

## TA COMPLETION REPORT

TA NO./NAME: TA 3134-UZB: PENSION REFORM				TA AMOUNT APPROVED: \$850,000	DIVISION: IEFI
				REVISED AMOUNT: Same	SOURCE: TASf
EXECUTING AGENCY: Ministry of Social Maintenance (MSM)				TA AMOUNT UNDISBURSED: \$8,521	TA AMOUNT UTILIZED: \$841,479
DATE:	APPROVAL: 22 December 1998	SIGNING: 21 January 1999	FIELD: 20 August 1999	CLOSING: ORIGINAL: 31 October 1999	ACTUAL: (Physical) 31 March 2001; (Financial) 30 September 2001
<b>TA DESCRIPTION:</b> The pay-as-you-go (PAYG) pension system in Uzbekistan has been characterized by various problems. These include (i) high payroll taxes of around 38 percent, (ii) high dependency rate, (iii) excessive incentives and exemptions to certain occupations and categories of workers; (iv) low wage replacement rate (around 35 percent); (v) cross-subsidization from the Pension Fund (PF) to meet social obligations, such as support for low income families; and (vi) administrative weaknesses, such as poorly designed business plans, and irregular and inadequate financial audits of PF. In view of these problems, the Government sought ADB's assistance to (a) modernize the administration and management of PAYG system; and (b) strengthen legal and regulatory framework to support a voluntary supplemental pension (VSP) scheme, to augment the PAYG system.					
<b>TA OBJECTIVES AND SCOPE:</b> The objective of the TA was to support pension reforms in Uzbekistan. The TA focused on: (i) a review of the legal framework, and administrative processes and procedures of the pension system and PF; (ii) an independent financial and operational review of PF; (iii) formulation of a legal and regulatory basis for VSPs; (iv) development of capital markets; (v) a feasibility analysis for introducing occupational pension plans; and (vi) a pilot project for information and data processing.					
<b>TA INPUTS EVALUATION:</b> Development Alternatives, Inc., (Thailand) was recruited to provide international consulting inputs of 20 person-months and domestic consulting services of 28 person-months. The consultants included experts in pension system analysis, administrative reforms, pension fund audit, legal and regulatory framework, capital markets review and social impact analysis.					
<p>The terms of reference (TORs) for consulting services were appropriate and met the TA's objectives. The consultants carried out their tasks satisfactorily. However, while MSM and the Government had shown strong commitment at the time of the design of the TA, MSM's overall commitment and support for the TA implementation were somewhat disrupted midstream due to a ministerial change at MSM. The legal and regulatory base for VSPs and the financial audit of PF became contentious due to skepticism caused by the failure of pyramid-type savings schemes in Russia and confidentiality of data. ADB launched three review missions, which clarified the purpose and intent behind these components and restored MSM's support for the TA.</p>					
<b>TA OUTPUTS EVALUATION:</b> The TA provided support to: (i) strengthen the legal framework, and administration and management of the PAYG system; (ii) formulate a legal and regulatory framework for VSPs; and (iii) improve capital market environment. The TA also conducted a financial review of PF, a demographic and industry-level social dimensions analysis on the need for VSPs, and a survey to assess the demand potential for VSPs. The TA underscored the need for delaying the introduction of VSPs until a sound macroeconomic and financial sector institutional framework were in place in Uzbekistan. The reports, and advisory and support services provided under the TA were fully satisfactory. The TA's findings and recommendations are below:					
<b>1. Amendments to the Law on State Pensions</b> to: (i) align contributions and benefits; (ii) address gender disparities in retirement ages and service requirements; (iii) streamline early retirement provisions and social allowances; (iv) rationalize and minimize exemptions from making payroll contributions to PF; (v) eliminate ad hoc decrees or Government resolutions which dilute the legal status of the PF or frequently change pension provisions; and (vi) separate PF from the MSM's reserve funds and the state budget, to enhance accountability of PF.					
<b>2. Reforms of Administration and Management of the PAYG System</b> involving: (i) integration of workload projections with strategic and business planning; (ii) introduction of a nationwide unique personal identification number (PIN) system, and integrating the system with the tax collection process in cooperation with the State Tax Committee (STC); and (iii) minimizing the burden of data collection on enterprises by streamlining Government processes. As part of the TA, and with support from the World Bank (WB), a seminar was held on Administration of Pension Program Collections in February 2000, with participation from 9 countries. Following the seminar, the Government established an inter-ministerial committee, comprising MSM, Ministry of Finance and STC to expedite work on the PIN system. The TA team provided support for this activity until July 2000.					
<b>3. Designing the Legal and Regulatory Framework for VSPs:</b> This involved (i) defining critical threshold legal questions on design, fund management, internal controls and good governance; (ii) addressing the need for rigorous regulation of VSPs in a transition environment to ensure investor confidence and safe custody; (iii) designing a sound registration and licensing regime for institutions as well as professionals; and (iv) emphasizing the need for regulatory enforcement audits, and regulatory provisions on guarantees against losses in case of defined benefit plans.					

