Report and Recommendation of the President to the Board of Directors

Project Number: 47305-002
November 2016

Proposed Loan
Republic of Uzbekistan: Horticulture Value Chain Development Project

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Asian Development Bank
CURRENCY EQUIVALENTS
(as of 3 October 2016)

Currency unit = sum (SUM)
SUM1.00 = $0.00034
$1.00 = SUM2,936.80

ABBREVIATIONS

ADB – Asian Development Bank
ESMS – environmental and social management system
GDP – gross domestic product
ha – hectare
m³ – cubic meter
PAM – project administration manual
PFI – participating financial institution
RRA – Rural Restructuring Agency
TA – technical assistance
US – United States

NOTES

In this report, “$” refers to US dollars.

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# PROJECT AT A GLANCE

## 1. Basic Data
- **Project Number:** 47305-002
- **Project Name:** Horticulture Value Chain Development
- **Country:** Uzbekistan
- **Borrower:** Republic of Uzbekistan
- **Department/Division:** CWRD/CWER
- **Executing Agency:** Rural Restructuring Agency

## 2. Sector
- **Subsector(s):**
  - Agriculture, natural resources and rural development
  - Small and medium enterprise finance and leasing
  - Agricultural policy, institutional and capacity development
  - Agro-industry, marketing, and trade
  - Land-based natural resources management

### ADB Financing ($ million)
- **Total:** 154.00

## 3. Strategic Agenda
- **Subcomponents:**
  - Inclusive economic growth (IEG)
  - Environmentally sustainable growth (ESG)

### Climate Change Information
- **Adaptation ($ million):** 50.00
- **Climate Change impact on the Project:** Low

## 4. Drivers of Change
- **Components:**
  - Governance and capacity development (GCD)
  - Knowledge solutions (KNS)
  - Partnerships (PAR)
  - Private sector development (PSD)

### Gender Equity and Mainstreaming
- **Effective gender mainstreaming (EGM):** Yes

## 5. Poverty and SDG Targeting
- **Location Impact:**
  - Rural: High
  - Urban: Low
  - SDG Goals: SDG5, SDG8, SDG9

## 6. Risk Categorization:
- **Low**

## 7. Safeguard Categorization
- **Environment:** FI
- **Involuntary Resettlement:** FI-C
- **Indigenous Peoples:** FI-C

## 8. Financing
- **ADB:** 154.00
- **Sovereign Project loan: Asian Development Fund:** 154.00
- **Cofinancing:** 0.00
- **Counterpart:** 61.00
  - Beneficiaries: 40.00
  - Government: 21.00
- **Total:** 215.00

## 9. Effective Development Cooperation
- **Use of country procurement systems:** Yes
- **Use of country public financial management systems:** Yes

Source: Asian Development Bank
This document must only be generated in eOps. 31102016112315025026 Generated Date: 31-Oct-2016 11:23:24 AM
I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed loan to the Republic of Uzbekistan for the Horticulture Value Chain Development Project.\(^1\)

2. The proposed project will support the Government of Uzbekistan strategy in horticulture value chain development by increasing outreach of participating financial institutions (PFIs) to horticulture farmers and entrepreneurs in all 12 regions nationwide and the Republic of Karakalpakstan. It will improve access to market-based bank finance for farmers, agro-processing enterprises, owners and operators of cold storage facilities, and trading and logistics service suppliers in the horticulture value chain. The project will help increase farm productivity, improve processing and storage capacity, and reduce post-harvest losses through upgrading and establishing intensive orchards, modern and efficient greenhouses, and processing, storage, and refrigeration facilities. This will, in turn, promote long-term economic and environmental sustainability, and enhance profitability for farmers and agribusiness enterprises.\(^2\)

II. THE PROJECT

A. Rationale

3. Sector performance. Uzbekistan’s economy has grown consistently during 2010–2015. During 2010–2013, gross domestic product (GDP) grew at annual rates of more than 8.0%, reaching $66.7 billion in 2015.\(^3\) The economy proved resilient to the downward pressures exerted from 2008 onward on other economies by the global financial crisis. Despite an economic downturn in the Russian Federation, Uzbekistan’s major trading partner and source of remittances, the Uzbek economy is expected to maintain GDP growth rates of 6.9% in 2016 and 7.3% in 2017. Overall poverty, according to national poverty line estimates, declined from 27.5% of the population in 2001 to 13.7% in 2014 as a result of rapid economic growth.\(^4\) Along with overall economic growth, agricultural GDP in Uzbekistan grew at annual rates ranging from 6.3% (2014) to 7.1% (2012). The agriculture sector is projected to grow by 6.0% in 2016 and 6.5% in 2017. However, the expansion of and higher rate of growth in other sectors resulted in a decline in the agriculture sector’s GDP contribution. In 2000, agriculture accounted for 34.4% of GDP. This had fallen to 18.3% by 2015. Agricultural GDP has traditionally derived from the production of cotton and wheat, which the government regarded as strategic crops and supported through preferential access to land, inputs, and finance. However, there has been a shift in these crops’ contribution to GDP since 2000. The share of cotton production in GDP declined from 3.6% in 2000 to 2.3% in 2013.\(^5\) Over the same period, the contribution of grains to

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\(^1\) The design and monitoring framework is in Appendix 1.

