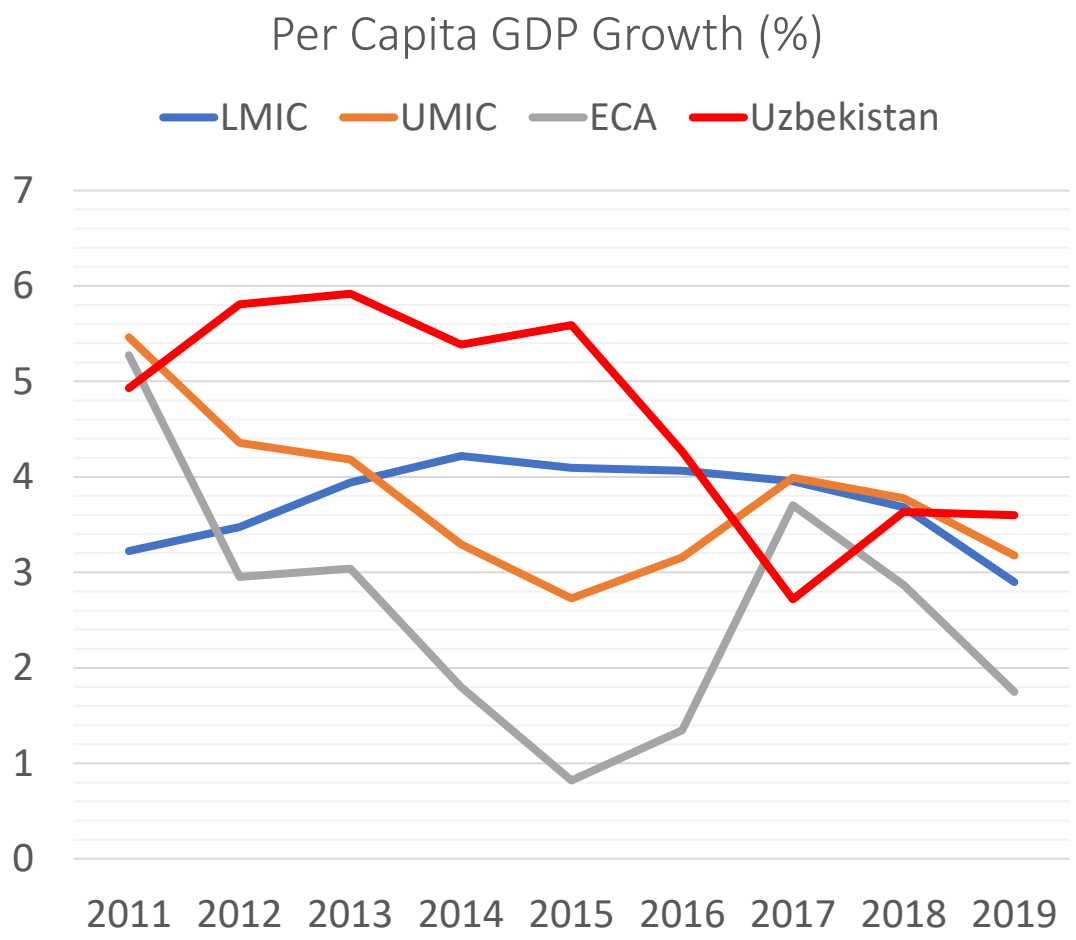
Uzbekistan
Systematic Country Diagnostic

Towards a Prosperous and Inclusive Future

Decades of growth but at high cost…



- Over the last two decades Uzbekistan's real GDP growth averaged 6.5 percent. But slowing.
- Growth achieved through an autarkic, state-controlled, and centrally planned economic strategy.
- State surpluses built large fiscal and external buffers that supported macroeconomic stability.

…to workers and firms…

Workers

- Legacy of state agriculture: forced labor, migration restrictions, low rural incomes
- High labor taxation, low labor share of income
- Chronic jobs shortages, unemployment rate 9 percent before pandemic
- Government's forecast: gap of 200K jobs per year – especially harms youth and women.

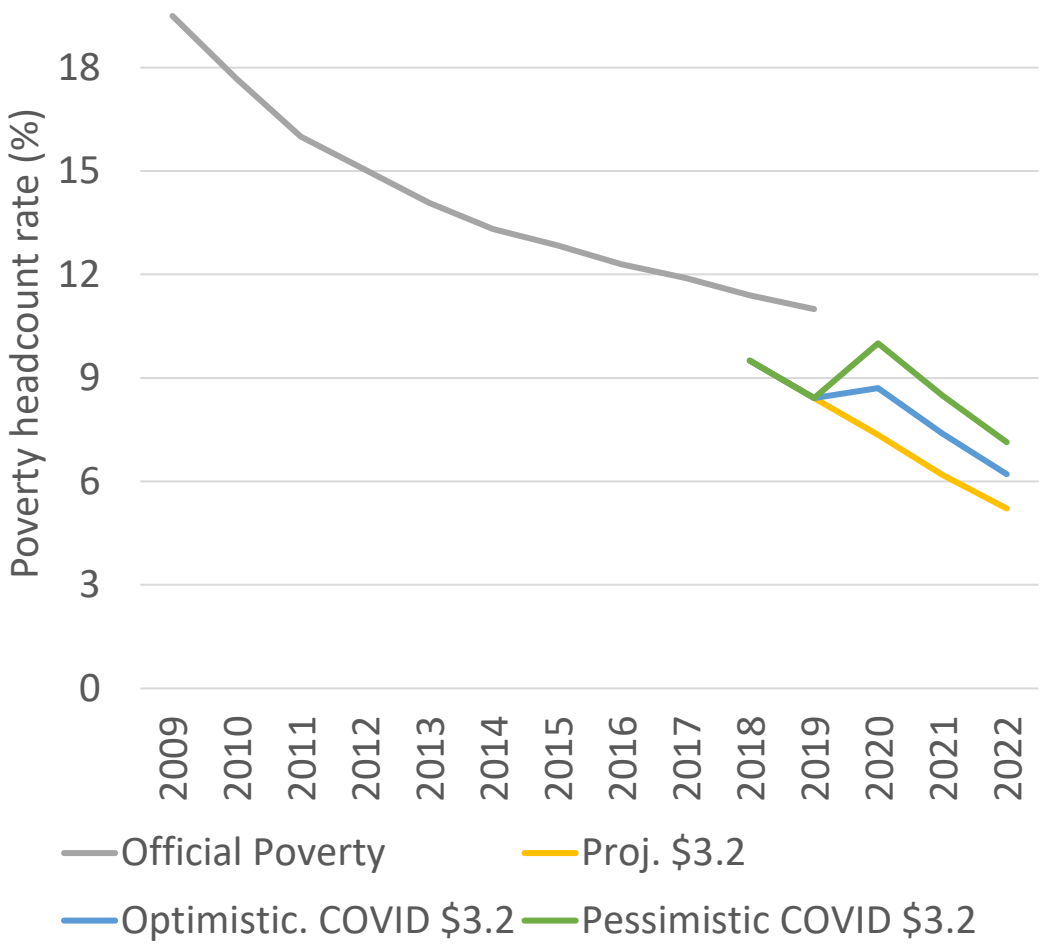
Firms

- Output from favored sectors grew, but total productivity growth was far below potential
- Regulatory controls limited Inter-sectoral resource shifts
- Low firm entry, firms forced to stay small and informal, tax on turnover
- Limited factor access, restricted global connections for private sector and capture by vested interests

