

particularly in the fiduciary area will be mitigated, and how the benefits of Bank lending for the people of Uzbekistan will be verified. The results framework will be further refined during the course of CAS implementation. Progress on results, measured against a set of target outcomes and implementation milestones, as well as the lending program for the next FY, will be reviewed with the Government at the time of the annual CPPR.

103. Building on work undertaken in the context of the existing portfolio, the results-based approach of the CAS will focus attention in all interventions on defining and achieving measurable outcomes. In this regard, the CAS will contribute to improved monitoring of service delivery standards, greater accountability at the point of delivery and feedback to allow for corrections and policy improvements. The WBG will seek to involve civil society as much as possible in its monitoring and evaluation work, making use of social and beneficiary assessments and consulting with all stakeholders on project outcomes. The focus on results will be supported by institutional support for the WIS implementation. This aims to build capacity in the Government for monitoring and evaluation, including through greater stakeholder and beneficiary group participation. It will also act as an instrument for the monitoring of outcomes under the CAS. The WBG will leverage its capacity building work in this area with additional donor funds.

104. The achievements of the results matrix will be discussed with the Government on an annual basis during the annual Country Portfolio Performance Review (CPPR) (carried out jointly with ADB during the last two years). The mid-term review would be another opportunity to review progress towards agreed results, and also to consider any appropriate adjustments to the CAS. To facilitate this process, the Bank will engage in ongoing training and capacity building of key Government counterparts. Monitoring of portfolio performance will be done through two main channels. Firstly, the established regular meetings of a Joint Technical Working Group between the Government and the Bank's Country Office will provide day to day support in resolving systemic and project specific issues. Secondly, the Bank will also seek to consult at regular intervals with project beneficiaries and wider stakeholders on the outcomes of its interventions, including the involvement of NGOs. Such an iterative process is necessary to ensure improvements in several areas such as establishing a reliable baseline for monitoring.

VII. POTENTIAL RISKS AND MITIGATION MEASURES

Fiduciary Risks

105. **Uzbekistan made some good progress in public financial management through the introduction of a modern treasury system, which will greatly improve financial reporting and transparency for the use of public resources.** With support from an IDF grant, the Ministry of Finance is also implementing a project aimed at establishing an institutional framework for modern internal audit function. Uzbekistan, however, has a centralized power structure with few checks and balances. The CFAA of 2004 indicated that there were significant risks that budget funds may not be used for their intended purposes due to the fragmentation and opacity of the budget. While there has been some progress in reducing the fragmentation of the budget, and certain increase in transparency since then these problems persist. It will be a challenging task for the

Bank to implement any broad-based reforms in improving governance and accountability. Nevertheless the active Uzbek participation in PEM-PAL activities and the moves towards reform of the budget and treasury systems indicate that engagement through a PEFA (Public Expenditure and Financial Accountability) type assessment, under the PPER, could be productive and move forward the public finance reform agenda in a manner consistent with the authorities' vision. The CAS strategy also proposes to engage the government in improving financial management and governance at sector and project levels, involving the civil society to play some role, where feasible.

106. Fiduciary risks remain high due to weak public finance management capacity and inadequate accountability mechanisms, including particularly the lack of an effective independent external audit function in public expenditure management. At the project level, the CFAA noted that the key financial management weaknesses are weak budgeting and internal control structures within PIU's (and also public bodies), which is partly the result of the lack of skilled staff. Nevertheless despite these weaknesses, project financial management arrangements have been judged to be satisfactory. In addition, the 2003 CPAR noted that the public procurement framework in Uzbekistan suffers from a multiplicity of uncoordinated regulations, a lack of transparency in the whole process and in particular in bid opening, with a large potential for petty corruption. Moreover one of the major obstacles to transparent procurement has been the process of price verification of winning tenders.

107. The WBG will continue to use and improve the current systems to implement on-going projects. 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. Such a move would be gradual, but would accelerate depending on demonstrable commitment by the authorities to strengthen public financial management systems and accountability mechanisms. The CFAA and the CPAR identified broad weaknesses in public financial management and procurement arrangements which indicate high fiduciary risk. They also identified broad (and probably impractical) reform agendas with little government ownership. Nevertheless, progress is being made with budgeting and financial management under the reforms linked to the establishment of the Treasury.