\(^2\) The Asian Development Bank (ADB) provided project preparatory technical assistance (TA) for the Horticulture Value Chain Development Project (formerly Innovations for Agriculture Modernization Project) (TA 8567-UZB), and a small-scale project preparatory TA was provided to assist with the national feasibility study and project start-up.


\(^4\) On the basis of $1.90 purchasing power parity criterion, an estimated 68.1% of the population was below the poverty line in 2012. ADB. 2016. Basic 2016 Statistics. Manila.

\(^5\) Cotton production area has been declining at an annual rate of 2.3%, from 2.1 million hectares (ha) in 1991 to 1.3 million ha in 2014, accounting for 27.4% of total cropland in 2014 (4.7 million ha) compared with 43.5% in 1991. Cotton output has been decreasing by 6.3% per annum, from 1.7 million tons of lint cotton in 1991 to 0.8 million tons of lint cotton (equivalent to about 3.0 million tons of seed cotton) in 2014. Cotton export has been declining at an annual rate of 10.0% since 1991, and average cotton yield from 2.7 tons to 2.1 tons per ha in seed cotton measures.
GDP fell from 3.4% to 2.4%\(^6\) while the combined share of fruits and vegetables increased from 5.2% to 10.6%.

4. Despite its declining share of GDP, agriculture remains an important sector. In 2015, it accounted for 32% of total employment. It is also a key income source in rural areas, where 49% of the population resides and which account for 75% of people living below the poverty line. About 4.7 million rural households operating *dehkan* (small-scale) farms derive their income from agriculture. *Dehkan* farms, which operate independently of government support, account for the production of 64% of vegetables, 75% of potatoes, 52% of fruit, and 45% of grapes on farms of 0.35–0.50 hectares (ha).

5. The shift in production from cotton and wheat to horticulture is also reflected in exports. Agricultural exports grew at an annual average rate (in current dollar terms) of 12.5% during 2000–2013, while cotton exports grew by an annual rate of only 2.0%. During 2010–2013, cotton exports declined from $1.5 billion to $1.1 billion, while the share of cotton exports in total exports fell from 27.5% in 2000 to 7.4% in 2014. By comparison, the share of food products in exports rose from 5% in 2000 to 12% in 2014.\(^7\) Fruit and vegetable exports grew from $68.7 million in 2000 to $1.4 billion in 2013, equating to an average annual growth rate of 26%, while the share of fruits and vegetables in total exports increased from 2% to 9%. In 2014, the value of fruit and vegetable exports exceeded that of cotton exports by 30% (almost $500 million).

6. **Binding constraints.** Although it is expected to continue to grow, agriculture is characterized by low productivity and remains labor intensive. The horticulture sector is constrained by limited access to quality land, specialized horticulture machinery, appropriate inputs, and in particular finance. Limited access to either equity or long-term debt financing for producers and enterprises throughout the value chain constrains the sector’s development. The horticulture sector does not receive preferential financing under government programs, as in the case of cotton and wheat production. Financial institutions have a largely negative perception of agriculture profitability and creditworthiness, exacerbated by an undeveloped regulatory framework for the use of movable assets as loan collateral, and a lack of acceptable collateral among many small-scale producers or collateral with low realizable values among agribusiness enterprises. Further, access to information on potential borrowers is limited as the credit information system is not yet effective. Financial institutions have yet to develop credit policies and loan products appropriate to the needs of horticulture producers and enterprises, including cash flow-based loan appraisal suitable for horticulture investment and seasonality of production.

7. The high cost of funds, perceived risks, and administrative costs associated with lending to individuals and small business require banks to charge interest rates from 11% to 25% for local currency loans and from 6% to 15% for foreign currency loans. Individuals and small businesses are required to borrow at the higher end of these ranges. Deposit mobilization is undermined by public mistrust in banks, compounded by administrative hurdles in withdrawing cash from bank accounts, with a fee of up to 20% of the transaction amount. Bank lending for investment is constrained by the predominantly short-term maturity of funding sources. Particularly, access to finance for private individuals and enterprises is constrained by weak rural branch networks and limited mobile banking services. Eighty percent of small businesses are funded by family, friends, and informal sources.\(^8\) In addition, farmers and agribusiness enterprises have poorly developed business and managerial skills and generally low financial

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literacy. Surveys indicate that small businesses generally lack access to information on market opportunities, suppliers, competitors, technology, and banking products. The low income level of rural households, many of which are led by women, also limits their access to financial services and ability to invest. Access to finance remains a constraint for private business growth.

