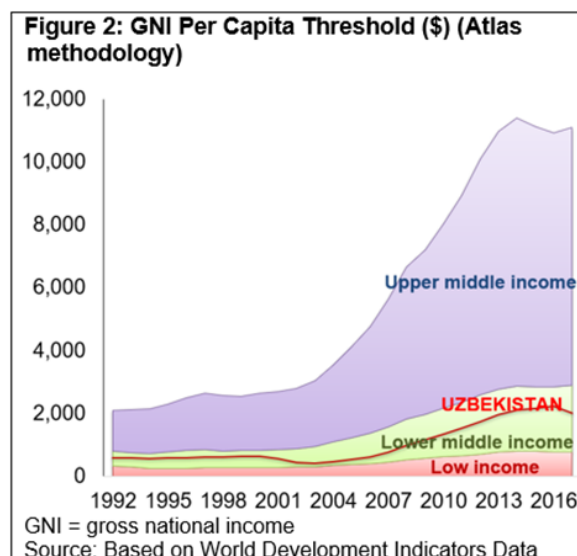
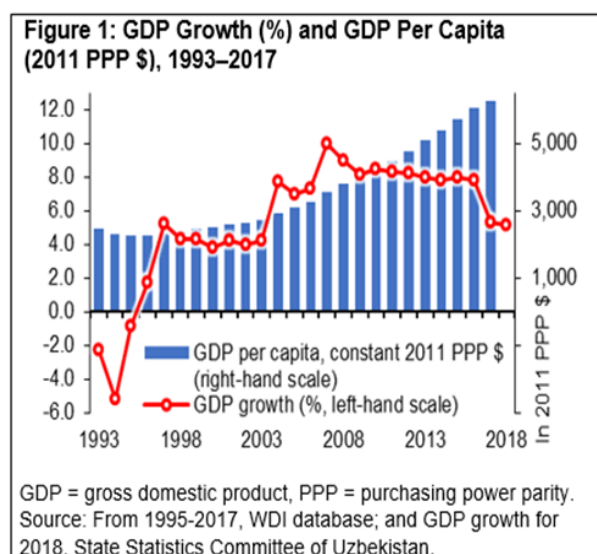


INCLUSIVE AND SUSTAINABLE GROWTH ASSESSMENT

A. Recent Growth, Poverty, Inequality, and Environmental Dynamics

1. Uzbekistan is the most populous country in Central Asia and South Caucasus and is one of only two doubly landlocked countries in the world, sharing borders with five Central and West Asia countries.¹ It is a lower middle-income economy, with a gross national income (GNI) per capita of \$2,000 in 2017.²

2. **Economic growth.** After independence, unlike other countries of the former Soviet Union, Uzbekistan opted to pursue *gradual* transformation reforms. It promoted an import-substitution strategy heavily driven by state investments, often implemented through directed credit to state-owned enterprises (SOEs); introduced foreign exchange controls; and imposed tariff and non-tariff barriers on foreign trade. Public sector companies and connected businesses enjoyed preferential access to physical and financial resources while being sheltered from domestic and external competition. Some economists claimed that the “Uzbek model” limited the impact of post-Soviet disruption, and the country managed to recover its pre-independence gross domestic product (GDP) level early on, by 1999 (Figure 1).³



3. High economic growth was recorded in the first two decades of the 21st century. While growth benefited from high commodity prices, the reliability of official data has been questionable.⁴ The economic system had become increasingly rigid, undermined by extensive state involvement, poor governance, and low foreign investment. Continued reliance on state control, particularly in agriculture and its cotton subsector, resulted in high levels of rural poverty and outmigration.⁵

¹ Afghanistan, Kazakhstan, the Kyrgyz Republic, Tajikistan, and Turkmenistan.

² In current United States dollars (<http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>).

³ R. Pomfret. 2006. *The Central Asian Economies Since Independence*. Princeton: Princeton University Press.

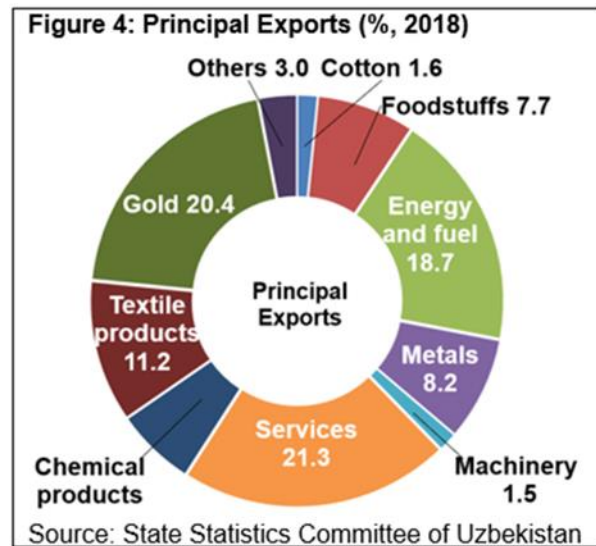
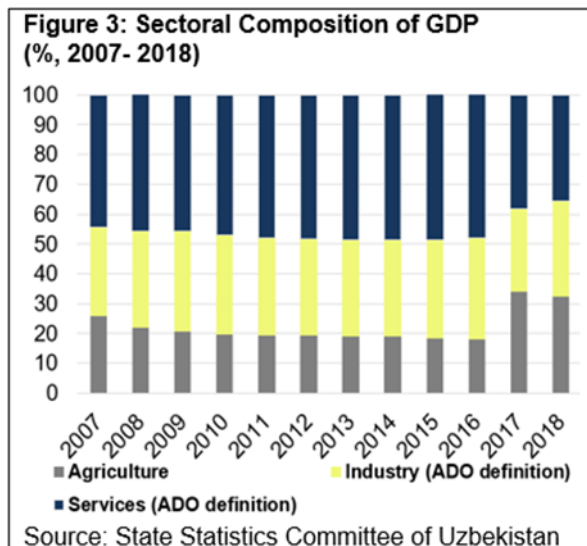
⁴ Many economic analysts have noted the unreliability of official data in that period. The government is currently improving official statistics, with Asian Development Bank (ADB) assistance.

