DOCUMENT OF THE EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT

STRATEGY FOR UZBEKISTAN

As approved by the Board of Directors on 26 July 2005

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I. EXECUTIVE SUMMARY

The last country strategy for Uzbekistan, adopted in March 2003, qualified Uzbekistan's progress towards implementation of the principles of Article 1 of the Agreement Establishing the Bank as being slow and characterised by setbacks. Although some progress has been achieved on the economic side since then, there was no improvement in Uzbekistan's political environment and prospects for quick political liberalisation remain remote. The May 2005 events in Uzbekistan, resulting in the indiscriminate use of force against civilians, as documented in various reports including the 12 July 2005 report of the UN High Commissioner for Human Rights, is a cause of serious concern for the Bank. The international community has strongly urged the Government of Uzbekistan to allow an independent international investigation of the violence in and around Andijan.

According to the OSCE/ODIHR, which deployed a limited observation mission, the parliamentary elections of 26 December 2004 fell significantly short of international standards for democratic elections, despite minor improvements in the election law. One new pro-presidential party was registered but genuine opposition parties were denied registration, which precluded their participation in the parliamentary polls. Lack of significant differences in the electoral platforms of the five registered political parties did not provide the electorate with a genuine choice. Lack of progress on democratic reform was reflected in non-registration of the opposition parties, closure of the Soros Open Society Institute and an independent media organisation, and cases of pressure on NGOs.

The authorities adopted a National Action Plan to implement the recommendations of the UN Special Rapporteur on Torture and convened meetings with relevant Government ministries. However, according to independent monitors, real progress in the practices of law enforcement agencies is yet to be achieved. The authorities continued to cooperate with the international community on the issue of prison reform.

The media remained subject to state controls even in the absence of official censorship. In the context of assessing the pre-electoral situation, the OSCE/ODIHR noted that media outlets and civil society groups came under increasing pressure.

Economic developments since the adoption of the last country strategy have been supported by strong world prices for a number of commodity exports, the highly favourable external economic environment, and some productivity gains in the agricultural sector. Recent independent estimates suggest a significant acceleration in economic growth to about 7.4 per cent in 2004, coupled with a sizeable current account surplus, and reserve accumulation to the equivalent of about 6.5 months of imports. Nevertheless, there remain serious shortcomings in the transparency, quality, and consistency of macroeconomic data. Moreover, both national accounts and household surveys find no improvement in the standards of living of the population. Current growth rates are unlikely to be sustainable, given the poor investment environment, and pervasive restrictions on external trade, and on domestic currency in circulation.

The performance of the state-owned sector has been supported by preferential tax and trade regulation, notably through the so-called localisation programme, in marked contrast to the private sector, which continues to languish. A notable exception is the textile and garments sector which also benefits from tax preferences, and continues to attract foreign investors. While there have been commitments and expressions of interest from Russian investors in Uzbekistan's telecoms and hydrocarbons sectors, at present the country continues to rank near the bottom of the CIS countries in terms of FDI inflows relative to the size of the economy.

As regards the areas of concern in the economic sphere set out in the 2003 strategy and reviewed in the 2004 strategy update, Uzbekistan has made progress only in certain areas. The authorities adopted current account convertibility under the IMF's Articles in October 2003. However, widespread restrictions on domestic currency in circulation were further tightened in October 2004, and undermine the benefits that could be derived from current account convertibility. The quasi-fiscal deficit has been addressed through successive increases in utility rates, and a metering programme. Progress on banking reform has been limited over the two years. Tax authorities continue to debit bank accounts without prior authorisation from the client, though the authorities intend to abolish this right. Restrictions on cash in circulation were ostensibly introduced for the purposes of tax enforcement in the informal sector, but have impeded key functions of the payments system and eroded confidence in the financial system. Corporate governance and transparency of asset quality in the financial system have not improved, and no progress was made on the privatisation of the large state-owned banks. Confidence in the banking sector was further damaged by the sudden withdrawal of Business Bank's licence in March 2005, the largest private bank in the country, at a time when the Bank was considering investing in it.

A further manifestation of the policy of curbing informal transactions has been the persistent restrictions on external, as well as domestic, trade. Despite Uzbekistan's continued engagement in various regional and multilateral fora, only limited progress has been made in bilateral trade relations, and several additional restrictions were imposed in 2004, in particular on the trade by individual entrepreneurs. The programme of utility tariff adjustments that was initiated in 2002 has continued, and was supported through an ambitious metering programme. However, in the context of re-emerging wage and pension arrears, and of an increase in consumer price inflation, affordability has deteriorated. In early November 2004 there were signs of increased social unrest in Ferghana Valley and other parts of the country related to the implementation of the legislation further restricting shuttle trade.

Regarding the benchmarks of the last country strategy, progress can be seen only on the issues of current account convertibility and adjustment of tariffs in public utilities, while the Government's reaction to the Andijan events in May 2005 reflects the worsening of the situation in the area of human rights, rule of law and openness of the political system. Overall, the progress towards the benchmarks is inadequate. Therefore, in its current Strategy, the Bank will limit its activities to private sector operations and will not undertake any new public sector projects. Only reforms can unlock Uzbekistan's significant economic potential and allow the Bank to operate on a full-fledged basis.

Considering the above, the Bank will focus on the following areas during this strategy period:

Supporting private sector development

The Bank will continue to support private sector investment and entrepreneurship provided that there is no direct or indirect link to the Government or Government officials. For the development of SMEs and micro-business, the Bank will channel its resources to the sector through its credit lines to local financial institutions. In addition, the Bank will continue operating its Trade Facilitation Programme. The programme will continue to be facilitated by the provision of the risk sharing guarantee under the Central Asia Risk Sharing Special Fund (CARSSF). The Bank, with donor support, will complement its SME financing with TurnAround Management (TAM) and Business Advisory Services (BAS) programmes.

Recognising that private banks will not be able to satisfy needs for microfinancing, the Bank will also investigate the possibility of establishing a microfinance bank, together with other IFIs. This is of particular significance in light of the recent closure of the country’s largest private bank. The Bank will also consider the possibility of expanding its leasing operation, as there is considerable demand for such financing.

The Bank will further develop its use of facilities available under the ETC initiative, increasing direct exposure to SMEs in the private sector in close cooperation with donors. Both the Direct Lending Facility and the Direct Investment Facility will continue to be utilised during the strategy period. In addition, extending the Co-financing Facility to selected Uzbek banks will enable the Bank to increase direct exposure to SMEs.

An important means for developing the private sector will be the promotion of foreign investment. The Bank will remain ready to work with foreign investors for joint venture projects. However, the current investment climate is of limited interest to foreign investors and further improvement is necessary in order to attract foreign investment, as well as closer dialogue between the Government and the investor community, to accommodate private sector initiatives. Based on its experience so far, the Bank will put more emphasis on the monitoring of the existing portfolio, both private and public sector projects, including integrity issues.

Policy dialogue

During the strategy period, the Bank will seek to engage in policy dialogue with the authorities, working for improvement in the investment climate and supporting their reform efforts. The Bank will continue to monitor political and economic reforms in Uzbekistan. This monitoring will be based on the assessment of progress on the following benchmarks:

In the political sphere:

- Ensure greater political openness of the system and freedom of the media. A multi-party democracy and a pluralistic society require greater pluralism of opinions.
- Open up the political processes to a variety of interests. Ensure free functioning of civil society organisations, including independent local NGOs in the areas of rule of law and protection of human rights.

- Improve the country's human rights record, including measures directed at implementation of the recommendations made by the UN Special Rapporteur on the elimination of systematic torture.

In the economic sphere:

- Continued and full current account convertibility, as supported through the elimination of restrictions on the availability of domestic currency, of daily cash deposit requirements for retailers, and of regulatory distinctions between cash- and non-cash payments.
- Opening of the economy to effective competition. Among other elements this could include the elimination of discriminatory barriers against foreign trade, a liberalisation of state procurement prices in agriculture, an improvement in the conditions for the entry of domestic businesses and protection of property rights, and the acceleration of large-scale privatisation in a transparent manner.
- Implementation of a banking sector reform programme, moving towards fully market-based allocation of credit and providing the basis for privatisation of the main state banks.
- Reform in public utilities, including through the further adjustment of tariffs towards cost-recovery levels in all sectors.

The Bank will seek co-financing opportunities with other IFIs and bilateral institutions to mobilise resources into the country. The Bank will continue to ensure that all Bank operations in Uzbekistan are subject to the Bank's Environmental Procedures and incorporate, where appropriate, Environmental Action Plans (EAPs) into the legal documentation, in order to address issues raised during due diligence.

LIST OF ABBREVIATIONS

ADB	Asian Development Bank
AM	Annual Meeting
BAS	Business Advisory Service
BEEPS	Business Environment and Enterprise Performance Survey
CARSSF	Central Asia Risk Sharing Special Fund
CBU	Central Bank of Uzbekistan
CDM	Clean Development Mechanism
CIS	Commonwealth of Independent States
CL	Credit Line
DIF	Direct Investment Facility
EAP	Environmental Action Plans
ETCI	Early Transition Countries Initiative
EU	European Union
FDI	Foreign Direct Investment
FI	Financial Institutions
GDP	Gross Domestic Product
GOU	Government of Uzbekistan
GSM	Global System for Mobile Communications
IAS	International Accounting Standard
IFC	International Financial Corporation
IFI	International Financial Institution
ILO	International Labour Organisation
IMF	International Monetary Fund
IMU	Islamic Movement of Uzbekistan
J-USBP	Japan-Uzbekistan Small Business Programme
KfW	Kreditanstalt für Wiederaufban
LTT	Legal Transition Team
MSE	Micro and Small Enterprises
NBU	National Bank of Uzbekistan for Foreign Economic Activity
NEAP	The National Environmental Action Plan
NGO	Non-Governmental Organisation
ODIHR	Office for Democratic Institutions and Human Rights
OSCE	Organisation for Security and Co-operation in Europe
OTC	Over the Counter
PCA	Partnership and Cooperation Agreement
PCF	Prototype Carbon Fund
RR	Resident Representative
SDTPS	Syrdarinskaya Thermal Power Station
SME	Small and Medium Enterprise
TACIS	Technical Assistance for Commonwealth of Independent States
TAM	Turn Around Management
TFP	Trade Facilitation Programme
TRACECA	Transport Corridor of Europe-Caucasus-Asia
UNEP	United Nations Environment Programme
UNDP	United Nations Development Programme
UNG	UzbekNefteGas
USAID	United States Agency for International Development
UTY	Uzebek Railways
ZNJV	Zarafshan-Newmont Joint Venture

II. COUNTRY STRATEGY

1. THE BANK’S PORTFOLIO

1.1 Overview of the Bank's Activities To Date

The Bank’s cumulative financing to date stands at EUR 584 million as of end-June 2005 in Uzbekistan with a diversified portfolio. A significant share of the Bank's funding has been directed to the financial institutions (29 per cent), natural resources and energy (29 per cent) and infrastructure (27 per cent) sectors. Most of the Bank's funding is in the form of debt (94 per cent) with 5 per cent in equity investments and the remaining 1 per cent in guarantees.

During the last strategy period, the Bank signed ten projects for EUR 66.2 million. The majority of the projects are private sector loans with foreign and local investors:

- (i) Bursel Tashkent Textile JV (EUR 10.3 million);
- (ii) Uz-Arctech, Welding Electrodes (EUR 7.2million);
- (iii) DLF – Berad-Agro (EUR 0.5 million);
- (iv) DLF – Gisad O’zbek (EUR 0.9 million);
- (v) DLF – Mekhnat Pivo (EUR 2.8 million).
- (vi) Nestlé Uzbekistan LLC (EUR 2.5 million);
- (vii) Unitel (equity - EUR 3.9 million, debt - EUR 24.5 million);
- (viii) MSE programme with Uzjilsberbank (EUR 3.8 million);
- (ix) MSE to Hamkorbank (EUR 2.3 million)
- (x) Tashkent Water Supply Improvement (EUR 7.5 million).

Table 1: Overview of Bank's Activities as at end June 2005

	No. of Projects	Total Project Cost (EUR millions)	EBRD Finance (EUR millions)	Share of Commitments (%)
Debt	18	1,093	549	94%
Equity	5.2	130	31	5%
Guarantee	1.8	12	4	1%
Private	15.5	757	332	57%
Public	9.5	478	253	43%
Non-sovereign	15.1	669	234	41%
Sovereign	9.9	566	341	59%
Natural Resources and Energy	4	448	167	29%
Financial Institutions	8	223	169	29%
General Industry	5.1	175	56	10%
Infrastructure	6	281	158	27%
Specialised Industries	1.9	108	35	6%
Totals	25	1,235	584	100%

1.2 Assessment of the Last Strategy Period

The main operational focus of the last Strategy for Uzbekistan (BDS/UZ/03-1 (Final), 14 March 2003) concentrated on three areas: (i) support for private investment and entrepreneurship; (ii) strengthening of financial institutions; and (iii) support for critical infrastructure. In the subsequent Strategy Update in March 2004, the Bank reiterated the focus on (i) private sector support, in particular with SMEs, FDI and privatisation; (ii) cross-border infrastructure to support regional cooperation; and (iii) municipal and environmental infrastructure that would be of direct benefit to the population.

(i) Private Sector Support

The Bank continued to support the private sector through its MSE/SME Credit Line (CL) activities, given the importance of these businesses in furthering economic reform and creating much needed employment outside the public sector. Thus the Bank has continued to support entrepreneurship and strengthen the financial sector with institution-building TCs. The inclusion of Uzjilsberbank and expansion of Hamkorbank in micro lending operations enabled these institutions to build their MSE lending capabilities, improve funding of the private sector and increase competition. In addition, the Bank supported participating banks' trade and trade finance skills through the TFP and sought opportunities to introduce the co-financing facility to leading banks, in order to develop the private sector further.

The Bank's further operations with larger, state-owned banks (NBU and Asaka) are proving to be limited, due to their lack of restructuring (bad debt issues in particular) and the suspension of privatisation plans for Asaka Bank. Our work on the SME line was severely hampered by lack of compliance with the conditions of loan agreements which led to a sharp reduction in disbursements. Confidence in the banking sector was further damaged by the withdrawal of the Business Bank's licence in March 2005, then the largest private bank in the country, at a time when the Bank was considering taking an equity stake.

The reason given by the authorities – lack of compliance with related party lending requirements – was unexpected, as related party lending has been a significant issue in the country for a long time, in particular in the state owned banks and especially given the fact that the EBRD had agreed an action plan to reduce related party exposures with Business Bank.

In order to support the private sector in Early Transition Countries, in 2004 the Bank introduced the Early Transition Countries Initiative (ETCI). ETCI aims to focus on local, small, private enterprises utilising new facilities created specifically for smaller transactions. In Uzbekistan, the Bank signed Berad-Agro, Gisad O'zbek, and Mekhnat Pivo; these were among the first three ETCI projects for the Bank and a reasonable pipeline of new projects has been developed. Given the BAS and TAM programmes' assistance in identifying existing and potential projects and capacity, Uzbekistan is thought to benefit considerably from ETCI.

The Bank supported FDI with the Nestlé, Bursel, Uz-Arctech and Unitel projects. Overall, however, private FDI investors are deterred by continued difficulties in Uzbekistan's investment environment.

(ii) Cross-Border Infrastructure

To promote regional cooperation, the Bank has been collaborating with the Asian Development Bank on the Regional Power Transmission project, an Uzbekistan-Tajikistan cross-border project. Whilst its transition impact will be significant, signing of the project is proving to be a challenging task. One of the conditions for proceeding, both for the Bank and the ADB, is for both countries to sign a Power Trade Relations Agreement (the "PTRA"). Although the Uzbek President has issued a decree to sign the Agreement, the matter is still being negotiated, with the Uzbek Government again raising environmental issues related to aluminium smelting in Tajikistan. Any further delay in signing of the PTRA may result in cancellation of the project by ADB. The Bank will continue to work together with the ADB to support the Agreement and implement this project.

(iii) Municipal and Environmental Infrastructure

The Bank signed the Tashkent Water Supply Improvement project in April 2004 and promoted private sector participation in the management of the company, commercialisation and related tariff reform. The project also included a study on developing appropriate subsidy schemes to minimise the social impact of tariff adjustment.

The Bank has not succeeded in signing the Tashkent District Heating project; it has been put on hold by the Uzbek Government. In the course of numerous discussions with the authorities, it became apparent that the targeted reforms in the heating sector relating to tariffs and subsidies were unlikely to meet time expectations and would additionally require substantial financial commitments from the state. Problems with consolidation of the central budget and an unwillingness to crystallise future financial contributions make all municipal projects difficult.

1.3 Transition Impact of the Bank's Portfolio and Lessons Learned

1.3.1 Influence on the Transition Process So Far

(i) Private Sector Manufacturing

The Bank has had moderate success in supporting private manufacturing and achieving transition impact in this sector to date. The projects' objectives have been to support increased value-added manufacturing with an export orientation, supported by FDI in comparative-advantage industries in the private sector, such as textiles.