…and to the environment

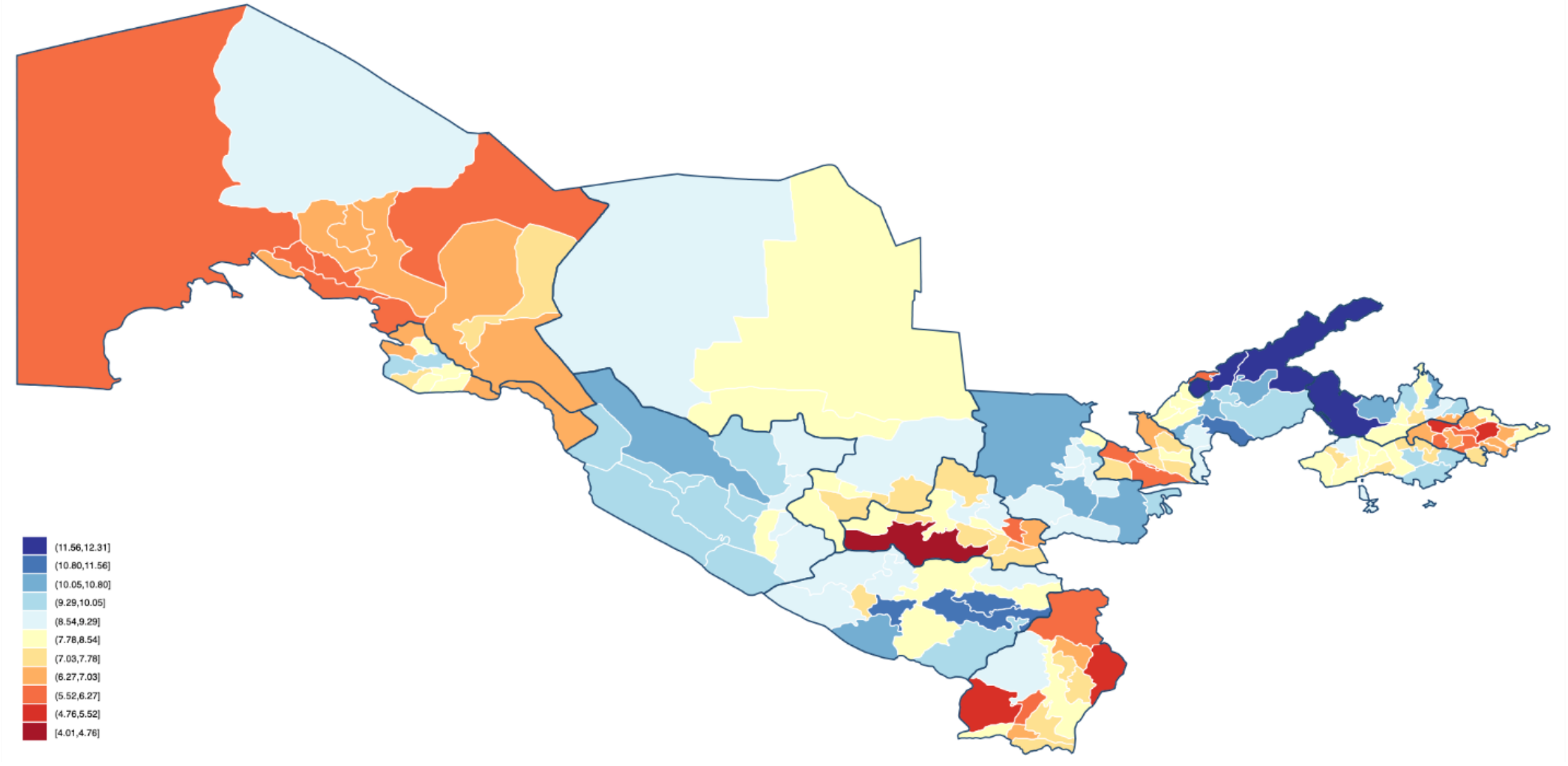
- The tragedy of the Aral Sea accelerated under the old model
- Soil salinity affecting over 50% of irrigated land
  - Lack of investments, State agricultural model and insecurity of tenure for landholders
- Pesticides and pollutants
- Inefficient use of natural wealth
- Isolationist policies limited regional cooperation to addressing sources of environmental risks

Poverty fell, but a low bar



- Uzbekistan achieved slow but steady poverty reduction over the last two decades (while never using the term).
- But the pace of poverty reduction has been painfully slow for a country of Uzbekistan's income level and growth record.
- As Uzbekistan's economy expands, more ambitious thresholds for how poverty is defined are appropriate – the minimum socially acceptable level of wellbeing should rise together with the country's prosperity

In addition, large disparities between advanced and lagging areas remain



Average Mahalla-level Consumption per capita 2011$ PPP

The model was reaching its limits

- Growth and poverty reduction were beginning to taper from the early 2010s:
  - Shifting terms of trade lowering accumulation of resource surpluses
  - Worsening agricultural outcomes
  - Widening of opportunity gaps accelerating discontent in a relatively “young” country
  - Inefficient practices and inefficient investments bringing Uzbekistan closer to resource limits (e.g., gas, water)
- Despite these warning signs, there were no imminent threats to the old model or a crisis that triggered the 2017 reforms:
  - The 2017 pivot deserves credit as early action has given Uzbekistan time and financial buffers to manage a complex transition from a position of strength

New leadership, and a sharply different direction

- 2017-2021 Development Strategy:
  - Structural reform, reorienting toward a competitive market-led economy, reducing the state's footprint
  - Data openness and transparency
  - Ban on forced and child labor, steady progress on achieving the vision
  - More social and religious freedoms
  - Warmer regional and global political and trade relationships
  - A greener economic agenda

Cluster analysis of distinctive words used in decrees during the Karimov and Mirziyoyev eras

Many reforms enacted to date

- Some reforms have been quick and impressive:
  - Liberalization of the foreign exchange market and current account
  - Product market and utility tariff liberalization
  - Removal of most export barriers across the economy; import tariffs
  - Overhaul of business regulation and tax system
  - Rapid agricultural reforms despite political and social complexity
  - Open data
- Strong focus on inclusive and green growth:
  - Agricultural liberalization to increase rural and farm incomes
  - Emphasis on social protection accompanied liberalizing reforms
  - Policies to increase inclusion of women and people living with disabilities
  - Removal of labor migration restrictions, demilitarization of security and police in day-to-day life, increased religious and social freedoms
  - Renewable energy and energy efficiency among the highest priorities

