

**BOARD
OF
DIRECTORS**

ASIAN DEVELOPMENT BANK

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**REVIEW OF THE CLASSIFICATION OF UZBEKISTAN
UNDER THE ASIAN DEVELOPMENT BANK'S GRADUATION POLICY**

1. Attached for the consideration of the Board is a paper on the above subject.
2. In the absence of any request for discussion (which should be communicated to The Secretary by the close of business on 23 September 2004), the recommendation in paragraph 20 of the Paper will be deemed to have been approved, to be so recorded in the minutes of a subsequent meeting of the Board. Any notified abstentions or objections will also be recorded in the minutes.

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ASIAN DEVELOPMENT BANK

REVIEW OF THE CLASSIFICATION OF UZBEKISTAN UNDER THE ASIAN DEVELOPMENT BANK'S GRADUATION POLICY

August 2004

CURRENCY EQUIVALENTS

(as of 19 August 2004)

Currency Unit	–	SUM
SUM1.00	=	\$0.0009703
\$1.00	=	SUM1030.58

ABBREVIATIONS

ADB	–	Asian Development Bank
ADF	–	Asian Development Fund
DMC	–	developing member country
GDP	–	gross domestic product
GNI	–	gross national income
GNP	–	gross national product
HIPC	–	heavily indebted poor country
IBRD	–	International Bank for Reconstruction and Development
IDA	–	International Development Association
IMF	–	International Monetary Fund
LDC	–	least developed country
OCR	–	ordinary capital resources
TA	–	technical assistance
UN	–	United Nations

NOTE

In this report, "\$" refers to US dollars.

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I. INTRODUCTION

1. In December 1998, the Board of Directors of the Asian Development Bank (ADB) approved a policy paper, *A Graduation Policy for the Bank's Developing Member Countries*.¹ The graduation policy paper indicated that Uzbekistan was classified as a Group C country, i.e., ordinary capital resources (OCR) only status. This paper reviews Uzbekistan's relevant economic position within the framework of ADB's graduation policy and makes a recommendation for reclassification of Uzbekistan.

II. CLASSIFICATION POLICY

2. According to ADB's 1998 graduation policy, classification, including determining the eligibility of developing member countries (DMCs) to borrow from the Asian Development Fund (ADF), is based on two criteria: per capita gross national product (GNP) and debt repayment capacity. Regarding per capita GNP, the 1998 graduation policy adopted the World Bank's per capita GNP estimates based on the Atlas method and the operational cutoff of the International Development Association (IDA) for eligibility. IDA's current GNP per capita operational cutoff is \$895 in 2003 prices.² A multidimensional evaluation procedure, combining quantitative and qualitative assessments, was used for measuring the debt repayment capacity of DMCs. The quantitative component uses four indicators: debt sustainability, private capital inflows, gross domestic saving rate, and size of the economy. The qualitative assessment captures five indicators: categorization as a heavily indebted poor country (HIPC) by the World Bank and the International Monetary Fund (IMF), volatility of export growth, main external financing source, degree of access to IDA funds, and whether sovereign borrowing by the country is rated by Moody's and by Standard and Poor's. DMCs are classified into four categories: (i) ADF only (Group A), (ii) ADF with limited amounts of OCR (Group B1), (iii) OCR with limited amounts of ADF (Group B2), and (iv) OCR only (Group C). The approach is captured in a decision matrix in Table 1 below.

3. The system of country classification has an additional impact on operations in regard to cost-sharing limits and domestic preferences. The cost-sharing limits for project financing by ADB change for the borrowing DMCs as follows: 80% for Group A, 75% for Group B1, 70% for Group B2, and 65% for Group C.³ The government contribution to technical assistance (TA) should be at least 15% of the total TA costs for Group A, 20% for Groups B1 and B2, and 30% for Group C. Such contribution will be subject to the limit of total TA costs minus foreign exchange costs and costs of domestic consultants.

¹ ADB. 1998. *A Graduation Policy for the Bank's Developing Member Countries*. Manila.

² The World Bank in 2001 adopted the terminology of gross national income (GNI), in place of GNP, to be consistent with the 1993 System of National Accounts. The definition of GNI is the same as that of GNP.

³ ADB. 2002. *Review of Cost-Sharing Limits for Project Financing as an Element of ADB's 1998 Graduation Policy*. Manila.

Table 1: Decision Matrix of Classification

Debt Repayment Capacity	Per Capita GNP Cutoff			
	Below per Capita GNP Cutoff		Above per Capita GNP Cutoff	
	LDC ^a	Other	LDC ^a	Other
Weak	ADF only (Group A)	ADF only (Group A)	ADF only (Group A)	ADF with limited OCR (Group B1)
Limited	ADF with limited OCR (Group B1)	ADF with limited OCR (Group B1)	ADF with limited OCR (Group B1)	OCR with limited ADF (Group B2)
Adequate	OCR with limited ADF (Group B2)	OCR with limited ADF (Group B2)	OCR with limited ADF (Group B2)	OCR only (Group C)

ADF = Asian Development Fund, GNP = gross national product, LDC = least developed country, OCR = ordinary capital resources

^a To be classified as an LDC on the basis of the United Nations' classification of low-income and less developed countries, a country must fall below thresholds established for income, economic diversification, and social development.