In recent years Uzbekistan has attracted several foreign textile manufacturers, mainly from Turkey and Korea. There have been some from European countries, due to increasing competition from Asia and in particular China. Western textile exporters are subject to further competitive price pressures after the elimination of textile quotas in January 2005, which forces them to find ways to reduce costs in order to maintain their competitiveness in the free-quota world. In view of the above, some producers are shifting their production bases to low-cost cotton growing countries. Central Asia, particularly Uzbekistan, is chosen due to the availability of good quality cotton, a well trained and educated workforce and government support for increasing the country's cotton processing capacity.

The Bank lent EUR 10.3 million for the Bursel Tashkent Textile Project in 2004, of a total project cost of EUR 34 million, with the anticipated employment of 2,000 people. The project involves the establishment of a state-of-the-art textile plant in Chirchik (35 km from Tashkent) to manufacture knitted cotton garments. The plant will operate with the latest technology, using locally manufactured cotton yarn and grey fabric to produce finished products (i.e. t-shirts, underwear and nightwear) for export, mainly to the USA and EU.

Uz-Arctech Welding Electrodes' EUR 7.2 million loan, signed in late 2004, is supporting the Turkish sponsor in the establishment of a welding electrode production facility with a total project cost of EUR 21 million.

The Gisad O'zbek project (EUR 0.9 million) is among the first ETC projects signed in 2004. The project is to finance working capital for a joint venture company. The Direct Lending Facility allowed the Bank to assist the textile manufacturer to increase its capacity utilisation and export potential.

(ii) The Financial Sector

The country's financial sector is still at an early stage of development and is in need of reforms to restructure a banking system suffering from the effects of the culture of state 'directed' lending to underperforming state owned companies.

The Bank committed EUR 165 million to the financial sector in Uzbekistan, most of which was provided through SME Credit Lines (CLs). It has been one of the few sources of funding available to Uzbek SMEs, as local banks were unable to provide long-term financing. The Bank's CLs were the pilot ones in this sphere; the institution building TC funds and the implementation of sound banking principles via the presence of credit advisors allowed participating banks to gain experience in appraisal and monitoring. This resulted in the subsequent attraction of additional funds for SME financing from other IFIs. However, due to the lack of development of the banking system, the unhelpful macroeconomic and business environment and continuing interference by the state many of the sub-loans became non-performing. Unfortunately, the Bank placed too great a reliance on the strategic investors in large joint venture sub-projects and monitoring by local banks, which has subsequently proved to be inadequate.

In April 2001, the Bank commenced the pilot phase of the Japan-Uzbekistan Small Business Programme (JUSBP). The transition impact achieved has been a transfer of knowledge through institution building TCs. The gradual increase of participating banks in the MSE programme enhanced the competitive environment in micro business financing and strengthened the banks' institutional capacities.

The Bank's equity investments in three financial institutions in the country (Uzbek Leasing, ABN AMRO and UzDaewooBank) had an impact on the sector through demonstration effects and increased competition, particularly for private sector clients. They operate without Government guarantees and were less involved in directed lending. In addition, the Bank's introduction of the Trade Facilitation Programme (TFP) supported trade activities for exporters and importers through participating local banks. However, banks' growth is limited due to the problems faced by the private sector and the smaller than expected amount of FDI in recent years.

Uzbek Leasing had significant problems in the early stages, including loss of guidance from its strategic shareholder. However it has had its operations restructured with the Bank's assistance and has become an effective financial intermediary.

(iii) The Natural Resources and Energy Sector

Non-ferrous metals has proven to be Uzbekistan's leading natural resources sector to date, in particular the gold sub-sector. The Bank has committed a total of EUR 100 million, including an A/B loan structure, since 1993, to the Zarafshan-Newmont gold mine. It has become one of the most efficient, lowest-cost secondary mining operations in the world and Newmont retains operational and management control. The joint venture has set proper environmental standards for heap leaching. Much of the legislation on the extraction of natural resources has been developed for this project. It is one of the few joint ventures that managed to satisfy both the Uzbek and the foreign investor interests well enough to warrant additional investment.

The Bank has contributed to the country achieving self-sufficiency in oil and oil products through financing EUR 70 million for the modernisation of the Fergana Refinery. The refinery rehabilitation operation has included the provision of a desulphurisation unit to produce cleaner oil products. It enabled the refinery to switch to domestic crude oil, which was developed several years earlier but had a very high sulphur content. It also introduced environmental and safety measures to the refinery and significantly improved the refinery's standards in this regard. The project contributed to convincing the government to prepare a programme for splitting the oil and gas holding company into separate operations for future privatisation.

In the energy sector the Bank financed the Syrdariya Power Station with EUR 22 million, to increase the system's capacity, and address issues relating to the sector's commercialisation and ultimate privatisation. The Bank was closely involved in policy dialogue with the government on power sector reform. The project transformed the station into a joint stock company, which set a model for the unbundling and corporatisation of the whole Uzbek power sector. The Bank has provided institution building TCs to improve the accounting system and rationalisation of the power tariff. The Bank is continuing policy dialogue in power on tariff structure, corporate restructuring and other issues, in relation to the Regional Power Transmission project.

(iv) The Infrastructure Sector

The Bank was relatively successful in the infrastructure sector, both in terms of numbers of projects, as well as their quality and transition impact, although implementation has become increasingly difficult.

Half of the Bank's infrastructure projects were in the municipal sector, where the Bank financed the Tashkent Solid Waste Management (TSWM) Project. This was the first project to be funded externally and implemented by a municipality (the City of Tashkent). The project is providing institutional strengthening of the municipal services administration. As part of the loan conditionality, waste collection charges have been raised and initial steps have been taken to contract out waste collection via a tender process in two areas of the City of Tashkent. As a result of increased charges there has been an increased level of private sector involvement in waste recycling, contributing to substantial waste minimisation.

The Tashkent Water Supply Improvement Project (EUR 7.5 million) was signed on 9 April 2004 with the aim of restoring and improving basic water supply services in the City. The project will support the reform process initiated by the TSWM project, and expand this process to water supply. The Bank's financial and operational performance improvement programme will help the company to develop and implement performance improvement targets; develop and implement a tariff reform plan to gradually eliminate cross-subsidies while protecting low income consumers from hardship; solicit private sector involvement. Furthermore, the company will also receive support in developing a public awareness campaign to increase understanding of the benefits of reducing water consumption.

Outside Tashkent, the Bank financed a project to upgrade the efficiency of the Andijan District Heating System. The project provides important transition impact by involving the private sector in the management of the company, commercialisation and related tariff reform. The project also included a study on developing appropriate subsidy schemes to minimise the social impact of tariff adjustment. In addition, the project is the first Bank project that has directly accessed the carbon credit markets through the 1997 Kyoto Protocol's Clean Development Mechanism (CDM)[1]. The Prototype Carbon Fund's Investors' Committee[2] approved the purchase of certified emissions reductions generated by the project. Implementation of the project and disbursement of the loan have been delayed due to lengthy project approval procedures and selection of a management contractor.

In the railway sector, the Bank has co-financed a project with the ADB to assist Uzbek Railways in developing a modernisation programme and financing priority investments. The Bank signed a EUR 30 million loan with Uzbek Railways for Freight Traction Renewal and Management Project, to finance the modernisation of its locomotive fleet through the purchase of new electric freight locomotives, while the ADB financed EUR 54 million for track maintenance. Following this project, the Bank also financed Uzbek Railways' Locomotive Re-Powering Project (EUR 52 million). The Uzbek Railway is an important part of the trans-regional corridor called Transport Corridor of Europe-Caucasus-Asia (TRACECA) linking Central Asia into the world economy.

The Bank has been involved in the air transport sector in Uzbekistan through a EUR 30 million rehabilitation project at Tashkent Airport. The airport is an important transit point for travellers from Europe to South Asia, as well as supporting tourism in Uzbekistan.

(v) Agribusiness

Agriculture generates more than 30 per cent of the GDP and employs at least 35 per cent of the workforce in the country. While there has been some progress in privatisating collective farms, transition is hindered by lack of capital; the sector remains heavily underinvested and suffers from the lack of working capital. The Bank supported the operation of the Nestlé water bottling subsidiary established in

[1] A mechanism that allows entities in industrialised countries to obtain carbon credits by financing emission reduction projects in developing countries.

[2] Committee comprised of private companies and Governments to approve transactions under the CDM.

Uzbekistan, by providing a guarantee for the amount of EUR 1.9 million and by attracting local banks' resources in the form of working capital. As well as supporting FDI, the Bank was able to identify a local private dried fruits and vegetables exporter, Berad-Agro. This company received a 3-year revolving working capital direct lending facility of EUR 0.5 million. The leading local private brewery Mekhnat-Pivo received a EUR 2.8 million financing for the implementation of its expansion programme.

(vi) Telecommunications

The Bank's contribution to transition in the telecom sector was limited, with the exception of the cellular services sector. Although the Government has defined it as a strategic sector, giving it a priority for liberalisation and reform, Uzbekistan lags in terms of infrastructure and market development, with only a relatively small proportion of the population benefiting from telecom services. The fixed line market is dominated by state-owned Uzbektelecom, which also holds a nationwide mobile license, CDMA. The cellular services and internet have been more successful. All mobile operators are joint ventures established with FDI.

The Bank's project involves a 100 per cent acquisition of Unitel, the second largest GSM operator in Uzbekistan, from Daewoo International, by Greek investors. The aim of the financing would be to increase the level of competition in the sector along with the establishment of high standards of corporate governance.

1.3.2 Financial Performance of Existing Portfolio

All projects in the public sector and those guaranteed by the state are performing, as are the larger projects in the private sector: the Zarafshan-Newmont Joint Venture, Bursel Tashkent Textile and those financed under the ETCI programme. However, other private projects in manufacturing, like Kasansay-Tekmen and Sergily Stroyservice, struggled to perform.

1.3.3 Mobilisation of Co-Financing

The Bank has been focusing on co-financing projects, especially those, which are considered to promote regional cooperation. At present, the Bank is preparing co-financing with the ADB for the Regional Power Transmission Modernisation project. Prior to this, the Bank co-financed the Uzbek Railways project with ADB in 1999. The Bank also co-financed projects in the financial sector (UzDaewoo, ABN-Amro, Uzbek leasing, etc). Mobilisation of co-financing has been successful in some projects (Tashkent Airport Rehabilitation (with KfW), Tashkent Solid Waste Management (with WB)); however, it remains problematic due to foreign investors' lack of interest in the country.

1.3.4 Lessons Learned

In spite of various efforts in the past years, the Bank has so far found it difficult to make any significant progress towards its main objectives in the banking sector, privatisation of the sector and widespread acceptance of 'sound banking' principles. Experience has taught us the difficulty of doing business under such circumstances; unreformed state-owned banks not able to successfully fulfil their role as intermediaries between the Bank and private banks are too small to fulfil this task. Until a major reform of the banking system is implemented the Bank will be forced to look for alternative ways of financing SMEs.

The Bank undertook a routine Operation Performance Evaluation Review on the SME CLs I & II in Uzbekistan, carried out in May and July of 2004. Its findings are that programmes were hindered by the failure of a significant proportion of the sub-projects. The main reasons for this were as follows: i) the lack of banking reforms: the privatisations of Asaka Bank and NBU are being delayed and although locally-owned private banks have begun to grow over the last 18 months, it is from a very small base; ii) large devaluation of the local currency, which greatly raised the cost of servicing the hard currency loans; and iii) lack of enterprise restructuring and transition in the country: the degree of state involvement and of concentration in the banking sector is very high, with seven state owned/controlled banks holding 90 per cent of the total assets in the banking sector. Initially the Bank relied on the strategic investors to manage joint venture projects, which had proved effective in other countries. Unfortunately this strategy was ineffective in the Uzbek environment.

The situation was further exacerbated by the limited development of retail banking, which is restraining the banking system from acting successfully as a financial intermediary between depositors and borrowers. The Bank has so far found it difficult to make any significant progress towards its main objectives, privatisation of the sector and widespread acceptance of 'sound banking' principles.

Supporting the development of private banks through equity investments is almost impossible if banking supervision is executed in an opaque and unpredictable manner. The withdrawal of the Business Bank licence in March 2005 was explained by the Central Bank as the result of an increase in undisclosed related party activity, which was identified by the bank inspectors during a periodic review and resulted in Business Bank being warned and fined for exceeding the Central Bank's prudential related party ratios. Although undertaken in the name of safeguarding depositors, the effect, nevertheless, was to highlight the non-transparent and arbitrary enforcement of banking laws within the country, as it is difficult to understand why such drastic measure was applied to Business Bank only and why at this particular moment.

There are early indications that the micro business financing under the Japan-Uzbekistan Small Business Programme (JUSBP) is proving more successful, due to a more intense approval and monitoring process. Nevertheless, local banks are neither able to fully utilise available funds nor meet the demand from small businesses. This is also the result of an underdeveloped branch network, as well as the reasons given above. On this basis, the Bank is considering the expansion of its work in this market segment through the establishment of a new micro-finance bank with other IFIs.

The investment climate has not changed significantly in 2004: Uzbekistan remains a difficult environment and FDI level is relatively low, although the total amount invested in 2004 was over EUR 100 million higher than in 2003. There has been a significant change of FDI sources – the growth seen in 2004 mostly came from Russia and FDI in 2005 is most likely to come from China. In both cases the investments are made as a result of intergovernmental agreements. Genuine private investors are facing increasing difficulties and without major changes in the legal framework and practice of central and local administrations, their share in FDI will decrease.

Poor original business concepts were responsible for difficulties in some early general industry projects. In the case of the Kasansay Tekmen project, it was expected that the main raw material would be sourced domestically; it subsequently emerged that the quality of locally produced wool is too low. Another set of issues relates to the foreign sponsor, who retained export proceeds abroad and failed to provide the necessary working capital support. Sergily's failure resulted mostly from lack of proper off-take agreements. However, learning from this experience, the Bank has been trying to structure new projects better and with more reliable sponsors.

Past experience of municipal and transport projects shows the importance and efficacy of extended discussions of the feasibility study and agreements on project specific issues. The success of the restructuring and implementation of a new tariff system was evident in Uzbek Railways, Tashkent Solid Waste Management (TSWP), Tashkent Water Supply, Syrdariya Power Plant Rehabilitation, and Tashkent Airport Rehabilitation. The technical assistance provided by the Bank ensured financial and operational improvement, through structural reforms which cover planning and the creation of a self-sustainable entity/utility, as well as the development of necessary management capacity. As a result, the separation of the supervisory and regulatory functions from the service provision is achieved.

The Bank needs to allow sufficient discussion to reach mutual understanding prior to signing, in order to resolve project issues; also, in future the Bank should consider the level of political will required for implementation. These are lessons learned from Regional Power Transmission (PRTP) and Tashkent District Heating (TDHP) projects, where the Bank continues its dialogue with the government on implementation of both projects. The main constraints in the implementation of the RPT are negotiations between the Uzbek and Tajik authorities on the Power Trade Relations Agreement. The Uzbek Government returned to environmental issues, already discussed at an earlier stage of the project, which is delaying negotiations on the PTRA. The government is taking a cautious approach to approving the TDHP, given the scope of commitments required to implement the project. The future of this project is uncertain due to a lack of political willingness to crystallise future budget commitments, although following implementation the overall amounts of budget subsidies would be reduced.

1.4 Portfolio Ratio

The private/public portfolio ratio was 57/43 at end-June 2005. The 2003 Strategy and Update in April 2004 focused on private sector operations, whilst pursuing key infrastructure projects. Despite the difficult investment climate and small size of investments, there has been a significant increase of the private portfolio ratio.

2. OPERATIONAL ENVIRONMENT

2.1 Political Environment

Uzbekistan is a presidential republic where the strong executive branch of power is not balanced by the legislature or judiciary. President Islam Karimov was first elected in 1991 and re-elected in 2000 in an election which did not conform to international standards.

The last parliamentary elections took place on 26 December 2004 and fell significantly short of international standards for democratic elections by not ensuring a pluralistic, competitive and transparent environment. Genuine opposition parties were denied registration, which precluded their participation in the parliamentary polls. The media remains subject to strict state controls even in the absence of official censorship.

There has been no progress on the political benchmarks of the 2003 country strategy envisaging greater political openness of the system and freedom of the media; registration and free functioning of political parties and NGOs; and improvement of the country's human rights record, including measures directed at elimination of systematic torture.

The indiscriminate and disproportionate use of force against civilians in Andijan in May 2005 is a cause of serious concern for the Bank. The international community has strongly urged the government of Uzbekistan to allow an independent investigation into the violence in Andijan.

(See detailed political analysis in Annex 1)

2.2 Economic Environment

Uzbekistan remains a laggard in economic reform. State intervention and control of the economy is pervasive, in particular in the financial system and external trade. A further tightening of import substitution policies and the attempt to eliminate informal economic transactions has led to a further deterioration in the investment climate.

