BCP20 (June 2020)
Prior Action 4: To increase private sector investment in the energy sector, the Borrower has taken measures to establish a legal framework for the development of renewable energy and to adopt procurement procedures for the selection of potential renewable energy providers.	**Results Indicator #4**: Competitive tendering of renewable energy projects under the new law.	0 (June 2018)	The government brings at least 1 RE project to the point of commercial tender announcement. (end-September 2020)

Prior actions and Triggers	Results		
Prior Action 5: To achieve financial sustainability of energy and water utility companies, the Borrower has adopted a revised tariff methodology, consistent with principles of full cost-recovery, for the provision of electricity and cold-water services.	**Results Indicator #5**: Number of end-user electricity and cold-water tariff changes made in accordance with new tariff methodology.	0 – Methodology did not exist (December 2018)	At least 1 electricity and 1 cold-water end-user tariff amendments are made in accordance with the new methodology. (June 2020)
Prior Action 6: To increase private sector participation in the aviation sector, the Borrower has (i) separated the Borrower's airline management, airport management, and air traffic control functions, and (ii) separated its policymaking, technical regulatory, and operational functions in the aviation sector.	**Results Indicator #6**: A change in the ownership structure of (i) the national airline, (ii) all airports, (iii) air traffic control services.	All airports under the sole ownership of NAK (June 2018)	Airport ownership separated from NAK into a new entity, and a process is under way to concession at least one airport in Uzbekistan under PPP arrangements following a competitive tender process. (September 2020)
Prior Action 7: To improve the financial transparency and accountability of State-Owned Enterprises, the Borrower has created a new Agency for the Management of State Assets, reporting to the Prime Minister, to be responsible for the management of state-owned enterprises and the implementation of an open and transparent process for the privatization of state assets.	**Results Indicator #7**: Number of independent financial valuations of State-Owned Enterprises conducted by the Agency for the Management of State Assets in accordance with International Financial Reporting Standards.	0 (December 2018)	Valuations for Uzbekenergo, Uzbekneftegaz, and at least 5 other SOEs have been completed (June 2020)
Pillar 2 – Enhancing Social Inclusion			
Prior Action 8: To encourage firm growth and formal job creation, especially of women, the Borrower has adopted a turnover-based definition of small businesses for tax and value-added tax registration purposes. **Prior Action 9**: To create better conditions for formal job creation in urban areas, especially of women, and enhance labor mobility, the Borrower has removed restrictions limiting employers from	**Results Indicator #8**: An increase in formal employment as evidenced by the number of private sector employees registered for payroll tax withholding, disaggregated by gender.	Male: 1,712,893 Female: 1,049,837 (end-December 2018)	Male: 1,952,698 Female: 1,207,315 (end-June 2020)

Prior actions and Triggers		Results	
hiring workers who do not have a local residence permit ("*propiska*").			
Prior Action 10: To improve educational standards and increase the quality of the labor force, the Borrower has (i) signed a participation agreement with the OECD to participate in the 2021 PISA, and (ii) created a National Center for International Research on Quality Assurance in Education which, along with the Ministry of Public Education, will be responsible for conducting national standardized and systematic student assessments of educational achievement.	**Results Indicator #9**: An increase in the roll out of standardized systematic national educational assessments.	No standardized and systematic national assessments in Uzbekistan (2018)	A new standardized and systematic national assessment is piloted in at least 2 regions (June 2020)
Prior Action 11: To improve the efficiency and effectiveness of social safety nets for low income families, the Borrower has approved the creation and development of a Unified Social Registry of Social Protection.	**Results Indicator #10**: An increase in the utilization of the unified social registry system, as evidenced by the number of administrative units that have adopted the unified social registry to process applicants' registration, beneficiary selection, program enrolment, and payment orders.	0 - No Unified System in place (December 2018)	10 (September 2020)
Prior Action 12: To increase fiscal transparency and improve citizen engagement in the budgetary process, the Borrower has required the Ministry of Finance to (i) annually publish citizens budget and budget execution reports, and (ii) ensure that at least 10 percent of each municipal district budget is allocated via input from a community-level participatory process, commencing from the 2019 Budget.	**Results Indicator #11**: Publication and availability of citizen budget documents.	A pilot Citizen Budget document for the 2018 Budget has been published and is available on the Ministry of Finance website (November 2018)	Citizen Budget documents for the 2019 and 2020 Budgets have been published and available on the Ministry of Finance website (June 2020)

ANNEX 2: FUND RELATIONS INDEX

Republic of Uzbekistan—Assessment Letter
for the Asian Development Bank and World Bank April 14, 2020

