ASIAN INFRASTRUCTURE INVESTMENT BANK

November 25, 2024

**Sovereign-backed Financings**

**Program Document**

# P000927 The Republic of Uzbekistan: Accelerating the Uzbekistan Climate Transition for Green, Inclusive, and Resilient Economic Growth (Subprogram 1)

**(Appraisal Review)**

**Currency Equivalents**
(As at date, November 19, 2024)

Currency Unit – Uzbekistan Som (UZS)
UZS 1.00 = USD 0.000077973
USD 1.00 = UZS 12825.01

**Borrower's Fiscal year**
January 1 to December 31

**Abbreviations**

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| ADB | Asian Development Bank |
| AFD | Agence Française de Développement |
| AIIB | Asian Infrastructure Investment Bank |
| CCDR | Climate Change Development Report |
| CCGAP | Climate Policy and Climate Change Gender Action Plan |
| CPBF | Climate Policy-Based Financing |
| ESP | Environmental and Social Policy of AIIB |
| E&S | Environmental and Social |
| EU | European Union |
| FX | Foreign Exchange |
| FY | Fiscal Year |
| GDP | Gross Domestic Product |
| GHG | Greenhouse Gas |
| GoU | Government of Uzbekistan |
| GW | Gigawatts |
| IFRS | International Financial Reporting Standards |
| IMF | International Monetary Fund |
| MDBs | Multilateral Development Banks |
| M&E | Monitoring and Evaluation |
| MoEF | Ministry of Economy and Finance |
| MTBF | Medium-Term Budget Reform |
| MtCO2e | Metric tons of Carbon Dioxide equivalent |
| NDC | Nationally Determined Contributions |
| PA | Paris Alignment |
| PBF | Policy-Based Financing |
| PEFA | Public Expenditure and Financial Accountability |
| PFM | Public Financial Management |
| SOE | State-Owned Enterprise |
| SPS | Safeguard Policy Statement of ADB |
| UNDP | United Nations Development Programme |

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| USD | US Dollar |
| WB | The World Bank Group |

## 1. SUMMARY SHEET

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| Project No. | P000927 |
| Project Name | Accelerating the Uzbekistan Climate Transition for Green, Inclusive, and Resilient Economic Growth (Subprogram 1) |
| AIIB Member | Republic of Uzbekistan |
| Borrower | Republic of Uzbekistan |
| Guarantor | Not applicable |
| Program Implementation Agencies | Ministry of Economy and Finance of the Republic of Uzbekistan, as the Executing Agency and, as the Program Implementing Agencies, the Committee for Family and Women under the Cabinet of Ministers; the Ministry of Agriculture; the Ministry of Ecology, Environmental Protection, and Climate Change; the Ministry of Employment and Poverty Reduction; the Ministry of Energy; Ministry of Higher Education, Science and Innovations; Ministry of Transport; the Ministry of Water Resources; and the National Agency for Social Protection under the President of the Republic of Uzbekistan. |
| Sector<br>Subsector | Others<br>Multi-subsector |
| Alignment with AIIB's thematic priorities | Green infrastructure |
| Program Objective | The objective of Accelerating the Uzbekistan Climate Transition for Green, Inclusive, and Resilient Economic Growth (the Program) is to support Uzbekistan in implementing crucial policy and institutional reforms to improve climate resilience and accelerate the climate transition, thereby achieving resilient, inclusive, and low-carbon economic growth. |
| Program Description | The Program comprises three Reform Areas.<br><br>**Reform Area 1:** Creating an enabling environment and institutional setup for the implementation of climate change actions<br><br>**Reform Area 2:** Strengthening climate change adaptation priorities<br><br>**Reform Area 3:** Accelerating Climate change mitigation actions |
| Program Type | The Program is comprised of Subprogram 1 of a programmatic series and it is the first of two subprograms |

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| | (Subprograms 1 and 2) that will be implemented in sequence over the period 2025-2026. |
| Implementation Period | 01/01/2025<br>06/30/2026 |
| Expected Loan Closing Date of Subprogram 1 | 06/30/2025 |
| Proposed Amount of AIIB Financing (USDm) | USD 250.00 |
| Financing Plan | Single tranche disbursement based on agreed prior actions.<br>Total Program (Subprogram 1) Loan Amount: USD 500 million<br>ADB: USD 250 million<br>AIIB: USD 250 million |
| Risk (Low/Medium/High) | Medium |
| Policy Waivers Requested | No |
| Policy Assurance | The Vice President, Policy and Strategy, confirms an overall assurance that AIIB is in compliance with the policies applicable to the Project. |
| Economic Capital Consumption (USDm) | USD52.85 million (ECap Ratio: 21.1%) |
| President | Liqun Jin |
| Vice President | Konstantin Limitovskiy |
| Acting Director General | Konstantin Limitovskiy |
| Team Leader | Emil Zalinyan, Sr. Investment Officer (PTL);<br>Manuel Cervero Bárcena, Investment Officer (Co-PTL) |
| Team Members | Sabyasachi Mitra, CPBF Advisor<br>Julija Kuklyte Polycarp, Climate Change Specialist<br>Paola Castillo, Senior Social Development Specialist<br>Vladimir Hecl, Senior Environment Specialist<br>Shonell Robinson, Financial Management Specialist<br>Marcin Sasin, Senior Economist<br>Nahom Ghebrihiwet, Economist<br>Shukhrat Khojiyev, Investment Associate<br>Luiz Eduardo Rodrigues, Counsel |