Growth over previous years has been well behind the regional average. A revival in growth in 2004, to an estimated 7.4 per cent, has been driven by some productivity gains in the agricultural sector, and by the exports of state-owned industries, which have benefited from preferential access to credit, and reduced tax and tariff rates. While this represents a substantial acceleration over previous years, it is unlikely that such growth rates can be sustained in the absence of reforms. Other international organisations have expressed serious concerns regarding the transparency and consistency of Uzbek national accounts data, which impedes an accurate assessment of the macroeconomic situation.

The unification of exchange rates represents a major achievement. In the period leading up to the introduction of current account convertibility in October 2003, several restrictive exchange regulations were lifted. Foreign investors now report a much improved availability of foreign exchange in the OTC market. However, access to foreign currency is still regularly disrupted. The private sector reports delays in obtaining foreign exchange for certain consumer goods. At times when the government or state-owned enterprises have large foreign payment needs, private applications for foreign exchange appear to be delayed, suggesting that administrative controls are still in place. Nevertheless, the authorities now hold very substantial foreign exchange reserves, according to official numbers at a level equivalent to over six months of imports of goods and services, which should ameliorate concerns regarding the stability of the exchange rate.

The introduction of current account convertibility has gone hand in hand with a tightening of a pervasive system of rationing domestic currency in circulation. Foreign and domestic investors now cite this as the primary impediment to doing business in the country. Retail outlets are required to deposit their cash receipts with their local commercial bank daily and commercial banks in turn are required to surrender most cash to the Central Bank system. Cash withdrawals from commercial banks are approved according to a list of prioritised uses mandated by the Central Bank. However, even for payments which are deemed a priority, such as wages, requests by account holders are rarely met in full. Restrictions on commercial banks' access to their correspondent accounts have further contributed to cash shortages. This system of cash rationing represents a particularly severe operational obstacle for small and micro enterprises with limited working capital, and has contributed to the re-emergence of wage arrears, in both private and state-owned enterprises. Claims that are settled in cash therefore regularly benefit from a discount, and there are strong incentives to conduct payments informally, rather than through the banking system. The fact that the largest banknote has a value equal to less that one USD creates additional problems and costs for consumers and companies.

The financial system remains largely dysfunctional. Depositors' confidence in the banking system is low, given the restrictions on cash withdrawals outlined above, and the tax authorities' right to debit individual accounts without the account holder's prior permission. Moreover, at the end of 2004, a number of decrees on the introduction of cash-less payments systems were passed. While the authorities have since scaled back their ambition on this project in response to public comments, uncertainty with regard to the use of domestic currency has increased, and public confidence in the banking system was further undermined.

Credit to entities other than the consolidated government remains low, at an estimated 24 per cent of GDP. The access of many SMEs and micro enterprises is further impeded by the multiple regulatory and licensing requirements that potential borrowers have to document to banks. These credit constraints come against the background of a rapid accumulation in the central bank's foreign assets and an expansion in broad money by over forty per cent in 2004.

The banking sector remains highly concentrated. The top two state-owned banks account for 60 - 70 per cent of total bank assets and remain essentially unreformed. Official data suggest that asset quality is good, with less than two per cent of assets classified as doubtful or in loss at end-2003. However, the private sector and assessments of other institutions suggest that following the major devaluation and a period of low economic growth, a much larger part of the portfolio is doubtful, in particular the assets that had previously been guaranteed, or directed by government intervention. Nevertheless, over the past two years the government has imposed tight restrictions on the extension of further sovereign guarantees.

The government has pursued a fairly disciplined fiscal policy. The 2005 budget introduced a number of changes in tax policy, most notably a further reduction in the corporate income tax from 18 to 15 per cent, and a reduction in the sales tax levied on small enterprises. Under the so-called localisation programme, the government has also considerably widened the exemptions from customs duties and profit taxes for selected enterprises. Together with a number of tax increases, including on the use of water and land, this is expected to result in a modest consolidated budget deficit of about 3 per cent of GDP. A key uncertainty in projecting the government balance is the contributions into the newly created funded pension accounts. Over the medium term, the government intends to further reduce individual rates while broadening the tax base and strengthening tax enforcement. Following a zero net borrowing policy, the authorities have successfully reduced gross public debt to about 38 per cent of GDP. After a peak in debt service in 2004, and given the projected further decline in the external debt to GDP ratio, this will substantially reduce external vulnerability.

Despite the stated objective of simplifying the tax structure for the corporate sector, both domestic and foreign investors view unpredictable tax rules, and arbitrary tax enforcement as a key factor in explaining the very poor investment environment. Lack of transparency and the discretion granted to tax and other law enforcement agencies have facilitated rent extraction from the private sector. A recent survey of SMEs by the IFC revealed a number of obstacles to doing business in Uzbekistan. Apart from restrictions on cash withdrawal from bank accounts, respondents cited difficulties in using land as collateral, the limited enforceability of contracts, and the restrictions imposed on individual traders. Together, these factors explain a low and declining propensity to reinvest profits in the country. European embassies in Tashkent report a near absence of interest from their investors, and point to several notable efforts to withdraw or scale back existing assets. One exception is the textile processing sector, in which investors benefit from subsidised access to raw cotton, and, as all joint ventures, from a five-year tax holiday. The Government sees great promise in the interest from Russian and Chinese investors in the hydrocarbon and telecom sectors. However, for 2004, FDI inflows were estimated at a still disappointing EUR 146 million.

Progress with privatisation, in particular of large enterprises, has been slow. In 2004, privatisation revenues were estimated at EUR 57 million, including a number of large scale enterprises such as Akhangarant Cement and Uzcable. 2004 also witnessed a significant increase in the number of small enterprises opened up to private investment, a process technically called privatisation by the Uzbek authorities. However, it is difficult to assess the true extent of private participation in the corporate sector.

Uzbekistan’s trade regime is among the most restrictive within the group of transition countries, and further contributes to the adverse investment environment. The tariff regime features a relatively moderate average of most favoured nation tariffs, which is subject to a number of exemptions on imports from regional trading partners or of certain goods. Yet, Uzbekistan discriminates against other countries and against imports by Uzbek individuals. Tariff peaks and discriminatory excise taxes have led to relatively high rates of effective protection, in particular for consumer goods. From late 2002 onwards, the authorities have also introduced a number of discriminatory administrative restrictions on imports. In parallel, the government imposed restrictions on domestic retail and wholesale trade, such as requirements for certain infrastructure to be in place, minimum capital requirements, and controls on domestic currency collected by individual traders, all of which have further strengthened the position of large, typically state-owned retailers.

Some restrictions in bilateral trade with Kazakhstan have recently been lifted, however progress in regional cooperation – importantly within the Ministerial Conference on Central Asia Economic Cooperation supported by the ADB – remains limited. Uzbekistan has further pursued its accession to the World Trade Organisation (WTO), though this process is still at a very early stage. Recent measures, such as substantial excise duties on imported products run counter to WTO principles.

While on the whole structural reforms have been limited, two areas stand out for some modest progress. First, following substantial investment to expand access to gas and electricity in the 1990s, payments discipline in the energy sector has been strengthened through a metering programme, and pre-payment requirements. Against the background of substantial deficits in the state-owned electricity provider, tariffs have been increased over the last three years, and are now close to cost recovery levels. Second, a number of reforms have been implemented in the agricultural sector. Mandatory sales to the state of raw cotton are now in principle limited to 50 per cent of output. However, as farmers depend on state entities for key inputs and financing, they are typically obliged to supply a larger share to the state cotton processors at official procurement prices. These prices are now close to world market prices, net of transport and processing costs, and smuggling of raw cotton to neighbouring countries has subsided. This convergence is in part due to the sharp and unexpected drop in world cotton prices in the middle of 2004. There has also been further progress on the privatisation of collective farms ("shirkats"), which has accelerated further in 2004. This appears to have increased agricultural productivity, though the system of mandatory allocations of arable land to certain uses and production targets remains in place.

2.3 Legal Environment

Uzbekistan's commercial laws remain generally limited in scope and their provisions open to conflicting interpretations. This is particularly true of the Law on Pledge and the Law on Bankruptcy. The registration and enforcement of pledges is still uncertain, costly and complex. There are inconsistencies and ambiguities concerning, inter alia, the scope of reorganisation proceedings and the priority of secured creditors in bankruptcy. See Annex 7 on the assessment of Uzbekistan's commercial laws.

The main legal impediments to investments by the Bank and other private sector investors in Uzbekistan remain: (i) the absence of an efficient pledge registration and enforcement system; (ii) complex and sometimes contradictory legal rules coupled with insufficient or weak implementation; (iii) practical difficulties regarding conversion of local currency into foreign currency; and (iv) a high level of discretion granted to government officials to interpret the legislative framework. In addition, there continue to be concerns about the readiness of courts to enforce foreign arbitral awards in Uzbekistan in accordance with the country's treaty obligations under the 1958 United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

Legal and judicial reform and institution building (pledge registries, independent regulatory agencies, training of court judges, etc.) need to remain firmly on the institutional agenda if Uzbekistan's investment climate is to improve sustainably.

2.4 Environmental Issues

Uzbekistan's environmental challenges remain significant. The legacy of environmental neglect and mismanagement in Uzbekistan is best exemplified by the catastrophe of the Aral Sea. Owing to the diversion of the Amu Darya and Syrdariya rivers for the irrigation of cotton fields and other purposes, what once was the world's fourth largest inland sea has shrunk to only about 25 per cent of the initial surface area which existed before Soviet central planning began to divert the rivers. Furthermore, the large-scale and chemical/water intensive cotton production supported by the previous regime has induced air and water contamination by chemical pesticides and fertilisers, as well as water and soil salinisation due to inefficient irrigation (it is estimated that more than 50 per cent of the irrigated areas are affected by salinisation and 89 per cent of the total cropland of the country is irrigated). These contaminations have caused significant adverse effects on human health and the ecology of the Aral Sea Basin. In order to address the significant land degradation of the country, the Uzbek Government ratified the United Nations Convention to Combat Desertification (UNCCD) in 1996, prepared a National Action Plan in 2000 and an updated National Report (2002).

At the regional level, the recent cooperation focus has shifted from the downstream Aral Sea issues to the balancing of irrigation and hydropower demands between downstream and upstream states. The Central Asian Cooperation Organisation and others are seeking to facilitate such a discussion: the Kyrgyz Republic and Tajikistan are interested in generating hydropower in winter to help meet heating and other electricity demands and Uzbekistan, Turkmenistan and Kazakhstan, on the other hand, continue to give priority to wintertime water storage to ensure adequate water flows during the summer growing season (2004 Country Environmental Analysis for Uzbekistan, ADB). Nevertheless, continued strong state control of grain production through loan programmes, declining yield, suppressed agricultural incomes, further deteriorating irrigation systems and a weakened rural social safety net have offset their effects. Therefore the agricultural sector, which is the country's key economic sector, continues to lack economic incentives and transparency.

Environmental problems such as land degradation and salinisation are also closely linked with rural poverty. The country, indeed, suffers from high poverty incidence (28 per cent of the population were living in poverty in 2002 and approximately 70 per cent of the poor live in rural areas). According to the 2003 World Bank's Irrigation in Central Asia, rural communities in Central Asia including those in Uzbekistan have been in a vicious cycle of falling income, reduced maintenance of irrigation and drainage systems, deteriorating irrigation services and environmental problems such as land degradation and salinisation. To break the cycle, the study recommends that the Central Asian governments should consider increasing investment in rehabilitating irrigation systems, which is one of the key elements for agricultural productivity, where such investments meet some economic criteria and obtain reasonably accountable institutional backup, together with vital policy and institutional reforms. Maintaining adequate agricultural infrastructure such as irrigation systems is critical in reducing rural poverty and addressing better water resource use in the rural environment.

In order to address overall environmental challenges, Uzbekistan's State Committee for Nature Protection has made an attempt at ensuring implementation of the Programme of

Actions on Environmental Protection 1999-2005, which was built upon the 1998 National Environmental Action Plan (NEAP). The Programme aimed to establish a clear environmental policy, strategy and associated programmes to support sustainable development. From the Programme's inception to the end of 2003, more than 75 per cent of tasks were reportedly implemented. The Programme was supported by the passage of new legislation including two laws contributing directly to the facilitating policy and financial structure: (i) Law on State Ecological Expertise; and (ii) Law on Wastes. Some 30 environmental regulations have been passed since the Programme was established. However, no assessment has been made of the effectiveness of the tasks implemented under the Programme. Overall efforts on environmental legislative and regulatory programmes generated only limited impact. As there are plans to prepare the second NEAP and/or revise the Programme, it will be an opportunity for Uzbekistan to address these constraints; including inconsistency among various legal provisions and policy approaches, weak administrative capacities and the wide scope of bureaucratic interpretations on the application of law (ADB's 2004 Country Environmental Analysis for Uzbekistan).

2.5 Social & Labour Issues

Despite the recent economic growth in Uzbekistan, income poverty still remains a problem with an estimated 27.5 per cent of the population characterised as poor and a third of these as extremely poor. Income poverty is mostly found in rural areas, with an estimated 70 per cent of all poor people residing in rural areas. The highest incidences of poverty are found in the regions of Kashkadarya, Namangan and Karakalpakstan. Poverty incidence amongst households where the head is employed and where s/he is unemployed are similar; partly due to the fact that remuneration in state industries in urban areas and in agriculture in rural areas is often low and irregular. In addition, wage inequality is high. The unemployed, however, have the highest rate of poverty amongst the working-age population and are a particularly vulnerable group. As in other CIS countries, a higher education and not just a secondary education protects against poverty. Indeed, the poor have lower enrolment rates, particularly at Teknikum and higher levels of education, which exacerbates the intergenerational nature of poverty within families.

Nonetheless, there has been a recovery and/or improvement in some of the country's well-being indicators such as life expectancy, enrolment rates in basic education and infant and child mortality rates. Some gains which had started before the transition have continued: illiteracy has now been eliminated, and gender gaps in education have been closing, now remaining mostly at the higher levels.

Women are not formally impeded from seeking a role in the workplace, and women who start businesses or seek careers are not hindered legally. Although the law prohibits discrimination against women, economic activity amongst women is low compared to that found in other CIS countries. Women are severely under-represented in high level positions. This can mostly be explained by the lack of a higher education, higher numbers of young children and cultural factors. During the past ten years, the government has attempted to institute some safeguards for women's rights, mainly in the area of social welfare support. Domestic violence remains a serious problem faced by women. State policies intended to keep families together and to provide assistance to families 'in conflict' often compound the problem, as women facing abuse in the home are often prevented by these policies from seeking redress and/or relief.

There have been recent improvements in the incidence of infectious diseases; however there has been a reported increase in the incidence of some preventable infectious diseases, such as tuberculosis and AIDS. In rural areas, the poor face a higher incidence of infectious diseases and poor nutritional status, which can be ascribed to relatively low coverage of running water (just 25 per cent in rural areas) and basic sanitation (less than 2 per cent are connected to central sewerage). In addition, public spending on health is targeted at the non-poor through high spending on hospitals.

3. STRATEGIC ORIENTATIONS

3.1 Bank's Priorities for the Strategy Period

In its current Strategy, the Bank will encourage the Government of Uzbekistan to make progress towards meeting the political and economic challenges faced by the country.

The key political challenge is the need to ensure greater political openness throughout the entire system. A multi-party democracy and a pluralistic society require greater pluralism of opinions, representing a variety of political interests. Essential elements of this process are free and fair elections, registration and free functioning of opposition parties and independent NGOs, freedom of the media, respect for the rule of law and protection of human rights.

The easing of restrictions on domestic cash in circulation, the opening of the economy to effective competition, key steps in reform of the banking system and public utilities, will be essential for any revival in private sector growth and, in consequence, for greater engagement by the Bank. Several other measures will be necessary to support household incomes, including the clearing of wage and pension arrears, and a closer alignment of cotton procurement prices with world market levels. The very strong figures in the current account and the continued accumulation of international reserves underline the potential for reigniting growth by lifting restrictions on domestic and external trade – in particular of individual entrepreneurs – without putting the external balance at risk.

Since no visible progress has been made on meeting these challenges during the previous strategy period, the scope for the Bank's investments will henceforth be limited to the private sector and the Bank will not undertake any new public sector projects. Only reforms can unlock Uzbekistan's significant economic potential and allow the Bank to operate on a full-fledged basis. Based on its experience so far, the Bank will put more emphasis on the monitoring of the existing portfolio, both private and public sector projects, including integrity issues.

Considering the above analysis and challenges, the Bank will focus on the following areas during this strategy period:

3.1.1 Supporting Private Sector Development

The Bank will continue to support private sector investment and entrepreneurship provided that there is no direct or indirect link to the Government or Government officials. For the development of SMEs and micro-business, the Bank will channel its resources to the sector through its credit lines to local financial institutions, In addition, the Bank will continue operating its Trade Facilitation Programme. The programme will continue to be facilitated by the provision of the risk sharing guarantee under the Central Asia Risk Sharing Special Fund. The Bank, with donor support, will complement its SME financing with TurnAround Management (TAM) and Business Advisory Services (BAS) programmes.