Background

1. **Uzbekistan continues to make good progress on reforms and entrenching macroeconomic stability**. Significant improvements have been made to the budget, the monetary policy framework, and operations of state enterprises. In 2019, growth was robust at 5.6 percent, while inflation continued to decline, averaging 14.5 percent. However, the global Covid-19 crisis has changed the near-term outlook and the authorities have announced measures to boost healthcare, protect the vulnerable, and support firms and workers. Growth is expected to slow markedly in 2020 and fiscal and external deficits are expected to widen. But with low public and external debt and adequate external and domestic buffers, Uzbekistan's macroeconomic outlook remains robust. The authorities have reiterated their commitment to sustainable macroeconomic policies and continued economic reforms: maintaining moderate fiscal deficits and public debt once the outbreak abates, improving budget processes, lowering inflation, reforming the financial system, and restructuring state enterprises.

Recent Developments and Outlook

2. **Uzbekistan's authorities have acted quickly to contain the impact of the Covid-19 virus**. The first case of Covid-19 was reported in Uzbekistan on March 15, 2020. The government promptly closed schools, cancelled religious and social gatherings, and suspended most border crossings. On March 19, the President announced anti-crisis measures including additional health care spending, support to firms and workers, and additional social support. The government also created a USD1 billion (1.5 percent of GDP) Anti-Crisis Fund to cover these costs and is seeking equivalent financing from multilateral donors.

3. **The Covid-19 crisis is having a strong negative impact on the economy, with the 2020 outlook worsening significantly**. The main economic channels are a fall in trading partner demand and natural gas prices, lower remittances and labor income—particularly from migrants in Russia, and lower activity as measures to contain the Covid virus reduce output, particularly in tourism and transportation. Higher gold prices and fiscal stimulus will help partially offset these effects. Overall, in 2020 real growth is projected to fall from 6 percent pre-crisis to 1.8 percent currently. In 2021, growth is expected to bounce back to 7 percent as economic activity rebounds.

4. **The fiscal deficit is expected to increase on the back of the economic slowdown and measures to contain the crisis.** In 2019, Uzbekistan implemented major tax reforms in 2019, which lowered rates on private firms, SMEs, and labor income and broadened the tax base. Adjusted revenues[12] performed better than expected, reaching 28.2 percent of GDP. Expenditures, particularly central government investment, increased in line with revenues generating a broadly balanced fiscal position. However, policy lending by the Fund for Reconstruction and Development (FRD) was significantly higher than planned and the overall fiscal deficit, including policy lending, amounted to 4 percent of GDP. Higher borrowing by the government and state enterprises from official creditors caused public and publicly guaranteed debt to rise to 29 percent of GDP at end-2019. For 2020, staff currently projects a fiscal deficit of 3.3 percent of GDP (before policy lending) and an overall deficit of 5.0 percent of GDP, including policy lending. Additional external borrowing

[12] The government of Uzbekistan has carried out significant reforms to its fiscal reporting and is expected to bring them in line with Government Financial Statistics standards in 2020. In the meantime, IMF staff adjusts revenues and expenditures for international comparison.

to finance an increase in the fiscal deficit due to the Covid crisis will raise PPG debt from 29 percent of GDP at end-2019 to about 33 percent of GDP. But the fiscal deficit and debt ratios are still be moderate by international standards and the most recent debt sustainability analysis indicates that Uzbekistan remains at low risk of debt distress.

5. **After improving in 2019, Uzbekistan's external position is projected to worsen in 2020.** At the time of the 2019 Article IV consultation, Uzbekistan's external position was assessed as moderately weaker than implied by economic fundamentals and desirable policies. Nonetheless, benefitting from strong external demand, the current account deficit narrowed to 5.5 percent of GDP, as growth of exports outpaced imports, external debt was 43.5 percent of GDP and FX reserves stood at a strong $29 billion. In 2020, the Covid-19 crisis is expected to weaken trading partner demand and remittances and staff projects the current account deficit will increase to 9.5 percent of GDP. On the financial account, foreign direct investment and issuance of external bonds by the government and state enterprises are projected to decline. Without additional financing, reserves would decline by USD3 billion bringing reserve cover down to about 11 months of imports of goods and services.