## 2. PROGRAM DESCRIPTION

### A. Program Overview

1. **Program Objectives**. The proposed Accelerating the Climate Transition for Green, Inclusive, and Resilient Economic Growth – Subprogram 1 (the Program) supports Uzbekistan in implementing crucial policy and institutional reforms to improve climate resilience and accelerate the climate transition for achieving resilient, inclusive, and low-carbon economic growth. The proposed Program is supportive of and consistent with Uzbekistan's updated National Determined Contribution (NDC, 2021), which emphasizes actions to reduce greenhouse gas emissions, as well as with the national development strategy for 2030 and the Strategic Framework for Transitioning to a Green Economy until 2030.

2. **Program Scope**. Structured as a series of two subprograms (Subprograms 1 and 2), the proposed Program, which focus only on Subprogram 1, will: (i) strengthen the institutional framework, planning, budgeting, and monitoring mechanisms; (ii) enhance climate resilience in water and land resources management, agriculture and social protection systems, state-owned enterprises' (SOE) climate and sustainability risk disclosure; and (iii) accelerate transitioning to a low-carbon economy, particularly in the climate-critical sectors of transport and energy.

3. **Program Financing**. The Government of Uzbekistan (GoU) has requested AIIB and the Asian Development Bank (ADB) to cofinance Subprogram 1 with a loan of USD 250 million each. Additionally, GoU intends to request AIIB and ADB to co-finance Subprogram 2, contributing another USD 250 million. Currently, AIIB's Board of Directors is being asked to approve the financing of Subprogram 1. As the lead co-financier, ADB will provide Program preparation and Environmental and Social (E&S) services to AIIB. The Co-financing Framework Agreement will govern co-financing arrangements between AIIB and ADB and will be formalized through a Memorandum of Understanding (MoU) to be signed by ADB and AIIB.

### B. Background and Development Constraints

4. **Macroeconomic Background.** Uzbekistan is a lower-middle-income country with a population of approximately 37 million and an income per capita of around USD 2,790. Landlocked and strategically positioned between Asia and Europe, Uzbekistan borders all other Central Asian countries. Since 2017, the country has embarked on an ambitious program of market-oriented reforms, which has made it an increasingly attractive destination for both foreign and domestic investment. Uzbekistan boasts a high investment rate, around 40 percent of GDP, and its strong growth potential is supported by a young and abundant labor force, diversified commodity exports, macroeconomic stability, and modest debt levels. From 2017 to 2023, the economy grew at an average rate of 5.5 percent per year, outperforming many other lower-middle-income countries. This growth was driven by income convergence, substantial investment, and significant expansion in the services and industrial sectors.

5. Following a significant initial phase of landmark reforms, Uzbekistan must now tackle a more difficult phase of reforms to ensure lasting improvements for its people. This is compounded

by the challenges of climate change, which Uzbekistan is already experiencing. The World Bank Group (WB) estimates[1] that without mitigation and adaption measures climate change will cause increased economic volatility and reduced average growth, with the economy projected to be 10 percent smaller by 2050 compared to a "no-climate-change" scenario, leading to significantly lower employment and higher poverty levels. Therefore, a comprehensive approach is needed to integrate climate resilience into the broader reform agenda.

6. **Climate Vulnerability.** Uzbekistan's landscape is dominated by large desert plains, including desert areas in the far west that formed as the Aral Sea dried up. With its arid climate, the country already experiences considerable variation in temperature and precipitation and is expected to be severely stressed by further temperature rises. Average temperatures, having risen 2.9°C from 1950 to 2020, are expected to rise by another 1.21°C–1.94°C over the century. According to the WB's Climate Change and Development Report, Uzbekistan is already experiencing the deleterious effects of a changed climate. Droughts, extreme heat, rainfall volatility, and dust storms are increasingly wreaking havoc on people and the economy[2].

