

Government on addressing regulatory obstacles in the business environment for SMEs and improving the legal framework for housing finance, and with private sector on improving access to finance for SMEs. Funding for IFC's regional advisory services, such as leasing, the mortgage program and the SME banking advisory, has been provided by IFC trust funds, the Swiss State Secretariat for Economic Affairs (SECO) and the Netherlands.

IV. BANK ENGAGEMENT IN UZBEKISTAN: LESSONS LEARNED

A. Background

37. **The operational environment for the Bank in Uzbekistan has been difficult for many years.** The previous CAS (2002-2004) attempted to establish a framework for policy dialogue and set policy triggers for various scenarios. This approach proved to be ineffective, given the authorities gradualist state-led development strategy. Triggers were often perceived as imposed external conditionalities, and there was thus little ownership. In addition, the fact that Uzbekistan had little need for external financing provided little incentive for active cooperation with the Bank in areas that were not clearly demand-driven by the government. Reforms which did take place came about from the gradual absorption of technical and project work over a number of years and the slow but steady build up of ownership and generation of a critical mass for reforms. In view of the good macroeconomic performance and buoyant growth over the past few years, the Government perceives its strategy to be successful and therefore has little motivation to fundamentally revise it in the short term.

B. The Interim Strategy

38. **A CAS was prepared in 2005 for discussion at the Board, but was eventually switched to an Interim Strategy Note (ISN) approved in July 2006 as questions arose on developmental effectiveness of the proposed program.** The ISN included financing of one project together with technical assistance and analytical advisory services to support the development of the WIS and ensure local stakeholder participation for increasing development effectiveness. The IFC's program focused on advisory services aimed at improving the business environment and legislation, as well as increasing access to finance to MSMEs and establishing the basis for the development of housing finance. The ISN was intended to give the Government and Bank staff a focused opportunity to work together to address areas of difference, while continuing to demonstrate good cooperation in the implementation of existing lending operations. A key question for the Interim Strategy was the process by which readiness to return to a standard assistance framework would be reviewed.

39. **The Government and the Bank agreed on assessing the results against four basic benchmarks to be achieved in the short-term:** (i) finalization of PRSP/WIS; (ii) stable macroeconomic management; (iii) improved portfolio performance and (iv) timely access to data. It was agreed to look at the totality of progress during the ISN, not treating each result area as a necessary pre-condition for moving ahead. In addition, it was agreed to carry out a governance assessment to be conducted jointly with the

Government in a sector selected by the authorities and where the Bank was active (health).

40. **In addition, in preparation of the ISN, the Bank reviewed jointly with the Government future reform priorities against the authorities' own policy plans.** Incomplete structural reforms were documented as a list of policy actions in the ISN as a guide for this review, noting that priorities could shift in reflection of the dialogue. As had been the case with the triggers under the previous CAS, however, the Government expressed the view that, while there was no fundamental disagreement on the need to ultimately move in the areas indicated, internal consensus on the timing of implementation of many reforms did not yet exist and could hardly be secured under the ISN. In this context, the policy actions specified in the ISN were a framework for organizing policy dialogue with the authorities and included governance, poverty monitoring, agriculture policy, financial sector, business environment and trade.

C. Progress Under the ISN

41. **On all four benchmarks, results have been achieved.** The WIS has been developed and approved by the government. Macroeconomic management has been prudent and stable, and growth high. There have been significant improvements in the portfolio, although still subject to heavy bureaucratic processes that slow down project implementation. While data sharing remains somewhat ad hoc and its timely provision inconsistent, the government has made genuine attempts to respond to data requests. Finally, the dialogue and collaboration established in the context of the governance assessment in the primary health care sector has been a success.

42. **During the ISN period, the Uzbek authorities succeeded in maintaining and strengthening macro-economic stability.** They continued the gradualist approach they have pursued since independence and advanced on a few of the structural reforms areas identified in the ISN. Although progress has been less than anticipated, actions were taken in those selected areas the government itself had committed to move on during the short ISN period. Progress was noted, for instance, on the launching of the preparation for privatization of one of the major state-owned bank (Asaka Bank), on the initiation of privatization of urban land, on the completion throughout the country of the transformation of collective farms ("Shirkats") into private leaseholds and on the slow but noticeable improvement of the business environment for SMEs (reduction of taxes, number of inspections and reporting requirements; reliance on court rather than administrative decisions; reduction in number of permits and licenses to start business activities; shortening of enterprise bankruptcy procedures, etc.).

43. **The overall quality of the working relationship between the WBG and the authorities has improved during the period of the ISN.** One example was the Government's close collaboration with the Bank team during the preparation of the WIS and joint work on poverty diagnostics. Another encouraging sign in the improving relationship between the Government and the WBG team is that the Government recognizes the shortcomings of the WIS as well as the challenges of its implementation and has recently indicated its interest in receiving TA to support the implementation of the WIS. The Government is also very appreciative of IFC's Private Enterprise

Partnership (PEP) TA services, and has been encouraged by this work to make improvements in the business environment for SMEs and establishing the legal basis for housing finance (Box 1).