8. **Opportunities.** The potential of a growing and more sophisticated consumer demand for both fresh and processed products in domestic and export markets is not being realized due to such constraints. Significantly larger volumes of produce with improved quality could be marketed with better post-harvest logistics, notably cold storage and transport. Of the 17.4 million tons of horticultural output in 2015, only 15% was processed. Of the 2.5 million tons of fruits produced, 69% are consumed fresh, 20% processed, and 11% exported, while for the 9.3 million tons of vegetables, 81% are consumed fresh, 11% processed, 4% used for seed, and 3% exported. This indicates a significant opportunity for improved value addition from increased processing and exports of both fresh and processed products. Revealed comparative advantage analysis suggests that Uzbekistan is more specialized in producing horticultural products than many of the world’s producers, indicating its potential to expand its exports. The traditional market for Uzbek horticulture produce has been the Russian Federation, which accounts for 80% of Uzbekistan’s exports, but these imports only account for 3%–4% of all fruit and vegetable imports to the Russian Federation. Uzbek exports could expand significantly by capturing a larger share of the Russian Federation market. Beyond this market, there is also scope for Uzbek horticulture exports to European markets. However, accessing European, especially European Union, markets will require improvement in horticulture quality and safety standards and certification systems. In this context, there is considerable scope to improve storage, processing, and marketing technologies.

9. **Continued diversification** from cotton and wheat production toward horticulture also offers significant environmental benefits as it could decrease demand for irrigation water. Climate change projections for Uzbekistan from 2005 to 2050 indicate that (i) water demand will increase from 59 billion cubic meters (m$^3$) to 62 billion–63 billion m$^3$, (ii) supply will decrease from 57 billion m$^3$ to 52 billion–54 billion m$^3$, and (iii) the water deficit will increase by more than 500% from about 2 billion m$^3$ to 11 billion–13 billion m$^3$. Horticulture crops typically use less water than cotton and are more efficient in water use than grain crops. In Uzbekistan, 4,426 m$^3$ of water is required to grow a ton of cotton and 2,068 m$^3$ of water for a ton of wheat. By comparison, grape and apple production per ton requires about 2,400 m$^3$ and 820 m$^3$ of water, respectively.

10. **Government’s sector strategy.** The government aims to take more steps to increase agriculture production. Measures include (i) further structural reforms in agriculture and diversification of agricultural production; (ii) mechanization of agriculture, improvement of infrastructure, and development of agribusiness; (iii) more productive use of land and water; (iv)

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11 The Ministry of Agriculture and Water Resources estimates post-harvest losses to be up to 45.0% of the harvested crop, and that existing cold storage will only be able to store 2.3% of the total forecast horticulture output by 2020.
greater financial stability of farm entities; and (v) more market-oriented agricultural policies. Ministry of Agriculture and Water Resources has prepared a sector development plan to 2020 that includes further reductions in cotton and wheat production and an increase in horticulture production. The strategy for further land reallocation will result in increased area for potatoes by 36,000 ha, vegetables by 91,000 ha, fruit orchards by 18,000 ha, and vineyards by 11,200 ha.\(^\text{15}\) The strategy will also target improved logistics, processing, and exports for several activities, including horticulture.\(^\text{16}\) A policy initiative has established a state procurement system for fruits and vegetables.\(^\text{17}\) It intends to procure fruits and vegetables for delivery to processors and for storage to ensure adequate off-season supply for consumers, and entrusts responsibility for fresh fruit and vegetable export to two state entities.

11. In the banking and finance sector, the government has implemented programs to support small business and banking sector growth, and has increased access to finance. To improve the capacity of the banks to assess borrower creditworthiness, the Law on Credit Information, promulgated in 2011, has established a public credit bureau. To facilitate registration of movable assets as loan collateral, the 2013 Law on Collateral Registry supports establishing an electronically secured transactions registry. Laws enacted in the late 1990s need to be improved to facilitate the use of movable property as collateral. Assisted by the International Finance Corporation, the government has prepared draft legal amendments for enactment in 2017. The government’s development strategy is consistent with the Asian Development Bank’s (ADB’s) country partnership strategy, 2012–2016 for Uzbekistan. And it is included in ADB’s country operations business plan, 2016–2018.\(^\text{18}\)

12. Development partners have supported agriculture and horticulture through a variety of projects and technical assistance (TA) support. The World Bank has implemented two rural enterprise restructuring projects that included the provision of credit to farmers and food-processing enterprises. The World Bank is implementing a $150 million Horticulture Development Project, which includes (i) providing credit lines to PFIs, (ii) improving financial literacy and business-planning skills for horticulture farmers and agribusiness enterprises, (iii) establishing the national network of private growers through training and TA, and (iv) strengthening state research institutes and plant protection services. The International Fund for Agricultural Development is implementing a $30 million Horticulture Development Project. Other development partners have also provided broad support to enhance the business environment, and capacity building for financial institutions and small business.\(^\text{19}\)