Recognising that private banks will not be able to satisfy needs for microfinancing, the Bank will also investigate the possibility of establishing a microfinance bank, together with other IFIs. This is of particular significance in light of the recent closure of the country's largest private bank. The Bank will also consider the possibility of expanding its leasing operation, as there is considerable demand for such financing.

The Bank will further develop its use of facilities available under the ETC initiative, increasing direct exposure to SMEs in the private sector in close cooperation with donors. Both the Direct Lending Facility and the Direct Investment Facility will continue to be utilised during the strategy period. In addition, extending the Co-financing Facility to selected Uzbek banks will enable the Bank to increase direct exposure to SMEs.

An important means for developing the private sector will be the promotion of foreign investment. The Bank will remain ready to work with foreign investors for joint venture projects. However, the current investment climate is of limited interest to foreign investors and further improvement is necessary in order to attract foreign investment; as well as closer dialogue between the Government and the investor community, to accommodate private sector initiatives.

3.1.2 Policy Dialogue

During the strategy period, the Bank will seek to engage in policy dialogue with the authorities, working for improvement in the investment climate and supporting their reform efforts. The Bank will continue to monitor political and economic reforms in Uzbekistan. This monitoring will be based on the assessment of progress on the following benchmarks:

In the political sphere:

- Ensure greater political openness of the system and freedom of the media. A multi-party democracy and a pluralistic society require greater pluralism of opinions.
- Open up the political processes to a variety of interests. Ensure free functioning of civil society organisations, including independent local NGOs in the areas of rule of law and protection of human rights.
- Improve the country's human rights record, including measures directed at implementation of the recommendations made by the UN Special Rapporteur on the elimination of systematic torture.

In the economic sphere:

- Continued and full current account convertibility, as supported through the elimination of restrictions on the availability of domestic currency, of daily cash deposit requirements for retailers, and of regulatory distinctions between cash- and non-cash payments.
- Opening of the economy to effective competition. Among other elements this could include the elimination of discriminatory barriers against foreign trade, a liberalisation of state procurement prices in agriculture, an improvement in the conditions for entry of domestic businesses and protection of property rights, and the acceleration of large-scale privatisation in a transparent manner.
- Implementation of a banking sector reform programme, moving towards fully market-based allocation of credit and providing the basis for privatisation of the main state banks.

- Reform of public utilities, including through the further adjustment of tariffs towards cost-recovery levels in all sectors.

The Bank will seek co-financing opportunities with other IFIs and bilateral institutions to mobilise resources into the country.

The Bank will continue to ensure that all Bank operations in Uzbekistan are subject to the Bank's Environmental Procedures and incorporate, where appropriate, Environmental Action Plans (EAPs) into the legal documentation, in order to address issues raised during due diligence.

3.2 Sectoral Challenges and Bank Objectives

3.2.1 General Industry

Supporting private sector development and fostering entrepreneurship are the key to the successful transition to a market economy. The Bank will continue to support three groups of players in this sector, using tools designed for each group. Individual entrepreneurs and very small companies will benefit from the development of micro lending; SMEs will be offered access to the instruments available under the ETC initiative, combined with TAM/BAS management support; the Bank will also continue to finance large projects with local and foreign private sponsors. The projects' objectives will remain the support of increased value-added manufacturing, in comparative-advantage industries in the private sector, such as textiles, construction materials and others.

The Bank will continue to support the smallest businesses through micro lending. Besides providing financing, in order to support SMEs and MSEs, the Bank will continue to provide assistance through the Turn Around Management (TAM) and the Business Advisory Service (BAS) programmes with donor support. Both programmes include a wide range of business advice, covering the development of business plans, marketing, and restructuring, implementation of quality management and information systems.

With the introduction of the ETC Initiative in early 2004 the Bank's private sector orientated operational framework will contribute to unlocking the economic potential in Uzbekistan. The ETC Initiative will increase its role in supporting private sector companies through the Direct Lending and Investment Facilities and will assess the possibility of extending the Medium Sized Co-financing Facility to local participating banks. The Bank has identified a potential pipeline of projects to be screened during the strategy period.

The Bank's first Direct Investment (DIF) project in Uzbekistan, a EUR 0.5 million investment in a local printing company, was signed in June 2002. It has achieved demonstration effect in promoting better business practices, IAS reporting and overall transparency in the sector. With the introduction of the Direct Lending Facility (DLF), new opportunities to support private entrepreneurs have been identified and financing extended. The Bank identified a potential pipeline of projects to be screened during the strategy period. The Bank will also assess the market appetite for the introduction of the Medium Sized Co-financing Facility in Uzbekistan. This new regional framework contemplates co-financing operations with leading local participating banks in early transition countries to support funded and/or unfunded risk participation in the sub-loans. Eligibility will be subject to a satisfactory track record, established under the Bank's existing programmes.

In recent years, Uzbekistan has attracted several foreign textile manufacturers. Some producers are expected to continue shifting their production bases to low-cost, cotton growing countries. Central Asia, particularly Uzbekistan, is chosen due to the availability of good quality cotton, a well trained and educated workforce and government support for increasing the country's cotton processing capacity. The Bank will place still greater emphasis on social, environmental and integrity issues in the textile industry. In addition, the Bank will aim to support knowledge transfer, and the introduction of best international practices through FDI. The investment climate is the most important element in increasing FDI to the country. The Bank will focus on funding private sector enterprises through both direct lending and investment facilities.

3.2.2 Agribusiness

The Bank will seek opportunities to provide financing to small fruit and vegetable processing plants, using the tools available under the ETC initiative. This sector of agribusiness is especially promising, due to the high quality raw materials available locally, the established position of Uzbek products on foreign markets – mostly in CIS countries – and growing interest from multinationals, like Coca Cola.

The Bank will also continue to investigate the possibility of working with foreign strategic partners in agro-processing as a way to promote foreign investment and knowledge transfer in a way similar to a framework guarantee facility of EUR 7.5 million to Nestlé Uzbekistan (signed in July 2003).

With regard to upstream activities in the sector, the Bank will examine the introduction of an agricultural financing scheme, such as the Grain Warehouse Receipt Programme, by which the Bank will share the risk of a local borrower with local participating banks, supported by the collateral of new crops stored in the grain warehouses. The implementation of reforms to the marketing of key cash crops, such as grain and cotton, will be a necessary precondition for the Bank to start developing structured trade finance operations in the sector.

3.2.3 Telecommunications

In 2004 the Bank supported FDI and participated in the acquisition (EUR 3.9 million) of private mobile operator Unitel and loan finance for the post-acquisition network expansion and capacity increase; the loan agreement, with an upper limit EUR 24 million, was signed on 7 June 2005. Going forward, the Bank will seek other opportunities to provide long-term financing to companies in the private sector. This, however, will be highly dependent upon improvements in the regulatory framework and stability in the broader macro-economic environment, including full currency convertibility and exchange rate predictability.

3.2.4 Natural Resources

Mining is one of the main sectors of interest for foreign investors. Based on the positive experience of the Zarafshan-Newmont gold mine (see Section 1.3 (iii)), the Bank will seek opportunities to support private projects in the sector involving sound foreign sponsors. In mining, the Bank will target the key transition challenges of introducing new technologies, enhancing business standards including adherence to international environmental standards.

3.2.5 Financial Sector

Since the banking sector has been a key vehicle for state-led investment policy, the Bank's assistance to restructuring of the sector could be one of the most important contributions it could make in supporting economic reforms in Uzbekistan. Market-based finance is critical to foster a positive supply response to reforms.

The policy challenges in this respect are manifold including: (i) to discontinue directed lending; (ii) to improve the corporate governance and management capacity of commercial banks; (iii) to upgrade the supervisory capabilities of the Central Bank; (iv) to solve the large potential portfolio of non-performing loans; (v) to privatise state-owned banks possibly with foreign strategic investors; (vi) to develop non-banking financial institutions; and (vii) to increase competition in the financial system and improve efficiency of financial intermediation.

The Bank will support systemic changes in Uzbekistan's financial sector. It has to be recognised, however, that banking sector reforms are tied to other key structural reforms. The privatisation of the banking system cannot proceed successfully while the banks remain burdened with directed credits to industries of strategic interest to the government. In this regard, the government's intention to proceed with banking sector reforms as declared in mid-April 2005 that, among others, targets restructuring of bad loans, including sovereign guaranteed portfolio, as preparation to privatisation is particularly important. Moreover, the resolution of non-performing loans would be best pursued in the context of enterprise restructuring. The Bank has previously made it clear in its policy dialogue with the government that these issues have to be addressed before the Bank participates in the bank privatisation programme.

(i) The Banking Sector

If Uzbekistan is to move decisively towards market liberalisation and structural reforms, the banking system needs to undergo a significant adjustment process that would involve dealing with the large portfolio of state-guaranteed and possibly doubtful loans and re-orientating lending policies towards the private sector. The Bank is willing to support this process through policy dialogue in consultation with other IFIs. The Bank intends to take a proactive approach towards the restructuring and privatisation process of the Uzbek banking sector, with the ultimate goal of increasing the level of intermediation in the country. It will pursue this approach by working with Asaka Bank to create a demonstration case for successful restructuring and investment by a strategic foreign bank.

The Bank will continue to promote competition in the banking sector through increasing the number of participating banks under the SMEs, MSE and TFP projects. This will further support the strengthening of the banking sector. In addition, the Bank will continue to support institution building in the sector through institution building TCs to improve the banks' credit assessment and monitoring processes, auditing, management information systems, the development of new products such as trade financing, etc.

Such TCs will benefit those banks, in particular, that could be included as additional participating banks under the SME and micro-business programmes as well as TFP.

The Bank will undertake a monitoring review of all the sub-loans under the existing SME lines to assess viability of the sub-projects, integrity and the Bank's process for monitoring SME lines.

In 2002, the Bank created a first loss guarantee fund to significantly enhance the above operations (SME, MSE, TFP and DIF) in Uzbekistan, the Kyrgyz Republic and Tajikistan[3]. Recognising the high risk, potential losses will be shared between the Bank and the CARSSF, contributed by donors. It will enable the Bank to include additional participating banks in the programmes and increase its own exposure several times. The governments of Germany and Switzerland have so far contributed to CARSSF and its current size, including the 35 per cent EBRD contribution, is about EUR 8.5 million.

The Bank will also consider, where feasible, making an equity or quasi-equity investment in a local private bank.

The Bank will also assess the market appetite for the introduction of the Medium Sized Co-financing Facility in Uzbekistan. This new regional framework contemplates co-financing operations with leading local participating banks in early transition countries, to support with funded and/or unfunded risk participation in the sub-loans. Eligibility will be subject to a satisfactory track record established under the Bank's existing programmes.

(ii) Non-bank Financial Institutions

If the structural reform in the banking sector progresses, this will form the basis of further development of non-banking financial institutions and instruments, to include leasing, mortgage, insurance, pension funds and securities. Such progress will help to (i) increase the efficiency of financial resource allocation, (ii) contribute to increase private savings, (iii) foster institutional investors, and (iv) assist in deepening financial markets.

Although the Bank's experience in this sector has been limited to its equity investment and senior loan to the Uzbek Leasing Company, it will seek opportunities for investment that could contribute to the development of non-bank financial institutions. It will consider the possibility of expanding its leasing operation as there is considerable demand for such financing. Another new area to explore is the extension of credit lines to non-bank microfinance institutions.

[3] Approved by the Board in July 2002.

4. OTHER IFIs AND MULTILATERAL DONORS

The Bank has worked closely with other IFIs, bilateral donors and Governments in the region on the subject of regional cooperation. Following the conclusion of the CIS-7 exercise, the Bank has participated in three ministerial conferences on regional economic cooperation under the auspices of the ADB. This forum covers the areas of trade facilitation, transport, energy, and water, for which working parties have been established. ETC Multi-donor fund assistance on those areas is to support a sustainable development objectives programme, including increased energy efficiency and reduced pollution. The Bank regularly exchanges information with the donor countries represented within the country through frequent meetings.

4.1 International Monetary Fund

Following the lapse of an unfunded staff monitored programme in 2002, the engagement of the IMF has been limited to technical assistance and surveillance in the context of the annual Article IV missions, most recently in March 2005. The authorities consulted with the Fund in the second half of 2003, leading up to the adoption of current account convertibility under Article VIII of Fund's Articles of Agreement, and IMF staff continues to monitor compliance with the obligations under this article closely. At present the authorities are not seeking support from the IMF under any of its arrangements, and given the high level of official reserves, such an arrangement does not appear necessary. In any case the resumption of negotiations on such an arrangement would be contingent on demonstrating a track record of successful implementation of reforms.

4.2 World Bank

The World Bank has thus far supported projects targeted at the modernisation of infrastructure, the reform of the rural economy, and the support for privatisation and financial sector restructuring. It co-financed the Tashkent Solid Waste Project with the EBRD. The World Bank is not, at present, providing Structural Adjustment Loans (balance of payment and budgetary support loans) to Uzbekistan due to the slow reform progress and absence of programme arrangements between the IMF and the Government. The World Bank is currently preparing a new Country Assistance Strategy, to be finalised in July 2005, which will include a particular focus on basic human needs. It places a particular emphasis on regional cooperation both through targeted investments in individual countries with clear cross-border benefits, as well as significant analytical work, focused on the water-energy nexus and trade and transport facilitation.

The World Bank has cooperated closely with other IFIs in the nascent Welfare Improvement Strategy Paper (WISP) process in Uzbekistan. An interim WISP was prepared in early 2005 (called the Interim, or I-WISP) and the World Bank together with the ADB and UNDP, as well as with the support of bilateral donors, has agreed a package of technical and analytical support for the preparation of a full WISP, under the Poverty Reduction Strategy Paper (PRSP) Trust Fund. The new CAS will be based on the priorities contained in the I-WISP.

4.3 International Financing Corporation

The IFC has worked on private sector development, and provided technical assistance for project identification, and capacity building in the financial sector, though little progress has been made in this area. The IFC has therefore focused its attention on SME credit lines and technical assistance in the areas of leasing, microfinance, and business regulation through its Private Enterprise Partnership (PEP) programme. A regional leasing facility was approved in early 2005. The annual survey of SMEs will provide an important gauge of the private sector environment.

4.4 Asian Development Bank

The Asian Development Bank (ADB) updated its 2000 Country Strategy and Programme in October 2004, envisaging lending levels of about US$ 100 million to US$ 150 million, including regional projects. Three loans totalling US$ 95 million are planned for 2005: for land improvement in farming areas, rehabilitation of regional railways, and improvement of rural water supply and sanitation services. An ICT basic education project is also under review and is on standby for 2005. An education sector development programme with loans totalling US$ 108.5 million was approved in 2002, and the first tranche of US$30 million was released in mid-2004, following ADB's acceptance of Government progress in four key reform areas, namely currency convertibility, agricultural reform, trade and statistics. The Government recently completed its medium term living standards strategy with technical assistance from ADB, which is being further developed into an interim poverty reduction strategy (PRSP). In addition to the living standards strategy assistance ADB undertook a number of thematic assessments in 2004 covering private sector development, agriculture, governance, gender. The purpose of these assessments being to help inform the targeting and formulation of ADB's future country strategy and programme for the country which is expected to be approved in mid-2005.

4.5 Islamic Development Bank

On 2 September 2003, at its 28th Annual Meeting, the Republic of Uzbekistan became 55th member of the IDB. Until that time IDB granted only donor financing, amounting to USD 1.9 million.

In 2004 the Board of Executive Directors of the IDB approved the following projects in Uzbekistan: State Medical Emergency Hospitals (US$ 23.8 million), Road Construction and Maintenance Equipment Project (US$ 12.6 million), and SME Credit Line to the National Bank of Uzbekistan (US$ 15 million). The bank is also considering the possibility of a grant for technical assistance with project preparation for Tashkent heat and water supply system modernisation. The IDB has received proposals for the realisation of the investment projects, amounting to US$ 400 million of financing, within the framework of the Investment Cooperation Programme of the Republic of Uzbekistan and IDB for 2005-2007.

4.6 United Nations

United Nations agencies (UNDP, UNESCO, UNFPA, WHO, UNICEF) are playing an important role in health and population, poverty reduction, environment, development of human resources and management capacities, gender and development, preservation of national cultural heritage, and strengthening of NGOs. There are a number of ongoing projects in Uzbekistan that UN agencies are either financing or implementing. Overall, according to a 2003 UNDP Human Development Report, in 2002 official development assistance to Uzbekistan amounted to almost US$ 190 million, less than 2.5 per cent of the country's GDP.

4.7 European Union

The European Union's cooperation objectives with Uzbekistan are based on the Partnership and Cooperation Agreement (PCA) with Uzbekistan which came into force in July1999. In October 2002 the European Commission adopted a new strategy for Central Asia for the period 2002-2006, of which the core objectives are i) promoting stability and security in the region; ii) eliminating the sources of political and social tension; and iii) assisting the pursuit of sustainable economic development, in particular by improving the climate for trade, investments and energy supplies.

