

Government, with support from the WBG and the Asian Development Bank (ADB), is increasingly focusing on student assessment and reforms in school governance.

III. COUNTRY DEVELOPMENT PROGRAM

A. Country Vision: the Government's WIS

28. **The Government of Uzbekistan has endorsed the MDGs.** For Uzbekistan, the main goal under the MDGs translates into a reduction of the poverty rate from 27.5 percent in 2000 to 14 percent in 2015. The Government has been increasingly concerned by the disconnect between the impressive economic results of recent years and the relatively modest reduction of poverty. Aggregated GDP growth in 2002-2005 was 24.9 percent, but the number of poor for the same period was reduced only by 2 percentage points.

29. **In response to this challenge, the Government approved its first Poverty Reduction Strategy paper (PRSP) – the Welfare Improvement Strategy (WIS)¹⁴ - in September of 2007.** The WIS is a national strategic document for the social-economic development of the country over the period 2007-2010. It was prepared by an interdisciplinary team of government experts under the leadership of the Ministry of Economy, with analytical support of the United Nations Development Programme (UNDP), ADB and the WBG. The WIS is a comprehensive framework to address poverty and living standards issues built on the policy of granting a greater role to market principles within a gradualist approach to structural reforms. It aims at improving the living standards of the population through sustaining a robust and inclusive economic growth, developing a modern and diversified globally competitive economy, enhancing the quality of public services and reducing inter-regional inequalities in socio-economic development.

Poverty Diagnosis:

30. **The WIS provides a candid assessment of poverty level and trends in the country relying primarily on the Household Budget Survey (HBS) data.** The quality of poverty monitoring and the capacity for poverty analysis, including that related to non-income dimensions of poverty and access to services, require further strengthening. Increased access to information and encouraging broad-based discussion of development challenges that the country faces, would enhance the possibility of analysis of the critical poverty-growth related issues and deepen the understanding of the linkages between policy actions and pro-poor growth.

¹⁴ The WIS was discussed by the Board in January, 2008.

Macroeconomic Framework and Main Policy Areas in the WIS:¹⁵

31. **The WIS highlights the role of maintaining sustainable high rates of economic growth as a main instrument for poverty reduction.** This goal is to be met by a combination of continued stable macroeconomic management, state-led industrialization policy and acceleration of structural reforms in selected areas.

- **Improvement of the business environment and tax reform.** The WIS recognizes the need to enhance private sector development through a gradual reduction of state regulation in the economy and reducing the costs of doing business. The WIS does not elaborate much, however, on the reduction of transaction costs, streamlining of customs procedures and simplification of certification and licensing.
- **Trade.** The WIS contains a candid discussion of the shortcomings of the trade regime and trade practices, but does not contemplate comprehensive changes to the current trade regime and practices. The Government however proposes to anchor its gradual trade liberalization to the process of harmonization with the EurAsEc and, in the future, through joining the World Trade Organization (WTO). For the time being, however, the Government intends to continue encouraging the build up of the industrial base of the country, using localization and import substitution as mechanisms to achieve this objective.
- **Financial sector reform.** The WIS includes a list of financial sector reforms needed to further enhance financial deepening and to strengthen the role of banks in economic development, as well as to improve the transmission mechanism of monetary policy. The WIS, however, would have been strengthened had the document explicitly included a road map for the further development of the financial sector over the next three years.
- **Rural sector development and environmental management.** The WIS recognizes the importance of agricultural growth for improving the livelihood of people and emphasizes the close link to environmental issues including sustainable irrigation and water management systems, soil improvement and drainage, more efficient use of water resources and the importance of cost recovery. The WIS, however, does not envisage the gradual reform of the state procurement system for cotton, although it may well have a huge potential to improve income and unleash new opportunities for growth in the rural economy.
- **Improving the performance of utility and communal services in large and small cities, towns and villages.** The WIS proposes rehabilitation and extension of water supply, sewerage and solid waste management systems, the reduction of physical and commercial losses in the electricity and gas systems, the installation of energy efficient heating systems including options to decentralize inefficient Soviet-era systems. It also proposes the development of appropriate market based pricing systems for utilities, so as to combine efficiency with financial sustainability and

¹⁵ For a detailed joint Bank-IMF assessment of the WIS please refer to the Joint Staff Advisory Note dated January 24, 2008 (Report No 41799-UZ).

protection of vulnerable social groups. In the field of public utilities, the Government strategy calls for private sector participation.