⁵ International Crisis Group. 2005. *The Curse of Cotton: Central Asia's Destructive Monoculture*. Europe and Central Asia Report 93. Bishkek/Brussels (February 2005).

Uzbekistan’s economic growth—though impressive by official numbers—has not yet resulted in moving the country to upper middle-income status (Figure 2).

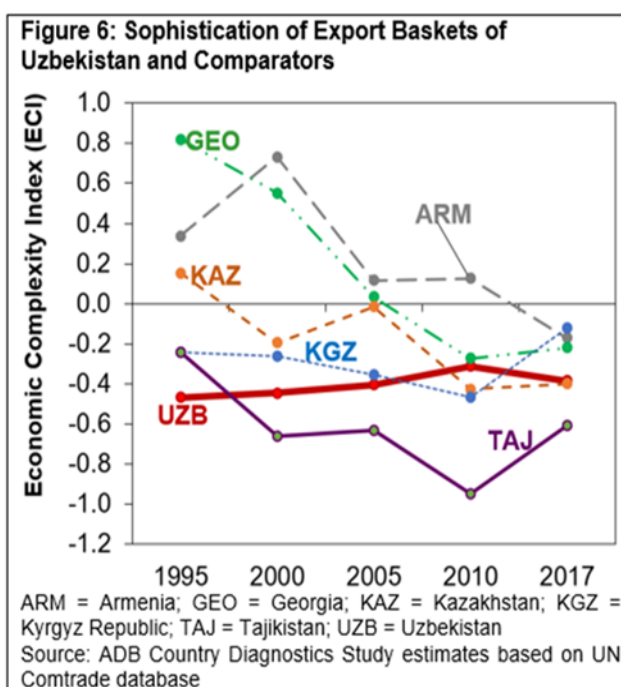
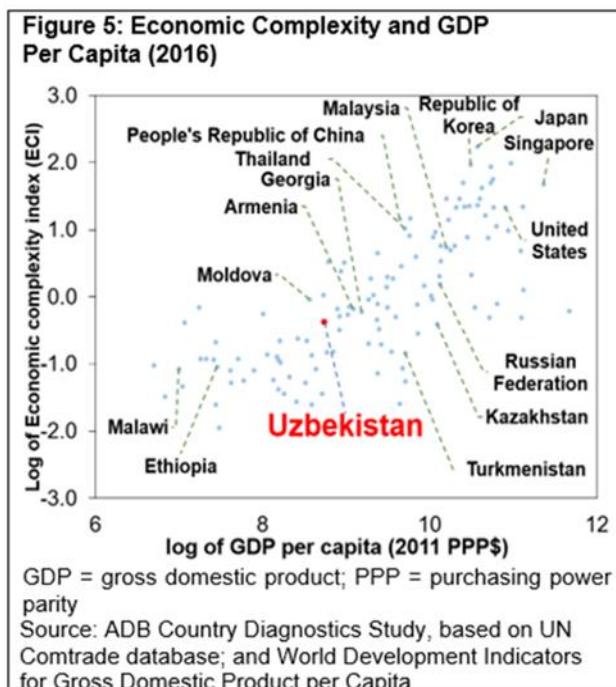
4. For 2018, the government reported GDP growth of 5.1%, matching independent estimates more closely. On the supply side, growth is driven primarily by industry (including construction) and services, and by public investment and exports on the demand side. A noticeable development is an increase in the trade of goods and services (tourism in particular) in response to currency liberalization and other reforms. Real GDP growth is expected to average 5.4% in 2019–2020.

5. **Structure of the economy.** Industry, agriculture, and services each contribute about a third of GDP (Figure 3). The economy is reliant on commodity exports (gold, cotton, natural gas, uranium, and oil) (Figure 4) but has developed some manufacturing through the state-led industrial policy in areas such as automobiles, chemical products, and food products. Services are dominated by traditional types such as retail trade and transportation. Overall, although the composition of exports changed, the country has not yet experienced rapid and intense structural transformation, and has substantial room to improve its economic complexity and sophistication of exports (Figures 5 and 6).⁶



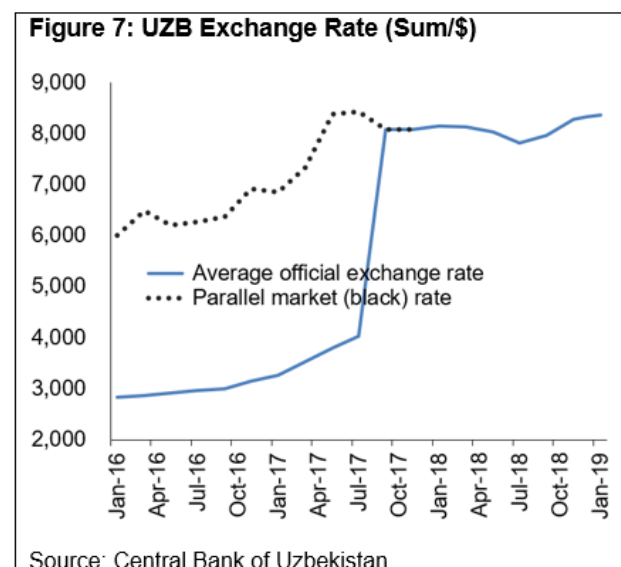
6. **Inflation.** Inflation increased, and remained high at 17.9% in 2018, compared with an average annual rise in the consumer price index (CPI) of 6.3% during 2012–2016. The CPI rise was mainly associated with the devaluation of the sum, Uzbekistan’s national currency, and the subsequent tariff hikes by utilities to move closer to cost-recovery levels. Upward pressures on prices remain as price adjustments continue, owing to the residual effect from inflationary pressures as a result of the sum depreciation and a pick-up in domestic demand. The CPI is projected at 16% in 2019 and 14% in 2020.

⁶ Uzbekistan’s production is concentrated on peripheral goods such as mining output, liquefied petroleum gas, cotton, fabric, and nonferrous metals. ADB. 2019. *Uzbekistan: Country Diagnostics Study* [forthcoming].