7. Although Uzbekistan is a minor contributor to global greenhouse gas (GHG) emissions, it faces significant climate change threats from rising GHG emissions, endangering its water security, agricultural productivity, and economic growth. Climate change is expected to increase climate risk exposure and exacerbate water scarcity, accelerating land degradation, and inflicting damage on infrastructure and agricultural productivity. Land degradation due to climate factors is causing economic losses equivalent to 4.6% of GDP. Around 80% of Uzbekistan's water supply comes from resources originating outside its borders, highlighting the country's specific transboundary water dependency.

8. Climate change, coupled with Uzbekistan's heavy reliance on natural resource exploitation, severely affects water security, soil health, air quality, and other ecosystem services due to inefficient irrigation practices and obsolete infrastructure. The energy-intensive pumped irrigation for high-water-consumption crops like cotton has accelerated desertification, notably contributing to the drying of the Aral Sea. Despite accounting for just 0.32 % of global emissions, Uzbekistan remains one of the most energy-intensive economies globally, with the energy sector responsible for 76%–80% of GHG emissions, primarily from fossil fuel combustion and methane leaks. The bulk of non-energy emissions comes from agriculture, accounting for 19% of emissions. Uzbekistan's first biennial report to the United Nations Framework Convention on Climate Change (UNFCCC) in 2021 indicated that the country's GHG emissions were 189 million tons of $CO_2$-equivalent in 2017. However, it has since increased steadily to 120.6 million in 2022[3].

9. The challenges posed by climate change are intensified by a range of cross-cutting and sector-specific constraints that impede the effective execution and oversight of climate actions. These constraints can include regulatory hurdles, resource limitations, and institutional inefficiencies, which collectively undermine efforts to effectively address the climate crisis. Consequently, a comprehensive understanding of these barriers is essential for developing

[1] World Bank Group, Uzbekistan, Country Climate and Development Report, November 2023
[2] World Bank Document
[3] Uzbekistan: CO2 Country Profile - Our World in Data

targeted policy and institutional reform actions to enhance accountability and foster more robust climate action across various sectors.

10. **Cross-cutting Constraints**. The adoption of the Strategy for the Transition to a Green Economy in Uzbekistan in 2019 marked a shift in the country's approach to climate change, leading to its integration into national and regional development strategies and programs. Climate change considerations have since then been reflected in various strategic documents, including "the Development Strategy of Uzbekistan for 2017-2021", "the New Uzbekistan Development Strategy for 2022-2026", and Uzbekistan's national development strategy for 2030, as well as several key sectoral plans. However, the effective implementation and accountability for climate actions has been hindered by the following constraints:

a) **Lack of a consolidated climate change policy framework**. The GoU has made consistent efforts to improve its national policies and plans on climate change. However, a lack of a cohesive climate policy has led to a fragmented framework consisting of approximately 59 laws, 50 presidential decrees, and 200 government resolutions. This fragmentation complicates the coordination of climate policies and actions across different sectors. The government must adopt a unified national climate change policy and strategy for adaptation and mitigation to address this fragmentation and strengthen the legal basis for climate change action. Efforts are underway to formulate the national strategy on adaptation and mitigation until 2030, aimed at supporting the updated nationally determined contributions (NDCs) and based on national adaptation plans for agriculture, construction, disaster risk management, and water sectors.

b) **Weak coordination among various government ministries and agencies involved in climate policy.** Multiple ministries are involved in climate-related activities, but there is a need to clarify and streamline the roles and responsibilities of various ministries and agencies involved in climate action. This would help eliminate overlaps and gaps in institutional arrangements. There is also a need for better interagency cooperation and coordination. A robust interagency coordination mechanism would facilitate collaboration among different sectors (e.g., energy, agriculture, water management) and levels of government and ensure that climate objectives are integrated into broader economic and development policies. The newly created Ministry of Ecology, Environmental Protection, and Climate Change has key responsibilities but may lack the necessary capacity and resources to effectively manage and coordinate climate initiatives.

c) **Limited integration of climate policies into budget allocations and public investment**. The Climate Public Expenditure and Institutional Review[4] for Uzbekistan found that while there has been progress in integrating climate considerations into the national policy framework, the impact of its Nationally Determined Contributions

[4] Climate Public Expenditure and Institutional Review: Uzbekistan, 2023, prepared within the framework of a joint initiative of the United Nations Development Programme (UNDP), French Development Agency (AFD) and the Ministry of Economy and Finance of the Republic of Uzbekistan

(NDCs) and various climate strategies on development planning and budgetary practices remains limited. The inaugural Climate Change Budget Integration Index, scoring just 14 out of 100, highlights the insufficient incorporation of climate policy within the public financial management (PFM) system. This deficiency stems from the absence of a comprehensive, costed climate policy framework and a PFM system that has yet to fully implement crosscutting policy elements, such as program budgeting and a clear program classification that ties budget allocations to policy objectives.

