



Program Information Document (PID)

Concept Stage | Date Prepared/Updated: 19-Oct-2020 | Report No: PIDC29340



BASIC INFORMATION

A. Basic Project Data

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

Proposed Development Objective(s)

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

Financing (in US\$, Millions)

SUMMARY

Total Financing	500.00
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DETAILS

Total World Bank Group Financing	500.00
World Bank Lending	500.00

Decision

The review did authorize the preparation to continue

B. Introduction and Context

Country Context

Prior to the COVID-19 crisis, the economy was expanding robustly, deriving from the substantial and wide-ranging structural reforms enacted since 2017. Unification of the multiple exchange rates and trade liberalization created much needed stability in the foreign exchange market and enabled firms to boost investment with imported machinery and equipment. Ambitious reforms of the tax system and the business regulatory environment reduced costs and the burden of compliance for the private sector, leading to more business dynamism and buoyant manufacturing and construction



activity. Trade liberalization – including restarting of the negotiations for WTO accession – the removal of horticultural export barriers, large increases in farmgate procurement prices of cotton and wheat, and improved reliability of energy supplies and other intermediate inputs led to a surge in trade and transport links with neighbors and was a boon for horticultural exports. A revamp of the visa process contributed to record tourist arrivals. Private consumption picked up through the release of pent-up demand after years of restrictions, supported by substantial increases in wages, a boost to rural incomes from agricultural reforms, and credit expansion. As a result, real gross domestic product (GDP) growth rose substantially in 2019 and was broad-based, sustaining the reduction in poverty.

The COVID-19 pandemic has extinguished economic growth in 2020, and poverty is expected to increase sharply. Using the poverty line appropriate for lower middle-income countries (US\$3.2 per person per day in PPP terms), the poverty rate is likely to increase to between 8.7 and 9.8 percent in 2020, compared to pre-crisis projections of 7.4 percent, after falling consistently over the last two decades. As a result, up to 900,000 more people are likely to fall into poverty, with many more at risk of facing considerable hardship. These outcomes could worsen further should there be additional disruptions to economic activity. The incomes of the poor and vulnerable have also suffered from a sharp fall in remittances, reflecting both the economic contractions in Russia and Kazakhstan (the main destinations for Uzbekistani migrants) and travel restrictions that have kept hundreds of thousands of seasonal workers from returning to work.¹ Macro risks have become more elevated due to the pandemic but internal and external imbalances remain sustainable, benefiting from the strong buffers that were present prior to the crisis.

The government's economic policy response to the pandemic has been to provide fast and sizeable help to the vulnerable and to the economy. Heeding early warnings about the COVID-19 pandemic, the government established an Anti-Crisis Commission at the end of January 2020, seven weeks before the first coronavirus case was detected in Uzbekistan. The Commission has spearheaded the government's policy response, with its priorities focused on saving lives, preserving livelihoods, and sustaining the reform momentum. These priorities mirror the four pillars of the World Bank's COVID-19 Crisis Response approach paper. The authorities provided substantial but temporary tax relief to firms and households, ramped up health spending, expanded social protection, and extended sizable support to small- and medium-size businesses. Dividends from sizable gold sales offset the impact of the economic slowdown and tax relief on fiscal revenues. The government hiked annual spending by about 4 percent of GDP through targeted and time-bound measures linked to the crisis impact.

Despite the significant shocks from the COVID-19 crisis, Uzbekistan's macroeconomic policy framework remains adequate for the proposed operation. Uzbekistan entered the crisis with sounder economic buffers than most of its peers. At end-2019, foreign exchange reserves covered 13 months of imports and public debt was at a modest 29 percent of GDP, which provided ample fiscal and external space to cope with a crisis. In the baseline, economic growth is expected to recover in 2021 and strengthen over the medium term, although this outcome depends on the success of global efforts to combat COVID-19 and the extent to which global trade and investment flows pick up. Sustainable external and fiscal balances, improved debt management and transparency, and greater flexibility in exchange rate management will help preserve buffers. Inflation is likely to decline over the medium-term, as administrative price increases are reduced and utility prices near cost-recovery, and as monetary policy transmission improves with less distortive and lower policy-based lending. The post-COVID-19 outlook remains vulnerable to further uncertainties and downside risks, including: (i) more prolonged health and economic crises driving even higher anti-crisis spending; (ii) a reversion to high government-directed credit growth; (iii) further external shocks impacting domestic economic performance and financial sector stability; (iv) adverse weather conditions; and (vi) the occurrence of a major natural disaster.

¹ World Bank simulations suggest that without remittance income Uzbekistan's poverty rate in 2018 would have increased from 9.6 to 16.9 percent of the population.