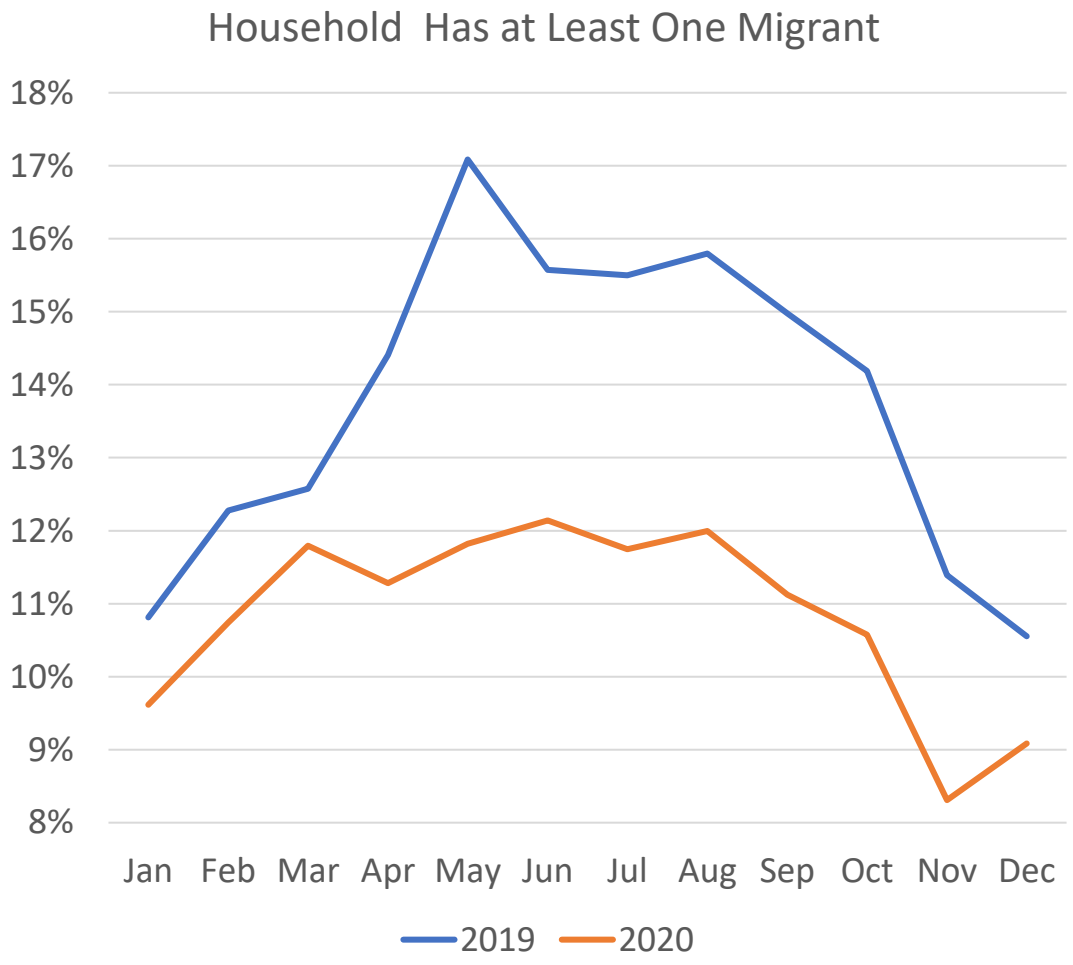
But much slower progress in other areas

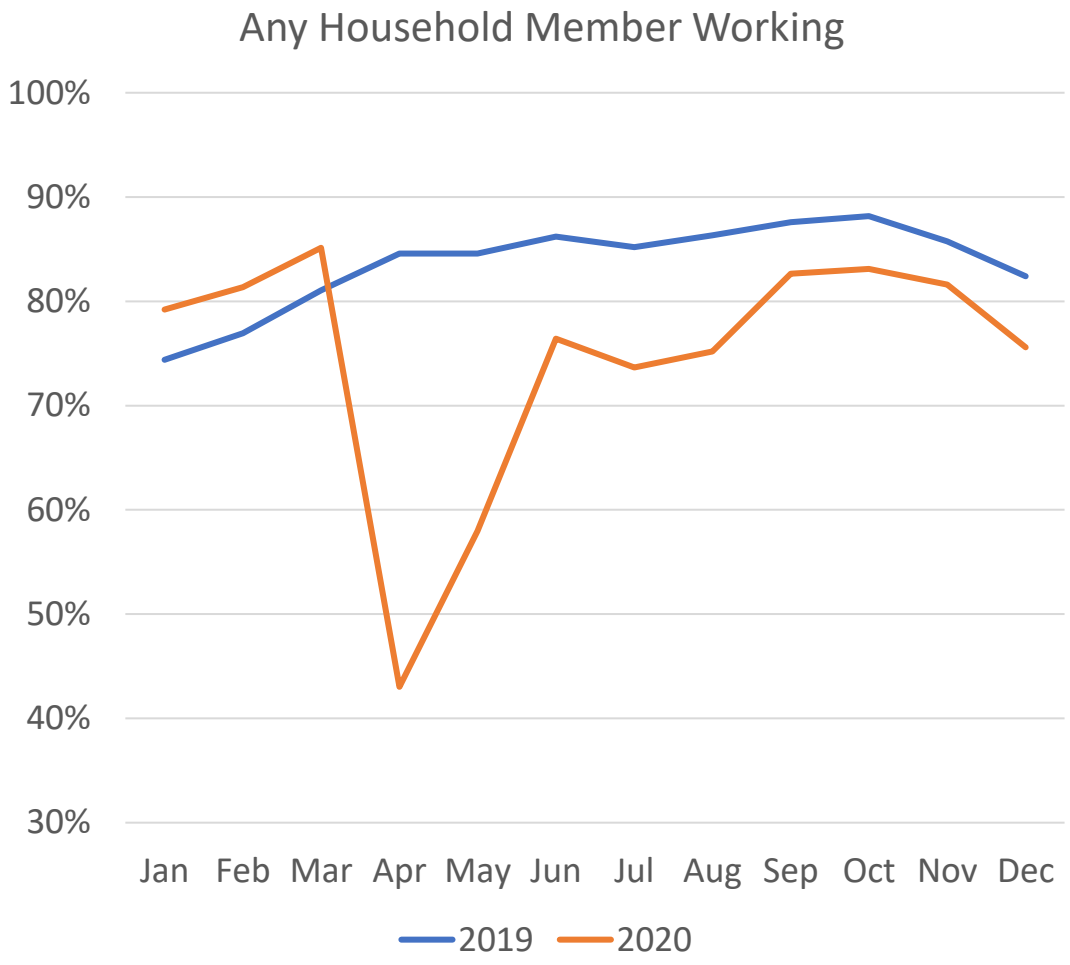
- Lack of coordination, no clear accountability, and political economy constraints:
  - Very incremental progress on land, other factor reforms (beyond removal of migration restrictions)
  - Early stages of addressing state enterprises and bank privatization
  - Public administration structure and accountability reforms
  - Important private sector enabling sectors still in state monopoly
  - Education, health, and judicial reforms
  - Community-level and NGO reforms
  - Environmental legal and regulatory framework

