

I. INTRODUCTION

1. **The proposed Country Assistance Strategy (CAS) builds on the experience of three previous CAS's and intensive dialogue during the Interim Strategy period.**

The previous CAS (FY02-04) expired on June 30, 2004. The level of assistance of that CAS was set at US\$350 million over three years, half International Bank for Reconstruction and Development (IBRD) and half International Development Association (IDA) lending. In practice, only US\$100 million was provided for 2 projects. During FY05, the Bank approved a US\$40 million Health project that had been identified in the previous CAS. The Interim Strategy was adopted for FY07-08. It included one lending operation of US\$40 million in Basic Education, the first phase of which was approved by the Board on October 26, 2006. In addition the Avian Flu Influenza project was approved by the Board on May 18, 2007. The new CAS covers the period FY08-11 and provides direction for Bank operations and Economic and Sector Work (ESW) during this period.

2. **Uzbekistan is an upper low income resource rich, doubly-landlocked country, strategically located in the heart of Central Asia.** It is the world's fifth largest cotton producer and second-largest cotton exporter. Major raw materials exports include gold, natural gas, copper and other non-ferrous metals and construction materials. The country possesses a young and educated labor force, rich agricultural resources and has significant economic potential. Uzbekistan accounts for one-third of the region's population, and its economic and social prospects are critical both for the 27 million Uzbeks, and for the neighboring region comprising of Afghanistan, Kazakhstan, Kyrgyz Republic, Tajikistan and Turkmenistan.

3. **During the Soviet era, increasing cotton production in conditions that lacked incentives for sustainable agricultural practices led to the massive expansion of irrigated lands, overuse and unbalanced application of agrochemicals and the depletion of water resources.** This has severely degraded the quality of large tracts of land and reduced the Aral Sea to almost one-tenth of its original volume. The country seeks to gradually lessen its dependence on primary agriculture while developing its mineral and hydrocarbon potential, further diversify its economy by expanding the share of services and manufacturing in the Gross Domestic Product (GDP) and address serious environmental challenges.

4. **In contrast to the majority of the Commonwealth of Independent States (CIS) countries, Uzbekistan has adopted a gradualist state-led development approach,** in which features of an open-market economy are introduced to the existing command and control system in a step-by-step manner. The guiding principle of reform for the authorities is to reduce the risk of being subject to external influences in the political and economic spheres. This has been manifested through – inter alia – a policy of minimizing public debt, accumulating considerable external reserves and cultivating wheat on irrigated land for food security and self-sufficiency. Adherence to this model is also based on the fundamental belief of Government that this approach is necessary: (i) to first build up Uzbekistan's domestic real sector economy before it can face open competition in the global marketplace with any chance of success; and (ii) to maintain social and political stability in an ethnically heterogeneous and potentially volatile region.

5. **This paradigm has resulted in a gradual economic and a less severe social transition than that experienced in most countries of the CIS.** A policy of high public spending during the transition years has mitigated the impact on human capital and on the quality of infrastructure compared with other countries in the region. Market-oriented reforms have been slow and uneven and progressed only in the areas which matched Government's development model and where support for reforms has prevailed over vested interests (such as the introduction of current account convertibility in 2003, the realignment of energy prices, the privatization through lease-holding of collective farms, the adoption of measures to improve the business environment for small and medium-sized enterprises (SMEs) and the modernization of the treasury). In recent years, the Government also achieved a strong macroeconomic performance. However, in spite of high growth rates achieved in recent years, the cost of the gradualist approach to reform in Uzbekistan was an insufficient utilization of the country's economic potential. The emphasis on large capital intensive projects, many of which were in the public sector, and slow private sector development proved to be insufficient to create the number of jobs required to absorb the growth of the working age population.

II. COUNTRY CONTEXT

A. Political Background, Governance and Civil Society

6. **Uzbekistan has a strong executive system with few checks and balances.** After the break-up of the Soviet Union in 1991, the ruling Communist Party of Uzbekistan was restructured as the People's Democratic Party of Uzbekistan, with Islam Karimov retaining the leadership. A referendum in 1995 extended President Karimov's term of office until 2000. He was re-elected to the presidency in 2000 and in December 2007. The Organization for Security and Co-operation in Europe (OSCE) has criticized the elections as failing to meet international standards. At the same time, however, observers from a number of countries and other organizations assessed the conduct of the elections positively.² In 2005 following the suppression of the Andijan uprising, relations with the US and the European Union (EU) deteriorated. Following US criticism of the Uzbek government, cooperation between the two governments in many spheres was reduced and US assistance to Uzbekistan was considerably cut. The EU imposed sanctions in the form of an arms embargo and visa restrictions for senior officials. However, these sanctions were relaxed in October 2007 and are now being reviewed.

7. **Economic management and governance remain characterized by low transparency, and limited voice and participation of citizens.** The restricted dissemination of basic economic and social information, and questions regarding the reliability of some data, is a serious impediment to strengthening the accountability of the authorities, to encouraging public participation in policy-making debate and to allowing civil society to play a constructive role in contributing to the effective monitoring and evaluation of implementation and results of state programs. However, the Government

² OSCE/ODIHR, LEOM, Republic of Uzbekistan, Presidential Elections 2007, Interim Report (5-15 December, 2007).