**4. Development of Capital Market:** Since pension reform and capital market development are intertwined, the TA has provided a number of recommendations to broaden and deepen the capital market, by focusing on: (i) privatization of state-owned enterprises; (ii) issuance of corporate bonds; (iii) adoption of International Accounting Standards (IAS); (iv) strengthening listing criteria on the Tashkent Stock Exchange; (v) changes in Tax Code to reduce capital gains taxes and eliminate double taxation of dividends and, (vi) improving the legal framework to enhance corporate governance in joint-stock companies.

**5. Financial Review and Audit of the Pension Fund** recommended that PF: (i) adopt IAS and modernize accounts management; (ii) formulate guidelines for collection and payments; (iii) conduct regular audits by external audit firms; (iv) strengthen risk analysis and management capacity; and (v) correct discrepancies between bank balances and reported cash balances.

**6. Analysis of Social Dimensions and Institutional Environment for VSPs** revealed that around 25 large enterprises and workers were in favor of VSPs. But participants expressed concerns that VSPs needed to be independent of state control, financial institutions cannot be trusted in general and workers need to be educated in VSP schemes. The TA has also provided recommendations for strengthening the financial sector institutional environment to promote VSPs, with focus on banking sector environment, skills and capacity of finance professionals and the current state of the insurance sector.

**7. Samarkand Pilot Project:** With ADB and WB support, MSM has initiated a pilot project in all districts in Samarkand Province to modernize collections and payments of pensions and test its benefits. The project will also test on a continuing basis the effectiveness of new software and database programs that the MSM may introduce in the future. The TA provided for around \$52,000 worth of computer equipment. The WB provided additional support of about \$40,000. The bidding process was completed in March 2001 and the project has recently started. Its benefits are yet to be evaluated by MSM.

**TA's OVERALL ASSESSMENT/RATING:** The TA is rated as "Generally Successful." The TA has achieved good results with regard to: (i) accelerating administrative reforms in the pension system; (ii) establishing guidelines to design a sound legal and regulatory framework for VSPs; and (iii) enhancing awareness amongst Government officials on the need for advance planning in these areas. However, there were implementation difficulties due to confidentiality of PF data and concerns over stability of VSPs.

The TA was closely coordinated with WB, which provided a grant from its Institutional Development Fund to carry out actuarial analysis of the state pension system and to computerize the information processing functions. A joint Memorandum of Understanding was signed between the fact-finding Missions of the two institutions and the Government. This cooperation continued until the end of the TA. The procurement of computers and software was also coordinated subsequently between the two institutions, to maximize quantity discounts for the Government through concurrent bidding.

The TA's closure was deferred due to a combination of factors, including an overoptimistic original closure date, delay in fielding of consultants, and bidding difficulties faced by MSM in procurement of computer equipment for the Samarkand Pilot Project, which were resolved only in late 2000. The actual physical completion of the consultant's work was in early July 2000, implemented over a period of 10.5 months, and the procurement of computers was completed in March 2001.

#### **MAJOR LESSONS LEARNED:**

1. The design of the TA, which focused on conducting diagnostic assessments, rather than using resources for drafting full schemes or plans (e.g. laws or regulatory framework), proved to be a sound approach. It was also useful in promoting awareness and building consensus for reforms.
2. TAs of this nature can contribute, particularly in transitional environments, by: (i) establishing and addressing a number of threshold questions that policy makers raise relative to pension reforms; (ii) providing guidelines for system design; and (iii) formulating forward looking recommendations to develop the institutional framework.
3. Donor cooperation and close coordination proved to be beneficial, given the TA resource constraints, and it also helped in continuous flow of information between the ADB and WB teams.
4. Financial reviews of state-owned agencies or funds should not be supported in advisory TAs of a stand-alone nature, as it is difficult to monitor them after the TA implementation.
5. TAs of this nature should plan for at least 15-18 months of implementation time, including procurement of services.

**FOLLOW-UP ACTIONS AND RECOMMENDATIONS:** Apart from this TA, to support financial sector reform in Uzbekistan, ADB has provided assistance to strengthen commercial banking skills, insurance industry, and corporate governance. While there was initial resistance to the introduction of VSPs, the Government is now keen on deepening coverage of pensions and strengthening financial intermediation through the non-bank sector. It is recommended that the ADB continue to engage in policy dialogue in this area.

Prepared by: Ramesh Subramaniam

Designation: Financial Economist, IEFI