6. **With the Covid-19 crisis, the outlook is subject to a higher degree of uncertainty and downside risk.** External risks could arise from further deterioration in trading partner demand, a fall in commodity prices—particularly gold or natural gas, or a sharper than projected fall in remittances or labor income. Domestically, measures to contain and mitigate the virus could result in a larger or more prolonged fall in GDP. Lower trade and GDP or higher expenditures for health, social protection, or support to individuals and firms could cause the fiscal deficit to increase further. The crisis also increases the potential for longer term problems, such as disrupted supply chains and lower tourism and remittances.

Economic Policies

7. **The government has made good progress on fiscal reforms, and its response to the Covid crisis is broadly appropriate**. Recent reforms include bringing major fiscal operations on budget, implementing significant tax reforms, and parliament's approval of the budget for the first time. In 2020, an increase in expenditures on health, social production, and support to firms and workers is appropriate to deal with the Covid crisis. The government has fiscal space to accommodate an increase in the fiscal deficit. Going forward, the government should continue to improve tax administration and public financial management. Adhering to its annual cap of USD 4 billion in new PPG debt would stabilize the debt to GDP ratio around 35 percent.

8. **Prior to the crisis, the CBU appropriately tightened monetary policy but could loosen if warranted to support the economy**. The CBU has kept the refinancing rate at 16 percent since 2018, but interest rates effectively increased in January 2020 when the rate on new policy loans was raised to the refinancing rate. Monetary tightening was appropriate in early 2020 to reduce excessive policy lending and reduce inflation, which has been driven by nominal exchange rate depreciation, gradual liberalization of administered prices, and lagged public wage adjustments. To deal with the Covid-19 crisis, the CBU can loosen monetary policy if warranted by developments but the government should avoid a return to subsidized policy lending. As the Covid-crisis abates, the CBU aims to reduce consumer inflation to 10 by 2021 and 5 percent by 2023. The CBU continues its neutral intervention policy, whereby purchases of domestically produced gold are offset by sales of foreign exchange. Nonetheless, the exchange rate depreciated 14 percent in 2019. Since the beginning of 2020, the exchange rate against the dollar has remained broadly stable due to strong FX sales by households, while CBU intervention to prevent excessive volatility appears to have played a minor role. However, greater exchange rate flexibility may be required as the external environment deteriorates.

9. **Financial sector reform is progressing and the CBU is encouraging banks to support firms affected by the Covid crisis**. In 2019, the authorities approved a new banking law and took steps to reform state banks, including: (i) limiting FRD funding, ii) improving balance sheets, iii) centralizing management oversight at the Ministry of Finance, and iv) set corporate governance objectives. To deal with the Covid crisis, the CBU has encouraged banks to consider grace periods on principal repayments by firms in affected sectors on a case-by-case basis. Moreover, the government has announced subsidies for interest payments to support households and SMEs. The worsening economic situation could lower banks' income and raise nonperforming loans, but strong financial indicators and recapitalization at end-2019 should help banks deal with these risks. Once the crisis abates, a challenge is to further orient state banks towards commercial lending and to attract strategic investors to support the modernization of the banking system.

10. **The authorities have made good progress on structural reforms and emphasized their continued commitment despite the crisis.** Major structural reforms have included trade and current account liberalization, freeing up price controls and raising energy prices, implementing tax reforms favorable to private sector businesses and workers, and improving the operations of state enterprises. The business environment is improving, and several international corporations have announced investment in Uzbekistan. The authorities have emphasized their ongoing commitment to reforms, including on public governance and corruption, despite the current crisis. Additional reforms should prioritize additional trade and price liberalization, restructuring state enterprises, and steps to promote competition and the private sector.

IMF Relations

11. **Surveillance.** The IMF Executive Board concluded the 2019 Article IV Consultation on May 9, 2019 (see IMF Country Report No. 19/129)**.** Uzbekistan is on a standard 12-month cycle. The next Article IV mission is expected to occur in fall 2020.

12. **Capacity Development**. In recent years, the IMF has significantly increased its technical assistance to Uzbekistan. Areas of focus include tax policy, tax administration, public financial management, medium-term debt management, monetary and FX operations, bank stress testing, and economic statistics (i.e., on the external sector, government finance, monetary and financial surveys, and national accounts).

ANNEX 3: SUMMARY OF GOVERNMENT ANTI-CRISIS MEASURES

First Package of Anti-Crisis Measures (March 19, 2020)

An anti-crisis fund of UZS 10 trillion (about US$1.1 billion) was established to increase spending in the following areas: (i) health response and quarantine costs; (ii) compensation to firms for directed production of essential goods; (iii) expansion of social safety nets; and (iv) financial support to firms most affected by the crisis and selected strategic firms. Key measures include:

Social protection spending and regulatory measures:

- Measures to simplify the safety net application process.
- A 10 percent increase in the under-14 and under-2 family allowances.
- Expansion of disability benefit eligibility to include parents who must be quarantined due to COVID-19 and caregivers of children under 14.
- A ban on firing any parent of a child affected by COVID-19 who is providing care to the child.