Then, severe impacts from the pandemic

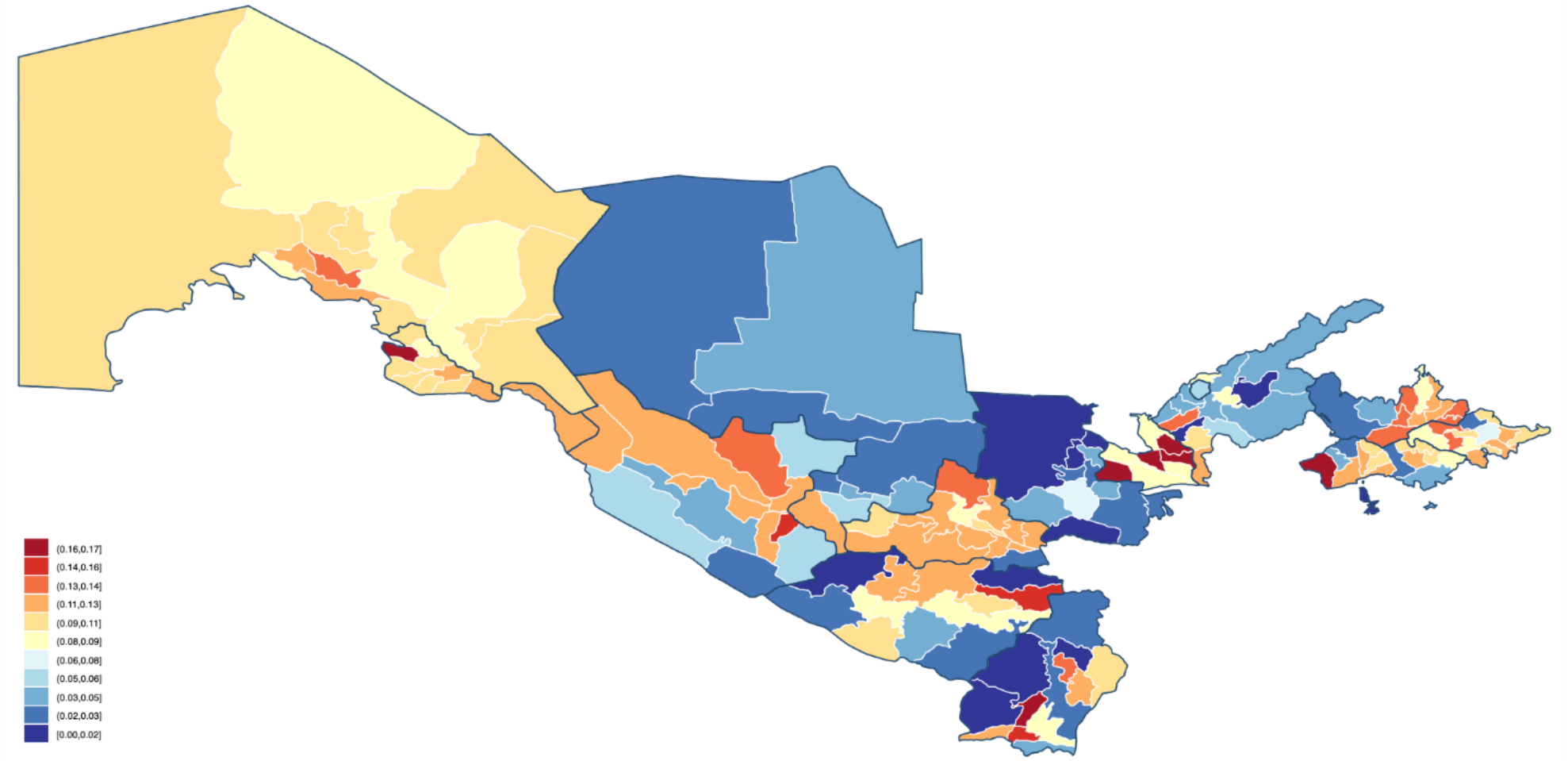
- **Employment fell dramatically following the outbreak.** Households with at least one member actively working fell more than 40 percentage points in April. Recovery began soon after.
- **At their lowest, remittances fell by more than half.** In April, the share of households receiving any remittances fell by 54 percent over the same time the previous year. Future migration expectations collapsed.
- **Introduced broad mitigation measures, but underscored gaps.** Social assistance not able to identify and meet need. Into recovery, there will be emphasis on the health of the labor market and targeting particularly affected populations.

Severe decline in work, though recovery underway. Much lower migration and uncertain outlook



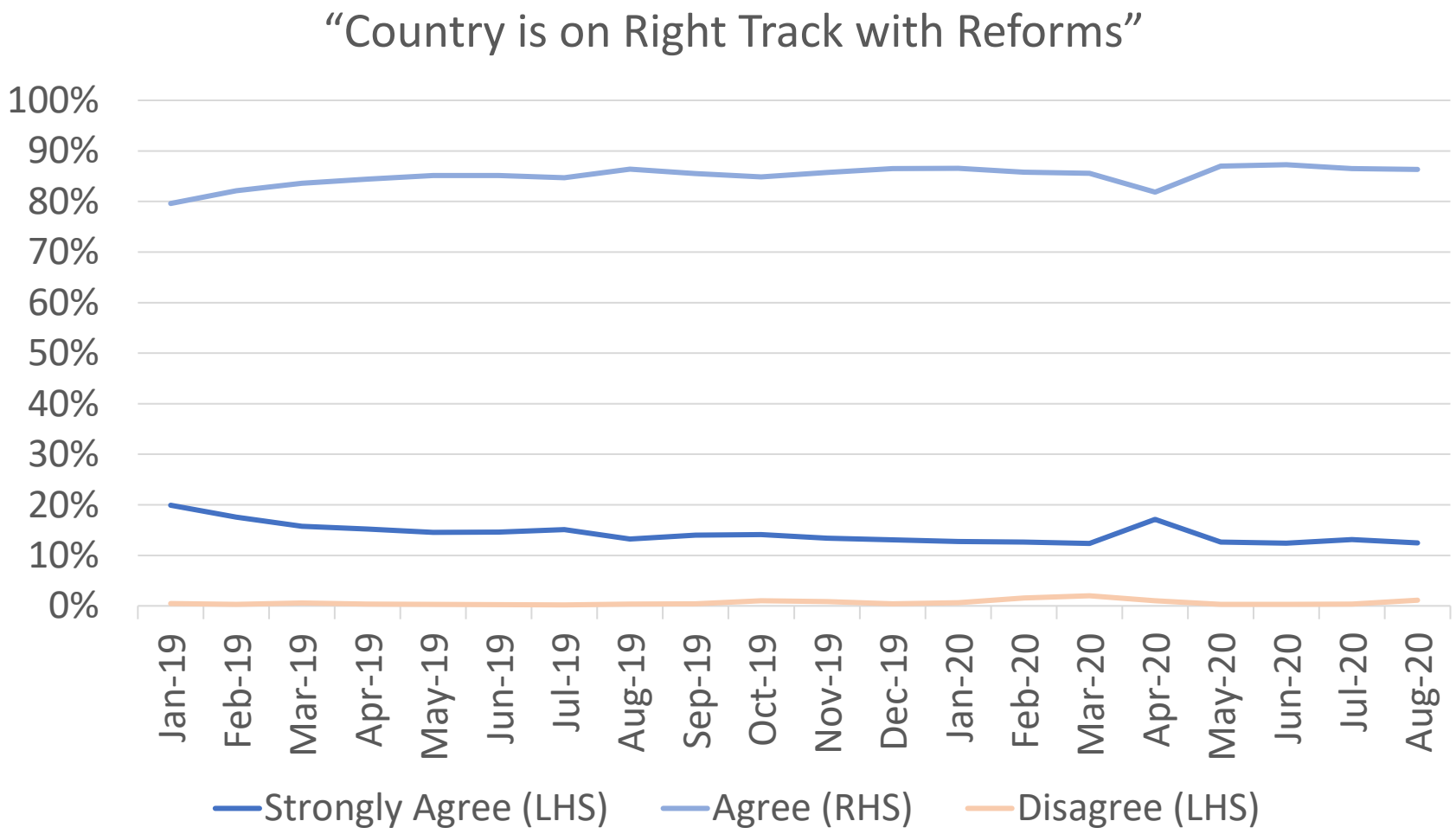


Concentrated reliance on remittance income among low-income people in lagging districts