13. **Potential for female entrepreneurship.** In 2015, agriculture accounted for 32% of the total workforce (or about 10 million people), of which men accounted for 54% and women 46%. Despite their prominent role in agricultural production, women are mainly engaged in simple and nontechnical fieldwork or cultivation of family-owned gardens. While rural women and female *dehkan* farmers, in particular, are an important part of the horticulture value chain, they lack confidence to start businesses and face difficulties finding formal jobs because of inadequate technical skills and access to information, and limited entrepreneurship and leadership skills.

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\(^{15}\) Under the farm size optimization program approved by the Cabinet of Ministers on 29 December 2015.

\(^{16}\) Government of Uzbekistan. 2016. *Presidential Decree PP-2505*. Tashkent. Under this decree, a program on measures to further develop the raw material base, expansion in processing of horticulture, meat and dairy products, increasing foodstuffs production and export within 2016–2020 was adopted.

\(^{17}\) Government of Uzbekistan. 2016. *President’s Resolution No. 2520*. Tashkent. Under this decree, a policy initiative on state procurement system for fruits and vegetables was established.


\(^{19}\) Development Coordination (accessible from the list of linked documents in Appendix 2).
There is a significant potential for job creation and entrepreneurship in horticulture for women.

14. **ADB’s value addition and lessons.** The project will help the government draw valuable lessons in formulating conducive and market-based sector policies, address water scarcity and soil salinity issues through crop diversification, and enhance private sector participation in the agriculture value chains to increase efficiency gains while reducing state fiscal burden. This will enable ADB and other development partners to focus on comprehensive export-expansion initiatives through best-practice production, and proper post-harvest processing and handling following international quality and safety standards. Moreover, through enhanced access to long-term finance, PFIs will be able to sustainably increase their outreach into horticultural business as a high-potential niche. Expanded export of horticultural produce will help increase overall price and income transmission to small-scale producers, and small- and medium-sized agribusinesses. Capacity development activities will enhance subborrowers’ technical capacity for their proposed investments. The project design incorporates lessons learned from previous and ongoing development partner-funded projects that support the government’s sector policies and strategies. Lessons call for (i) diversifying from cotton–wheat crop rotations; (ii) investing in modern production systems; (iii) addressing the whole value chain to ensure sufficient logistical capacity; (iv) implementing a demand-driven approach to commercial financing; and (v) providing technical support to PFIs, enabling them to better assess horticulture-related loan applications. Project readiness is enhanced by financing of taxes and duties on eligible project management expenditures.

B. **Impact and Outcome**

15. The impact will be improved contribution of the horticulture sector to inclusive economic growth and rural employment (footnote 14). The outcome will be increased production and marketing of horticultural products.

C. **Output**

16. The output will be increased financing for horticulture sector. PFIs will receive credit lines from the ADB loan to extend subloans to interested and qualified subborrowers for horticulture operations, including planting materials, processing and storage equipment, and mechanical equipment. Through the management and implementation budget, the project will provide capacity building, training, and technical support to (i) PFIs in subloan appraisals and environmental safeguards compliances; and (ii) subborrowers in business planning, horticulture agronomic techniques, post-harvesting operations, and export market penetration. The project management office based in the Rural Restructuring Agency (RRA) will oversee implementation activities, including monitoring of sublending; compliances for safeguards, gender, and financial covenants; and financial auditing.

D. **Investment and Financing Plans**

17. The project is estimated to cost $215 million (Table 1).

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20 Lessons and Synergies (accessible from the list of linked documents in Appendix 2).
22 Eligibility criteria for PFIs, subborrowers, subprojects, and subloans are detailed in the project administration manual (PAM) (accessible from the list of linked documents in Appendix 2).
Table 1: Project Investment Plan
($ million)

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount&lt;sup&gt;a&lt;/sup&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Base Cost&lt;sup&gt;b&lt;/sup&gt;</td>
<td></td>
</tr>
<tr>
<td>1. Finance to horticulture sector</td>
<td>210.0</td>
</tr>
<tr>
<td>2. Project management and implementation</td>
<td>2.6</td>
</tr>
<tr>
<td>Subtotal (A)</td>
<td>212.6</td>
</tr>
<tr>
<td>B. Contingencies&lt;sup&gt;c&lt;/sup&gt;</td>
<td>0.4</td>
</tr>
<tr>
<td>C. Financing Charges During Implementation&lt;sup&gt;d&lt;/sup&gt;</td>
<td>2.0</td>
</tr>
<tr>
<td>Total (A+B+C)</td>
<td>215.0</td>
</tr>
</tbody>
</table>

<sup>a</sup> Includes import taxes and duties of $19.0 million, financed by the government, and $0.2 million in taxes and duties related to project management expenses, financed by the Asian Development Bank (ADB). ADB will finance taxes and duties related to project management, as they do not represent an excessive share of the financing plan and are within applicable country partnership strategy parameters, in accordance with ADB. 2005, *Innovation and Efficiency Initiative—Cost Sharing and Eligibility of Expenditures for Asian Development Bank Financing: A New Approach*. Manila.