7. **Exchange rates.** In early September 2017, the central bank ended its long-running policy of administrative support of the sum and allowed it to float freely (Figure 7). The official exchange rate converged to the parallel rate of Sum8,100 = \$1, marking a depreciation of almost 100%. In addition to the rate unification, the government relaxed some stringent capital controls on foreign currency for businesses and individuals.⁷ The exchange rate unification played a key role in reducing the macroeconomic distortions.

8. **Fiscal policy.** Historically, fiscal policy has been conservative. In 2017, it became mildly expansionary when government compensated SOEs whose balance sheets had become strained because of the currency devaluation, and increased outlays to shield vulnerable population groups from the adverse effects of the reforms. Support for SOEs and other expenditures were primarily channeled through off-budget operations financed by the Uzbekistan Fund for Reconstruction and Development. The fiscal deficit, comprising both on- and off-budget expenditures, rose from 0.6% of GDP in 2016 to 3.3% in 2017, and decreased to 2.5% of GDP in 2018. Public debt (all external) is low at about 20% of GDP, and is deemed sustainable.



⁷ Enterprises are now permitted to trade currency for any purposes, including imports and repatriation of profits, which were previously subject to controls; citizens also are allowed to purchase foreign exchange without the use of a special bank card, the previously prevailing practice.

9. Historically, revenue performance and expenditure management were characterized by a lack of transparency and accountability, and low mobilization of tax revenues.⁸ Companies actively avoided entering the standard regime, which imposed an onerous tax burden, by artificially constraining company growth, restricting employment, or breaking companies into smaller units to remain below the threshold for the standard regime. Tax reform, covering both tax policy and administration, became a priority for the new government. It launched a comprehensive tax reform in 2018, expected to boost budget revenues, primarily as a result of improvements in tax administration. The new tax regime is also expected to create a more equitable treatment for businesses and boost economic activities, but its implementation faces administrative hurdles in the short term.⁹

10. Other existing challenges include the remaining credit market segmentation—still about 60% of credit is funded by the state and allocated on preferential terms—as well as the need for better transparency of public finance, e.g., traditional fiscal operations need to be consolidated with various policy-based investments by the state. The government plans to improve the transparency of fiscal management by bringing all its operations on-budget in 2019.

11. **External balances and external debt.** Past national policies limited foreign trade, outside a narrow range of commodity exports (for example, total trade amounted to 83% of GDP in 2008 but fell to 43% in 2015). This decline reflected both lower commodity prices and government restrictions on cross-border activity. In 2017–2018, boosted by higher commodity prices and liberalized cross-border and foreign exchange procedures, trade flows increased. The current account recorded a surplus of 2.9% of GDP in 2017, also reflecting the rise in remittances. In 2018, however, the preliminary estimate puts the current account at a deficit of 7% of GDP, mainly because of higher imports of intermediate goods.¹⁰ As of year-end 2018, the gross foreign reserves amounted to a healthy \$27 billion, covering about 17 months of imports.

12. External debt at 34.7% of GDP (as of year-end 2018) is relatively low by international standards for a lower middle-income country. It increased by half from about 22% of GDP in 2016, in response to the impact of devaluation and additional foreign borrowing. The external debt servicing is nevertheless likely to remain below 20% of export revenues, and the overall debt levels remain manageable. In light of the country's recent opening-up and increased borrowing by the private and public sectors, it is important to carefully monitor the external debt situation. The government recently obtained its first sovereign rating: both Fitch and Standard & Poor's assigned a rating of BB- (with a stable outlook), just below investment grade but in line with other emerging markets. The government also successfully launched a debut euro bond issue at international capital markets in February 2019.¹¹ Given the country's ample foreign exchange reserves, tapping the international capital markets signals the government's intention to create an additional layer of accountability, especially to attract foreign investors.

13. **Poverty reduction and inequality.** According to the official household survey, the average annual per-capita income in 2018 was Sum8.7 million, about \$1,078 (or \$90 per month) at average

⁸ For example, in 2017, only 4.5 million out of 13.3 million employed people consistently paid taxes and social contributions; likewise, only about 8,000 firms paid taxes under the standard regime, out of an estimated total of 350,000 firms. Tax revenue mobilization, measured as the ratio of tax to GDP, amounted to about 17% in 2015–2016.

⁹ For example, some 28,000 firms were to be added to the standard tax regime in early 2019, although tax administration capacity remains constrained.

¹⁰ Exports of goods and services grew by 13.6%, while imports jumped by about 40%, reflecting largely an increase in imports of machinery and equipment to modernize industry and infrastructure.

¹¹ The bond issue yields 5.4% over 10 years, and was heavily oversubscribed.

market exchange rates. The poverty level—as recorded by official statistics—has fallen markedly, from 27.5% of the population in 2001 to 11.4% in 2018.¹² The urban poverty rate declined from 11.6% in 2012 to 9.2% in 2016, while the rural poverty rate dropped from 18.3% to 15.1%. Poverty is concentrated in rural areas, distant from centers of economic activity and with inferior public services and infrastructure. Incomes are below the national average in the remote region of Karakalpakstan, in the rural provinces of Jizzakh, Samarkand, Surkhandarya, and Kashkadarya, and in the three regions of the Fergana Valley—Namangan, Andijan, and Fergana. Urban–rural disparity in poverty (section B) is also attributed to low productivity in labor-intensive agriculture, deficiencies in the coverage and quality of infrastructure, existence of informality in the labor market, and regional disparities in endowments. The impact of per-capita growth on poverty reduction was modest in 2012–2016,¹³ mainly because growth was concentrated in capital-intensive sectors, productivity in agriculture remained low, and economic rigidities constrained the development of small businesses.

14. The official unemployment rate of 9.3% (2018) does not adequately reflect economic realities, given continued labor migration and the extent of the informal economy.¹⁴ According to an earlier survey, the informal sector accounted for 54% of total employment.¹⁵ The working-age population is growing, and according to the Ministry of Labor and Employment Relations, about 500,000 graduates of the technical and vocational education system are entering the labor market each year.