Mahalla-level estimation of remittance reliance index, 2019

But COVID-19 did not shake support for reform



The transition is a window of opportunity

- Uzbekistan has ingredients for a successful transition – rich in endowments, large reserves, favorable terms of trade, relative economic stability, and strong administrative capacity.
- But the outcome is still uncertain, both a “good” and a “bad” economic future are possible.
- Signs that the transition is moving in the right direction:
  - A strong response from domestic and foreign private sector
  - More winners than losers, and those left behind supported by strong public services
  - The avoidance of elite capture
  - Choices that amplify sustainability and resilience to risks

State surplus at high cost to individual economic freedom and prosperity	Environment limiting private sector in favor of state enterprises	Low productivity, misallocation, weak structural transformation	Unemployment, low wages, exclusion of vulnerable groups	Environmental degradation

Diagnostic: Uzbekistan held back by a system that was reaching its limits

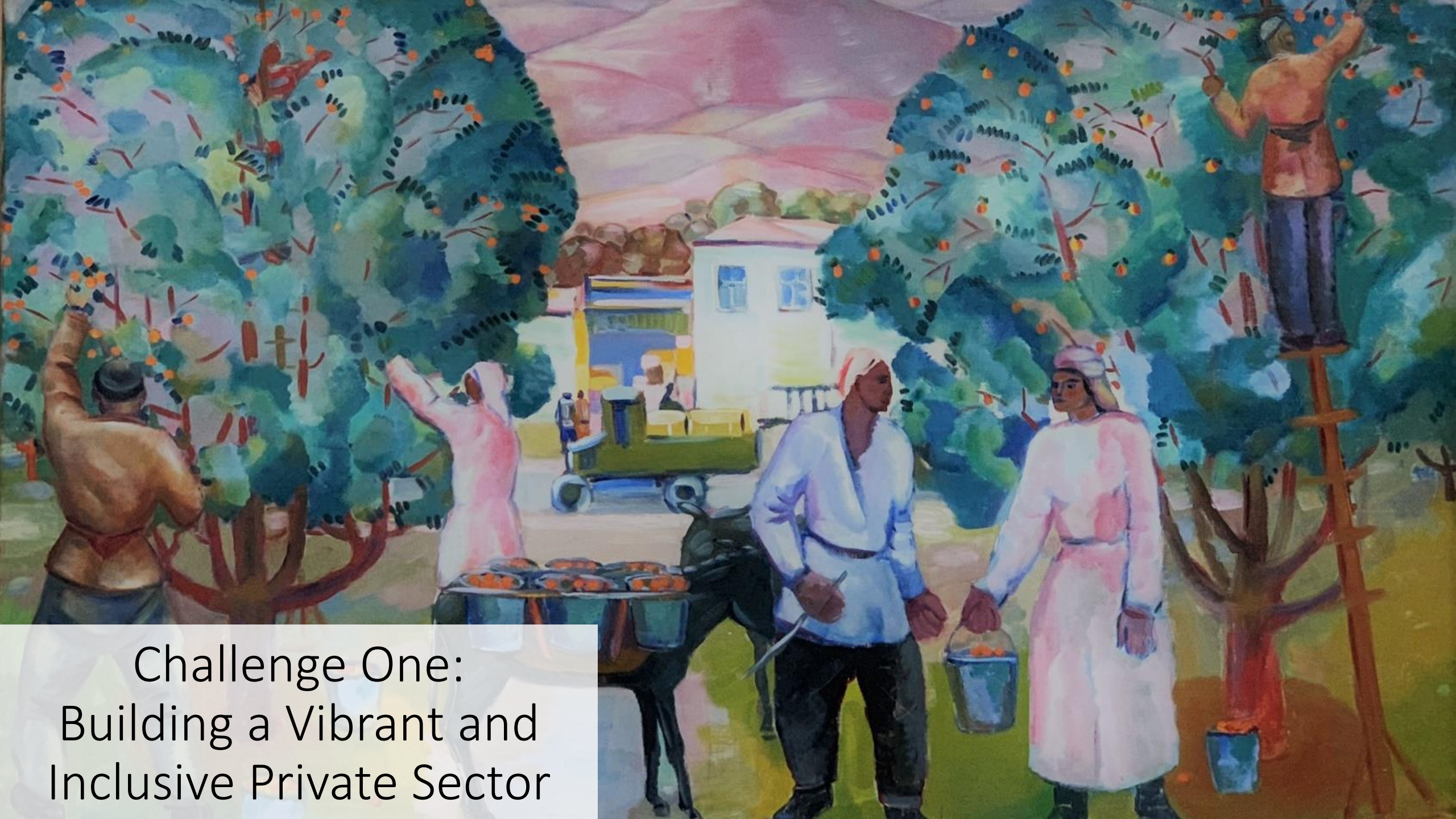
By a state-led growth model that was growingly unsustainable	By limited access and inadequate quality of public services	By insufficient investment in human capital, social protection, and citizen engagement	By setting low (or unrealistic) goals on social assistance, employment support, and poverty reduction

Uzbekistan has the necessary ingredients for a better future…

- Competitive private-sector led growth that integrates Uzbekistan with the world
- High quality public investments and services, more effective regulation
- Citizen-centric public services that leave no one behind
- Strong accountability and the absence of elite capture
- A sustainable and resilient model of growth

…and can get there by responding to four challenges

Challenge One: Fostering a Vibrant and Inclusive Private Sector	**Challenge Two:** Building an Effective and Accountable State	**Challenge Three:** Investing in People	**Challenge Four:** Investing in a Sustainable and Resilient Future
•Competitive land, labor, and financial markets •Fewer and more efficient SOEs •A level playing field •A well-regulated business environment •Greater outward orientation for trade and investment	•Strong economic management •High quality enabling infrastructure •Effective public services •Stronger public accountability	•Investments in human capital •Encouraging broad participation and inclusion •Protecting the vulnerable with a strong safety net •Greater citizen involvement	•Responsible stewardship of natural resources •Greening the development model •Resilience to climate change and disaster risks
Faster private sector growth and investments driving productivity and job creation	An accountable state in the service of the economy and citizens	Equal opportunities and strong safeguards to protect the vulnerable	A sustainable transition that safeguards pathways to prosperity for future generations