The EC strategy builds on a regional approach for its cooperation with the countries of Central Asia, including Uzbekistan. The EC cooperation programme aims to promote good neighbourghly relations and confidence building between the countries of the region and enhance opportunities to advance a comprehensive regional perspective for sustainable development, notably through the compatibility of reforms and the convergence of the legal harmonisation processes

These objectives are to be pursued through three 'tracks' for European Union/TACIS assistance:

- **a regional cooperation programme** designed to promote good neighbourly relations and collaborative work between the Central Asian countries using a pragmatic, 'variable geometry' format in areas where the European Union has a strategic interest. These include transport and energy networks, sustainable use of natural resources (water, Kyoto Mechanisms) and implementation of international environmental conventions, justice and home affairs (border flow facilitation and improved management, the fight against all forms of trafficking). This track represents one third of the total budget.
- **a regional support programme, implemented at national level,** addresses the main common challenges to sustainable economic development and poverty reduction. Adjusted to the needs of each country, it focuses on facilitating investment and trade through PCA implementation, WTO accession, statistics, improved customs, upgrading public administration and civil services, good governance and the rule of law, as well as supporting reforms to the general and technical higher education systems. In Tajikistan and Kyrgyzstan, EC assistance also supports the implementation of Poverty Reduction Strategy papers (PRSPs) in particular in connection with the EC aid instruments for sectoral reforms through budget support. For this track Uzbekistan will receive EUR 45 million for the period 2002-2006.
- **pilot poverty reduction schemes** in target regions, focusing on long term poverty alleviation, community driven rural development, centred on the most vulnerable groups. The focus in Uzbekistan has been on the Ferghana province, in particular the enclaves. Twenty per cent of the total budget is allocated to this track.

III. ANNEXES

ANNEX 1 – POLITICAL ASSESSMENT

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ANNEX 1 - POLITICAL ASSESSMENT

The last country strategy for Uzbekistan, adopted in March 2003, qualified Uzbekistan's progress towards implementation of the principles of Article 1 of the Agreement Establishing the Bank as being slow and characterised by setbacks.

A year later, in April 2004, the Bank reviewed economic and democratic progress in the country. At that review it was concluded that, while the Uzbek authorities have taken some steps, the overall impact of reform efforts has been very limited. The Bank encouraged the authorities to take a number of critical steps in the political and economic sphere to put Uzbekistan on a path of sustained progress towards multi-party democracy and a market economy.

There has been no improvement in Uzbekistan's political environment since then. Moreover, the indiscriminate use of force against civilians in Andijan in May 2005 is a cause for serious concern for the Bank. The international community, including inter-governmental organisations such as the UN, the EU and the OSCE as well as individual governments and NGOs, has strongly urged the government of Uzbekistan to allow an independent international investigation of violence in and around Andijan. So far the calls have been rejected.

Among the critical steps on the path of sustained progress towards multi-party democracy and pluralism, the 2003 country strategy established the following political benchmarks:

- Ensure greater political openness of the system and freedom of the media. A multi-party democracy and a pluralistic society require greater pluralism of opinions.
- Open up the political processes to a variety of interests. Ensure free functioning of civil society organisations, including independent local NGOs in the areas of rule of law and protection of human rights.
- Improve the country's human rights record, including measures directed at implementation of the recommendations made by the UN Special Rapporteur on the elimination of systematic torture.

No progress has been achieved on any of these areas since then. The events of May 2005 in and around Andijan was a tragic reflection of the lack of progress on achieving greater openness of the political system, leading to grave human rights abuses and loss of human life.

Elections

Uzbekistan is a presidential republic where the centralised executive branch dominates over the legislature and the judiciary. President Islam Karimov was first elected in 1991 and was re-elected in 2000 in an election which did not conform to international standards for democratic elections. The OSCE refused to monitor the presidential polls as the preconditions did not exist for the election to be free and fair. A 2002 referendum extended the term of the presidency from five to seven years. The next presidential elections are due in 2007.

Independent opposition political parties were denied registration which precluded their participation in the 2004 parliamentary elections. The 26 December 2004 parliamentary elections were the third parliamentary elections since 1991. These were the first elections for a lower house of the two-chamber parliament (Oliy Mejlis), consisting of the legislative chamber including 120 seats and elected in single-mandate constituencies. The upper chamber consists of 100 senators with 84 senators indirectly elected by regional councils and 16 appointed by the President.

According to the OSCE/ODIHR, which deployed a limited mission to observe the polls, the parliamentary elections of 26 December 2004 fell significantly short of international standards for democratic elections, despite minor improvements in the election law. The OSCE/ODIHR report on the elections noted that fundamental freedoms remain severely restricted and the relevant principles necessary for a meaningful democratic election process, such as freedom of expression, association and assembly, were not respected.

Political Parties

A political party can only compete in the election once it is registered with the Ministry of Justice. Five pro-government political parties have been registered and fielded candidates for the December 2004 elections – People's Democratic Party (PDP), Social-Democratic Party Adolat, National Democratic Party Milli Tiklanish, National Democratic Party Fidokarlar and the new Liberal Democratic Party of Uzbekistan (LDPU), which was registered in December 2003. The LDPU, whose stated objective is to represent the interests of businessmen and farmers, is widely seen as another pro-presidential party. Lack of differences in the electoral platforms of the five registered political parties did not provide the electorate with a genuine choice.

The genuine opposition parties meet with continuing obstacles for their registration and free functioning. There are four unregistered political parties in Uzbekistan, which were excluded from the 2004 parliamentary elections: Ozod Dekhkonlar (Free Peasants), Party of Agrarians and Entrepreneurs (both established in 2003), Birlik (Unity) and Erk (Freedom) in existence since 1989 and 1991 respectively. Erk's registration was discontinued by the Justice Ministry in 1993. The other three parties had unsuccessfully tried to register over 2003-2005.

Birlik's latest attempt to register was turned down for the fifth time by the Ministry of Justice in April 2005, based on the alleged failure to meet requirements of the Law on Political Parties.

Media

The media remains subject to heavy state controls even in the absence of official censorship, which was formally abolished in May 2002. Journalists remain concerned about possible reprisals and continue to exercise self-censorship. The freedom of the media is envisaged in the Constitution but, in practice, there are no independent media outlets in Uzbekistan. Although the number of Internet users has continued to increase in the last few years, it remains small relative to the size of the population. There are numerous cases of the blocking of websites posting critical material, which was especially evident prior to the parliamentary elections and in the aftermath of the Andijan events.

In the context of assessing the pre-electoral situation, the OSCE/ODIHR noted that media outlets and civil society groups came under increasing pressure. In September 2004 the authorities suspended for six months the activities of, and in July 2005 opened a criminal investigation against, Internews, an international media organisation, which was the main sponsor of Uzbekistan's independent broadcasters, in the run-up to the parliamentary elections. Internews was involved in training independent television and radio workers and in monitoring violations of journalists' rights. The authorities denied that there was a political motivation behind the decision, claiming that the NGO did not register its trademark, failed to inform the authorities of a change in its location, illegally distributed bulletins and conducted business outside of the capital despite being registered as a city-only organisation.

At the end of October 2004 Ruslan Sharipov, an independent Uzbek journalist, whose imprisonment in 2003 was widely perceived as being politically motivated, was granted political asylum in the United States. Sharipov strongly criticised the media's lack of freedom in Uzbekistan.

Human rights

Most human rights violations are related to the government's continued harsh treatment of unauthorised Islamic groups suspected by the government of extremist activities, arresting numerous members of these groups and sentencing them to lengthy jail terms.

Following a series of terrorist attacks in Tashkent and Bukhara in March-April and at the end of June 2004, there were trials of persons charged with terrorism and intention to overthrow the constitutional order. Foreign media – particularly Radio Free Europe/Radio Liberty and local journalists from the London-based Institute for War and Peace Reporting (IWPR) – have been harassed for their coverage of the bomb attacks and the government crackdown that followed. Human Rights Watch and other human rights organisations pointed out that the trials were unfair, as the government resorted to torture to extract confessions. The authorities adopted a National Plan to combat torture and there were no credible reports of persons dying in custody as a result of torture. However, according to independent monitors, there was no real progress in the practices of law enforcement agencies and torture continues to be used systematically to extract confessions.

Notwithstanding positive steps undertaken by the authorities by allowing an independent international investigation into the causes of death of Andrei Shelkovenko and continuing cooperation with international community on the issues of prison reform, the overall human rights record of the government remains dismal and has further worsened after the Andijan events. The government denied registration to local human rights NGOs, harassed human rights activists and refused to re-register the Open Society Institute (OSI). Freedom of religion continued to be restricted with numerous cases of harassment and arrests of individuals suspected of belonging to extremist religious groups.

In July 2004 the US Congress declined to certify Uzbekistan on human rights, quoting lack of progress on democratic reforms reflected in cases of suspicious deaths in custody, non-registration of the opposition parties, closure of the Soros Open Society Institute and harassment of NGOs, independent journalists and human rights activists.

There was no substantial change in the area of labour rights. As in previous years, there is a widespread practice of compulsory mobilisation of students and schoolchildren helping with the cotton harvest. The 2005 International Crisis Group (ICG) report recommended urgent action to end child labour in cotton fields, by calling on the government of Uzbekistan to adhere to the ILO Convention C182 on the Prohibition and Immediate Action for the Elimination of the Worst Forms of Child Labour; make clear public statements against the activity; punish officials who continue to turn a blind eye to child labour; and establish monitoring bodies to ensure that the laws against child labour are actually implemented. The ICG called to end the use of students and government employees as forced labour in the cotton fields and recommended inviting the ILO to investigate labour abuses in the cotton industry.

According to the latest State Department's Trafficking in Persons Report of June 2005, Uzbekistan is qualified as Tier 2 – Watch List country, i.e. a country which does not fully comply with the minimum standards for the elimination of trafficking but is making significant efforts to do so. According to the report, Uzbekistan is a primary source, and to a lesser extent a transit country, for people trafficked for the purposes of sexual exploitation and forced labour.

Andijan Events

The events of May 2005 in Andijan were triggered by a jail sentence delivered by a local court to 23 businessmen accused for their alleged belonging to an extremist Islamic organisation. On 13 May 2005 government soldiers opened fire on protesters after militants stormed a local jail and freed its prisoners, including the 23 men accused of Islamic extremism, and then took control of the regional administration and other government buildings. The Uzbek authorities blamed Islamic extremists for the violence and said that 187 people died, while independent sources put the death toll much higher. The violence in Andijan resulted in hundreds of people fleeing across the Uzbek-Kyrgyz border to seek refuge in neighbouring Kyrgyzstan.

Deeply disturbed by the events, the UN and the OSCE, strongly supported by the EU, the US and other governments, called for an independent international investigation into the May 13 events. The Uzbek authorities have not accepted the proposal for the international probe, notwithstanding a strong international pressure, and only agreed to a parliamentary enquiry into the events and a working group of diplomats monitoring national investigation, which falls far short of the demands of the international community. Failure to allow an independent investigation into the violence may trigger negative consequences for the country. Uzbekistan, as a partner state of the OSCE community, is expected to honour democratic standards and commitments to which all 55 participating states of the organisation subscribe.

There have been other instances of social unrest over the past year, including significant disturbances in Kokand (and, on a smaller scale, in other cities) on 1 November 2004, which were mostly driven by the restrictive trade laws. The primary cause of the disturbances were the government decrees restricting the activities of shuttle traders in a country where trade across borders is sometimes the only way of making a living.

External Relations

The doubly-landlocked Uzbekistan is strategically located in the heart of Central Asia. With nearly half of the population of the whole of Central Asia (26 million people live in Uzbekistan), and significant economic potential, the country is bound to play an important role in the regional economic and political context.

It is actively involved with various regional organisations but clearly prefers those which promote economic cooperation. In May 2005 Uzbekistan withdrew from the GUUAM, a grouping comprising Georgia, Uzbekistan, Ukraine, Azerbaijan and Moldova, claiming that the latter became too politicised and does not serve its original purpose of promoting economic cooperation among its members. In practice, however, the move was widely seen as aimed at distancing Uzbekistan from the group, which has a strong pro-Western orientation, especially in the aftermath of the revolutions in Georgia and Ukraine.

Although Uzbekistan continues to stay outside of the CIS collective security arrangements and has allowed the US military presence on its territory as part of the fight against international terrorism, the country maintains good relations with Russia. Two years after relations with Turkmenistan were severely damaged, in 2004 the two countries moved to restore normalcy to their bilateral links. In 2003 Uzbekistan joined the Shanghai Cooperation Organisation and in 2005 moved to strengthen economic links with China, one of the organisation’s five founding members, which also includes Russia, Kazakhstan, Kyrgyzstan and Tajikistan.

ANNEX 2 – BANK'S ANNUAL BUSINESS VOLUME

(EUR million)

	1991-1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Non-Sovereign	43.0	55.0	72.4	0.0	25.5	91.8	57.0	13.0	25	21.3	20.8
Loans	43.0	54.6	47.5	0.0	25.5	86.0	57.0	13.0	22	21.3	31.1
Equity	0.0	0.5	24.9	0.0	0.0	5.0	0.0	0.0	3	0.0	3.9
Sovereign	49.0	0.0	0.0	150.2	3.4	39.8	0.0	93.8	9	1.8	8.6
Private Sector Share (%)	100%	43%	100%	0%	13%	70%	100%	12%	100%	92%	61%
Non-Sovereign Share (%)	47%	100%	100%	0%	88%	70%	100%	12%	74%	92%	61%
Equity (%)	0%	1%	34%	0%	0%	4%	0%	0%	26%	0%	11%
Financial Institutions	49.0	31.7	41.1	0.0	12.4	86.0	25.0	13.0	33.0	8.5	14.5
Industry and Commerce	43.0	23.4	0.0	81.5	0.0	0.0	32.0	0.0	1.0	10.3	7.8
Infrastructure	0.0	0.0	0.0	68.7	16.5	39.8	0.0	93.8	0.0	1.8	7.3
Specialised Industries	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	2.5	4.4
Annual Business Volume	**92**	**55.0**	**72.4**	**150.2**	**28.9**	**131.6**	**57.0**	**106.8**	**34.0**	**23.1**	**34.0**

ANNEX 3 – SIGNED PROJECTS

(30/06/2005) EUR million

Name of Project	Signing Date	EBRD Finance
Zarafshan-Newmont Joint Venture	16/11/93	43.5
Uzbekistan SME Credit Line I - NBU	23/11/93	49.7
First NIS Regional Fund	21/11/94	0.3
Zarafshan-Newmont JV Additional Facility	26/04/95	16.6
Uzbek Leasing International AO (equity)	28/08/95	0.5
Sergily Building Materials	05/03/96	9.7
ABN-AMRO Bank Uzbekistan (equity)	12/06/96	0.9
Kasansay-Tekmen Wool Products	18/07/96	20.6
Uzbekistan SME Credit Line II - Asaka Bank	17/12/96	24.8
Uzbekistan SME Credit Line II - NBU	17/12/96	45.6
UzDaewoo Bank Equity Investment	17/12/96	4.1
Fergana Refinery Rehabilitation	20/01/97	71.9
Syrdariya Power Plant Rehabilitation	05/11/97	23.0
Tashkent Airport Rehabilitation	18/12/97	31.8
Tashkent Solid Waste Management Rehabilitation	16/12/98	15.9
Regional TFP: Asaka Bank	22/06/99	0.0
Regional TFP: NBU (Guarantee & Pre-export)	22/06/99	1.7
Regional TFP: UzDaewoo	22/06/99	0.0
Kasansay-Tekmen Wool Products 2	17/09/99	5.4
Uzbek Railways Freight Traction Renewal & Management Project Direct	01/12/99	33.1
Uzbekistan SME Credit Line II - UzPromstroy Bank	01/12/99	12.4
Uzbek Leasing International Capital Increase	15/06/00	2.0
Uzbekistan SME Credit Line II - Pakhta Bank	14/12/00	12.4
Zarafshan Newmont Joint Venture- Third facility	14/12/00	12.4
Andijan District Heating Improvement and Reform	12/11/01	12.4
Locomotive Re-Powering Project	12/11/01	56.3
DIF - SealMag	28/06/02	0.6
J-USBP - Hamkor Bank	02/09/02	1.7
J-USBP - Pakhta Bank	02/09/02	5.8
Bursel Tashkent Textile Joint Venture	11/12/03	10.8
Nestlé Uzbekistan LLC	24/07/03	2.5
Tashkent Water Supply Improvement	09/04/04	8.3
MSE programme with Uzjilsberbank	14/05/04	4.1
MSE to Hamkorbank	21/07/04	2.5
DLF – Berad-Agro	15/09/04	0.5
Unitel (Equity)	07/12/04	4.1
Uz-Arctech, Welding Electrodes	14/12/04	7.9
DLF – Gisad O'zbek	17/12/04	1.0
DLF – Mekhnat Pivo	21/01/05	2.8
Unitel (Debt)	07/06/05	24.8
TOTAL		**584.3**