15. Remittances form an important component of average household incomes. The Russian Federal Migration Service estimated that 2.32 million Uzbek citizens were residents in Russia in 2013. Unofficial figures suggest that as many as 4 million people (of a total workforce of 11.6 million) are working abroad, mainly in the Russian Federation, Kazakhstan, and the Republic of Korea. The financial crisis in the Russian Federation and Kazakhstan in 2014–2015 forced many Uzbek labor migrants to return home or to reduce remittances. In 2015, remittances fell by 40% year-on-year in United States dollar terms. At their peak, in 2013, remittances reached \$6.7 billion, before falling to \$2.5 billion in 2016. In 2017, total remittances between the Russian Federation and Uzbekistan increased to \$2.8 billion. As of nine months of 2018, remittances from the Russian Federation to Uzbekistan, made by individuals, were equal to \$3.8 billion.¹⁶

16. **Income inequality.** The country made modest progress in reducing income inequality in 2012–2016, according to official data. Although the Gini coefficient moderated from 0.30 in 2011 to 0.26 in 2016,¹⁷ inadequate data makes measuring income inequality in Uzbekistan difficult.¹⁸

¹² The poverty line is calculated using 2,100 calories per person per day (this methodology is to be updated): State Committee of the Republic of Uzbekistan on Statistics. 2017. *Analysis of the Development of Living Standards and Welfare of the Population in the Republic of Uzbekistan*. Tashkent (July 2017).

¹³ According to computations by ADB's Uzbekistan Resident Mission, with GDP per capita growth of 35% in 2012–2016, the share of the population below the national poverty line dropped by 23%.

¹⁴ Ministry of Employment and Labor Relations. 2018. *Household Survey on Employment Issues (July–August 2018)*. Tashkent. The youth unemployment rate is especially high, estimated at 17.4% per year during 2012–2017.

¹⁵ The Central Asia Labor and Skills Survey was carried out in 2013 covering 1,500 households and 8,622 individuals. World Bank. 2014. *The Skills Road: Skills for Employability in Uzbekistan*. Washington, DC.

¹⁶ Central Bank of the Russian Federation data.

¹⁷ Government of Uzbekistan. 2013. *Welfare Improvement Strategy of the Republic of Uzbekistan for 2013–2015*. Tashkent. The Gini coefficient is estimated using annual household survey data by the State Committee on Statistics.

¹⁸ In general, the Gini coefficients in former Soviet Union countries are notorious for inadequate representation of inequality. L. Sabyrova. *Take Gini Coefficients with a Grain of Salt*. Asian Development Blog. May 2017 (<https://blogs.adb.org/author/lyaziza-sabyrova>).

17. **Human development.** According to the human development index (HDI), Uzbekistan is a *high* human development country—HDI equal to 0.710 (ranked 105th out of 189 countries).¹⁹ This represents an improvement on 2010, when the HDI score was 0.664; and in relative terms, Uzbekistan is placed six positions higher in the table. Progress was made in meeting the Millennium Development Goals, particularly on schooling and poverty reduction, although data has not always been complete. Uzbekistan benefited from a legacy of Soviet-era achievements in education, welfare, and public health, although challenges exist and reforms are now planned in all these areas. However, the country overall underperformed its peers in the high human development group (average HDI value of 0.757) and in the Europe and Central Asia group (0.771).²⁰

18. **Gender equality.** Uzbekistan made progress in improving its gender equality, although challenges persist, including the existence of traditional values and attitudes that affect the distribution of gender roles and the segregation of women in the labor market,²¹ and asymmetry in higher segments of decision making and managerial positions.²² As of 2017, the country was ranked 59th out of 189 countries in terms of the gender inequality index value (0.274). It underperformed its peers in the Europe and Central Asia region on the maternal mortality ratio (36 deaths per 100,000 live births) and the share of women in parliament seats (16.4%).²³ Lack of sex-disaggregated data hinders the evaluation of gender disparities. To tackle these key problems, the government adopted an action plan in 2018 to promote women’s employment and private entrepreneurship among women.²⁴ In addition, the government envisages improving women’s reproductive health, strengthening the institution of family, and reforming the Women’s Committee in 2018–2021.

19. **Effects of economic reforms.** The economic reforms of the new government have caused price increases. Given that the average household’s consumer expenditures are mainly allocated to food products (47.3%) and services (20.4%), the rise in prices for foodstuff and utilities critically affects people’s livelihoods. The reforms and the economy’s structural changes may also cause a reduction in jobs and therefore rising insecurity and inequality. It is important to prevent people from falling back into poverty and to ensure that all members of society can participate in and benefit from the country’s economic growth.

20. **Uzbekistan’s critical role in Central Asia.** The new administration in Uzbekistan formally identified Central Asia as a foreign policy priority and undertook significant steps to open up the economy to its neighbors. Regional trade increased and Uzbekistan resumed energy trade within the Central Asia Power System (CAPS). The government also started the process of acceding to the World Trade Organization in earnest, streamlined the border control systems, and allowed visa-free travel for many countries. Other important developments include border delineation with the Kyrgyz Republic and Kazakhstan, hydropower developments with Tajikistan, and energy trade with Afghanistan. At the initiative of President Mirziyoyev, the first Central Asian Leaders’ Summit

¹⁹ United Nations Development Programme (UNDP). *Human Development Index* (<http://hdr.undp.org/en/countries/profiles/UZB#>).

²⁰ The key disparities between Uzbekistan’s and its peers’ scores were in income per capita and life expectancy at birth.

²¹ According to a household survey by the European Bank for Reconstruction and Development, “Life in Transition-III”, only about 33% of women were economically active in 2016, compared with 74% of men. UNDP. 2018. *Sustainable Employment in Uzbekistan*. New York.

²² ADB. 2018. *Uzbekistan: Country Gender Assessment Update*. Manila.

²³ UNDP. 2018. *Human Development Report 2018: Human Development for Everyone*. New York.

²⁴ Government of Uzbekistan. 2018. *Presidential Resolution No. 5325, On Measures to Improve the Activities in Supporting Women and Strengthening the Institution of Family*. Tashkent.

in 9 years was held in 2018, which paved the way for open discussions on the transboundary use of water resources and electricity sharing. New bus routes, and regular flights and train services started functioning between the neighboring countries.