Budget spending measures:

- New hospital constructions, including accelerated construction of temporary hospitals.
- A 6 percent increase in salaries for healthcare workers involved in the COVID-19 response, and ex-gratia payments for frontline workers who are infected, hospitalized, or die from contracting the virus.
- Maintenance of salaries for all government workers in jobs that are suspended.
- Concessional short bridge loans to help businesses maintain employment and domestic supply.
- Compensation of lost income to export transport businesses, and resources to support additional cargo transport to help exporters.
- Green lane customs processes to expedite goods traffic.
- Public infrastructure projects to mop up potential income and employment shocks (to be implemented after social distancing policies are relaxed).

Financial sector measures:

- Domestic and foreign currency liquidity measures.
- Restructuring of loan repayments by Uzbek Airways.
- Deferrals of private sector loan repayments for businesses in severely affected sectors of the economy.

Temporary tax and non-tax revenue deferrals and rebates (between April and October):

- Reduction in social contributory taxes by 50 percent (from about 12 to 6 percent of wages).
- Suspension of tourist taxes.
- A reduction in water fees for irrigation.
- Deferral of income, property, and land taxes.
- A reduction in income tax rates by 30 percent for all individual entrepreneurs registered in the tourism sector.
- Waivers of all late payment penalties on tax payments in 2020.
- Waivers to allow exporters with dues to the state to continue exporting.
- Waivers to allow large capital and raw material importers to defer dues to the state (e.g., import VAT).

Second Package of Anti-Crisis Measures (April 3, 2020)

A second package of measures was announced to strengthen the government's economic policy measures through further revenue and budget measures. Key measures include:

Further deferrals and reductions of taxes, social insurance contributions, and other payments:

- Tourism sector firms will have until the end of the year to pay their tax obligations and will have their social payments reduced from 12 to 1 percent in 2020. This covers about 1,000 firms.
- The presumptive tax on individual entrepreneurs who are forced to suspend their activities for the period of quarantine is suspended. About 150,000 individual entrepreneurs will benefit.
- Small businesses whose revenue decreased by 50 percent, compared with the previous month, are granted the right to defer payment of taxes on sales, land tax, property tax, social and water taxes until October 1, 2020.
- From April 1, 2020, a requirement for legal entities to prepay their gas and electricity bills is reduced from the current 100 to 30 percent.

Further budgetary measures to support businesses and entrepreneurs:

- Interest rate subsidies to entrepreneurs via the Entrepreneurship Development Support Fund will be expanded. Entrepreneurs can also seek a financial guarantee from the Fund up to a fixed amount.
- Individual entrepreneurs and enterprises who can demonstrate difficulty in meeting debt obligations will receive forbearance for a fixed period (to be determined).

Further social measures:

- Customs duties and excise taxes will not be levied on the import of such basic consumer goods as flour, vegetable oil, meat and dairy products, sugar, and hygiene products.
- Expiring social assistance payments will be automatically extended from six to 12 months.
- During the quarantine period, elderly people living alone, and people with disabilities, will be supplied with basic food and hygiene products free of charge.