Box: 1: IFC helps Uzbekistan Improve the Business Environment

IFC's SME Survey and the BEE work has included the following accomplishments which in part led to Uzbekistan improving seven places in the "Doing Business" report:

- **Assisted in developing 9 Presidential Decrees, expected to free up \$45 million for the SME sector.** The project has worked closely with government agencies to improve the business environment leading to streamlined registration, permits, inspections, business liquidation and tax reporting procedures.
- **Conducted 5 nationwide surveys of the SME sector.** These annual surveys have provided the basis for more than 150 policy recommendations, 100 of which have been fully or partially adopted by the government.
- **Introduced risk-based management in inspections.** The project has helped to implement risk-based management at all 33 inspectorates across the country.
- **Provided trainings for over 2,200 government officials.** Trainings have been provided on new regulatory procedures, such as risk based inspections, inspections checklists and the streamlined registration process.
- **Increased awareness on the new procedures.** The project developed and disseminated easy-to-read information materials on inspections and business registration procedures to SMEs.
- **Created 11 inspections checklists.** The project developed checklists for the Fire and Sanitary Inspectorates, to be used by both agencies in the course of inspections of business entities.

Source: Doing Business 2007.

44. **Strong progress has also been made in portfolio performance, which resulted in upgrading all of the problematic projects to "satisfactory" status and in a significant improvement in disbursement ratios.** As of March 2008 the Uzbekistan portfolio has no problem projects (as opposed to 2 problem projects at the time of the ISN), resulting in a 100 percent Proactivity Index. This portfolio improvement effort was also supported by high disbursement ratios (24 percent in FY07 and 20 percent in FY08 - above the current ECA average of 14.5 percent). Critical systemic issues are common for all IFIs and across the Bank's portfolio (e.g., contract award delays, slow project start and weaknesses in project monitoring and evaluation systems). To address these problems the Country Office has intensified work with the Government on project implementation through the Joint Technical Group and the Portfolio Action Plan reviews and is also providing support for improving monitoring and evaluation.

45. **Perhaps the most significant achievement during the ISN period was in project implementation.** Some projects were able to implement important policy components and innovative features (e.g., Rural Enterprise Support project (RESP) has been able to support privatization of collective farms ("Shirkats"), Health I and II have contributed to a major reform in the financing of primary health care, Basic Education supported the development of parental participation in school governance, etc). Under the Basic Education project, two important governance improvement measures (the activation of school boards, and progress in standard student assessments, measured against the State Standards for Public Education (GOS OSO)) were agreed upon with the Government. Notwithstanding much evidence of stronger engagement and a more trusting relationship with the WBG, the dialogue and progress are not as smooth as they could be. An area causing continuing bureaucratic complications in project implementation is the process of contract expertise of public procurement. As a result,

project implementation remains fraught with unnecessary delays and complications despite recent improvements.

46. **General access to data has improved, but unpredictability and ad hoc data provision continues, and more work needs to be done by the WBG and the authorities to ensure smooth data exchange in the future.** On the WBG side, streamlining economic and sectoral data requests that can prove onerous, acknowledgement that information requested may not be readily available and requires a special effort to collect and/or analyze, and establishment of clearer linkages between Bank requests for detailed data and Bank's output would probably help increase trust and improve collaboration. On the government's side, automatic and timely routine fulfillment of its obligations as regards data sharing deriving from its membership in the WBG should become the norm.

47. **During the ISN period, engagement on governance issues was also strengthened.** The Bank has been able to conduct regular Beneficiary Assessments for projects under implementation. Beneficiaries and civil society are very positive about project benefits and delivery of results on the ground (Box 2). In addition, cooperation with the authorities in the discussion on selected governance dimensions such as PFM, HR management and even procurement was encouraging, as it demonstrated that a careful, selective dialogue on governance is possible. The Primary Health Care Governance assessment has now been completed and will be shared and discussed with the government in April 2008. Building on these experiences, the CAS will strengthen the dialogue on selected governance issues through projects as well as dissemination and advocacy work.

Box: 2: Voice of the Beneficiaries

A beneficiary assessment on selected projects was carried out at the ISN Mid-term Review, in March-April 2007. Beneficiary views on project outcomes were sought on the Bukhara-Samarkand Water Supply (BSWS), Rural Water, and the RESP, and the Health II projects. Health II project focus group discussions were carried out in Khorezm and Karakalpakstan regions. A summary on BSWS, Rural Water Supply and RESP is based on social assessments conducted under these projects in FY07. The beneficiary assessment provided useful information on project results, especially ones that depend on new institutional developments in respective sectors such as agriculture and primary health. A summary of key findings on the impact of WB-supported projects is presented below:

- Nearly 44,000 people got access to safe water and over 800,000 receive improved quality and quantity water in South Karakalpakstan
- 90 percent of covered population have access to water and 75-87 percent satisfied with water supply services
- Over 5,000 farmers benefited from improved irrigation
- Over 11mln rural population using improved medical services in over 2,300 refurbished primary care centers
- The incidence of infectious diseases has reduced

Source: World Bank project supervision surveys and consultations.

