

REPUBLIC OF UZBEKISTAN
COUNTRY ASSISTANCE STRATEGY

EXECUTIVE SUMMARY

i. The Government of Uzbekistan has been following a gradual approach to economic reform to minimize the social costs of transition. Market-oriented reforms have been slow and selective and focused on a few areas (e.g., current account convertibility, adjustment of energy prices, privatization through lease-holding of collective farms, gradual improvement in business environment and modernization of the treasury). In recent years, the Government improved its macroeconomic performance and significantly diversified exports. While the development model adopted by Uzbekistan has brought benefits, it has also had opportunity costs, as evidenced by the slow reduction of poverty and lower improvement in living standards than in reforming Commonwealth of Independent States (CIS) countries. Constraints on the growth potential of the private sector have dampened job creation, at a rate below the growth of the working age population. In response to this challenge, the Government approved its first Poverty Reduction Strategy paper (PRSP) – the Welfare Improvement Strategy (WIS)¹ - in September of 2007. The WIS is a comprehensive framework to sustain high growth and address poverty and living standards issues. The strategy is built on the policy of granting a greater role to market principles within a gradualist approach to structural reforms.

ii. Of the four key commitments which the Government made to the Interim Strategy Note (ISN), three were carried out (maintaining macro stability, improving portfolio performance, and preparing the WIS) and the remaining one (timely access to data) was carried out partially. The quality of the working relationship between the Bank and the authorities has improved and productive relationships have been established in a number of key areas, including some aspects of Governance, where the authorities have cooperated with the Bank under the Primary Health Care sector Governance Assessment, which opened up significant opportunities for engagement and dialogue in this area. The authorities have also been willing to allow significant elements of citizens' voice and participation during the design and implementation of the projects. A particularly notable example of this (and a radical departure from previous practice) is the introduction of public sector accountability mechanisms by stakeholders through the activation of school boards in the Basic Education project.

iii. Key Government commitments made to the ISN in support of private sector development were carried out. The International Finance Corporation (IFC) SME Survey has been continued, in the framework of business enabling environment (BEE) work and for further legal and regulatory reforms to establish a better framework for microfinance and mortgage lending. IFC has continued to maintain a good working relationship with its Government counterparts which resulted in the development of significant legislative

¹ The WIS and the associated JSAN was discussed by the Board on January 24, 2008 (Report No 41799-UZ).

and procedural improvements in the business environment, including in streamlined registration, permits, inspections, business liquidation and tax reporting procedures that are expected to free up US\$45 million for the SME sector. These reforms enabled Uzbekistan to improve its “Doing Business” rating by seven places.

iv. This Country Assistance Strategy (CAS), rooted in Uzbekistan’s own vision (the WIS), sets out the planned lending and advisory support to the country from the World Bank Group (WBG) over the period FY08-11. The new CAS will rely both on the implementation of ongoing WBG projects and the development of technical assistance and new lending. Six Bank projects in the current portfolio will continue during the CAS period. These are concentrated in key areas of support for human development: improved access to safe water, improved health status, improved incomes in rural areas, and protection of the environment. The average annual International Development Association (IDA) allocation to Uzbekistan was approximately US\$77 million over the last three years (IDA 14). The indicative 3-year allocation for the IDA 15 period corresponding to that of the CAS is SDR 195 million, with final allocation for the Fiscal Years 2010 and 2011 determined annually through the IDA Performance Based Allocation (PBA) system. New IDA lending of about 2-3 projects per year will continue to focus on the development of economic opportunities in rural areas, where the majority of the poor live; on improving delivery of basic municipal services as well as reforms in health and education; promoting sound environmental management, regional development and the contribution of Uzbekistan to the provision of global goods. The size of the projects will be determined based on the overall IDA envelope available. IFC will continue its active engagement in advisory services in the areas of BEE and financial sector development; provide funding and advisory services to support financial intermediation to micro and small business enterprises, particularly in rural areas in collaboration with IDA; increase its direct lending to SMEs; and seek opportunities to finance and provide advisory services to support energy and infrastructure development with private sector participation.

v. The CAS is built around a dual track approach, where in addition to the core program, the WBG will focus its analytic work on key areas to increase consensus with the authorities. The advisory program will be focused on enhancing the environment for shared growth, including through promoting good governance and assistance in implementation of the WIS; as well as selected demand-driven analytical and capacity-building support in priority sectors, including activities to promote regional cooperation. A CAS monitoring framework has been built around an explicit results framework (Annex 1) of existing and currently planned activities. The evaluation of progress against these results will take place in the mid-term review. In the event of significant progress in key areas, and project proposals consistent with the CAS strategy, additional activities outside of the core program may be supported by the WBG.

vi. The present CAS faces four critical risks: (i) *Fiduciary risks* which are rated as high due to weak Public Finance Management (PFM) capacity and accountability mechanisms, and lack of transparency particularly in procurement. To mitigate this risk, the WBG will assure that adequate resources are allocated to fiduciary supervision of projects and project implementation arrangements will seek to strengthen procurement procedures. In addition, financial management arrangements for new projects would

build on the lessons of existing practices, but would be cautious in any move to make use of country systems, and focus rather on the improvement of transparency and accountability at a sectoral and project level; (ii) *Development effectiveness*. To ensure the development effectiveness of the proposed program, all projects are assessed through a results framework and by beneficiary monitoring. The WBG will closely monitor the CAS implementation, and in case of adverse developments, will reassess the level and focus of its engagement; (iii) *Exogenous risks*. These include possible regional tensions over water and energy, reduction in regional growth rates or reductions in flows of remittances or commodity prices, all of which could directly or indirectly affect internal political stability, and security. Managing exogenous risks will require close cooperation with the Government to encourage Uzbekistan's continued international engagement and integration. The above risks, if they materialize, may hinder the country's ability to fully utilize its IDA allocation. Uzbekistan also faces *natural disaster risk*. The current CAS recognizes lessons from past engagement and builds clear linkages to the Disaster Risk Management (DRM) agenda.

vii. Executive Directors may wish to consider the following issues for discussion:

- Do the Directors endorse the strategic approach proposed in the presented CAS?
- Is the proposed program sufficiently aligned with the country's own strategy?
- Is the level of engagement adequate to address the developmental challenges?