ANNEX 4: JUNE 2019 DPL MACROECONOMIC AND FISCAL PROJECTIONS

Table 1: Uzbekistan: Key Macroeconomic Indicators – June 2019 DPL

	2016	2017	2018	2019	2020	2021
					(Projected)	
National Income and Prices			(Percent, unless otherwise noted)			
Real GDP growth (annual percent change)	6.1	4.5	5.1	5.5	6.0	6.0
Consumer price inflation (end of period)	9.8	18.8	14.3	15.6	12.4	9.1
Real effective exchange rate (levels, 2015=100)	84.3	65.9	60.2	64.6	67.8	72.4
External Accounts			(Current US$ million, unless otherwise noted)			
Export of goods, of which	8,581	9,512	10,939	11,925	12,350	12,951
Gold	2,808	3,260	2,910	3,755	3,861	3,972
Merchandise imports, of which	11,154	12,501	17,679	19,658	20,446	21,199
Machinery and Equipment	5,018	4,552	7,491	8,797	8,348	7,930
Gross worker remittances	1,200	1,200	1,000	1,200	1,300	1,400
Services Balance	-1,610	-2,053	-2,442	-2,150	-2,011	-1,911
Current account balance (percent of GDP)	0.2	1.2	-6.9	-6.5	-5.6	-4.7
Foreign direct investment, net	1,572	1,263	679	1018	1299	1626
Gross international reserves (US$ billion)	26.5	28.1	27.1	27.5	27.0	27.6
Gross international reserves (months of import cover)	19.2	14.8	13.0	12.6	12.2	11.3
Gross external debt (percent of GDP)	18.6	34.0	34.4	34.0	33.5	32.1
Consolidated Fiscal Accounts			(Percent of GDP, unless otherwise noted)			
Revenues	25.4	24.7	27.9	25.4	25.4	25.6
Expenditures	23.8	22.9	25.6	24.8	25.0	25.4
Policy-lending	2.1	3.6	4.3	2.2	2.2	2.1
Overall fiscal balance	-0.5	-1.9	-2.1	-1.6	-1.8	-1.8
Total public debt	8.6	20.2	20.6	23.2	24.7	24.6
Monetary Accounts			(Annual percent change)			
Broad money growth	23.5	40.3	14.4	21.0	20.3	18.5
Credit to the economy	28.4	103.0	50.8	25.0	20.2	18.9
Memorandum Items						
Nominal GDP (som trillion)	242	303	408	523	642	760

Sources: World Bank and IMF staff calculations/estimates based on official data provided by the authorities.

Table 2: Uzbekistan: Fiscal Operations (percent of GDP) – June 2019 DPL

	2016	2017	2018e	2019p	2020p	2021p
			(e)stimate (p)rojected			
Total Revenues, of which:	**25.4**	**24.7**	**27.9**	**25.4**	**25.4**	**25.6**
Tax revenues, of which	15.5	15.2	17.4	17.8	18.0	18.2
Income and profit taxes	4.6	4.3	4.2	5.8	6.2	6.7
Value added taxes	4.9	4.9	6.8	6.5	6.6	6.7
Excise taxes	2.6	2.5	2.4	1.8	1.8	1.8
Mining Taxes	1.0	1.1	2.1	2.5	2.2	2.0
Taxes on international trade	0.6	0.7	0.4	0.4	0.4	0.3
Other revenues (tax and non-tax)	**2.3**	**2.2**	**3.3**	**3.3**	**3.2**	**3.1**
Extra-budgetary Funds	**7.5**	**7.3**	**7.2**	**4.3**	**4.3**	**4.3**
Pension fund[13]	6.1	5.9	5.9	4.3	4.2	4.2
Road fund	1.0	1.0	0.9	Fund closed		
Other extra-budgetary expenditure	0.4	0.4	0.4	0.0	0.0	0.0
Total expenditures, of which:	**23.8**	**22.9**	**25.6**	**24.8**	**25.0**	**25.4**
Social safety nets	6.0	5.5	5.0	5.2	5.3	5.4
Social and cultural expenditure	9.6	9.2	10.0	9.6	9.9	10.0
Public investment	0.9	1.1	1.3	0.8	0.8	0.8
Wages and wage-related expenditure	8.0	7.2	6.9	7.8	8.0	8.2
Interest expenditure	0.0	0.0	0.1	0.1	0.2	0.2
Consolidated Balance	**1.6**	**1.8**	**2.2**	**0.6**	**0.4**	**0.3**
Policy-based lending, of which	**2.1**	**3.6**	**4.3**	**2.2**	**2.2**	**2.1**
Fund for Reconstruction & Development	0.8	1.9	2.2	0.8	1.1	1.0
Equity investments	0.0	1.2	0.6	0.4	0.1	0.1
Other policy lending	0.5	0.0	0.9	0.6	0.5	0.5
Externally financed policy lending	0.8	0.5	0.7	0.4	0.5	0.5
Overall fiscal balance	**-0.5**	**-1.9**	**-2.1**	**-1.6**	**-1.8**	**-1.8**
Statistical discrepancy	**-0.4**	**-0.3**	**0.8**	**-**	**-**	**-**
Financing, of which	**0.0**	**1.6**	**2.9**	**1.6**	**1.8**	**1.8**
Domestic	-0.7	0.2	-1.2	-3.0	-2.2	-0.3
External	0.7	1.4	4.1	4.7	4.0	2.0

Sources: Ministry of Finance, IMF and World Bank staff estimates.

[13] The reduction in pension fund revenues is due to a reduction in pension-ringfenced payroll taxes. Pension fund expenditure however, will not be affected under a Presidential Decree committing to funding ringfenced pension fund revenue shortfalls from the general budget.