21. **Climate change and environmental challenges.** The key environmental challenges are land degradation, deficiency of water resources, and the drying up of the Aral Sea. The impact of climate change on Uzbekistan is evident in the rise of the average air temperature—increasing by 0.29°C for every decade since the early 1950s, which is about twice the global warming rate.²⁵ Climate change is expected to cause rising surface temperatures, particularly in winter, less snowfall, and faster glacier melt in the upstream areas in Tajikistan and the Kyrgyz Republic, upon which Uzbekistan is dependent for water supply. This is expected to increase water demand and reduce water availability, deepening the risk of water stress, particularly in irrigated agriculture. Increasingly variable precipitation patterns and melting permafrost may result in higher frequency of natural hazards such as flooding and landslides. Consequently, in its Nationally Determined Contributions (NDCs) to the Paris Agreement, Uzbekistan identified key climate change adaptation measures in agriculture, natural resources, and infrastructure. They include (i) introducing and scaling up modernized agricultural methods and technologies that are more productive and resilient to the impacts of climate change and variability; (ii) restoring degraded land and improving the management of water resources to ensure sustainable and efficient use of resources with better drought resilience;²⁶ (iii) modernizing, constructing, and maintaining climate-resilient irrigation, water supply, and other infrastructure that is more resilient to extreme weather events; and (iv) conserving and restoring livelihoods and ecosystems the Aral Sea Basin.

22. Uzbekistan is overall a relatively small contributor to global annual carbon dioxide (CO₂) emissions, and its annual per-capita CO₂ emissions (3.4 tons) are below the global average (5.0 tons per capita). However, its CO₂ intensity of GDP is high—2.5 kg per \$ of GDP compared with a global average of 0.5 kg per \$ of GDP (in 2010 United States dollar terms)—indicating a high dependence on fossil fuels, particularly in power generation and industry. As a result, Uzbekistan, under its NDCs, intends to reduce its annual greenhouse gas emissions per unit of GDP by 10% by 2030 (relative to 2010), and has ongoing, legally binding programs for energy efficiency and the deployment of renewable energy technologies. Greenhouse gas reductions are expected to be achieved through incentives, mandates, and financing for (i) improvements in energy efficiency of industrial and power generation facilities and residential buildings; (ii) deployment of renewable energy systems; (iii) fuel switching in transport; (iv) reduction of methane losses in the natural gas subsector; and (v) stronger monitoring and reporting of emission levels.

23. **Sustainable Development Goals.** Uzbekistan endorsed the Sustainable Development Goals (SDGs) in 2015, and in 2018 adopted its national goals and targets until 2030.²⁷ In terms of stakeholder participation, the proposed national SDGs and targets, and the respective draft government resolution on the SDGs' adoption, were submitted to public review and consultations on the government web portal. The targets are ambitious, focusing on the development of physical and human capital and on the improvement of the environment. To reach the national targets for

²⁵ Government of Uzbekistan. 2017. *Intended Nationally Determined Contributions of the Republic of Uzbekistan*. United Nations Framework Convention on Climate Change. Tashkent.

²⁶ About half of the total irrigated area is saline. The estimated annual economic cost of land degradation accounts for 4% of GDP; most degraded areas are in the lowlands of the Amudarya River–Khorezm region, the Republic of Karakalpakstan, and the regions of Bukhara, Navoi, Kashkadarya, and Fergana. International Food Policy Research Institute and Center for Development Research. 2016. *Economics of land degradation and improvement*. Cham, Switzerland.

²⁷ Government Resolution No. 841 *On Measures to Implement the National SDG Goals and Targets until 2030*. October 2018.

the SDGs, the government established a coordination council and developed a road map for implementing and monitoring the SDGs.

B. Key Impediments to Inclusive and Sustainable Growth

24. Uzbekistan is facing considerable long-term (structural) and medium-term challenges. They include the country's demographic characteristics coupled with jobless economic growth, infrastructure constraints, strain on the country's water resources, rising urbanization, the country's landlocked nature and the associated low level of integration into regional or global value chains. In addition, the move toward vibrant private sector-led and inclusive economic growth is slowed by impediments to private sector development, poor governance and political economy, and capacity limitations.

25. **Demographics and jobs.** The country's unusually high share of young people coupled with largely jobless economic growth is a key area for concern. The population grew overall by an average 1.7% per year, from 30 million in 2012 to 32.4 million in 2017, and the rural population increased from 14.6 million to about 16 million in that period. The working-age population grew by 1.7 million in the same period, whereas employment growth was low at 0.2 million, excluding migrants and informal workers.²⁸ Although somewhat mitigated by outmigration, the lack of meaningful employment prospects, especially for the young, may result in an unrealized demographic dividend at best and, at worst, may lower the country's potential output and deepen social concerns.

26. **Rural–urban migration.** A growing rural population, coupled with mechanization and diversification in agriculture, results in greater numbers of people migrating to urban areas.²⁹ This burdens hard and soft urban infrastructure and requires modern solutions, including integrated urban planning and management.

27. **Old and deteriorated infrastructure.** The age and deterioration of critical infrastructure—power supply, roads, water supply and sanitation (WSS)—outside the capital city, especially in small towns and rural areas, where half of the country's population resides, is a constraint to vibrant economic growth. Enterprises report frequent outages, and expanding the water supply coverage is made difficult by system-wide deficiencies, including operational inefficiency (e.g., deteriorated water pump stations, treatment equipment, and transmission networks) and inadequate revenue collection. As regards electricity, although the household electrification rate is almost 100%, the aging infrastructure as well as insufficient and inefficient investment increasingly widened the demand and supply gap and disrupted the provision of electricity. Power outages are particularly severe in rural areas during the cold season (November–March), lasting from 6 hours a day to weeks in some villages and disrupting the operations of local businesses. In the same vein, natural gas supply suffers from seasonal low pressures and interruptions. Irrigation systems are outdated and rely on old and inefficient pumps that consume 20% of the country's electricity.³⁰ Irrigation and agricultural practices are vulnerable to future changes in temperature and water availability as a result of climate change.³¹

²⁸ The growth elasticity of aggregate employment ranged from its lowest level of 0.24 (2015) to 0.31 (2017).