D. Lessons Learned from the Last CAS and ISN Implementation

48. **In preparation for this CAS, the lessons of the CAS Completion Report (CAS CR) of the previous FY02-04 CAS and of the ISN implementation have been.** The CAS CR concludes that, notwithstanding the slow overall pace of reforms, there were successes during the CAS period at the sectoral level, particularly in the implementation

of projects targeting improved public service delivery and benefiting from strong local stakeholder support (health, water supply, and municipal services). Government ownership of the reform process in these areas has allowed the Bank to orient public policy attention towards improving the efficiency of public service delivery as well as issues affecting poor people's access to basic services. The intensive dialogue around the LSA was the first time poverty issues were openly discussed with the Government. This experience suggests that development results can be achieved even against the background of a difficult overall policy dialogue and significant remaining differences on economic policy and the pace of structural reforms. However, the CAS CR¹⁸ cautions against expecting much more movement in areas where the Government's approach differs from that of the Bank. By diverting attention towards areas of disagreement, the Bank missed opportunities to contribute to enhanced living conditions and income earning opportunities for the poor that were feasible even under the prevailing policy regime, according to the CR.

49. **Over the years, the policy dialogue between the Government and the WBG has proved effective when demand-driven, specific and clearly articulated, like in the reform of health financing.** Officials are often keen to receive and act upon the Bank's advice and capacity building activities (for example in utility reform and housing finance). The dialogue has largely failed, however, when perceived by the Government as supply-driven or in areas where the Bank and the Government have different time frames and overall approaches, such as in reform of the cotton sector. Several important lessons emerged from past experience, which have been factored into the design of the FY08-11 CAS. They include:

- Positive development outcomes in support of basic human needs and improved living standards can be achieved within the prevailing policy environment of Uzbekistan.
- The WBG interventions are likely to be more successful in areas where common ground exists. While the Bank will need to continue to advocate reform on a broad front, the use of CAS triggers will be avoided. A move toward a deeper engagement will be facilitated by assisting the authorities prepare areas for enhanced engagement outside basic human needs.
- Shared ownership is key to successful engagement and can be strengthened through the use of pilots, demonstrating and communicating success, and involving stakeholders and beneficiaries in the design and implementation of projects. Building on the WIS as an explicit guide to Government's own priorities and objectives, should also serve this purpose.
- The WBG experience in Uzbekistan clearly demonstrates that investment projects rather than stand alone ESW or TA have been the most effective 'entry points' for policy dialogue and ultimately reform as they demonstrate effectiveness impact through concrete results.
- Future Analytical and Advisory Activities (AAA) will need to consider carefully both the Government's demand for advice and the readiness to provide access to data.

¹⁸ Distributed to the Board in August, 2005. Report No. 32293-UZ.

- Involving a wider group of stakeholders both in the preparation and dissemination of AAA to build a constituency for reform.
- There is a need to tackle limited capacity for project implementation through renewed attention to generic issues such as the public procurement process.
- Incorporation of Project Implementation Units (PIUs) into Government Ministries can promote the longer term objective of gradual integration of the WBG operations into government systems. Notwithstanding this longer term agenda, the Bank should remain uncompromising in its defense of the highest standards of fiduciary management, which is rightly regarded as important to mitigate governance risks.

E. Rationale for CAS Engagement

50. **The progress achieved under the ISN indicates that the WBG support to some key Government priorities can achieve effective results.** The proposed CAS framework will allow the consolidation of results, expansion of the areas of engagement and the establishment of the Bank as a trusted partner. It will allow engaging the authorities in areas where there is potential for common agreement, particularly to increase the effectiveness of service delivery through good governance.

51. **Consultations with non-government stakeholders in Uzbekistan indicated that a majority of local development partners support the Bank's continued financial assistance and advice.** There is a consensus that the WBG assistance should focus in areas which they regard as critical to improve people's livelihoods, rather than disengagement leading to increased isolation. Moreover there is a broad-based consensus that this is an appropriate role for IFIs (ADB has a similar approach). As was previously discussed, engagement has only been effective when sustained and long term.

52. **Finally it is important to recognize that given the regional importance and close linkages to neighboring states, engagement and development in Uzbekistan has the potential to bring benefits well beyond Uzbekistan's borders.** The importance of regional stability cannot in this context be underestimated. The Bank's experience and analysis of regional issues suggests that the potential costs of Uzbekistan disengaging from the regional dialogue are high, given the country's strategic location and its role in the future development of the entire Central Asia region. These concerns warrant continued efforts by the international community to advocate the benefits of greater cooperation with the country's neighbors.

V. THE WBG SUPPORT FOR IMPLEMENTATION OF THE WIS

53. **There is broad agreement between the Government, the WBG the donor community and other stakeholders on the overall direction and end-result objectives of the economic strategy of the Government expressed in the WIS.** There is also a consensus on the need to accelerate the pace of poverty reduction and persistent socio-economic inequalities. Thus, support to the market based elements of the Government's growth agenda provides broad areas for effective engagement with the Government. Nevertheless, there is a difference of views on the pace of transition.