<sup>b</sup> In mid-2016 prices.

<sup>c</sup> Contingencies are only computed for project management. Physical contingencies have been estimated at 5% for all goods and services. Price contingency for local currency costs is based on the following rates: 11.0% for 2017, 9.7% for 2018, and 10.0% thereafter; and for foreign exchange costs at 1.4% in 2017 and 1.5% thereafter.

<sup>d</sup> Interest charges during implementation for ADB’s Asian Development Fund loan, financed by the government.

Source: ADB estimates.

18. The government has requested a loan in various currencies equivalent to SDR111,585,000 from ADB’s Special Funds resources to help finance the project. The loan will have a 25-year term, including a grace period of 5 years, an interest rate of 2% per annum, and such other terms and conditions set forth in the draft loan and project agreements. Subborrowers will contribute $40 million as their equity contribution for subprojects financed by the loan, and the government will contribute $21 million, including $19 million through exemptions of taxes and duties for imported goods and $2 million for interest charges during implementation.<sup>23</sup> The financing plan is in Table 2 and further detailed in the project administration manual (PAM).<sup>24</sup>

Table 2: Financing Plan

<table>
<thead>
<tr>
<th>Source</th>
<th>Amount ($ million)</th>
<th>Share of Total (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asian Development Bank</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Asian Development Fund loan</td>
<td>154.0</td>
<td>71.6</td>
</tr>
<tr>
<td>Subborrowers’ Equity Contributions</td>
<td>40.0</td>
<td>18.6</td>
</tr>
<tr>
<td>Government</td>
<td>21.0</td>
<td>9.8</td>
</tr>
<tr>
<td>Total</td>
<td>215.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: Asian Development Bank estimates.

19. The government will relend the loan proceeds in United States (US) dollars to PFIIs through subsidiary loan agreements that satisfy ADB’s eligibility criteria set out in the PAM and the loan and project agreements.<sup>25</sup> The government is expected to relend the loan proceeds to PFIIs for a tenor of 20 years and a grace period of 3 years. The government’s relending rate will

<sup>23</sup> PFIIs will determine subborrower equity contributions based on the nature of the credit risk, which, depending on each PFI’s credit policy, would range from 20% to 30% of the subproject cost.

<sup>24</sup> Project Administration Manual (accessible from the list of linked documents in Appendix 2).

<sup>25</sup> Based on each PFI absorptive capacity, tentative allocation of loan proceeds is as follows: Asaka Bank ($10 million), Davr Bank ($6 million), Hamkorbank ($25 million), Ipak Yuli Bank ($10 million), Ipoteka Bank ($11 million), National Bank of Uzbekistan ($50 million), Turon Bank ($5 million), and Uzpromstroybank ($15 million). An amount of $17 million is reserved for competitive withdrawal and/or new PFI accreditation.
be the interest rate charged by ADB for the loan plus an appropriate margin to cover administrative and risk costs.\textsuperscript{26}

20. PFIs’ subloans may be issued in US dollars and/or local currency, and priced by PFIs at market rates that cover risks related to foreign exchange, credit, maturity, and interest rates. Subloan repayment may be in US dollars and/or local currency subject to the subborrowers’ demand and subprojects’ revenue streams, as well as specific agreements between PFIs and subborrowers. Subloans extended by PFIs will have a tenor of up to 10 years. PFIs will determine the creditworthiness of subborrowers and assume the full credit risk. The maximum subloan size will be $5 million based on previous and prospective demand of PFIs’ clientele.

21. **Participating financial institutions.** Eight PFIs were selected among commercial banks that expressed interest to participate in the project, and underwent subsequent detailed due diligence by ADB. They are Asaka Bank, Davr Bank, Hamkorbank, Ipak Yuli Bank, Ipoteka Bank, National Bank of Uzbekistan, Turon Bank, and Uzpromstroybank. PFIs for the most part are in compliance with the Central Bank of Uzbekistan prudential regulations and meet ADB’s eligibility requirements for financial intermediaries and ADB-determined financial covenants.\textsuperscript{27} To address areas of minor noncompliance, PFIs will be required to satisfy disbursement conditions and to implement action plans for financial covenants, as indicated in the PAM.