d) **Need to improve the public investment management processing by integration climate considerations**. Uzbekistan grapples with substantial infrastructure deficiencies, exacerbated by climate change, highlighting a critical investment and climate gap. The interplay between these gaps and public investment management (PIM) processes is pivotal in shaping the efficacy of climate-relevant investments essential for bridging these disparities.[5] The 2020 IMF Public Investment Management Assessment (PIMA) pinpointed several weaknesses in Uzbekistan's PIM process, including fragmented processes and institutional responsibilities, the absence of a unified project pipeline, inadequate methodologies for maintenance needs, poor budget coordination, and a lack of retrospective evaluations.[6] In response, the government implemented Cabinet Resolution 206 in April 2022, aiming to address these deficiencies. However, the PIM legal framework remains tangled, characterized by multiple laws, decrees, and resolutions. Recommendations for improvement include integrating climate change considerations into all phases of project management, from preparation to monitoring; requiring estimates of operation and maintenance costs for new facilities to be presented to the Ministry of Economy and Finance; refining investment project selection criteria to prioritize project readiness and climate sensitivity and aligning the project pipeline schedule with the existing budget calendar. Addressing climate risks at every PIM step and in all regulatory updates is essential.

11. **Sectoral Constraints.** Sectoral constraints present significant challenges within climate-critical areas, including water and land resource management, agriculture, state-owned enterprise green financing, transport, and energy. The subsequent sections will delve into the unique obstacles faced by each of these sectors, highlighting their implications for sustainable development and climate resilience.

a) **Water resource management**. As of 2014, 80% of Uzbekistan’s water supply came from resources originating outside its borders. Uzbekistan shares the major rivers of Central Asia (Amu, Darya, Syr Darya, and Zarafshan) with its neighbors; less than 10%

[5] ADB. 2024. *A Governance Framework for Climate-Relevant Public Investment Management*. PIM is a subset of PFM that oversees public investment planning, project evaluation, and the delivery of investments, including those targeting climate objectives. To tackle the challenges present in climate-relevant PIM and PFM processes, countries should integrate adaptation and mitigation strategies into their regular (“business-as-usual”) investment planning. To this end, countries need to develop and evaluate climate-relevant projects within the same best practice PIM and PFM frameworks as regular investments to ensure effectiveness and alignment with broader national objectives.
[6] A. Sayegh et al. 2021. Republic of Uzbekistan: Public Investment Management Assessment. IMF Technical Report.

of Uzbekistan's water resources originate in the country[7]. Climate projections suggest[8] that the flow of the Amu Darya will decrease by 5 percent and the Syr Darya by 15 percent by 2050, with an increase in the frequency of low-water flow and drought years and with expected runoff losses of as much as 25–40 percent. Meanwhile, heat stress will increase the demand for water. Also, uncertainties related to the transboundary nature of water resources will exacerbate the water situation. In some catchments, water availability is projected to decrease by 30–40 percent by 2050, while irrigation water demand will rise by 25 percent. The total annual water shortage will increase to 7 billion cubic meters in 2030 and to 15 billion cubic meters in 2050. The impacts of climate change are worsened by obsolete water infrastructure, ineffective water use, and inadequate development in the sector. With irrigated agriculture accounting for 90% of water use, these challenges threaten the country's food security and production. The rural poor and women will be disproportionately affected. Therefore, a coherent regulatory framework is essential for ensuring a sustainable water supply, safeguarding against pollution and depletion, and promoting ecologically responsible water use. Effective implementation of policies and regulations must incorporate gender-sensitive and climate-responsive investments, supported by robust asset management systems and cost-recovery mechanisms. This integration is vital for the sustainable operation and maintenance of irrigation systems, ultimately facilitating equitable access to water resources and enhancing overall resource management.

b) **Land resource management.** The projected reduction in river flow in the Amu Darya and Syr Darya basins, along with the projected increase in average temperatures, are likely to accelerate the desiccation of the Aral Sea[9]. This, in turn, could hasten the process of desertification across the wide area of land adjoining the Aral Sea, with winds carrying sand, dust, agricultural chemicals, and salt up to 300 kilometers from the former seabed. Dust storms affect 5.5 million people in Uzbekistan, and their increasing frequency, driven by desertification, has been shown to pose a risk to public health.