²⁹ Tashkent is the main source of economic activities and hence the main destination for the rural population.

³⁰ Losses caused by the outdated irrigation systems and their poor management were estimated at about \$1.7 billion annually, or 8% of GDP (data as of 2014).

³¹ M. Punkari et al. 2014. *Climate Change and Sustainable Water Management in Central Asia*. ADB Central and West Asia Working Paper Series No. 5. Manila.

28. The disparity in the quality of public infrastructure and social services between the capital city and small towns and rural areas is evident to any visitor to Uzbekistan. WSS, gas, and electricity networks do not adequately cover the rural population and are of inferior quality.³² About half of the districts in Uzbekistan lack all-weather access to the provincial and national roads, impeding the economic activities of small farms. Public education and health care in many rural areas are also inadequate. For example, only about 9% of all children aged 1–6 years in rural areas were covered by early childhood education services, three times less than in urban areas (2016). Rural health care is not adequate, and rural patients must often travel to regional or district health facilities, incurring significant human and economic costs. To rectify these problems, the government launched the *Obod Qishloq* (Prosperous Village) program, which aims to rehabilitate infrastructure in rural areas.

29. **Strain on water resources and degradation of land.** Uzbekistan receives about 80% of water from the neighboring countries. According to the Ministry of Water Resources, whereas the annual water inflow in the 1990s was about 61 billion cubic meters for a population of 20 million, the country now receives only about 52 billion cubic meters for a population of about 33 million. This shortfall causes substantial problems—threatening agricultural productivity, food security, and regional cooperation and integration—and highlights the urgent need for water-conserving policies and technologies. Uzbekistan is increasingly aware that the management of its water resources cannot be undertaken in isolation of the broader transboundary context in Central Asia. As for its land resources, soil salinization is the key driver of irrigated land degradation. In view of the arid climate and agriculture’s significant dependence on irrigation, the country is susceptible to serious water shortages and associated droughts.

30. **Constraints to private sector development.** Several factors hamper private sector development. The state and the SOEs play a significant role in Uzbekistan’s economy. The true extent of the state’s involvement in the economy, even in terms of ownership, is difficult to ascertain.³³ More than 8,000 SOEs dominate most areas of the economy, particularly energy (power generation and transmission as well as oil and gas refining, transportation, and distribution), metallurgy and mining (nonferrous metals and uranium), telecommunications (fixed land lines), agriculture (cotton processing and food product exports), machinery (automotive industry, and locomotive and aircraft production and repair), and transportation (airlines, railways, municipal public transport). In some areas—mining, energy, water supply, and waste management—SOEs are responsible for about 90% of total output.³⁴ The expansion of the private sector has been constrained by monopolistic practices and a myriad of tax, customs, and licensing privileges granted to SOEs. Despite the overall intentions to move toward a market economy, the role of the state in the economy remains pervasive. Reducing its dominant role, reallocating human and capital resources, and realizing productivity and efficiency gains from price liberalization and other structural reforms could create opportunities for new investments by the private sector.³⁵

³² The coverage of centralized water supply is 50% in rural and 84% in urban areas; that of sanitation is 9% in rural and 55% in urban areas, while that of natural gas supply is 63% in rural and 86% in urban areas.

³³ According to official definitions, enterprises or businesses with state ownership of less than 100 percent are in the category of ‘non-state’ enterprises.

³⁴ U. Abdullaev, 2018. *State-Owned Enterprises in Uzbekistan: Taking Stock and Options for the Future*, Preliminary European Bank for Reconstruction and Development (EBRD) Working Paper (May).

³⁵ ADB. 2019. *Uzbekistan Private Sector Assessment*. Manila. The assessment highlighted construction, chemical industry, trade and catering, transport and communication among the areas with promising prospects for job creation combined with productivity advances.

31. Despite some improvements in their corporate governance, many SOEs still resemble sector ministries, effectively combining regulatory, operational, and social protection functions. The government has moved to separate these functions in some sectors by establishing the ministries of energy and transport, for instance.³⁶ But major SOEs still run into conflicts of interest when fulfilling supervisory and regulatory functions in their sectors while concurrently pursuing their goals as commercial enterprises. Governance tends to be opaque, and supervisory boards are often chaired by a government minister. The devaluation of the sum impacted SOEs' debt obligations in foreign currency, triggering adjustments in financial management and tariff policies. Key deficiencies in the governance structure of SOEs include (i) weak control of payroll and non-payroll expenditures, (ii) poor quality and timeliness in preparing financial statements and audits, (iii) poor legislative scrutiny and lack of follow-up of external audits, and (iv) nontransparency. SOEs are subject to domestic accounting standards and rules, which are still not fully comparable with International Financial Reporting Standards.³⁷

32. **Business environment.** Since the 1990s, the business environment has been challenging for both domestic and foreign companies. For example, in the World Bank's 2009 Doing Business ranking, Uzbekistan was placed 166th out of 183 countries. However, the country gradually improved its position and in 2019 was ranked 76th out of 190 countries, a considerable achievement. Progress was particularly noted in simplifying business procedures, such as company registration, which is now done online or through single-window centers under the Ministry of Justice and takes only 2–3 days.³⁸ But Uzbekistan continues to have low rankings on certain critical issues, notably on trading across borders (165th) or dealing with construction permits (134th).³⁹ The government is aiming to ensure that Uzbekistan enters the top-20 ranked countries by 2023. Inadequate workforce skills also dampen business activity because they can act as a brake on private sector growth and discourage foreign direct investment in the country.

33. Lack of effective financial intermediation facilities (including limited rural branch networks), the high cost of funds, and administrative hurdles in withdrawing cash from bank accounts hinder private investment. In addition, business development services that are essential for nurturing small and medium-sized enterprises are mostly lacking. Limited fiscal space does not provide adequate flexibility for public investment in key infrastructure. Consequently, public investment fails to crowd in private investment.