Source: Asian Development Bank. 1998. *A Graduation Policy for the Bank's Developing Member Countries*. Manila.

III. CURRENT POSITION

4. The 1998 graduation policy reviewed country classification based on 1997 per capita GNP and assessment of debt repayment capacity based generally on a specific set of data sources covering 1989–1996. For consistency, this section examines Uzbekistan's status in terms of per capita GNP 2003, and debt repayment capacity up to 2002,⁴ using generally the same data source and same methodology applied for the 1998 graduation policy paper. The latest available data from other specific sources have also been used.

A. Per Capita Gross National Product

5. By United Nations (UN) standards, Uzbekistan does not belong to the group of least developed countries (LDC).

6. As per *Asian Development Outlook 2004*,⁵ real gross domestic product (GDP) grew at 4.4 % in 2003, higher than the 4.0% growth in 2002. The real GDP growth in 2004 and 2005 are estimated to be around 4.5% and 4.0%, respectively, while annual inflation were estimated to be 20.0% in 2004 and 20.0% in 2005. Average annual population growth rate for 2000–2003 was 1.5%.⁶

⁴ Currently, a complete set of data is available from the same data sources only up to 2002.

⁵ ADB. 2004. *Asian Development Outlook 2004*. Manila.

⁶ ADB. May 2004. *Basic Statistics*. Manila.

Table 2: Some Economic Indicators of Uzbekistan

Item	1998	1999	2000	2001	2002	2003
GDP Growth (% , in constant prices)	4.4	4.4	3.3	4.1	4.0	4.4
Consumer Prices (annual percent change, end of period)	26.1	26.0	28.0	27.4	27.0	10.0
GNP (\$ billion, nominal prices) ^a	22.9	17.6	15.6	14.0	11.5	10.8 ^b
GNP per capita (\$, nominal prices) ^a	950.0	720.0	630.0	560.0	460.0	420.0

^aThe World Bank estimates, using the Atlas methodology.

^b Staff estimates.

Sources: ADB. 2004. *Asian Development Outlook 2004*. Manila; ADB. May 2004. *Basic Statistics*. Manila; World Bank. 1998–2001. *World Bank Atlas*. Washington DC; World Bank. 2003 (August 22). *Uzbekistan at a Glance*. Available: www.worldbank.org; World Bank. 2002–2004. *Operational Policies, OP3.10, Annex D*. Available: www1.worldbank.org.

7. The GNP per capita was estimated at \$420 in 2003 (in 2003 US dollars), which was significantly lower than the IDA operational cutoff of \$895 in 2003 prices.⁷ GNP per capita in dollar terms (nominal prices) using the Atlas methodology has steadily declined from 1998 to 2003 (Table 2 above).⁸ It is believed that Uzbekistan's per capita GNP will stay below IDA's operational cutoff in the medium-term, in view of the projected real GDP growth and inflation in 2004–2005.

B. Debt Repayment Capacity

1. Quantitative Variables

8. **Debt Sustainability Ratio.**⁹ The 3-year moving averages of debt sustainability ratios from 1997 to 1999 were negative, and from 2000 to 2002 became positive. Based on more recent criteria developed by IMF and the World Bank, Uzbekistan is nevertheless considered to be at significant risk of “debt distress.”¹⁰ In the case of IDA, Uzbekistan would be a blend borrower and not eligible for IDA grants.

9. **Gross Domestic Savings Rate.** The gross domestic savings rate was 18.6% in 2002. The average of gross domestic savings rates for 1997–2002 was around 18.6%, lower than the average of 20.5% for 1993–1996.

10. **Private Capital Inflows.** The share of private capital inflows in total capital inflows as an indicator of debt repayment capacity was 65.6% in 2001 and dropped to 57.0% in 2002. The average value of the share of private inflows in total capital inflows for 1997–2002 was 60.9%, higher than the average of 46.4% for 1993–1996. Foreign direct investment and private long-term capital disbursement were the factors for the higher average.¹¹

⁷ The World Bank. July 2004. *Operational Policies, OP3.10, Annex D*. Available: www1.worldbank.org.

⁸ The decline in per capita GNP and overall GNP in US dollar term is the result of SUM devaluation over the period 1998 - 2003 and also due to the fact that the World Bank's estimates of GNP in US dollars use the Atlas conversion factor (see www.worldbank.org/data/aboutdata/working-meth.html).

⁹ The debt sustainability ratio as defined in the graduation policy paper links the key elements bearing on a country's external debt sustainability: non-interest current account balance, the inflow of foreign direct investment, the stock of external debt, and the differential between the growth rate and the real interest rate.

¹⁰ The World Bank. June 2004. *Debt Sustainability and Financing Terms in IDA14*. Available: www.worldbank.org. The percentage distances from indicative thresholds for net present value of debt-to-GDP ratio, net present value of debt-to-exports ratio, and debt service-to-exports ratio were, respectively, -49.2, -32.7, -49.1. These results indicate risk of “debt distress.”