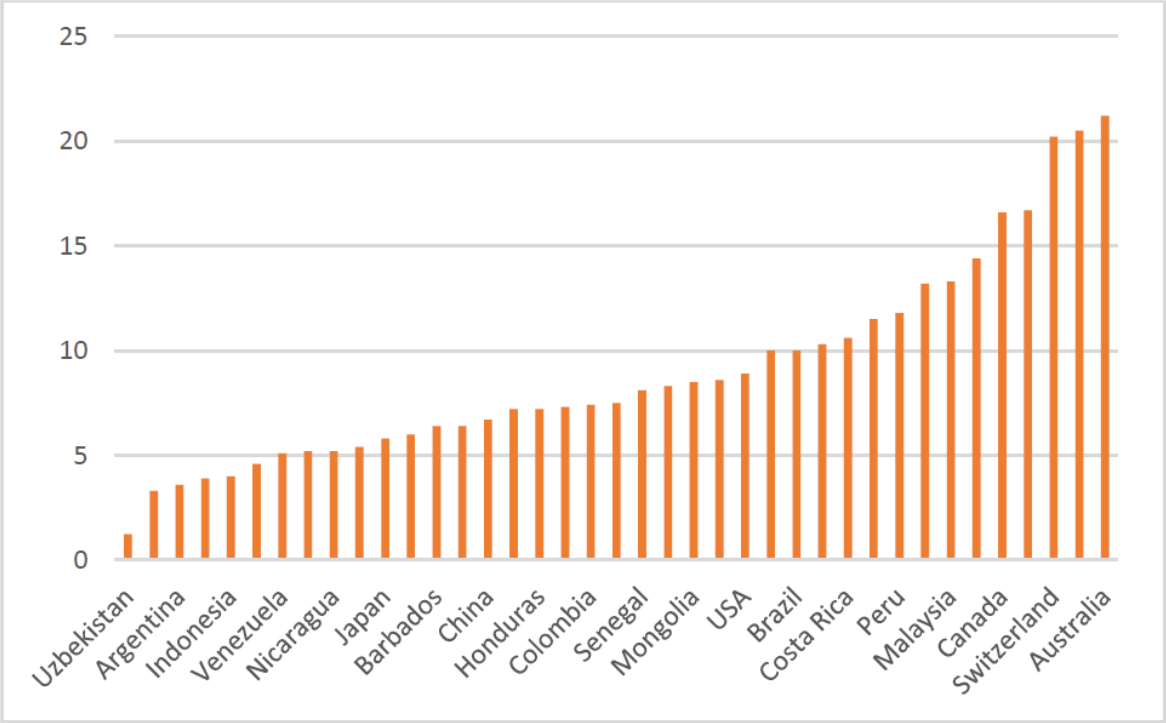


Challenge One: Building a Vibrant and Inclusive Private Sector

Building a vibrant and inclusive private sector

- Addressing the significant productivity and jobs deficit requires a different growth model that is competitive, inclusive and led by the private sector:
  - Competitive factor markets that move resources to their most efficient use
  - A level playing field for competition
  - Fewer State enterprises that are on an equal footing with the private sector
  - A business investment environment that encourages productive firms to grow
  - Greater outward trade and investment orientation that goes beyond natural resource exports

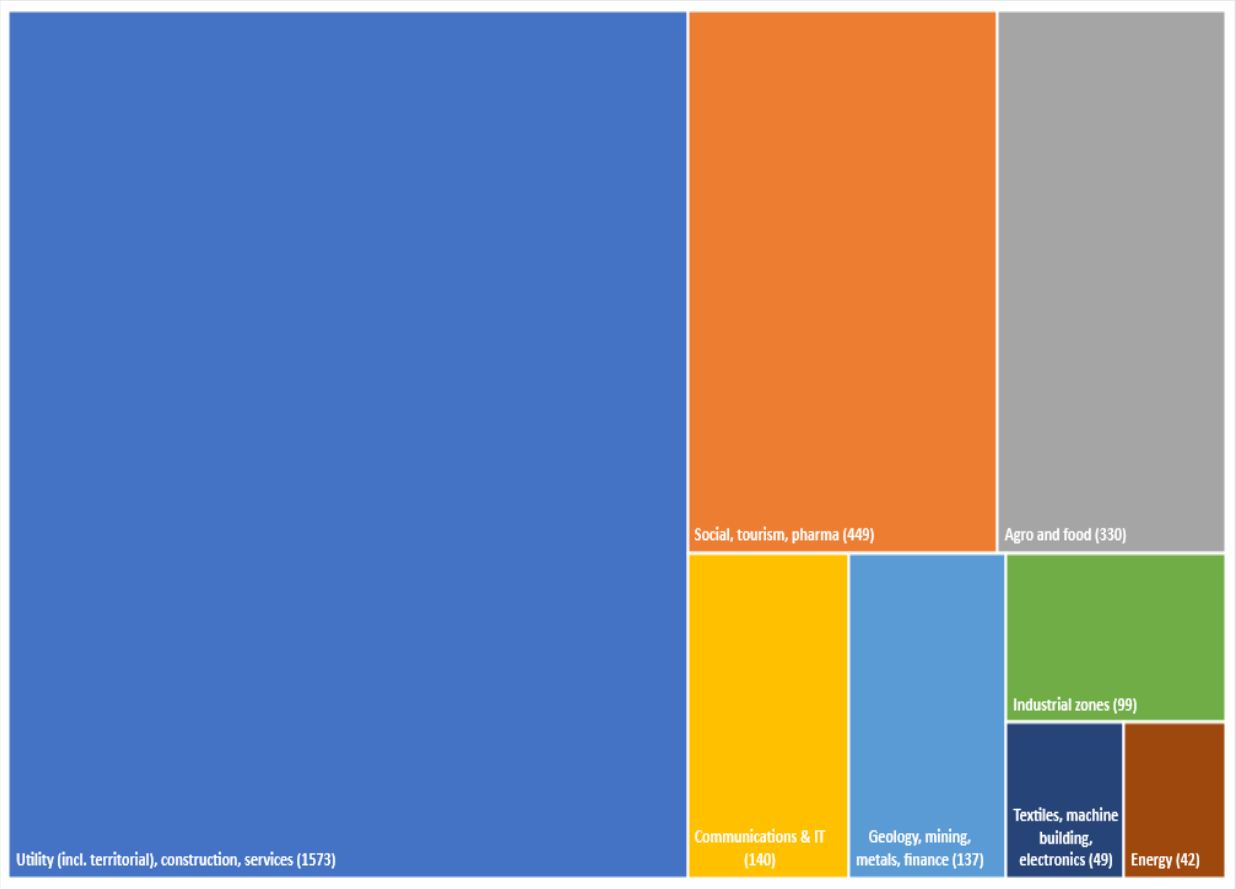
The urgency of factor market reforms



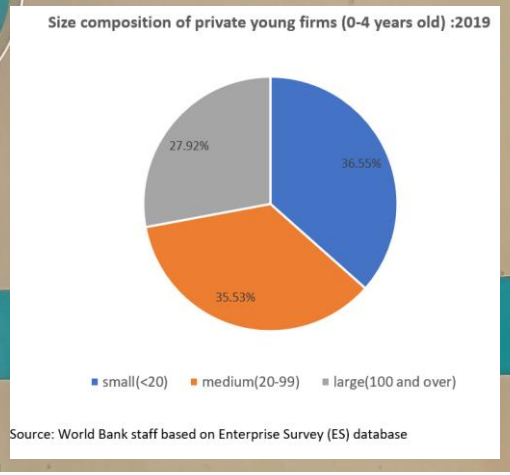
- Land reforms:
  - Land issues cited as among the most pressing constraints to investment and growth
  - Process of urban land acquisition and development is complex, fragmented
  - Weak and arbitrary security of tenure severe constraints to investments
  - The exception: small family *Dehkan* farms, about 15% of irrigated area under cultivation, is responsible for most of the horticultural output and the sector's value added
- One of the lowest labor mobility rates in the world
  - Propiska reforms have helped, but still many constraints interlinked with land and other public service reform challenges
- State dominance in the financial sector
  - In 2019: 86 percent of banking assets and 89 percent of credit outstanding was to the State
  - Very little financial intermediation beyond state-to-state transactions in the economy as a result