An estimated half of all irrigated land in Uzbekistan is affected by soil salinity, with considerable spatial variation: less than 10% of the irrigated area is affected along the major rivers, while nearly all irrigated land is affected in the northwestern region of Karakalpakstan. Significant areas of land in Uzbekistan bordering the Aral Sea are affected by acute secondary soil salinization. This phenomenon may be hastened by climate change, to the extent that the expected increases in average temperatures may cause increased evapotranspiration and higher water demand for irrigation. Some 26% (13.7 million hectares) of the country's land is severely degraded. Half of this is natural pasturelands, while 40% is land that is not used for agriculture, pasture, or forest. Negative impacts are estimated to be greatest, along with population increases, in agricultural areas of the Fergana Valley and around Karshi, Samarkand, and

[7] Climate Risk Country Profile: Uzbekistan, WBG & ADB, 2021
[8] WBG, Uzbekistan Country Climate and Development Report, 2023
[9] United Nations Economic Commission for Europe. 2020. *Environmental Performance Reviews: Uzbekistan, Third Review.*

Tashkent. The government needs to address climate impacts by establishing a robust legal framework in soil protection and fertility, the rights and obligations of landowners, users, and tenants. Effective implementation requires classifying and mapping degraded lands and enhancing pasture productivity by setting regulatory standards for groundwater usage and grazing. Moreover, reforming agricultural subsidies is increasingly important.

c) **State-owned enterprises.** The SOE sector overall accounts for 20% of GDP as of 2021, 18% of employment, and 20% of exports. In 2019, the total assets of SOEs reached 102% of GDP. The development of Uzbekistan's SOEs is crucial to absorb the costs and capitalize on the opportunities presented by the climate agenda and green transition. Because these SOEs play a central role in many high-emitting sectors such as energy and transport, they need to mobilize substantial funding to invest in new assets, while reducing reliance on high-emitting and inefficient assets as quickly as possible. Because government funds for this transition have become difficult to mobilize, SOEs must find ways to use the growing toolbox of green and sustainable finance instruments. Green bonds can serve as important tools to mobilize private sector capital for green transition. However, SOEs have untapped potential in the green bond and green financial markets because of governance, bankability, and green eligibility issues. SOEs that successfully utilize the green finance toolbox can provide relatively large bond issuances at potentially lower risk that are particularly interesting for global investors. To unlock green finance for SOEs and improve the availability of reliable and comparable information on sustainability risks and opportunities, under Subprogram 1 the government required SOEs under the supervision of Uzbekistan Assets (UzAssets)[10] to adopt the National Sustainability Reporting Framework[11], comprising (i) the International Financial Reporting Standard (IFRS) S1 on sustainability-related financial disclosures; (ii) IFRS S2 on climate-related disclosures; (iii) Global Reporting Initiative framework for environmental, social, and governance reporting; and (iv) publication of independent environmental, social, and governance ratings.

d) **Transport**. The transport sector, predominantly reliant on road-based modalities, has experienced a significant increase in GHG emissions driven by an uptick in both freight and passenger transit. As per the updated NDC of Uzbekistan (2021), the sector witnessed a 22.4% increase in GHG emissions in 2017 relative to the figures in 2010. Furthermore, according to the latest data from 2022, total transport emissions are equal to 16.35 million/tCO2, and as a sector it is the 5$^{th}$ largest polluter[12]. A shift to e-

[10] UzAssets is a government-owned asset management company under the Ministry of Economy and Finance managing all the major SOEs (22 nonfinancial SOEs and nine state-owned banks) which constitute around 65% of the economy and over 90% of SOE assets.

[11] On February 24, 2020, the President of Uzbekistan signed Resolution No. 4611, establishing the legal framework for adopting International Financial Reporting Standards (IFRS) in the country. Following this, on August 24, 2020, the Cabinet of Ministers approved Resolution No. 507, which mandates that joint-stock companies, commercial banks, insurance organizations, and large taxpayers must prepare their financial statements according to IFRS starting January 1, 2021.

[12] Uzbekistan: CO2 Country Profile - Our World in Data

mobility in the transport sector can address climate change by reducing dependence on fossil fuels, decreasing emissions, and promoting improved air quality and healthier urban environments. The government introduced tax measures to broaden the use of vehicles that are energy efficient or electric in alignment with the Euro-4 standard that reduces total hydrocarbon emissions of no more than 0.10 gram per kilometer. However, the government does not have a strategic framework for developing and expanding low-carbon public transport e-mobility solutions. There is also a need for a comprehensive digitalization strategy to further transform the transport sector.

e) **Energy.** Uzbekistan's pursuit of a green shift in the energy sector faces challenges due to continued high energy intensity and aging infrastructure. Due to inefficient energy use, Uzbekistan's energy sector accounts for most of the nation's total carbon emissions (76%–80%). The increased usage of electricity, heating, manufacturing, construction, and transport, along with considerable fugitive emissions, were mainly responsible for GHG emissions from the energy sector. To address these challenges, Uzbekistan's updated NDC aims to increase renewable energy sources to 25% of total power generation by 2030, improve energy efficiency, and reduce the energy intensity of GDP. Subsidy reforms are necessary[13] which would promote energy efficiency and conservation by encouraging consumers to use energy more wisely and spur competition and innovation in the energy sector by removing distortions in the market. This can lead to the development of new technologies and business models that could accelerate the transition. The government needs to align reforms to a long-term decarbonization strategy and implement cross-cutting reforms. This includes energy efficiency standards, introduction of green tax measures to incentivize more efficient transport, a carbon pricing framework, a national carbon credit registry, and a monitoring, reporting, and verification (MRV) system.