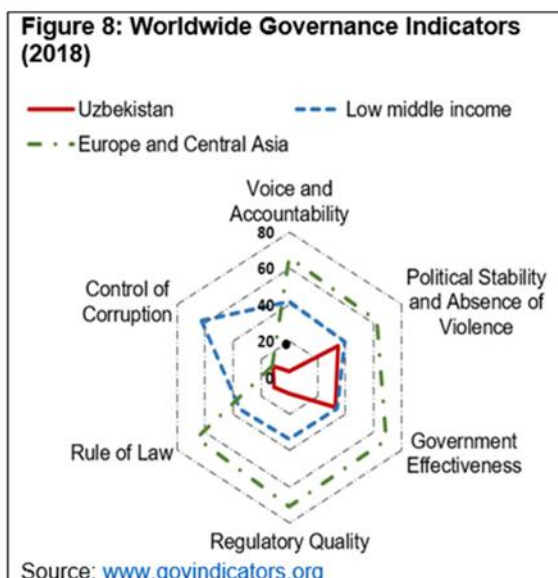
³⁶ The government is restructuring the Cabinet of Ministers and respective line ministries, detaching them from the SOEs' decision making as of February 2019. In addition, the government has recently established the Agency for State Assets Management to improve SOEs' performance, including transparency and corporate governance, and to promote privatization.

³⁷ ADB is already assisting the government's reforms of the SOEs. The *Economic Management Improvement Program, Subprogram 1* (2018) supports the establishment of corporate governance rules in line with the Corporate Governance Guidelines for SOEs of the Organisation of Economic Co-operation and Development (OECD), and the introduction of stricter asset and debt management as well as audit practices. ADB. 2018. *Report and Recommendation of the President to the Board of Directors: Proposed Programmatic Approach, Policy-Based Loan for Subprogram 1, and Technical Assistance Grant to the Republic of Uzbekistan for the Economic Management Improvement Program*. Manila.

³⁸ Since 2016, the President has issued several instructions limiting state agencies and security agencies from restraining business activity; for example, the *Additional Measures to Ensure Rapid Development of Entrepreneurial Activity, Protection of Private Property and High-Quality Improvement of the Business Climate* (2016).

³⁹ World Bank. 2018. *Doing Business 2019: Training for Reform*. Washington, DC.

34. **Public governance.** Challenges exist on the public governance side. Despite drastic improvements in the business climate, Uzbekistan still records low ratings in governance compared with its peers (Figure 8). The pursuit of structural reforms remains constrained by potential oligarchic trends in some sectors of the economy.⁴⁰ Involvement of multiple government agencies and ineffective public services are operational risks for businesses, and constrain private sector development. In addition, extensive staff turnover in public agencies continues to undermine the capacity of the civil service, and hinders the delivery of quality public services. Assistance is needed to strengthen institutional capacity both at the strategic and policy level and at sector and technical levels.



35. In the Heritage Foundation's ranking of economic freedom, Uzbekistan's economic freedom score was 51.5 in 2018, ranking it 152nd in the index (out of 180 countries, 1 being 'most free economy'). Despite government reforms, Heritage rated Uzbekistan's economic freedoms as slightly worsened (by 0.8), as downward trends on judicial effectiveness, trade freedom, and government integrity indicators outweighed improvements. Heritage ranks Uzbekistan 37th among the 43 countries in the Asia and Pacific region, with a score below regional and world averages.⁴¹ Uzbekistan is not ranked in the World Economic Forum's Global Competitiveness Report.

36. A Concept on Administrative Reform, approved by the President in September 2017, has yet to produce substantive results in terms of a road map for institutional reform. Various state functions (such as birth and death registration, issuance of passports, property registration) are still inefficient and unnecessarily complicate the lives of ordinary citizens, although some initial modernization efforts are being made.

37. Alongside the formal governance system, Uzbekistan's political economy has been characterized by a powerful system of informal governance, in which networks and personal connections have taken precedence in decision making over formal procedures. Since 2016, the political leadership has aimed to weaken powerful, informal networks in order to pursue economic reforms. Vested economic and political interests will remain an obstacle to developing effective anticorruption policies and improving the business environment for all economic players.

38. The current economic reforms put a significant strain on public finances, since they aim to elevate the quality of life for the country's population, especially in rural areas, by providing better infrastructure and social services. These needs are vast. Public financial management (PFM) itself is undergoing reforms, including fiscal decentralization and a significant tax reform.

39. **Risks factors.** As economic reforms deepen, these will increasingly challenge vested interests in key economic sectors and government agencies. So far, the President's reform program has been successful in liberalizing foreign trade and foreign exchange, and in developing

⁴⁰ To ensure competition in economic sectors amid privatization, the government established the Antimonopoly Committee in January 2019.

⁴¹ The Heritage Foundation, Index of Economic Freedom (<https://www.heritage.org/index/>).

a new tax code and other measures to improve the business environment. Some other initiatives (such as privatization efforts) were slower, reflecting the need to maintain political support. Avoiding the risks of the reform agenda being thwarted requires a coherent team of reformists, as well as reliable governance mechanisms to pursue strategic reforms effectively. A regular policy dialogue, and significant capacity development and institution building under the ADB's Uzbekistan country partnership strategy (CPS), will help improve the likelihood of success of current and future reforms.

40. In terms of external economic factors, the past upward trend in prices of key export commodities (gold, natural gas, cotton) is projected to level off in the near future. At the same time, growth in import demand by Uzbekistan's main trading partners (the People's Republic of China, Kazakhstan, the Russian Federation, and Turkey) may slow down, with significant downside risks if current international trade tensions escalate. The impact of sanctions on the Russian Federation remains to be seen, and may prove another downside factor through the remittances and investment channels. In terms of external stability, however, these risks should remain modest given the country's large foreign exchange reserves and moderate external debt.