E. **Implementation Arrangements**

22. The implementation arrangements are summarized in Table 3 and detailed in the PAM.

<table>
<thead>
<tr>
<th>Aspects</th>
<th>Arrangements</th>
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<tr>
<td>Implementation period</td>
<td>January 2017–December 2021</td>
</tr>
<tr>
<td>Estimated completion date</td>
<td>31 December 2021 (loan closing date: 30 June 2022)</td>
</tr>
<tr>
<td>Management</td>
<td></td>
</tr>
<tr>
<td>(i) Executing agency</td>
<td>RRA</td>
</tr>
<tr>
<td>(ii) Key implementing</td>
<td>PFIs: Asaka Bank, Davr Bank, Hamkorbank, Ipak Yuli Bank, Ipoteka Bank,</td>
</tr>
<tr>
<td>agencies</td>
<td>National Bank of Uzbekistan, Turon Bank, and Uzpromstroybank</td>
</tr>
<tr>
<td>(iii) Implementation units</td>
<td>Project management office under RRA and one project implementation unit in</td>
</tr>
<tr>
<td></td>
<td>each PFI</td>
</tr>
<tr>
<td>Procurement\textsuperscript{a}</td>
<td>Shopping (goods)</td>
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<tr>
<td>Consulting services\textsuperscript{a}</td>
<td>CQS (advisory services)</td>
</tr>
<tr>
<td></td>
<td>LCS (financial auditing)</td>
</tr>
<tr>
<td>Advance contracting</td>
<td>Not applicable</td>
</tr>
<tr>
<td>Disbursement</td>
<td>Loan proceeds will be disbursed following ADB’s <em>Loan Disbursement Handbook</em> (2015, as amended from time to time) and arrangements agreed between the Government of Uzbekistan and ADB.</td>
</tr>
</tbody>
</table>

\textsuperscript{a} Goods and consulting services related to project management will be procured by RRA following ADB’s Procurement Guidelines (2015, as amended from time to time) and ADB’s Guidelines on the Use of Consultants (2013, as amended from time to time).

Source: ADB.

26 The government will charge the interest on the ADB loan plus 0.2% per annum to the PFIs. The PFIs’ interest rates carry the cost for (i) loan origination, (ii) provision of foreign exchange to service the ADB loan, and (iii) credit risk and related capital charges.

23. The executing agency is RRA, which was established under the Ministry of Agriculture and Water Resources in the form of an incorporated agency as part of the government to facilitate the implementation of certain agriculture projects. RRA is familiar with similar projects financed by the World Bank for small- and medium-sized enterprises and the horticulture sector development. To ensure long-term programmatic development in the horticulture sector, it is important to engage RRA as a sector institution to (i) coordinate and facilitate sector development, (ii) monitor sublending to PFIs, and (iii) provide capacity building and technical support to other sector institutions, PFIs and subborrowers, in addition to monitoring compliance for safeguards, gender, and financial covenants. Based on lessons from previous ADB-financed financial intermediation projects and those with RRA as the executing agency, the project will channel more than 95% of the loan proceeds directly to PFIs through their imprest accounts to expedite disbursement. Tasks assigned to RRA’s scope of contract management will cover the purchase of minor items such as vehicles, office equipment and supplies, and supervision of certain technical expert service contracts, estimated at a total of $3 million. The borrower accepts RRA’s liabilities under the project through covenanting in the loan agreement that it will ensure that RRA has sufficient funds to satisfy its liabilities arising from any goods and/or consulting services contracts.

24. Based on PFIs' portfolio analysis and loan utilization on various development partner-financed projects of a similar nature, it is envisaged that many potential subborrowers of PFI subloans will procure goods, works, and consulting services from both ADB and non-ADB member countries, including the Russian Federation and Israel. A request to ADB’s Board of Directors is being made, pursuant to Article 14(ix) of the Agreement Establishing the Asian Development Bank (the Charter), to approve procurement of goods, works, and consulting services from non-ADB member countries by subborrowers using loan proceeds under the project in appropriate circumstances. This request reflects the market-based nature of the project, subborrowers’ demand, and procurement history.

III. DUE DILIGENCE

A. Economic and Financial

25. The project will help improve horticulture sector productivity and value addition in line with government strategy. By addressing the horticulture sector constraint of accessing long-term finance, it will facilitate and spur investment in intensive water-efficient technologies for fruit and vegetable production and post-harvest storage, processing, and marketing facilities. This will increase the volume and enhance the quality of Uzbek horticultural produce for both domestic and export markets. Expanding exports is a goal of the government’s agricultural strategy to 2020. Analysis of a sample of indicative production and agribusiness investments shows financial rates of return from 15% to 33%, suggesting these investments are viable.