12. **Gender Disparities and Social Protection**. Climate change worsen gender disparities, especially among poor and vulnerable communities. Women's participation in the labor market in Uzbekistan falls well below the participation of men. In 2021, about 70.9% of the male population was part of the labor force compared to 44.9% of the female population. Women's employment is concentrated in sectors such as health (9% employment for women compared to 2% for men) and education (16% of employment for women compared to 4% for men). Agriculture accounts for about one-fourth of employment for both men and women, with a very small gender gap, confirming its important role in the Uzbek economy and in women's work. Over three-quarters (77.8%) of agricultural employment is informal, compared to 40% in the rest of the economy. While men constitute a larger absolute number in agricultural roles, women are heavily engaged in low-paid agricultural employment. Women headed almost 6,000 out of more than 80,000 farms operating throughout the country (8%).

[13] IEA estimates that in 2020, Uzbekistan's implied subsidies on natural gas, electricity and oil amounted to USD 3.8 billion, or 6.6% of the country's GDP. The GoU has initiated an ambitious structural reform agenda to phase out energy subsidies aiming to achieve full cost recovery for the energy sector by 2026. Current policy and price reforms include a price increase of 70% in 2025 and continuing price liberalization; other sector reforms aim to push for SOE privatization and regulatory reforms to level the playing field for the private sector.

13. The gender inequalities described above profoundly affect women's vulnerability to environmental hazards, constraining their resilience and adaptive capacities in the face of climate change. Despite their crucial contributions to environmental sustainability, food security, and adaptation initiatives, women frequently encounter significant barriers, including limited access to resources, exclusion from policy-making spaces, and prevailing social norms that undermine their voice and participation. This is particularly evident in female-headed households and communities reliant on agriculture and natural resources, who face heightened risks from climate-related events. For instance, as water scarcity intensifies due to climate change, employment opportunities in cotton production will diminish, disproportionately impacting women. Additionally, women farmers face unique challenges, including inadequate seed quality, declining crop yields from land degradation and insufficient water resources, and restricted access to essential machinery, all of which hinder agricultural productivity. Their participation in decision-making regarding water resource management remains minimal, resulting in continued inequities. Although recent policies, such as the Strategy for Achieving Gender Equality (2020-2030), aim to eradicate discrimination and promote gender equality, there is an urgent need for these objectives to be effectively translated into action through targeted investments and programs that empower women and enhance their resilience against environmental shocks.

14. The effectiveness of climate change policies and strategies depends on a green transition that balances the benefits against the potential adverse impacts of climate initiatives. The green transition may negatively impact workers in traditional carbon-intensive sectors. Industries like oil and gas are likely to see job cuts, potentially leading to the loss of approximately 2 million jobs by 2030. Sectors such as agriculture and renewable energy services offer employment prospects but ensuring that the transition is equitable and sustainable is necessary. It is essential to pair these climate actions with well-designed social protection policies. Such policies can mitigate any negative consequences for vulnerable communities, fostering a resilient society that can adapt to the changes brought about by climate action while maximizing its benefits.

15. **Government Strategy and the Program**. Despite significant cross-cutting and sectoral challenges, Uzbekistan remains resolute in tackling climate change through comprehensive government strategies, demonstrating a firm commitment to transitioning towards a sustainable, resilient, and low-emission future. After ratifying the Paris Agreement in 2018, committing to a 10% reduction in GHG emissions by 2030 based on 2010 levels, the Government raised its GHG reduction target in the updated NDC to 35% by the United Nations Climate Change Conference (COP26) in 2021. The country joined the Global Methane Pledge in 2022, committing to a 30% reduction in methane emissions by 2030. The Strategic Framework of Transitioning to a Green Economy until 2030 outlines a strategic roadmap for private sector green finance, especially through public-private partnerships and promoting climate resilience and mitigation in sectors such as agriculture, water management, land sustainability, green employment promotion, and decarbonization. It aims to reduce land degradation on up to 1 million hectares and increase crop yields by 20%–40% through enhanced water use efficiency and the introduction of drip irrigation technologies. The Water Resource Management and Irrigation Sector Development Strategy for 2024–2026 will prioritize climate and gender-relevant investments in irrigation modernization, developing a climate-resilient framework for asset management, and revising cost recovery

mechanisms to ensure sustainable management, operation, and maintenance of irrigation systems.