Relationship to CPF

This proposed DPO is fully consistent with the new focus areas of the 2018 Performance and Learning Review (PLR) which adjusted the 2016-2020 Country Partnership Framework (126078-UZ; June 26, 2018). Adjustments to the CPF were made following a clear signal from authorities about its intentions to undertake a deeper and broader program of economic and social reform (**Figure 7**). The first pillar of the PDO, to increase efficiency, sustainability and transparency of resource utilization is consistent with the first and second focus areas in the revised CPF (supporting a Sustainable Transformation toward a Market Economy and Reforming State Institutions and Citizen Engagement). Measures in this pillar focus on increasing the factor market efficiency and strengthening the sustainability of the agriculture and energy sectors. The second pillar of the PDO supports the third CPF focus areas of investing in people, with measures to improve economic opportunities for rural citizens, increase the economic participation and well-being of women, and improve social safety net coverage. Both the revised focus areas under the PLR, and the pillars of the PDO, are consistent with the findings of the first Systematic Country Diagnostic, and the emerging findings of the second Systematic Country Diagnostic under preparation.

The proposed operation is consistent with the WBG's strategy aimed at eradicating extreme poverty and promoting shared prosperity, and with the pillars of the approved COVID-19 Response Approach Paper. The program pillars are designed to support a systematic and sustainable transformation to a competitive market economy, and that the transformation is underpinned by wide participation, long-term economic stability, and social cohesion. These are key preconditions for sustained poverty reduction. The reforms supported in this pillar are also consistent with the pillars of the approved COVID-19 Response Approach Paper. Actions in the first PDO pillar support the third and fourth pillars linked to ensuring sustainable business growth and job creation and on strengthening policies, institutions, and investments for rebuilding better. The second PDO pillar is consistent with the second pillar of the approach paper linked to protecting poor and vulnerable people

C. Proposed Development Objective(s)

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

Key Results

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

D. Concept Description

Consistent with the Government's priorities to implement an inclusive and sustainable market transition, the Program Development Objective (PDO) of the proposed operation is to (i) increase the efficiency, sustainability and transparency of resource allocation; and (ii) enhance economic inclusion and social resilience. The proposed operation



substantially deepens the program of reforms supported under the previous DPOs. The first two full DPOs², approved by the World Bank Board in June 2018 and June 2019, focused on a first wave of measures to support price liberalizations, measures to reduce burdensome regulations and increase productivity, increasing the financial transparency and performance of large state-owned enterprises, strengthen the financial sector, and addressing weaknesses in the tax and social safety net systems. Building on these operations, this proposed operation supports the deepening of the reform agenda to address binding constraints to transparent, inclusive, and market-led growth. The first pillar of this proposed operation supports measures to reduce distortions in the banking sector, modernize agriculture by ending state cotton production, reduce highly inefficient fossil fuel subsidies, improve the investment environment for public-private partnerships (PPPs), reform SOEs, and overhaul the budget preparation and accountability process. The second pillar of the PDO, the operation supports the removal of almost all internal migration controls, measures to strengthen the economic inclusion, safety, and well-being of women, and modernize social safety net administration. The development objective of this proposed operation is closely aligned with the Government's focus on accelerating inclusive, sustainable, and market-led growth, and on strengthening public transparency and accountability.

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

Poverty and Social Impacts

Overall, the proposed operation is expected to improve the efficient deployment of resources and increase the progressivity of the fiscal and regulatory system. Of the proposed prior actions, six have clear, significant, and direct poverty and/or distributional implications. Four actions are expected to have positive poverty and or distributional implications, including through relaxed internal mobility constraints, improved social safety nets, improved gender equality and the safety of women, strengthened fiscal transparency and local budget involvement. Two actions, to reform the financial sector and to address agricultural constraints, could potentially increase the short-term incidence of poverty and/or entail short-term negative social impacts, while at the same time generating progressive distributional outcomes. Where negative effects are present, they are not unprecedented or irreversible, and mitigation measures through the social protection system could moderate the expected poverty impacts relating to these actions

Environmental, Forests, and Other Natural Resource Aspects

Actions supported by the are largely neutral or positive for the environment, but two actions carry potentially positive and negative effects, and risks that can be mitigated through better integration of environmental considerations in the policymaking process. Actions to strengthen the agriculture sector, address constraints to increased renewable energy and PPP investments, and the reform of SOEs will require careful integration of environmental policy issues to avoid longer-term adverse environmental impacts. While these areas have the potential to generate considerable positive effects, such as strengthening environmentally friendly practices, improved natural resource management, and the use of climate change adaptation technologies, there are also risks of land and biodiversity degradation, soil and water pollution, occupational hazards, and poorly managed legacy environmental liabilities. Negative effects arising from agricultural reforms are also sometimes associated with areas considered priorities for agricultural development in Uzbekistan: intensive orchards and/or vineyards expansion, construction and operation of new greenhouses, construction and/or rehabilitation of irrigation schemes, construction and operation of new agricultural processing enterprises. Although the area of focus under this operation is non-hydro renewable energy, measures adopted through the prior action supported will benefit all infrastructure projects, including potential hydroelectric projects. If increased investments in small hydropower, wind turbines, or biogas production are made without considering environmental requirements, these could also lead to negative environmental and health impacts and risks.

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



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APPROVAL

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Approved By

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