108. The WBG will focus on building in accountability mechanisms at a sectoral and project level, identifying issues of efficiency which can be addressed through greater accountability (as was shown by the governance assessment of the health sector). Thus Project implementation arrangements would seek to strengthen procurement procedures and to link project activities with development outcomes. The WBG will also develop new approaches towards discussing efficiency constraints related to procurement issues as part of its efforts to engage the Government on the importance of public procurement reform and the need to bring domestic practices more closely in line with accepted international standards. In the meantime, an internal Government circular has been developed with input from the WBG to try and smooth the process of contract registration and improve the cooperation between the PIUs and the Agency for Foreign Economic Relations, responsible for reviewing all foreign contracts with public entities.

Risks to Development Effectiveness

109. **The effectiveness of development assistance in Uzbekistan depends strongly on the maintenance of a good dialogue and common understandings between the Bank Group and the authorities in the agreed focus areas of the CAS.** A loss of such common understanding as a result of a stalling of even the gradualist reform process could potentially reduce the effectiveness of assistance in achieving development goals. 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 CAS implementation and in case of adverse developments in broad policy fields or in project specific areas, which may put at risk the development effectiveness of the program, will reassess the level and focus of its engagement. Among current areas of concern in this area is the impact of recent Decrees that are seen as moving the legal framework of Uzbekistan away from an internationally recognized AML/CTF regime and has the potential to cause difficulties in international banking relationships and to limit the range of foreign investment available to the country, including from the IFC.

Exogenous Risks

110. **The continued tensions over the use and exchange of energy and water have the potential to undermine trade and economic cooperation between Uzbekistan and its neighbors.** In particular concerns about the use of water by Tajikistan and Turkmenistan could lead to a deterioration of relations. A fall in regional growth and the potential outlet for rural migration could feed tensions and become linked to growing political extremism (or at least the fear of such extremism by the government). The result would likely be increasing the isolation of the Uzbek government. Further risks include a deterioration of the security situation in Afghanistan and the increased trade in drugs.

111. **Uzbekistan's vulnerability to exogenous economic shocks.** Economic performance over the past few years has been strong. Nevertheless, the reliance of the country on high commodity prices, as well as on the demand for goods and labor from its rapidly growing partners, whose continued high growth is itself highly dependent on continued high commodity prices, represents a potential risk for the future.

112. **The existence of exogenous risks could threaten internal political stability and security.** In addition to presenting a direct threat, these tensions may generate a government's response in which moves towards economic freedom are reversed, and political activity focuses on maintaining power and security rather than economic development.

113. **Managing risks will require that the Bank Group work cooperatively with the Uzbek Government to encourage Uzbekistan's continued international engagement and integration.** Given the very high level of uncertainty in the region, this CAS is perhaps best seen as setting out a broad engagement strategy rather than as a detailed blueprint for Bank Group support, which would in any case imply a return to the failed conditionality of the past.

Natural Disaster Risks

114. **Uzbekistan has faced severe natural disasters in the recent past**—drought of 2000/2001 affected 1.1 million and an earthquake in 1992 affected about 50,000 (EM-DAT 2008). About two thirds of the population as well as about two thirds the GDP are at economic risk from two or more hazards (WB/Columbia University 2005). The previous CAS progress report draws several lessons pertinent to Disaster Risk management (DRM) in the country, for example, the Rural Water Supply, Sanitation and Health (RWSP), which was used effectively as a tool for disaster mitigation during the drought of 2000/2001, and in mitigating the environmental consequences of the Aral Sea disaster. The current CAS has recognized these lessons and has clear linkages to the agenda of DRM in Uzbekistan through several projects such as the Drainage, Irrigation and Wetlands Improvement (Phase I) project, and new AAAs such as the Disaster Risk Mitigation and Adaptation, Climate Change Mitigation and Adaptation.