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ANNEX 4 – TC PROGRAMMES

Commitment Number	Fund Approved Date	Commitment Name	Sector Name	EUR Committed	EUR Disbursed
AUS-1999-06-02	07/06/99	Turnaround Management Programme - Fargana Yog Moi	Manufacturing	41,252	41,252
CA3F-2002-08-05	09/08/02	Andijan District Heating: Legal Services to prepare a MSA contract	Finance, Business	75,870	0
CA3F-2002-08-06	09/08/02	Andijan District Heating: Legal Services to prepare a MSA contract	Finance, Business	186,925	0
CAN-1995-08-10	02/08/95	Regulations for law on subsoil	Community/Social Services	36,223	36,223
DEN-1999-10-04	19/10/99	TurnAround Management Programme (TAM) - Tashkent Strojmaterialy	Manufacturing	42,982	42,982
EC-1993-07-27	20/07/93	Project preparation unit	Manufacturing	747,432	747,432
ECT2000-2002-06-02	27/06/02	Uzbek Railways: Implementation Assistance & Fleet Management - extension	Transport, Storage	277,159	100,194
ECT96-96-11-17	22/11/96	Post-privatisation Fund - fund manager	Manufacturing	999,817	999,817
ECT97-97-05-18	22/05/97	Post-privatisation Fund - ABN AMRO fund manager contract	Manufacturing	260,390	260,390
ECT98-2000-11-75	29/11/00	Uzbek Railways - Implementation Assistance & Fleet Management Study	Transport, Storage	14,897	14,897
ECT98-98-12-47	02/12/98	Tashkent Solid Waste Management Rehabilitation Programme - Management Support	Energy	722,167	722,167
ECT99-2000-09-72	29/09/00	Tashkent Solid Waste Management Rehabilitation Programme - Support for Municipality	Energy	41,672	41,672
ECT99-99-08-05	20/08/99	Uzbek railways - implementation assistance and fleet management	Transport, Storage	748,655	748,655
FRB-1993-03-04	05/03/93	Optimisation study of petroleum products distribution system	Manufacturing	46,193	46,193
GER-1993-05-04	12/05/93	Preparation of energy savings and efficiency project	Energy	177,337	177,337
GERK-1999-02-01	26/02/99	TurnAround Management Programme - Sankurtamirlash	Manufacturing	19,673	19,673
GERK-2000-08-07	01/08/00	TurnAround Management Programme (TAM) - Pod'emnik	Manufacturing	16,301	16,301
HOL-2002-04-02	16/04/02	Tashkent Solid Waste Management Rehabilitation Programme	Energy	33,985	0
JAP-1993-03-07	01/03/93	SME sector development - demand assessment and business plan preparation	Finance, Business	43,380	43,380
JAP-1993-10-51	17/11/93	National Bank financial facility for SME development - implementation support	Finance, Business	928,690	928,690
JAP-1994-06-23	01/06/94	Fergana refinery rehabilitation	Extractive Industries	438,319	438,319
JAP-1995-03-10	01/03/95	Procurement advisory services	Energy	246,772	246,772
JAP-1995-04-12	01/04/95	Preparation of Fergana refinery rehabilitation project - studies	Manufacturing	336,654	336,654
JAP-1995-04-13	01/04/95	Preparation of Fergana refinery rehabilitation project - project consultant	Manufacturing	222,814	222,814
JAP-1995-10-28	01/10/95	Financial facilities for SME development (Phase II)	Finance, Business	216,623	216,623
JAP-1997-04-10	03/04/97	Regional Bank Training Centre, Tashkent	Community/Social Services	685,529	685,529
JAP-1997-06-12	17/06/97	Development of commercial management system - Uzbekneftegas	Extractive Industries	350,000	350,000

Commitment Number	Fund Approved Date	Commitment Name	Sector Name	EUR Committed	EUR Disbursed
JAP-1998-07-23	29/07/98	Syrdarinskaya Thermal Power Rehabilitation Project Electricity tariff and collection mechanism	Energy	300,000	0
JAP-1998-07-24	29/07/98	Syrdarinskaya Power Plant - Development of accounting system	Energy	390,000	0
JAP-1998-12-35F	30/12/98	Japan-Uzbekistan Small Business Programme - Pilot	Finance, Business	4,800,645	895,139
JAP-1999-03-06	31/03/99	Tashkent solid waste management (ear-marked portion)	Energy	48,124	48,124
JAP-1999-03-07	31/03/99	Tashkent solid waste management - project management support (ear-marked portion)	Energy	510,861	425,231
JAP-2000-11-25	29/11/00	Tashkent Solid Waste Management Rehabilitation Programme - Landfill Engineering and Operations	Energy	509,970	431,088
JAP-2001-03-04	21/03/01	Uzbekistan leasing law project	Community/Social Services	59,264	59,264
JAP-2001-05-09	04/05/01	Tashkent solid waste management - project management support (ear-marked portion)	Energy	82,800	40,120
JAP-2002-04-01	16/04/02	Uzbek Railways (UTY) Assistance with Implementation of Railway Restructuring	Transport, Storage	1,000,000	0
JAP-2002-05-04	29/05/02	Andijan District Heating Management Contractor	Finance, Business	1,431,161	0
JAP-2002-10-13	22/10/02	Uzbekistan Asaka Bank Pre Privatisation Restructuring - Phase 1A Audit	Finance, Business	195,437	0
JAP-2002-10-14	22/10/02	Uzbekistan/Asaka Pre Privatisation Restructuring Phase 1B	Finance, Business	429,051	0
LUX-1998-12-02	15/12/98	TurnAround Management Programme - Pod'emnik	Manufacturing	29,343	29,343
SPA-1993-09-01	08/09/93	Project evaluation system for line of credit to SME's	Finance, Business	138,754	138,754
SWEF-2002-07-02	30/07/02	Tashkent DH Rehabilitation and Reform	Energy	199,300	0
SWI-1993-03-01	13/03/93	Cotton processing feasibility study	Manufacturing	442,793	442,793
SWI-1993-07-02	15/07/92	Seminar on the legal and democratic aspects of transition	Community/Social Services	11,733	11,733
TAI-1994-12-04	01/12/94	Regional Bank Training Centre, Tashkent (NB - untied)	Community/Social Services	22,748	22,748
TCS-2002-12-05	20/12/02	Identification of Agribusiness Investment Opportunities	Manufacturing	28,623	0
TUR-1993-02-01	25/05/93	SME sector development - demand assessment and business plan preparation	Finance, Business	32,626	32,626
UKB-1995-05-07	05/05/95	Preparation of Fergana - due diligence of borrower	Manufacturing	94,714	94,714
UKD-1999-10-25	19/10/99	TurnAround Management Programme (TAM) - Tashkent Strojmaterialy	Manufacturing	33,020	33,020
UKPF-2002-08-01	05/08/02	Andijan District Heating Tariff & Subsidy Reform Study	Finance, Business	120,000	0
USTD-1993-05-02	30/04/93	Kokdumalak oil field development project	Extractive Industries	64,060	64,060
USTD-1994-03-02	13/06/94	Digital overlay network	Telecommunications	40,007	40,007
USTD-1994-09-03	01/09/94	Digital Overlay Network joint venture (Phase II) - financial and legal advice	Telecommunications	162,167	162,167
WAL-1999-01-02	25/01/99	TurnAround Management Programme - Pod'emnik	Manufacturing	14,619	14,619
WAL-1999-03-03	03/03/99	TUrnAround Management Programme - Sankurtamirlash	Manufacturing	12,747	12,747
WAL-1999-05-05	21/05/99	TurnAround Management Programme - Fargana Yogi Moi	Manufacturing	13,833	13,833
WAL-1999-07-06	09/07/99	Turnaround Management Programme - Tashkent Strojmaterialy	Manufacturing	12,566	12,566

ANNEX 5 – TC PIPELINE[4]

TC Title	Sector Name	Provisional Amount
Tashkent District Heating Management Advisory Services	Energy	€800,000
Tashkent Solid Waste Management Rehabilitation Programme	Energy	tbd
Tashkent Water Supply Financial and Operational Performance improvement Programme	Energy	$500,000
Japan-Uzbekistan Small Business Programme - Credit Advisers	Finance, Business	tbd
Japan Uzbekistan Small Business Programme - Legal Advisory Services	Finance, Business	tbd
Insurance market development and strengthening	Finance, Business	tbd

[4] The list is a provisional TC pipeline currently seeking funding. It is not a comprehensive list and additional TC requirement will emerge during the Strategy period

ANNEX 6 - LEGAL TRANSITION

The EBRD has developed and regularly updates a series of assessments of legal transition in its countries of operations, with a focus on selected areas relevant to investment activities: capital markets, corporate governance, concessions, insolvency, secured transactions and telecommunications. The existing tools assess both the quality of the laws "on the books" (also referred to as "extensiveness") and the actual implementation of laws (also referred to as "effectiveness"). All available results of these assessments can be found at www.ebrd.com/law. This annex presents a summary of the results for Uzbekistan, accompanied by critical comments of the Bank's legal experts who have conducted the assessments.

Concessions

Concessions are governed mainly by the 1995 Law of the Republic of Uzbekistan "On Concessions", (the "Concession Law"). In addition, several foreign investors have undertaken natural resources projects under the rules of the 2001 Law "On Production Sharing Agreements".

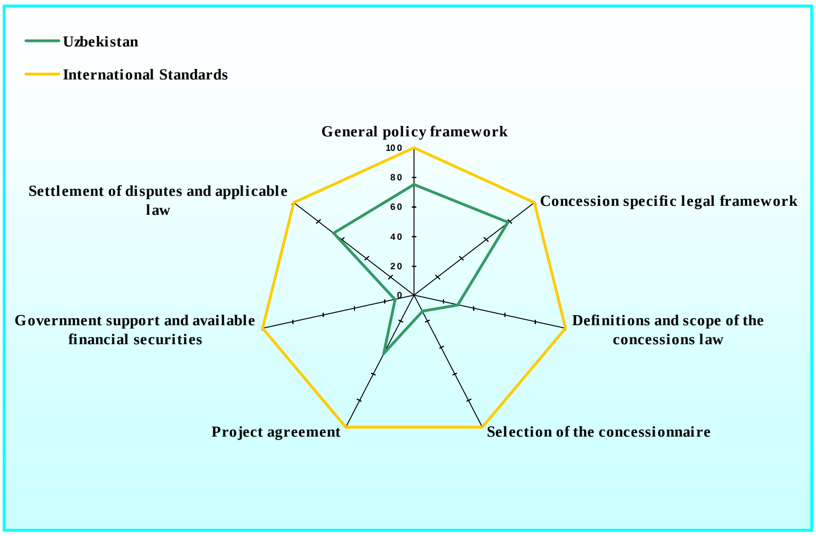
There exists a written policy framework for improving the legal environment and promoting Private Sector Participation ("PSP") in Uzbekistan in the form of a Resolution On approval of the concept of strengthening economic reforms in the public utility services system, issued in 1998 by the Commission on Perfection of the Public Utility Services in the Market Economy. Accordingly, some general provisions on this account could be found, in particular, in the 1998 Law on Guarantees and Measures for the Protection of Foreign Investors' Rights.

Overall, the Concession Law's provisions are fairly vague (as far as all the major modern concession legislation core areas are concerned) and discriminate against domestic investors.

A positive feature of the Concession Law is that a concession agreement may not be terminated unilaterally, except where the concession authority discovers that the concessionaire provided false information at the time at which the agreement was entered into. Another welcome rule of the concession regime is that it allows a concessionaire to dispose freely of its profit after payment of fees, taxes and payments required by Uzbek law.

The Government of Uzbekistan has the preemptive right to purchase the products from the concessionaire. This results in foreign investors being concerned that they may be forced to sell products at a price specified by the State and lower than the market price. Moreover, according to the Concession Law, foreign investors are to keep accounts and financials in accordance with Uzbek law, which does not correspond with the international accounting standards. Another major drawback of the Concession Law is the standard provision that disputes between a concessionaire and the concession grantor fall under the exclusive jurisdiction of economic courts of Uzbekistan. Unfortunately therefore, parties to a concession agreement are not entitled to refer a dispute to international arbitration.

Quality of concession legislation –Uzbekistan (2004)



Note: the extremity of each axis represents an ideal score in line with international standards such as the UNCITRAL Legislative Guide for Privately Financed Infrastructure projects. The fuller the 'web', the more closely concessions laws of the country approximate these standards.

Source: EBRD Concessions Sector Assessment 2004

The recent EBRD Concession Laws Assessment project undertaken to evaluate applicable regime throughout the 27 countries of EBRD operations (the "laws on the books" only, rather than how they work in practice), revealed that Uzbek laws presented "low compliance" with internationally accepted standards in this sector. As can be seen from the above graph, while rules covering the settlement of disputes in concession-related arrangements, for instance, are regulated fairly extensively, even though not providing for an international arbitration option, most other areas, and, in particular, selection of a concessionaire and availability of financial instruments and state support, need to be dramatically improved in order to meet requirements of modern legal framework facilitating private sector participation.

As far as the selection procedure is concerned, the rules are very general without, for instance, any reference to the pre-selection procedure or to the publication of concession awards. Moreover, there are no sufficiently clear grounds provided for the possibility of direct negotiations and no reference is made to review procedures. Even though the Concession Law contains provisions regulating project agreements, these are not flexible enough to encourage true negotiation of an agreement. Finally, the Concession Law is silent as far as government support, financial securities and lenders' rights are concerned.

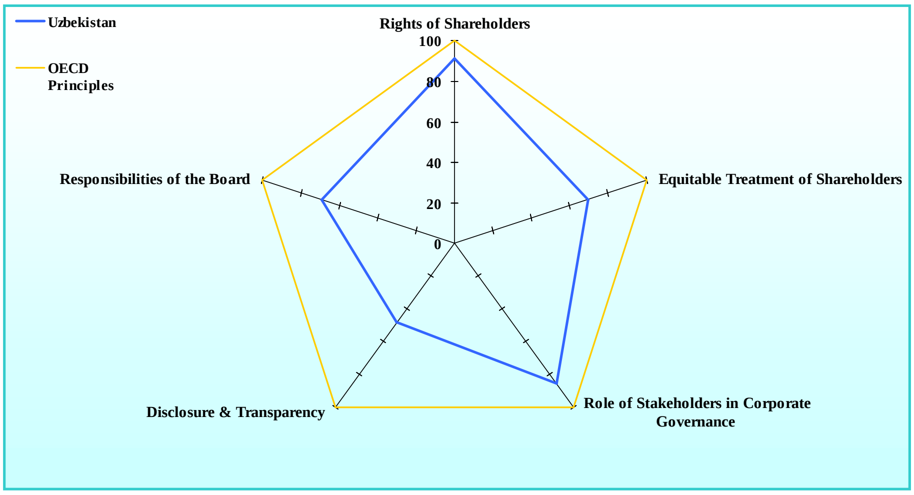
Overall, the Concession Law does not constitute a sufficiently solid legal basis for the development of private sector participation in the infrastructure and utility services in Uzbekistan. Thus, a major reform of concession enabling legislation is desirable in order to create a clearer, more flexible and investor-friendly legal environment for private sector participation in Uzbekistan.

Corporate Governance

The Law on Joint-Stock Companies and Protection of the Rights of Stockholders, based on the Russian model, entered into force on 26 April 1996 and was amended in 1997, 1998, 2002 and 2003. The Law on Companies with Limited and Additional Liability, dated 6 December 2001, extended the application of the standards of the Law on Joint-Stock Companies to limited liability companies. These laws, along with the decree of Cabinet of Ministers "On improvement of state registration system and record keeping of subjects of entrepreneurship”, dated 22 August 2001 and the Decree of Cabinet of Ministers “On substantial improvement of registration procedure system for organization of entrepreneurial activity”, dated 20 August 2003, constitutes the legal framework on corporate governance in Uzbekistan.

In 2003, the EBRD conducted an assessment on the extensiveness (i.e. the quality of the “law in the books”) of Uzbek corporate governance legislation, which scored “medium compliance” when measured against the OECD principles. When compared to similar legislation in other Early Transition Countries, the laws of Uzbekistan seem to constitute a good basis to develop sound corporate governance practices in the country. In assisting Uzbekistan in this respect, the Asian Development Bank undertook two initiatives aimed at enhancing transparency and disclosure and at safeguarding investors' rights, helped Uzbekistan define appropriate efforts in the state and private sector, which, among other things, would improve corporate governance practices.