¹¹ The World Bank. 2003. *World Development Indicators Online*. Available: devdata.worldbank.org.

11. **Size of the Economy.** The size of the Uzbek economy as measured by GNP, Atlas method, decreased significantly from \$24.2 billion in 1997 (in 1997 prices) to \$11.5 billion in 2002 (in 2002 prices) (Table 2). Uzbekistan remains the second largest economy in Central Asia, with its 2002 GNP lower than the 2002 GNP for Kazakhstan, which was \$22.3 billion, but much higher than the 2002 GNPs for Azerbaijan, Kyrgyz Republic, Tajikistan, and Turkmenistan.¹²

2. Qualitative Variables

12. **Classification as Heavily Indebted Poor Country.** Uzbekistan is not classified as an HIPC, and this status has been unchanged since 1997.

13. **Vulnerability to Fluctuation in Export Growth.** Uzbekistan's exports of goods and services increased by 2.6% in 1997, then declined by 14.6% in 1998, declined further by 7.2% in 1999, increased by 7.0% in 2000, declined by 5.2% in 2001, and increased by 1.4% in 2002.¹³ Cotton and gold exports accounted for up to 54% of total exports in 2001 and 60% of total exports in 2002.¹⁴ Export earnings remain vulnerable to commodity prices fluctuations and agriculture outputs.

14. **Main External Financing Source.** Private financing, including foreign direct investment and portfolio investment, accounted for about 60.9% of Uzbekistan's total external financing for 1997–2002.¹⁵ Uzbekistan's main external source of financing continues to be categorized as “diversified financing,” as neither official financing nor private financing accounted for more than two-thirds of the country's 1997–2002 external financing. This has been unchanged since 1997.

15. **Rating for Sovereign Borrowing.** Uzbekistan was classified as “not rated” for the 1998 graduation policy. Uzbekistan is still classified as “not rated” since Uzbekistan has not been rated by Moody's and Standard & Poor's.

16. **Degree of IDA Access.** Previously, the World Bank classified Uzbekistan as an International Bank for Reconstruction and Development (IBRD)-only borrower. However, the World Bank classified Uzbekistan as a blend country in late 2001 and Uzbekistan is currently eligible to borrow IDA concessional resources, in addition to IBRD resources.

3. Findings on Debt Repayment Capacity

17. Considering the quantitative and qualitative variables (paras. 8-16), Uzbekistan's debt repayment capacity remains to be classified as “adequate.”

C. Joint Application of the Two Criteria

18. The 1998 graduation policy paper stated that the decision matrix (Table 1) provides the foundation for classifying and graduating DMCs. The decision matrix also applies for reclassification and graduation of DMCs. Thus, Uzbekistan should currently be in Group B2 (OCR with limited ADF).

¹² The World Bank. 2003. *World Development Indicators Online*. Available: devdata.worldbank.org.

¹³ Ibid.

¹⁴ The World Bank. 2003, August 22. *Uzbekistan at a Glance*. Available: www.worldbank.org.

¹⁵ The World Bank. 2003. *Global Development Finance Online*. Available: www.worldbank.org.

IV. CONCLUSION

19. Economic conditions of Uzbekistan have deteriorated since the time of its original classification in ADB. Uzbekistan's per capita GNP has fallen well below the operational cutoff of IDA eligibility and is very likely to stay below the IDA cutoff over the medium-term based on current economic outlook. Uzbekistan's debt repayment capacity is considered "adequate," but the country is also at risk of "debt distress." It is therefore proposed that Uzbekistan be reclassified as a Group B2 country.

V. RECOMMENDATION

20. It is recommended that the Board of Directors approve the classification of Uzbekistan as a Group B2 country for the purpose of access to ordinary capital resources and eligibility for limited amounts of resources from ADB's Asian Development Fund,¹⁶ and with regard to cost sharing limits on ADB financing of project costs, norms for sharing of TA costs, and the domestic preference scheme for procurement of goods and civil works, as prescribed under the graduation policy framework. Under that classification, Uzbekistan would not be eligible for ADF grants on country considerations.

¹⁶ Uzbekistan is not included in the list of Borrowers in ADF VIII (2001-2004) of Appendix 10, Attachment I, of the paper *Seventh Replenishment of the Asian Development Fund* (ADB. R221-00, Revision 1, Final, 2 November 2000). However, reference to Uzbekistan is included in the *ADF IX Donors' Report: Development Effectiveness for Poverty Reduction* (Para. 74) (ADB. R111-04, Revision 1, Final, *Eighth Replenishment of the Asian Development Fund and Third Regularized Replenishment of the Technical Assistance Special Fund*, 22 July 2004) which states that "Donors noted that the Board of Directors would review the possible eligibility of Uzbekistan for limited access to ADF funds." Therefore, Uzbekistan will become eligible to ADF resources during ADF IX period (1 January 2005 – 31 December 2008) only. Actual allocation of ADF resources will be determined in line with the revised performance-based allocation policy and associated procedures.