16. The proposed Program aligns with Uzbekistan's development objectives articulated in the national development strategy for 2030, updated Nationally Determined Contribution 2021 and the Strategic Framework of Transitioning to a Green Economy until 2030. It focuses on strengthening the policy and institutional framework for climate actions and mainstreaming climate change in planning, budgeting, and public resource allocation. It also aims to enhance climate adaptation policy and strategy in water and land resource management, provide expanded benefits for women and vulnerable groups, and accelerate decarbonization through increased renewable energy utilization and an efficient transport system.

17. **Government's Climate Expenditure Performance and Climate Investment Needs.** As Uzbekistan navigates the challenges of climate change, the state budget allocations for climate-related initiatives have grown steadily. From 2020 to 2022, climate-positive expenditures rose from 2.5% to 3.0% of the total budget, amounting to 26,302.4 billion UZS in 2022. This upward trend in climate expenditure is primarily concentrated in the agriculture and transport sectors, which together account for over 65% of these investments. Notably, around 95% of total climate expenditures are allocated to adaptation measures. These efforts focus on enhancing water use efficiency across all economic sectors, introducing water-saving irrigation technologies, and maintaining the sustainability of irrigated lands. Such measures are critical, particularly given the country's vulnerability to water scarcity and soil degradation. In addition to adaptation, Uzbekistan is pursuing ambitious projects aimed at transitioning to green energy. Projects, such as the construction of solar and wind energy stations, are being implemented on the basis of Public-Private Partnerships (PPPs), which partly explains the reasons behind the significantly lower share of mitigation and mixed (joint) impact measures.

18. The World Bank's Climate Change Development Report (CCDR) highlights a significant financing requirement for Uzbekistan to address the pressing challenges posed by climate change, estimating that the country will need approximately USD60 billion to enhance labor productivity and infrastructure, including roads, bridges, livestock, and irrigation systems. Additionally, a staggering USD340 billion will be necessary by 2060 to upgrade its aging energy infrastructure and implement decarbonization strategies. Private sector involvement is crucial to bridge this substantial climate and investment gap, as public resources alone are insufficient. This necessitates comprehensive policy reforms and regulatory frameworks to create a conducive environment for private investment. Key strategies include implementing a long-term decarbonization plan (including subsidy reforms) that offers clear economic signals and identifies priority investment areas, thereby deterring fossil fuel-dependent investments. Moreover, adopting international green reporting standards, such as IFRS and ESG guidelines, will empower state-owned enterprises (SOEs) to access green financing opportunities while effectively managing climate risks. Equally important is the provision of fiscal incentives and investment in human capital to foster renewable energy initiatives and cultivate green skills, ensuring a skilled workforce capable of attracting private investment in Uzbekistan's burgeoning green economy.

19. **Strategic Fit for AIIB**. The Program is in line with the Bank's Articles of Agreement, meets the eligibility criteria for Climate Policy-Based Financing (CPBF), supports the Bank's Corporate Strategy, and contributes to the Bank's climate financing. It will aid the GoU in promoting sustainable and climate-focused development and encouraging public and private financing in green infrastructure. The Program aligns with AIIB's transport strategy by supporting the transition to e-mobility in public transport and promoting the adoption of a strategic framework for developing low-carbon public transport and e-mobility solutions. Additionally, the Program will directly contribute to AIIB's water strategy by improving integrated water resources management and enhancing Uzbekistan's water resilience. The Program also aligned with AIIB's energy strategy, as it supports the adoption of a legal framework outlining obligations for energy consumers and suppliers to enhance energy conservation and efficiency across economic sectors.

20. **Paris Agreement Alignment and Climate Finance**. Based on the joint MDB methodological principles for Paris Agreement Alignment for Policy-based lending[14], the Program is aligned with the Paris Agreement. It is consistent with the country's priorities on climate change and does not hinder the achievement of national climate goals and commitments for achieving the goals of the Paris Agreement. On the contrary, it is developed with the objectives to promote green growth and enhance the country's resilience. The Program's reform actions related to e-mobility and actions related to green finance frameworks for state-owned enterprises (SOEs) will promote decarbonization (BB1). Policy actions linked to water efficiency through an integrated approach to climate-smart water resource management and conservation will support the building of country's resilience (BB2). The Program is considered 100 % climate finance, accounting for climate mitigation (47.8%) and adaptation (52.2%). More details on the step-by-step assessment are provided in Annex 4.