41. As regards the country systems, PFM is deemed reliable in budget credibility, debt management, and treasury functions, but weaknesses exist in transparency, public participation, off-budget funding, internal audit, and external audit. The new PFM reforms aim to improve tax administration, introduce a medium-term budget framework, establish International Public Sector Accounting Standards and strengthen external audit. The public procurement system has historically been viewed as inefficient and nontransparent. In 2018, the government adopted a Public Procurement Law that established a unified institutional and operational procurement approach. While these developments demonstrate political commitment to reforms, given that the government's reforms are still relatively new, ADB will carefully monitor mitigation measures for ongoing and future ADB-financed operations as well as continue the policy dialogue to support further reforms. It will also be important to monitor the debt situation carefully, especially in light of the country's ongoing liberalization and increasing borrowing by the private and public sectors.

C. Implications for ADB Country Engagement

42. Uzbekistan has embarked on substantial reforms since early 2017, aiming to improve the lives of ordinary citizens, enable the development of businesses, open up to its neighbors, and sustain political reforms.⁴² The scale of changes is unprecedented. The government aspires to modernize the country and to move toward upper middle-income status. The adoption of a national development strategy in early 2017 marked a radical break with the state-led model.⁴³ The strategy outlines five priority areas of reforms, including those in governance, public administration, and economic and social development.⁴⁴ The government further elaborated on the direction of reforms

⁴² The latter includes attempts at political decentralization and at giving citizens more voice. For example, a recently established internet portal (<https://meningfikrim.uz/ru>) provides a mechanism for citizens to raise various economic and social concerns with the authorities.

⁴³ Government of Uzbekistan. 2017. Presidential Decree No. 4947. *On Strategy of Actions for Further Development of Uzbekistan*. Tashkent.

⁴⁴ In particular, (i) governance and public administration—improvement of e-government services, and quality and efficiency of public services; (ii) rule of law and judicial system—stronger independence of the judiciary, guaranteed protection of the rights and freedoms of citizens; (iii) economic development—liberalization, competitiveness and modernization, intensive development of agriculture, institutional and structural reforms to reduce the state's presence in the economy, further strengthening of private ownership, small businesses and private entrepreneurship, socioeconomic development of the regions, and attraction of foreign direct investment by improving the investment climate; (iv) social development—improved social protection and health care; expansion of the social and political

in numerous other legislative acts, such as the Concepts of Administrative Reform and Innovative Development, and the Reform Roadmap for 2019–2021.⁴⁵ The formulation of the CPS is timely for supporting this reform agenda through investment financing, policy support, and capacity development.

43. The key objective of the strategy is to support the country’s move toward a vibrant and inclusive market economy, including the transformation of the state’s role. The government’s ultimate objectives of improving the quality of people’s lives and enabling the creation of quality jobs can only be achieved by developing a robust private sector and reducing the state’s pervasive footprint in the economy. ADB will assist in this transition by providing policy advice, investments, and capacity development in three strategic areas: (i) supporting private sector development; (ii) reducing economic and social disparities; and (iii) promoting regional cooperation and integration.

44. In the spirit of “One ADB”, the proposed sovereign operations will be complemented by nonsovereign operations to provide financial assistance directly to bankable private sector and SOE clients, principally in the finance and infrastructure sectors and in agribusiness. ADB will continue to support the government in establishing an enabling environment for public–private partnerships (PPPs) and in scaling them up, and will also provide transaction advisory services for PPP projects in various areas, including solid waste management, water supply, education, and power generation and distribution.

45. **Alignment with Strategy 2030.** ADB’s Strategy 2030 prescribes a differentiated approach to ADB’s developing member countries, in particular the lower middle-income countries such as Uzbekistan. The CPS incorporates integrated cross-sector and cross-thematic solutions. For example, the focus on private sector development and on overcoming economic and social disparities encompasses several infrastructure and social sectors; an interplay between the public and private sectors; a mix of lending modalities; and a mix of sovereign, PPP, and nonsovereign operations. ADB’s flagship operations in the infrastructure sectors feature both financing, policy advice, and capacity development. Support to public governance and SOE reform also embraces a systemic approach in tackling the fundamental constraints to private sector development. Another example is the promotion of regional tourism, which covers various modalities, sectors, and themes (e.g., urban infrastructure, planning, public and private services, gender, regional cooperation and integration).

46. ADB intends to maintain a significant operational presence in the country, given its size, the large and growing operational program,⁴⁶ diverse development challenges, and the reform momentum. The strategic selectivity is motivated by prioritizing government demands, establishing clear divisions of labor across sectors and subsectors, and considering ADB’s track record, past operational performance, and current comparative advantage. For example, the World Bank, the United Nations Development Programme, the United Nations Children’s Fund, and the International Labour Organization are supporting the social sectors. ADB’s support in those areas

activity of women; affordable housing, transport system, education, and culture; and improvement of the state youth policy; and (v) security, tolerance, and foreign policy—reinforcement of the state’s sovereignty, creation of a security belt around Uzbekistan, and inter-ethnic harmony and religious tolerance.

⁴⁵ Government of Uzbekistan. 2017. Presidential Resolution No. 5185. *On Approval of Administrative Reform Concept*. Tashkent. Government of Uzbekistan. 2019. Presidential Decree No. 5621. *On Drastic Improvement of the Implementation System of State Policy in Economic Development*. Tashkent. Government of Uzbekistan. 2019. Presidential Decree No. 5614. *On Additional Measures to Ensure Further Development of the Economy and to Enhance the Economic Policy Effectiveness*. Tashkent.

⁴⁶ ADB’s ongoing Uzbekistan portfolio is the largest among the Central Asia and South Caucasus countries.

will be modest during the CPS period, focused on complementing the lead work of other development partners and addressing key constraints to human capital development. The issues of the Aral Sea Basin will be tackled by increasing the water productivity of irrigated agriculture—the largest consumer of water resources—and strengthening transboundary water resources management. With a long tradition of supporting regional cooperation and integration in Central and West Asia, ADB will continue promoting regional public goods and other regional activities. Selectivity will also be governed by Strategy 2030's operational priorities with which the CPS is aligned: for example, ADB's program will focus mainly on public management, service delivery, and capacity in line with the operational priority of strengthening governance and institutional capacity, or on minimizing disparities and creating quality jobs in line with the operational priority of addressing remaining poverty and reducing inequalities. The CPS will build in a certain amount of flexibility to remain effective while facing changing realities.