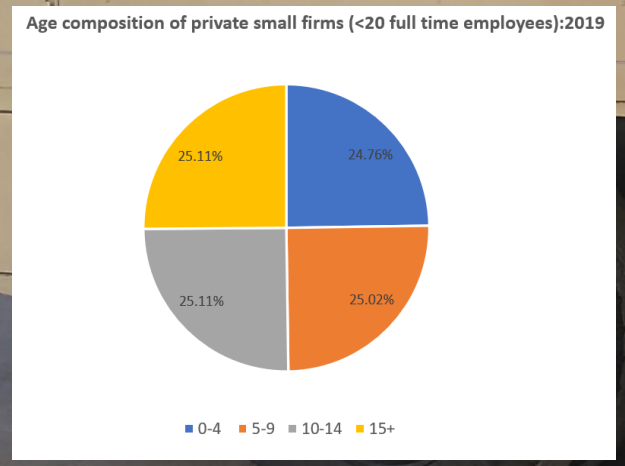
Dominance of SOEs

- 3000 SOEs, 18% of employment, 20% of exports
- SOEs + Budget and other Off-Budget activities about 50% of GDP
- Almost entirely different business regulatory regime, preferential access to inputs and finance, monopoly protections
- Dated, weak corporate governance framework
- *At least* 7 percent of GDP in on-budget and quasi-fiscal support, with below-average service outcomes to show for it



Not enough competition





- Largest share of monopolies in the region, and increasing trend since mid-2000s (Enterprise Survey)
- Sectors with significant private sector potential under state monopoly control with few signs that this is changing
- Untransparent investment agreements regime:
  - Each investment with its own Resolution outlining terms of arrangement, often not published
- Firms still face onerous regulatory burdens:
  - Complex registration and reporting requirements
  - Trading and licensing restrictions
  - Constraints to factoring and credit-based commerce
  - Kassa (encashment) requirements

Challenge Two:
Building an effective and accountable State

Stronger economic management

- Fiscal policy: a more strategic approach to public spending:
  - Two competing and uncoordinated fiscal policies: budget and UFRD, both not well aligned to reform priorities
  - Weaknesses in public investment model that limit effectiveness of capital spending
  - Coverage issues a major concern, especially of off-budget projects and SOE spending
  - Tax policy reforms that now need administrative follow-up
  - Debt policy that is constrained by the pace of the broader structural reform agenda
- Monetary policy: a nascent institution that must contend with a legacy of high inflation and dollarization

More effective public investments

- Intermediate inputs and infrastructure among the most binding private sector constraints in the economy:
  - Small firms: 29 days of electricity disruption; 46 days of gas disruption to production
  - 7 percent of perishable exports lost in rail transport
  - Highest road transport costs in region, and among highest road fatality rates in ECA
  - A viable aviation sector under a State monopoly chokehold driving the lowest sector growth in the region
  - Soil salinization has damaged over 50 percent of irrigated land (which produces 97 percent of agricultural output) as a result of dated infrastructure and investment inertia
  - Among the lowest mobile and broadband penetration in the region

More effective enabling services

- Judicial services:
  - Weak property rights driven by arbitrary asset seizures by tax and law enforcement and mandatory land acquisition limit securitization
  - Unfavorable minority shareholder rights limit investment and stymie interest in partial privatizations of SOEs
  - Weaknesses in contract enforcement and bankruptcy legal environment
- Private sector development:
  - Ineffective approach to entrepreneurship development that almost exclusively relies on loans to individuals/households
  - No clear strategy in place to encourage and support growth of small/medium productive firms
- Labor market encouragement:
  - Nascent active labor market program that suffers from lack of funding, weak links with private sector, poor training/delivery infrastructure
  - Fragmented labor market programs, and major gaps such as unemployment insurance and strategy to deal with retraining people displaced by SOE reforms

Strengthening public accountability

- Lessons from other CIS transitions: elite capture one of the biggest risks
- Room for more citizen and community engagement:
  - NGO registrations and involvement of community/mahalla in decision making virtually absent from reform process
- Administrative and fiscal centralization limits public accountability:
  - Significant room to increase local accountability and responsibilities for service delivery