- **Strengthening human development.** The WIS recognizes that, although the Government pays special attention to the development of social services, including health and education, the quality of these services still needs to be improved. Therefore, continued public investments and more efficient financing mechanisms in education and health, would be needed to ensure that the poor contribute to and benefit from economic growth. The WIS focuses on achieving the MDG's and envisions improvements in primary, emergency and specialized health care, preventive health measures, and a gradual transition to output-based financing. In education, the Government's objective is to maintain a high literacy rate. The Government's priorities therefore include providing 12 years of mandatory free education and improving the quality of primary and secondary education while maintaining universal access.
- **Improving the functioning of the labor market and social protection systems.** The WIS recognizes how critical the strengthening of the social protection programs is to protect the poorest sections of population. The WIS also stresses gender equality as one of its goals and contemplates targeted government interventions to support investment and job creation in less advantaged regions of the country and ensure equality of access to services regardless of the place of residence. However, the WIS does not provide a detailed program on how to improve the (pro-poor) targeting performance of social assistance programs, although it highlights the importance of programs targeted to the poor households. The WIS contains clear labor market objectives, but specific policy actions, regulatory changes and measures will have to be elaborated in the course of implementation.
- **Improving governance.** The WIS includes measures on administrative reform, improvements in policy-making structures and in strengthening the role of the legislature in oversight of the executive, greater access to information, decentralization, as well as longer term reform of the civil service. It proposes to tackle the challenge of more transparent and efficient allocation of resources through reforms in public expenditure management and introduction of a robust monitoring and evaluation mechanisms. However, the WIS does not propose an actionable plan of measures to implement the stated objectives.

32. **Broad participation of both line ministries and civil society would enhance WIS implementation.** As noted in the Joint Staff Advisory Note (JSAN), the implementation of the WIS will be challenging and will require Government's further efforts to: (i) set clear priorities amongst policies, programs and investments through costing and cost/benefit analysis; (ii) establish methods and institutions for monitoring and evaluation; (iii) sharpen policy analysis in selected sectors and detailing the measures to be taken in support of sector goals and (v) strengthen public and civil society participation.

33. **The authorities have recognized the central importance of technical assistance and external advice in WIS implementation.** Their request for such involvement from the donor community is encouraging. The preliminary estimate for TA support across the WIS agenda that would be provided by a combination of largely local

and selected international experts amounts to approximately US\$6 million over an implementation period of three to four years. The Government has initiated and will continue to seek grant funding support from donors to meet these technical assistance needs. It should be recognized, however, that progress on understanding and addressing the poverty challenge will depend both on funds being available for TA support for WIS implementation and on willingness by all partners and Government to cooperate and advance a more open dialog and improved information sharing.

B. Donor Partnership in Support of Uzbekistan's Economic Development Objectives¹⁶

34. **There is a relatively small group of donors active in Uzbekistan and overall external funding decreased during the ISN period.** However, there is strong support among all donor agencies for coordination and harmonization of activities. There is extensive collaboration in capacity building, as illustrated recently in the joint involvement of the UNDP, ADB and the WBG in support of the Government's preparation of the WIS. There is also considerable collaboration at the project level in the health sector in partnership with the United States Agency for International Development (USAID) and ADB. In the areas of irrigation and drainage, the Bank has active partnerships under its existing projects with the number of international agencies. The Government of Japan is a source of significant trust funding through the Japan Social Development Fund (JSDF) and Japan's Policy and Human Resources Development (PHRD) in support of activities planned in this CAS. The ADB and the WBG conduct Joint Portfolio Reviews with the Government, and where possible use the same implementation arrangements. UNDP and the World Bank have also coordinated to provide support for improved monitoring and evaluation systems in the context of implementing the WIS.

35. **Uzbekistan is party to all of the United Nations Office on Drugs and Crime (UNODC's) regional projects (which are supported by other donors including the WBG).** These projects are focused on drug abuse prevention and treatment, HIV/AIDS prevention, and counter-narcotics enforcement all of which promote regional cooperation and coordination. The WBG and UNODC have also collaborated in the delivery of capacity building workshops in the context of the AML/CFT Mentor Program since Uzbekistan enacted an AML/CFT law (in 2004), created a financial intelligence unit, and ratified the major United Nations (UN) Conventions¹⁷ covering money laundering and terrorism financing. These workshops covered role and functions of a Financial Intelligence Unit, training on international AML/CFT obligations and best practices.

36. **The WBG is working closely with the IMF on issues related to macroeconomic stability and economic management.** The Government is cooperating fully with the IMF, in particular in the context of the Article IV review, and is benefiting from continued IMF's Technical Assistance (TA). IFC has been working with the

¹⁶ For more detailed information on donor partnership please refer to Annex 3.

¹⁷ UN Convention Against Illicit Trafficking of Narcotics and Psychotropic Substances; the UN Convention for Suppression of Financing of Terrorism; and the UN Convention Against Transnational organized Crime (Palermo Convention).

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