Quality of corporate governance legislation – Uzbekistan (2003)



Note: The extremity of each axis represents an ideal score, i.e., corresponding to OECD Principles of Corporate Governance. The fuller the ‘web’, the more closely the corporate governance laws of the country approximate these principles

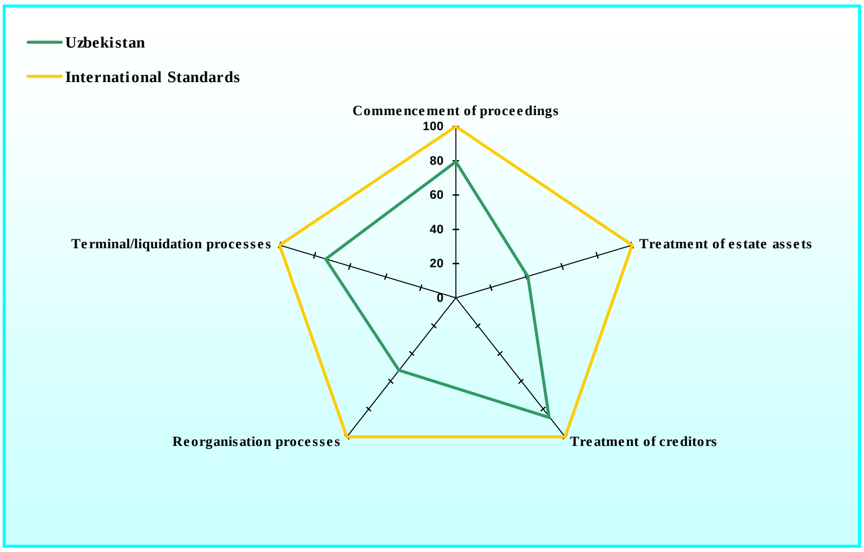
Source: EBRD Corporate Governance Sector Assessment, 2003 assessment

On the other hand, areas for improvement still remain. In particular, provisions requiring that shares be fully paid before a transfer should be introduced as a specific quorum in cases of restrictions of specific shareholders rights. Companies should be required by law to prepare quarterly financial reports and group accounts on a consolidated basis, in line with internationally recognised accounting standards, and the law should set specific rules to guarantee auditors’ independence.

Information on the compensation of board members and key executives should be determined by the shareholders and the board’s responsibilities should include monitoring the effectiveness of the governance practices in place. Boards should include a certain number of non-executive and independent directors and separate committees for dealing with financial reporting. Executive and board remuneration and board nominations should be created. Finally, as highlighted in the chart above, corporate information disclosure should be generally improved, as should legislation on insider trading.

Insolvency

Bankruptcy and insolvency in Uzbekistan are governed by the 2003 Law on Bankruptcy of the Republic of Uzbekistan (as amended) (the "Insolvency Law"). This law scored "low compliance" when compared with international standards in the EBRD's 2004 Sector Assessment.



Note: The extremity of each axis represents an ideal score, i.e., corresponding to the international standards such as the World Bank's Principles and guidelines for Effective Insolvency and Creditor Rights Systems, the UNCITRAL Working Group on "Legislative Guidelines for Insolvency Law", and others. The fuller the 'web', the more closely insolvency laws of the country approximate these standards.

Source: EBRD Insolvency Sector Assessment Project, 2003/4

As the above graph reveals, this law is deficient in many key areas of insolvency. Specifically, the Insolvency Law does not provide for a 'balance sheet' test for insolvency and does not provide expedited time limits within which an insolvency case must be heard by the court. In addition, the law's provisions on the avoidance of suspicious pre-bankruptcy transactions are extremely vague and do not provide the necessary detail to create a predictable avoidance regime.

As is common in insolvency legislation in the ETC, the Insolvency Law is particularly deficient in addressing the issue of reorganisation. At present, the reorganisation provisions provide for virtually no supervision of the debtor company and prescribe woefully inadequate requirements for the qualification on insolvency administrators, who are vital to the reorganisation process. In addition, under the current scheme there is virtually no opportunity to obtain ongoing financing during restructuring. All of these issues must be addressed. Finally, it would also be worthwhile for the law to address the issue of cross-border insolvency proceedings (although, admittedly, this is not as pressing an issue as the other deficiencies discussed herein).

Although the Insolvency Law does contain some positive elements, such as the adequate notice given to creditors when proceedings are commenced, there is some doubt as to whether any positive attributes in this law can be properly implemented. The results of the EBRD 2004 Legal Indicator Survey on Insolvency, which examined the 'effectiveness' (or how the law works in practise) of insolvency regimes in both creditor-initiated insolvencies and debtor-initiated insolvencies showed that the practical application of the insolvency law by creditors is likely to be unduly expensive and overly complex. In addition, the results of the survey show that the quality of insolvency administrators, in both creditor and debtor initiated cases, is extremely unreliable.

All of these factors, together with the law's deficiencies, militate against the insolvency regime functioning properly as a 'stick' to induce debtors to act in good faith and as a 'carrot' to induce insolvency debtors, with businesses that are fundamentally viable, to try to promote the rescue of such businesses. It appears that a comprehensive package of reforms (of both the legislative and institution-building variety) is required to remedy this situation.

Secured Transactions

The legal regime of security rights over movable and immovable assets is defined in the Civil Code of 1 March 1997 and the Pledge Law of 1 May 1998.

Security over movable tangible assets can be structured in several different ways:

- transferring possession of the collateral to the creditor or a third party;
- marking or locking and sealing the assets which would then remain in the possession of the borrower;
- agreeing between the parties that the security will be created without such formalities (in particular for commodities in circulation).

Notarisation of the agreement is not compulsory but recommended as it would constitute a "receiving order" allowing the lender to start enforcement upon default without having to obtain a court judgement. There exists no general system of registration of charges over movable property and the question of priority and enforcement remains highly hazardous. Registration is required only when the charged assets themselves are subject to registration, such as (intellectual property rights, and vehicles).

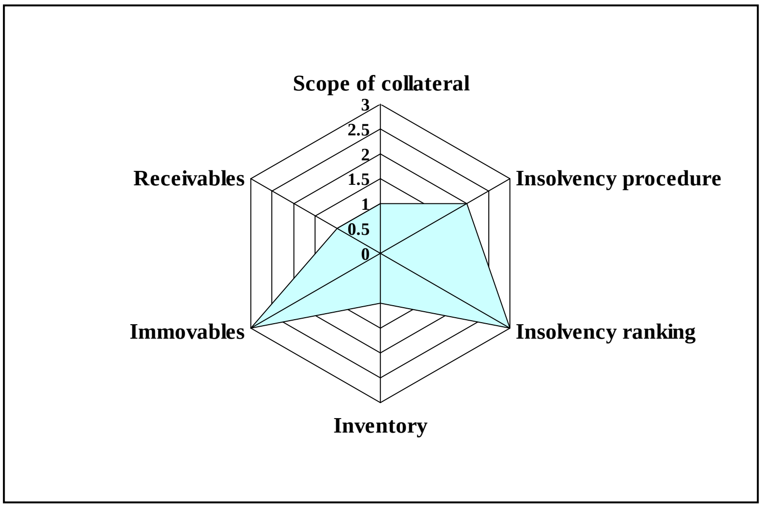
In the case of security over immovable assets (which would include the enterprise), perfection of the mortgage requires notarisation of the mortgage agreement and registration in the Land Registry.

Uzbek law is quite rigid in terms of what the parties can agree to: a general description of the collateral is only allowed for security over commodities in circulation and processing. Otherwise, specific identification of charged property is required. Although the charging of future property is explicitly envisaged, it seems that notaries would not accept to notarise agreements for security over future assets. Also, specific identification of the secured debt is generally required: the agreement must include details of the essence and maturity date of the secured debt. Another serious impediment consists in the creditor's priority: tax arrears and certain debt for which creditors have previously obtained a court order may have priority over the secured creditor, including outside bankruptcy. In bankruptcy, secured claims would be preceded by unpaid wages, taxes and social security claims.

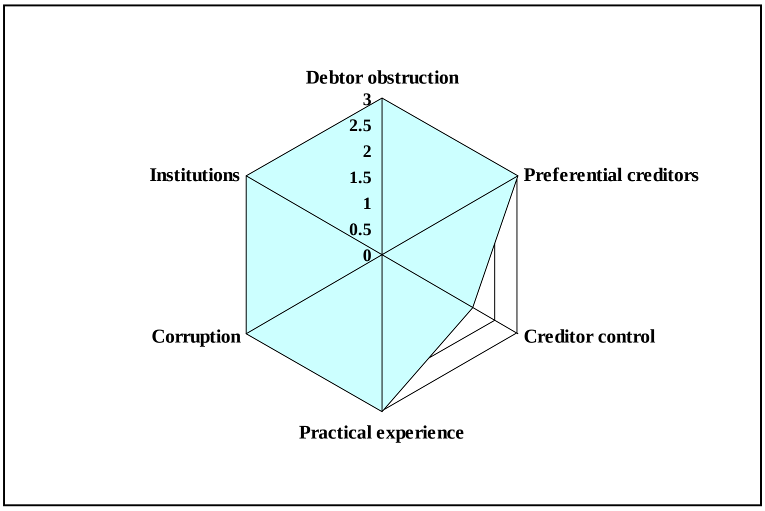
As in many other transition countries, enforcement remains unsatisfactory - being slow and uncertain. In a survey conducted by EBRD in 2003 on enforcement of charges in its countries of operations, the results for Uzbekistan showed that the process is very slow and complex, and the proceeds that the lender can expect upon realisation of the assets, limited. This is due to the many opportunities that the debtor would have to obstruct and delay the process (e.g. the sale of charged property could be postponed by up to one year upon the debtor's request) and the clear inability of courts to support the process (see graphs below).

Obstacles to charge enforcement process –Uzbekistan (2003)

Scope



Process



Note: The fuller the coloured area, the more serious the problems are in each of the respective categories. “Process” factors measure the impact of specific incidences on the enforcement proceedings. “Scope” factors relate to the ability of the system to deal with specific situations or items.

Source: EBRD Legal Indicator Survey 2003

Securities Markets

The Law on Exchanges and Exchange Activities of 2001, the Law on Securities and Stock Exchange of 1993, as amended in 1999 and 2002, the Law on Mechanism of Operation of Securities Markets of 1996, as amended in 2002, the Law on Depository Activities at Securities Markets of 1998 as amended in 2002, the Law on Protection of Investors’ Rights at Securities Markets of 2001, and the Law on Joint Stock Companies and Protection of Shareholders of 1996, as amended in 1997, 1998, 2002 and 2003, constitute the main legal framework on securities markets in Uzbekistan.

The Centre for Coordination and Control of the Securities Markets, established in March 1996 on the basis of an Edict of the President of Uzbekistan, is the regulator of the Uzbek Securities Market.

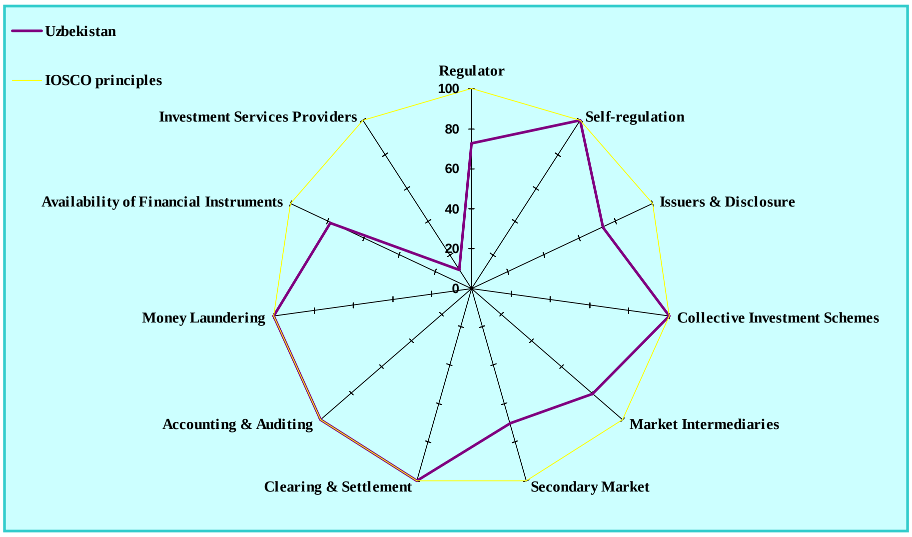
The Tashkent Republican Stock Exchange was created in 1994, following the first stage of privatisation. Access to the system is limited to licensed brokers, who can make transactions from 12 branches of the exchange located in different regions of the country. In 2003, the turnover of equities in the securities market amounted to approximately USD 33 million, while that of government bonds amounted to approximately USD 56.4 million and that of corporate bonds to around USD 19.1 million. In 2000, an electronic OTC[5] system came into being. Trading on the OTC is limited and in 2002 the total volume of transactions amounted to just USD 575,000.

[5] Over-the-Counter (OTC): a market for securities made up of dealers who may or may not be members of a securities exchange.

Notwithstanding the major improvements to the system in recent years, the Uzbek Securities Market is characterised by low liquidity, the absence of an effective system of information disclosure and a low number of investment intermediaries and other investment institutions.

In 2004, EBRD measured the Uzbek Securities Markets legislation against the "Objectives and Principles of Securities Regulation" published by IOSCO and the results demonstrated that such legislation is in "medium compliance" with the IOSCO principles.

Quality of securities market legislation –Uzbekistan (2004)



Note: The extremity of each axis represents an ideal score, i.e., corresponding to the standards set forth in IOSCO's *Objectives and Principles for Securities Regulations*. The fuller the 'web', the closer the relevant securities market legislation of the country approximates these principles.

Source: EBRD Securities Market Legislation Assessment 2004

Among the major shortcomings evidenced in the EBRD Securities Market Legislation Assessment, both the regulator's powers on enforcement of disclosure requirements and the disclosure requirements in cases of change in corporate control should be strengthened. Disclosure and transparency are also issues to be tackled in collective investment schemes. Front-running practices are not prohibited and there is no legislation in place specifically defining investment service providers and preventing financial difficulties of market intermediaries.

Telecommunications

The telecom sector is currently governed by the Law on Communications of 1999 (the "Telecom Law") and regulated by the Uzbek Agency for Communications and Information (UzACI). The Telecom Law is supplemented by myriad of presidential decrees, cabinet resolutions and regulations. Similarly, basic sector policy is not found in one concept paper, but found in various laws, cabinet resolutions and other legislative instruments.

UzACI is the successor of the Ministry of Communications, has the rank of a ministry and performs both strategic policymaking function and regulatory implementation. The Director-General of UzACI also holds the post of a Deputy Prime Minister, making UzACI a *de facto* ministry. The UzACI system currently covers a large number of different activities ranging from regulation, management/supervision of commercial and quasi-commercial entities, an educational institution, services for maintaining telecom network integrity and operations in emergency situations, to funding of telecom and informatics development. Additionally, the General Director of ACI is also Chairman of the Board of Supervisors of UzbekTelekom (UT), the majority state-owned incumbent operator.

Fixed-line services are provided mainly by UT, owner of the fixed-network, with all other operators required to interconnect for local and long distance calls to fixed-line subscribers and for international calls through UT. UT currently holds a monopoly on international voice services and Voice over Internet Protocol (VoIP), which, unless extended, will expire in 2007. The Government has been trying to privatise UT since 1999 without any apparent success, recently back-tracking on this initiative by reducing the available stake to a minority holding.

Tariffs for universal services are regulated for UT and other operators providing universal services. The State Committee of Demonopolisation and Competition Development (CDC) set tariffs for universal services in accordance with the Law on Natural Monopolies. Little progress appears to have been made with respect to the implementation of tariff policy or tariff setting mechanism. While a programme of tariff increases for local telephony is understood to be in place, there appears to be no serious attempt to rebalance tariffs, with little movement to decrease the high international call rates.

Currently, the licensing framework is somewhat burdensome requiring licences for design, construction, operation and provision of telecom services, requiring updating to harmonise with international best practices, including those of the World Trade Organisation (WTO).

While there are obligations as to interconnection in the Telecom Law and licences, they fail to provide the necessary framework for implementation of a modern interconnection regime. Interconnection would appear to be based solely on commercial agreement at present and given UT's overwhelming market position this can lead to a significant imbalance in bargaining power for alternative operators.

While the Telecom Law covers certain fundamental aspects of telecom regulation, in many instances it is vague and too imprecise to present a clear picture of rights and obligations and would, thus, benefit from revision, consolidation and rationalisation. Similarly, government sector policy would greatly benefit from clarification, restatement and publication. On the institutional side, while the state's shareholding in UT has been formally transferred to the State Property Committee (GKI) in anticipation of privatisation, the continuing influence of UzACI in the management and operations of UT (through the representation on the UT supervisory board) seriously impacts upon independence and impartiality, and has the potential to give rise to significant conflicts of interest within the sector. While the current situation is understood to be partly transitory, delays in separation of regulatory and non-regulatory functions and in making the regulatory authority truly independent of operator interests will continue to affect investor confidence and hamper development of the sector. Additionally, lack of detailed implementing regulations and mechanisms for interconnection, tariffs and universal service will likely slow sector development.

LEGAL REFORM PROJECTS

Telecommunications Regulatory Development Project

The EBRD has been providing assistance to the authorities to implement a clear, predictable and modern telecommunications regulatory framework likely to attract private investment, enabling overall development of the sector. Phase one of this assistance recently concluded, with key recommendations on tackling the above issues being provided to the government. While government engagement was positive at the outset of the assistance, more recent responses to phase one recommendations have been less than positive, preventing the Bank proceeding with further phases of assistance (implementation of recommendations).