Challenge Three: Investing in People

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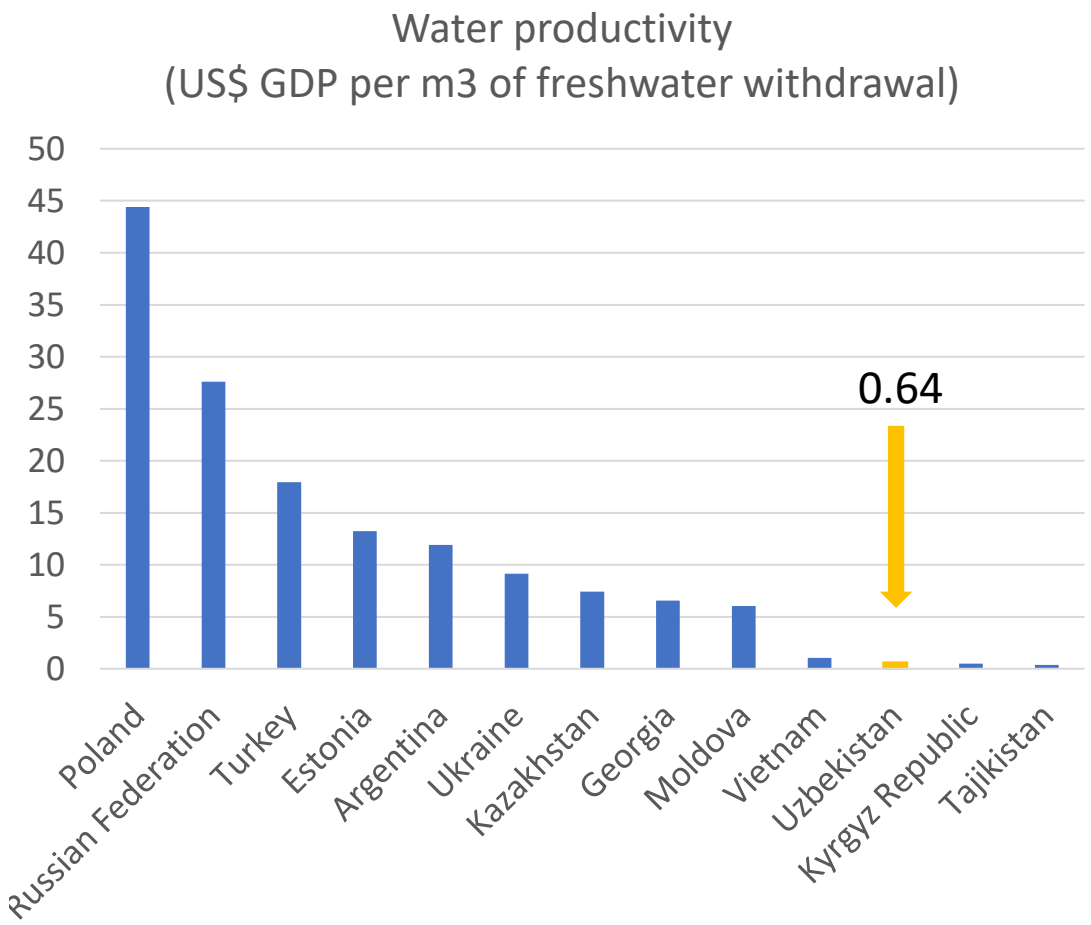
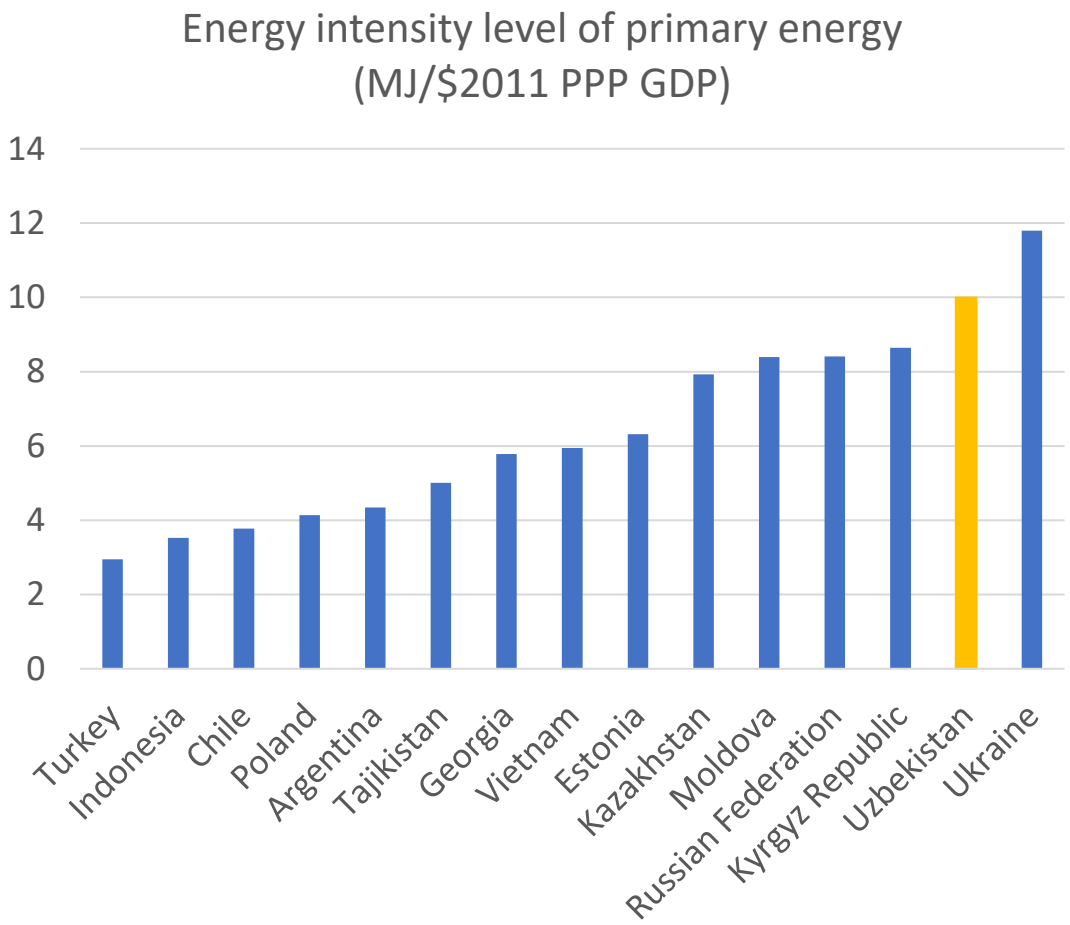
- The transition will generate winners and losers
  - Jobs are consistently the highest development priority in national surveys
  - Essential to generate inclusive employment growth
  - Strengthen the safety net
  - Strengthen services for unemployed, and job-seekers
- COVID-19 increased the urgency of these priorities
  - Falling employment, low savings, rising prices
  - Increased food insecurity
  - Increased concern about basic services, especially health and education
  - Social assistance has helped, but crisis underscores the system’s weaknesses

- Focus on those at risk of being left behind
  - Social protection: safety net and pensions reforms
  - Gender disparities, discrimination, and people living with disabilities
  - Job losses and transition costs
  - Financial inclusion
  - Correcting spatial disparities in basic public service quality and access
  - Improving the quality of healthcare
  - Improving the quality of education
  - Improving equitable access to tertiary education

Challenge Four: Investing in a Sustainable and Resilient Future

Highly inefficient resource use





Challenge four: Creating a more sustainable and resilient transition

- Responsible stewardship of natural resources
  - Improving efficiency and sustainability of natural resource use
  - Addressing the drying of the Aral Sea
  - Reducing land degradation and increasing biodiversity
- Greening the development model
  - Addressing pollution issues: legacy, air, GHG emissions
  - Reducing environmental exposure to transition risks
  - Creating an enabling environment for a green, circular economy
- Resilience to climate change and disaster risks
  - Water resource management
  - Disaster risk resilience and management

Determining Reform Priorities

Prioritization process ahead of final SCD

- Focusing on reforms that minimize regrets and risks from the transition process:
  - That the private sector response is tepid
  - That elite capture and vested interest risks materialize
  - That the transition process leaves too many excluded, disempowered, and discontented
  - That policy choices create further environmental degradation and sustainability risks that weaken the endurance of the transition
- Three “filters” which prioritize:
  - **Enacting system-wide reforms faster:** Reforms that have a systemic impact in advancing the four outcomes, and that are currently “lagging”
  - **Tractability:** Reforms that are politically, socially, economically, technically feasible
  - **Inclusion:** Prioritizing reforms that can quickly increase opportunities for a larger number of citizens, and reforms where citizen and political interests align in the same direction to help sustain momentum and popularity of reforms
- Develop a “long list” of reform priorities by consulting with stakeholders to understand how they might further prioritize based on the filters and their views on development priorities
- Final short list reflecting this process into the final SCD

Private Sector and Investment Response

- Increased private sector share of economic output
- More and better-paid jobs
- Higher private investment (domestic and foreign)
- Removal of constraints to lagging sectors (e.g., services)
- Greater outward orientation and international connections

Equality of Opportunities

- Better and more widely accessible public services
- Stronger social protection, especially safety nets
- Wider participation in the economy

Accountability

- Thwarting elite capture and vested interests
- More citizen-centric decision-making
- More transparent decision making
- More voice, representation, and fiscal empowerment of citizens and communities

Sustainability

- More sustainable and efficient resource use
- Sustainable and productivity-enhancing urbanization
- A cleaner approach to development
- Higher human capital
- Increased core state and private sector capacity

Reforms that are tractable

- Sufficient knowledge of what to do, risks and mitigation
- Achievable in 5-year timeframe
- Sufficient political and social support

System-Wide Reforms that are Lagging

- Reforms that have a system-wide impact to advance structural reforms
- Improves factor efficiency
- Enhances quality and capacity of institutions
- Increases environmental and social sustainability and resilience
- Reforms that are currently “lagging” and need to be accelerated

Reforms that are inclusive

- Focus on people: inclusion, enablement, protection
- Focus on “quick wins”: incomes and jobs for a wider group of people
- Political and social incentives are aligned

Questions for you:

- Do we have the right:
  - Outcome focus areas for the next 5 years?
  - Do the pillars and areas of focus under each pillar make sense?
  - Prioritization framework?
- Are there any areas that we are missing?
- What do you think are the top three priorities in each pillar?