26. The eight proposed PFIs have experience in lending to agriculture, with varying levels of agricultural loan portfolios. They have all been assessed as financially sound. Financial projections for the project implementation period indicate the PFIs will continue to perform well and comply with the Central Bank of Uzbekistan regulations and loan financial covenants. The maximum value of project-financed subloans is projected to range from 0.2% to 2.2% of PFIs’ gross loan portfolios during project implementation in 2017–2021. Borrowing under the project is, therefore, well within the absorptive capacity of each PFI.

29 Financial Analysis and Economic Analysis (accessible from the list of linked documents in Appendix 2).
B. Governance

27. Financial and integrity due diligence has been undertaken on each PFI. Based on the due diligence, the overall pre-mitigation financial management risk is classified as medium. An action plan for each PFI to address financial management issues has been prepared and will be implemented up to the first quarter of 2018. A financial management assessment of RRA, the executing agency, did not identify any issues that would adversely affect its project management role. ADB’s Anticorruption Policy (1998, as amended to date) was explained to and discussed with the government, RRA, and PFIs. The specific policy requirements and supplementary measures are described in the PAM (footnote 24).

C. Poverty and Social

28. The project supports poverty reduction indirectly through horticulture value chain development. With 32% of the total workforce (or about 10 million people) in agriculture, the project will help many horticulture farmers and entrepreneurs boost their investments, maintain and expand employment, and provide stable incomes for themselves and their employees and suppliers. The project is classified as effective gender mainstreaming. Gender actions will help enhance female entrepreneurship in the horticulture sector. ADB conducted due diligence and confirmed that core labor standards are complied within the horticulture sector. The loan and project agreements include covenants on labor standards and safety.

D. Safeguards

29. The project is classified as financial intermediation for environment and category C for involuntary resettlement and indigenous people safeguards. Subprojects that are identified in ADB’s Prohibited Investment Activities List in ADB’s Safeguard Policy Statement (2009), classified category A for environment, and classified as category A or B for involuntary resettlement or indigenous people safeguards are not eligible for project financing. In addition, eligible subprojects will comply with applicable national regulations. ADB carried out due diligence of the PFIs’ environmental and social management systems (ESMSs). All PFIs must have an ESMS that satisfies Safeguard Policy Statement requirements prior to the first disbursement of their respective loans.

E. Risks and Mitigating Measures

30. Major risks and mitigating measures are summarized in Table 4 and described in detail in the risk assessment and risk management plan. The overall project risk is medium. The integrated benefits and impacts are expected to outweigh the costs.

Table 4: Summary of Risks and Mitigating Measures

<table>
<thead>
<tr>
<th>Risks</th>
<th>Mitigating Measures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reduced economic activity affects debt service capacity of horticulture farmers and enterprises.</td>
<td>PFIs will carefully underwrite their lending to help their clients achieve adequate debt service capacity.</td>
</tr>
</tbody>
</table>

30 Summary Poverty Reduction and Social Strategy, and Gender Action Plan (accessible from the list of linked documents in Appendix 2).
31 Detailed Social and Gender Assessment (accessible from the list of linked documents in Appendix 2).
32 Financial Intermediary: Environmental and Social Management System Arrangement (accessible from the list of linked documents in Appendix 2).
33 Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).
### Risks

<table>
<thead>
<tr>
<th>Risks</th>
<th>Mitigating Measures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increased risk provisions and adopting the Central Bank of Uzbekistan’s capital adequacy standards require additional capital to maintain compliance with prudential regulations.</td>
<td>PFIs and the CBU will conduct stress testing and internal capital adequacy assessment. PFIs will raise capital as required.</td>
</tr>
<tr>
<td>PFIs incur credit risks.</td>
<td>PFIs were selected based on their past financial track records, including their prudent management of credit risk in lending to small and micro enterprises.</td>
</tr>
</tbody>
</table>

CBU = Central Bank of Uzbekistan, PFI = participating financial institution.

### IV. ASSURANCES AND CONDITIONS

31. The government has assured ADB that implementation of the project shall conform to all applicable ADB policies, including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, and disbursement as described in detail in the PAM and loan documents.

32. The government has agreed with ADB on certain covenants for the project, which are set forth in the loan and project agreements. As a condition to loan effectiveness, at least three PFIs shall have entered into a project agreement with ADB, and the government and RRA shall have entered into a tripartite subsidiary loan agreement with such PFIs, in form and substance satisfactory to ADB. Conditions for loan disbursement for relending to a PFI includes the execution of a project agreement with ADB, a subsidiary loan agreement with the government and RRA, the establishment of an ESMS in accordance with ADB’s Safeguard Policy Statement requirements, and the appointment of designated staff to implement the ESMS, by each PFI.

### V. RECOMMENDATIONS

33. I am satisfied that the proposed loan would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve the loan in various currencies equivalent to SDR111,585,000 to the Republic of Uzbekistan for the Horticulture Value Chain Development Project, from ADB’s Special Funds resources, with an interest charge at the rate of 2% per annum; for a term of 25 years, including a grace period of 5 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft loan and project agreements presented to the Board.