ANNEX 7 – ENVIRONMENTAL ISSUES: THE BANK'S APPROACH

The Bank will continue to ensure that its environmental requirements are followed on existing projects. Should the Bank consider new projects with Uzbekistan, the Bank will apply its Environmental Policy and Procedures conducting environmental due diligence on environment, health and safety issues as appropriate. The Bank may seek to utilise the Early Transition Countries Initiative (ETCI) Technical Assistance Facility to support environmental initiatives where appropriate. The Bank is also mindful of specific social conditions of the country, such as child labour during the cotton harvest, and will continue to ensure that activities financed by the Bank comply with the country's labour law and conventions of the International Labour Organisations (ILO) relating to the employment of children and young people, discrimination at work and forced labour. Furthermore, the Bank continues to engage in dialogue with other organisations which address the child labour and poverty issues, to generate synergy.

As noted in the Municipal and Environmental Infrastructure section, the Tashkent Water Supply Improvement project and Andijan District Heating Rehabilitation project are two key Bank projects which will generate direct environmental benefits by providing safe drinking water and reducing carbon emissions, respectively. Attention is to be paid to ensure that a) any new tariffs do not adversely and disproportionately affect the poor and other vulnerable groups and b) are designed so that the specific needs of women and people with disabilities are taken into consideration.

With the Bank's emphasis on SME development through local FIs, the Bank will continue to support environmental due diligence training of partner FIs. Furthermore, the Bank's continuous involvement in the SME sector through micro financing will help to address the uneven access to formal credit across society, as well as help increase transparency in the financial sector. Efforts will be made to ensure that rural locations are included and that women as well as men are enabled to benefit from these projects.

Among other institutions operating in the country, ADB has prepared an updated environmental analysis of Uzbekistan and has been implementing projects in the field of rural water supply, irrigation and drainage. The World Bank has been implementing the Wetlands Improvement Phase I project, Tashkent Solid Waste Management project and the Fural Water Supply and Sanitation project. The World Bank is preparing a Welfare Improvement Strategy Paper (WISP) and the ADB, UNDP and other bilateral donors have agreed technical and analytical support to finalise the WISP. The Bank will continue to cooperate with other organisations to generate synergies in the environmental sector.

ANNEX 8 – SELECTED ECONOMIC INDICATORS

Uzbekistan	1999	2000	2001	2002	2003	2004	2005
						Estimate	*Projection*
Output and expenditure			*(Percentage change in real terms)*				
GDP [1]	4.3	3.8	4.1	3.1	1.5	7.4	4.0
Private consumption	na	na	na	na	Na	na	na
Public consumption	na	na	na	na	Na	na	na
Gross fixed capital formation	na	na	na	na	Na	na	na
Exports of goods and services	na	na	na	na	Na	na	na
Imports of goods and services	na	na	na	na	Na	na	na
Industrial gross output	6.1	3.5	8.1	8.5	6.2	8.0	10.0
Agricultural gross output	5.9	3.2	4.5	6.1	4.7	na	na
Employment			*(Percentage change)*				
Labour force (end-year)	1.0	1.1	1.5	2.4	Na	na	na
Employment (end-year)	1.0	1.1	1.5	2.4	Na	na	na
			(In per cent of labour force)				
Unemployment (end-year) [2]	0.4	0.4	0.4	0.4	0.3	na	na
Prices and wages			*(Percentage change)*				
Consumer prices (annual average)	29.1	25.0	27.2	27.6	10.3	15.0	13.0
Consumer prices (end-year)	26.0	28.2	26.4	21.6	7.7	12.0	10.0
Producer prices (annual average)	38.0	61.1	42.2	46.0	Na	na	na
Producer prices (end-year)	34.5	70.2	44.0	36.7	Na	na	na
Gross average monthly earnings in economy (annual average)	33.4	47.4	58.2	32.9	13.0	12.0	7.1
Government sector [3]			*(In per cent of GDP)*				
General government balance	-2.6	-2.2	-2.1	-1.5	-0.6	-2.0	-1.2
General government expenditure	32.0	30.2	36.0	37.2	39.9	34.4	32.7
General government debt	11.8	16.6	24.3	22.4	19.1	19.4	19.7
Monetary sector			*(Percentage change)*				
Broad money (M3, end-year)	32.1	37.1	54.3	29.7	27.2	21.7	14.0
Domestic credit (end-year)	34.5	88.8	90.8	41.1	3.8	1.4	0.0
			(In per cent of GDP)				
Broad money (M3, end-year)	13.6	12.2	12.4	10.6	12.1	11.9	11.5
Interest and exchange rates			*(In per cent per annum, end-year)*				
Refinancing rate	42.6	26.8	26.8	34.5	20.0	20.0	na
Treasury bill rate (3-month maturity)	16.5	17.1	17.1	17.1	Na	na	na
Deposit rate (1 year)	13.5	18.8	21.2	26.0	Na	na	na
Lending rate (1 year)	32.7	27.6	27.6	33.4	Na	na	na
			(Sums per US dollar)				
Exchange rate (end-year) [4]	348.4	631.3	937.6	1,068.3	980.0	1,040.0	1,050.0
Exchange rate (annual average) [4]	257.2	360.7	646.3	885.0	995.5	991.8	991.8
External sector			*(In millions of US dollars)*				
Current account	-164	218	-113	122	883	922	951
Trade balance	203	494	186	324	836	1,030	1,133
Merchandise exports	2,790	2,935	2,740	2,510	3,240	4,050	4,455
Merchandise imports	2,587	2,441	2,554	2,186	2,404	3,020	3,322
Foreign direct investment, net	121	75	83	65	70	180	250
Gross reserves, excluding gold (end-year)	763	684	1,212	1,215	1,659	2,200	2,400
External debt stock	4,805	4,418	4,279	4,260	4,149	3,884	3,642
			(In months of imports of goods and services)				
Gross reserves, excluding gold (end-year)	2.9	2.8	4.6	5.4	6.7	7.3	7.3
			(In per cent of exports of goods and services)				
Debt service	17.8	25.5	26.2	24.6	22.2	17.7	na
Memorandum items			*(Denominations as indicated)*				
Population (end-year, million)	24.3	24.7	24.9	25.6	26.0	26.0	26.0
GDP (in millions of sums)	2,128,659	3,255,567	4,925,000	7,469,300	8,362,217	10,328,175	12,137,671
GDP per capita (in US dollar) [5]	340	366	306	330	323	401	471
Share of industry in GDP (in per cent)	14.3	14.2	14.1	14.1	Na	na	na
Share of agriculture in GDP (in per cent)	29.0	30.1	30.0	30.6	Na	na	na
Current account/GDP (in per cent)	-2.0	2.4	-1.5	1.4	10.5	8.9	7.8
External debt - reserves (in US$ million)	4,042	3,734	3,067	3,045	2,490	1,684	1,242
External debt/GDP (in per cent)	58.1	48.9	56.2	50.5	49.4	37.3	29.8
External debt/exports of goods and services (in per cent)	155.4	131.4	133.7	142.7	110.9	84.9	73.1

Updated 05/05

[1] EBRD estimate. Official figures are considerably higher, at 4.2 per cent in 2001 and 2002, 4.3 per cent in 2003, and 7.6 per cent in 2004.

[2] Officially registered unemployed. No labour force survey estimates available.

[3] Includes extra-budgetary funds, but excludes local government.

[4] Dual exchange rates were in operation until October 2003. Before that point data show a weighted average of the official, bank, and parallel market rates.

[5] Calculated at the weighted exchange rate.

ANNEX 9 - BILATERAL ASSISTANCE[6]

Canada

Funding for Canadian cooperation efforts with Uzbekistan is provided through the Canadian International Development Agency's (CIDA) Programme of Cooperation with Asia. Priority sectors in the region include technical training, governance and water resources management. CIDA's efforts in Central Asia are concentrated in Tajikistan.

Bilateral funds are supplemented by funding through CIDA's multilateral programming. Programs applicable to Uzbekistan include: the CIDA Industrial Cooperation Program, the South Europe and Central Asia Climate Change Support Fund, Canadian Human Rights Foundation training courses, the EBRD Trust Fund, Strategic Information Management Program (SIMP), and the Partnerships for Tomorrow Program II. Through the OSCE, CIDA supports the Environment and Security Initiative (ENVSEC) in order to promote the use of environmental management strategies to reduce insecurity, notably with 3 projects in the Ferghana Valley area, as well as gender equality capacity building programs.

CIDA also finances a US$ 4 million Caspian Basin Greenhouse Gas Emissions Reduction Training Programme with the goal of developing the management and operational capacity within key sectors to identify and develop greenhouse gas emission reduction projects that would meet the rules of, and could be funded under, the Kyoto Protocol's Clean Development Mechanism or Joint Implementation. Eligible countries are Uzbekistan, Azerbaijan, Kazakhstan, and Turkmenistan.

France

French bilateral aid was EUR 4.56 million in 2000 and EUR 4.17 million in 2001.

Germany

Germany has committed EUR 192,2 million in Financial Co-operation mostly through KfW in the form of loans on IDA conditions and EUR 47,2 million in Technical Co-operation mostly through GTZ as grants to supports the Government of Uzbekistan’s programme of reforms, with the long-term objectives of encouraging democratic and market-orientated institutions and providing technical assistance for economic policy advisory services, promotion of private entrepreneurship, restructuring of agriculture, transportation, legislation, professional training, and for environmental protection. The future co-operation has to focus on the priority area, 'economic reforms and establishing a market economy' (in particular the financial system, promotion of small and medium sized enterprises (SME) as well as vocational training). Moreover the German government supports the envisaged Financial Co-operation project 'Electrification of the railway line between Tashkent and Angren'.

In the framework of ongoing Technical Co-operation projects, priority areas are the improvement of the living conditions of the people around the Aral Sea (Karakalpakstan) and assistance to vocational training. Projects in the health sector will be continued within the framework of regional co-operation.

[6] Information was provided by the relevant authorities.

Japan

Japan commenced bilateral assistance to Uzbekistan in 1991. At the end of March 2005, total commitments of yen loans and grant financial aid together with disbursements of technical assistance totalled JPY 119.2 billion. This consisted of 82% of yen loans, 13% of grant financial aid and 5% of technical assistance.

Total disbursements in 2003 reached USD 63.2 million equivalent. According to DAC (OECD) data, Japan was the top bilateral donor in terms of disbursements in 1999-2000, and second in 2001-03 after the United States.

Yen loans were commenced in 1995. Recently, official notes were exchanged in May 2002 on a modernisation project of a Tashkent thermal power plant (JPY 25.0 billion) and in July 2004 for the construction of a new Tashguzar-Kumkurgan railway line (JPY 16.4 billion).

Grant financial assistance was commenced in 1994 and has since been extended annually in such areas as medical care and food production increase. In January 2002, JPY 1 billion was donated to Uzbekistan as a part of assistance to countries neighbouring Afghanistan.

A Japan International Cooperation Agency (JICA) office was opened in March 1999 in Tashkent. Its activities include the dispatch of Japan Overseas Cooperation Volunteers (JOCV). In 2000 a Japan-Uzbekistan Centre for Human Resources Development was opened.

The following priority areas were agreed at bilateral aid policy discussions held in Tashkent in April 2005:

(a) Human resources development and institutional development for economic and industrial development. Improvement of the financial and banking systems, trade, SME development, justice system reforms (civil and commercial laws) and tourism development;

(b) Restructuring of the social sector. Agriculture and rural development, education, health and medical care;

(c) Renewal and development of economic infrastructure. Transport and energy.

Spain

Spain has committed so far bilateral aid in excess of EUR 13.4 million, focused on health and water treatment sectors.

Switzerland

Based on the bilateral framework agreement on technical, financial and humanitarian co-operation signed in 2002 and the Regional Program Central Asia 2002-2006, the State Secretariat for Economic Affairs (**seco**) and the Swiss Development Co-operation (SDC) are both engaged in co-operation with Uzbekistan. Including regional activities covering Uzbekistan, funds amount to US$ 6-10 million per year and cover natural resources management, infrastructure, vocational training, private sector development as well as macroeconomic policy and conflict prevention. They involve government partners on various levels as well as non-government partners.

A special priority is given to **infrastructure development** and **natural resources management**. US$ 9 million have been granted to co-finance a World Bank project to refurbish and improve the management of water supply networks in Buchara & Samarkand. Switzerland has allocated in 2002 US$ 4.3 million for a co-financing of the EBRD District Heating Rehabilitation Project in Andijan. Switzerland is also supporting a regional hydro-meteorological project based in Tashkent.
Switzerland has also been supporting the **economic development** of Uzbekistan by financing credit guarantees and project preparation through the Public-Private Infrastructure Advisory Facility (PPIAF) as well as regional training and advisory programmes on the customs administration and international economic relations.
With respect to **private sector development**, Switzerland is currently supporting Uzbek SMEs through technical assistance projects and finance. In the past two years Switzerland funded a comprehensive survey of the Uzbek SMEs, developed a training programme for local consultants, and supported the development of the leasing industry. **seco** is also a shareholder of a private equity fund investing in Uzbekistan. As for the EBRD projects, Switzerland is contributing to the Central Asia Risk Sharing Support Fund (CARSSF) through its participation in the Trade Facilitation Programme. Further, **seco** is currently considering a contribution to the EBRD/BAS programme in Uzbekistan.

With regard to **macroeconomic policy**, **seco** has financed a regional technical assistance project in public debt management for Uzbekistan. The project aims at assisting the Uzbek government to improve the management of external debt and to strengthen the legal and institutional framework for public debt as warranted.

Turkey

According to the governmental protocol in 1992, Turk Eximbank allocated a credit line of US$ 250 million for Uzbekistan. In 1993, US$ 125 million of this line was fully utilised for the export of Turkish goods. The remaining amount of US$ 125 million was allocated to three big projects: the first and second phases of 'Construction of International Trade and Exhibition Centre' and the 'Sugar Factory' projects.

As a result of an excellent repayment record of Uzbekistan, an additional US$ 125 million was extended in 1995 with the second governmental protocol. Under this line, so far three projects have been financed: 'Integrated Woollen Products' project of Kasansay-Tekmen by means of a parallel financing with EBRD, 'Plant of Production of Midibuses, Trailers and Semi-Trailers' project, and a transportation project financed by IDB backed by Turk Eximbank. Both lines required the sovereign guarantee of the Uzbek Government. As a whole, disbursements have reached US$ 347 million.

Apart from those two governmental protocols, Turk Eximbank extended a total amount of approximately US$ 44 million credit to the National Bank of Uzbekistan for four projects -renovation of three hotels and an exhibition centre- in Uzbekistan in 2002. The hotel projects in question are aimed at satisfying the accommodation needs which will arise during the prospective EBRD Annual Meeting in 2003. Currently, the Loan Agreements for two of those projects have come into force.

As for the future work, Turk Eximbank will continue to take into evaluation the applications of Uzbek side on project basis.

United Kingdom

The UK's strategy is to work with other key partners to support the improvement of living standards, reduce poverty and support economic and governance reforms. DFID's bilateral assistance framework for Uzbekistan is GBP 750,000 for 2005-06. This assistance focuses on three main areas:

1. Joint work with UNDP on cross-border cooperation with Tajikistan to improve growth and reduce poverty in the Zarafshan valley;
2. Cooperation with the World Bank and other partners on a regional programme to provide technical assistance for the development, implementation and monitoring of national HIV AIDS programmes;
3. Provision of assistance through a World Bank Trust Fund to help improve the quality of national statistics related to living standards and poverty.

Following the events at Andijan, DFID has suspended its support for the work on national poverty statistics (component 3 above) which entails provision of support to central Government. They intend to review this decision at the end of July. The UK has also called on other international partners to review their engagement in Uzbekistan to ensure that all interventions – including those with Central Government – form part of the reform agenda and/or contribute to poverty reduction.

The UK's share of multilateral aid to Uzbekistan was GBP 1.7 million for 2002-03. This was primarily through the European Commission and the United Nations.

United States

Between 1992 and 2001 the United States allocated approximately US$ 286.18 million to programmes in Uzbekistan. In 2002 there was a one-time tripling of USG assistance to approximately US$ 224 million, following the 9/11 attack in 2001 and the war in Afghanistan. Priority has been given to training and exchange programmes that target Uzbekistan's next generation of leaders. U.S. Government assistance is also directed towards building the capacity of non-governmental organisations through a system of training and small grants, in addition to continued support for security and improved health care programmes.

The **United States Agency for International Development (USAID)** is active in private sector development, banking and finance, fiscal policy reform, legal regulation, taxation, small-scale agricultural development, and drinking water supply.

USAID funds have focused on support to small business, democracy and governance, energy and environment and social sector reform. USAID is moving away from support to related agencies of the Government of Uzbekistan for economic reform at the national level to private enterprise development. USAID is currently supporting fiscal and banking sector reform programmes as well as those to back WTO accession, an independent media, and participation in environmental conventions. At a regional level, USAID focuses on the expansion and reform of primary health care and promotes water and energy cooperation.