34. I also recommend that the Board approve the proposal in para. 24 of this report that goods, works, and consulting services procured from non-ADB member countries are eligible for financing under subloans provided to subborrowers in the Republic of Uzbekistan under the Horticulture Value Chain Development Project. If the requisite affirmative vote of Directors representing not less than two-thirds of the total voting power of ADB members, pursuant to Article 14(ix) of the Agreement Establishing the Asian Development Bank, is not obtained for this recommendation and the Board only approves the recommendation in para. 33, then only goods, works, and consulting services procured from ADB member countries will be eligible for financing under subloans provided to subborrowers under the Horticulture Value Chain Development Project.

Takehiko Nakao
President

4 November 2016
## DESIGN AND MONITORING FRAMEWORK

### Impact the Project is Aligned with
Contribution of horticulture sector to inclusive economic growth and rural employment improved (Presidential Decree UP-4707)\(^a\)

<table>
<thead>
<tr>
<th>Results Chain</th>
<th>Performance Indicators with Targets and Baselines</th>
<th>Data Sources and Reporting</th>
<th>Risks</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Outcome</strong></td>
<td>By 2022:</td>
<td>a–b. National Statistics Committee, Ministry of Economy, MAWR, RRA monitoring reports, customs data, and Uzagroexport reports</td>
<td></td>
</tr>
<tr>
<td></td>
<td>a. Exports of horticultural produce increased:</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>(i) vegetables to 630,000 tons (2015 baseline: 286,600 tons);</td>
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<tr>
<td></td>
<td>(ii) melons to 16,900 tons (2015 baseline: 7,700 tons);</td>
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<tr>
<td></td>
<td>(iii) fruits to 239,140 tons (2015 baseline: 108,700 tons);</td>
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<tr>
<td></td>
<td>(iv) grapes: to 326,300 tons (2015 baseline: 186,900 tons).</td>
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</tr>
<tr>
<td></td>
<td>b. Value of horticultural produce exports increased to $1.3 billion (2015 baseline: $0.6 billion).</td>
<td></td>
<td></td>
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<tr>
<td><strong>Output</strong></td>
<td>By 2021:</td>
<td>1a–b. PFIs’ progress reports and RRA monitoring reports</td>
<td></td>
</tr>
<tr>
<td></td>
<td>1a. 332 subloans extended to horticulture development:(^b)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(i) 181 for production; and</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>(ii) 151 for storage improvement and processing.</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1b. Subprojects financed by PFIs’ subloans employ at least 20% female workers.</td>
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</tbody>
</table>

### Key Activities with Milestones
1. Finance to the horticulture sector increased
   1.1 Establish environmental and social management systems at PFIs (Q1 2017).
   1.2 Disburse PFIs’ loans to horticulture farms and enterprises (Q2 2017–Q4 2021).

### Project Management Activities
Set up project management office with required staff by Q1 2017.
Establish project implementation unit at each PFI by Q1 2017.
Set up project performance management system by Q1 2017.
Provide technical support to PFIs and subborrowers (Q2 2017–Q4 2021).
Prepare project completion report by Q4 2021.

### Inputs
Asian Development Bank: $154 million (Asian Development Fund loan)
Subborrowers: $40 million (equity contribution)
Government of Uzbekistan: $21 million (including $19 million through exemption of taxes and duties for imported goods and $2 million for interest charges during implementation)
Assumptions for Partner Financing

Not applicable

MAWR = Ministry of Agriculture and Water Resources, PFI = participating financial institution, Q = quarter, RRA = Rural Restructuring Agency.


b Of the $149 million available for credit lines to PFIs, tentative allocation is as follows: $40 million for production and $109 million for storage improvement and processing. However, actual subloans and amounts will be demand driven. Source: Asian Development Bank.
LIST OF LINKED DOCUMENTS
http://www.adb.org/Documents/RRPs/?id=47305-002-3

1. Loan Agreement: Special Operations
2. Project Agreement: Rural Restructuring Agency
3. Project Agreement: Participating Financial Institutions
4. Sector Assessment (Summary): Agriculture, Natural Resources, and Rural Development
5. Project Administration Manual
6. Contribution to the ADB Results Framework
7. Development Coordination
8. Financial Analysis
9. Economic Analysis
10. Country Economic Indicators
11. Summary Poverty Reduction and Social Strategy
12. Gender Action Plan
13. Financial Intermediary: Environmental and Social Management System Arrangement
14. Risk Assessment and Risk Management Plan

Supplementary Documents
15. Detailed Sector Assessment: Agriculture, Natural Resources, and Rural Development
16. Detailed Project Economic Analysis
17. Detailed Social and Gender Assessment
18. Lessons and Synergies