21. **Consultations and Collaboration with Development Partners and Stakeholders.** The Program is effectively coordinated with development partners, including WBG, IMF, UNDP, EU, and AFD, through a country platform[15]. MoEF established a web portal to report on development partner activities in their respective areas of engagement, with contributions also from AIIB to facilitate coordination. The Program also complements programs and policy actions supported by other multilateral and bilateral development institutions, as well as reforms under the previous PBFs under the COVID-19 Crisis Recovery Facility (see Annex 6).

22. In relation to Reform Area 1, focused on strengthening the enabling environment, close coordination with AFD, EU, IMF, and WBG addresses issues related to the Public Financial Management (PFM) Strategy, adoption of program-based budgeting, and climate fiscal risk. In Reform Area 2, which centers on climate change adaptation, policy and institutional reform areas for sustainability and climate-related disclosures are reinforced by the Food and Agricultural Organization (FAO) on Recarbonization of Global Soils (RECSOIL) and AFD's support for the adoption of a corporate and social responsibility charter for key SOEs in the water, energy, and industrial sectors. In Reform Area 3, pertaining to climate change mitigation, the Program's support for the development of e-mobility for public transport complements the adoption of new

[14] Joint MDB Methodological Principles for Assessment of Paris Agreement Alignment of New Operations, June 2023
[15] Green Economy Platform: https://green.imv.uz/en/

air quality standards to reduce particulate matter and transport emissions under the WBG-AIIB jointly financed "First Inclusive and Resilient Market Economy Development Policy Operation." Additionally, the UNDP and Global Environment Facility's pilot project in Tashkent deploying electric buses for public transport aligns with the Program's objectives. Furthermore, the Program's support in green taxes is in line with the IMF's Technical Assistance support on drafting the medium-term revenue strategy and AFD's introduction of tax packages incentivizing circular economy practices and energy efficiency in the construction sector.

23. As a backdrop for this Program, ADB has undertaken extensive consultations regarding its new country partnership strategy (CPS) for Uzbekistan for 2024-2028. These consultations involved development partners and all relevant stakeholders. The key pillars of the CPS support the objectives of Uzbekistan's national development strategy, which focuses on various areas, including the acceleration of the green transition in energy, public sector management and governance, transportation, agriculture, and water resource management.

24. **Value Addition by AIIB**. Upstream policy engagement has been integral to the design of the Program, reflecting AIIB's commitment to robust analytical groundwork from the onset of AIIB's involvement. In collaboration with ADB, AIIB conducted a comprehensive assessment of climate risks and policy constraints, informed by detailed analytical work from development partners. This assessment effectively consolidated AIIB's extensive country and sectoral experience, drawn from previous and ongoing investment operations and policy-based financings[16] within Uzbekistan. As part of this initiative, AIIB has initiated systematic coordination with both development partners and the Government of Uzbekistan, ensuring that the Program incorporates valuable insights and lessons learned. Notably, AIIB participated in a virtual fact-finding mission alongside ADB, further enhancing its understanding of Uzbekistan's climate challenges and enabling the identification of targeted upstream and implementation support essential for the Program's success.

25. Drawing on its extensive experience in both sovereign and non-sovereign financed operations in Uzbekistan and the wider region, AIIB is committed to offering comprehensive advisory and technical assistance to the GoU in implementing and monitoring an ambitious reform agenda under Subprogram 1 and strengthening the proposed reforms under Subprogram 2. Specifically, AIIB's support will encompass a thorough review of and actionable recommendations to enhance the water sector's management practices and regulatory framework. Moreover, AIIB will help the GoU execute and implement the Water Resource Management and Irrigation Sector Development Strategy. This will involve the development of a robust, climate-resilient framework for managing water and irrigation sectors, as well as the establishment of sustainable cost-recovery pricing mechanisms.

26. In the field of electric mobility, AIIB will partner with ADB and the United Nations Development Programme (UNDP) to provide support to the GoU in the implementation of the Concept for Development of e-Mobility in the Republic of Uzbekistan. This collaborative effort by

[16] Bukhara Region Water Supply and Sewerage Project (Phase 1&2); Advancing Uzbekistan Economic and Social Transformation Development Policy Operation; First Inclusive and Resilient Market Economy Development Policy Operation

development partners aims to assist the government in formulating the necessary policy and regulatory framework to encourage and facilitate the adoption of electric vehicles in public transportation and commercial fleets. Furthermore, the government's focus also includes addressing obstacles in the establishment of charging infrastructure by creating pertinent local policies and programs and aiding in the execution of the Presidential decree related to charging infrastructure.

27. Furthermore, in collaboration with ADB and Agence Française de Développement (AFD), AIIB will provide critical guidance and recommendations to the GoU for drafting the carbon pricing framework. This framework aims to encourage changes in behavior and promote a transition towards the use of low-carbon products and services.

28. **Value Addition to AIIB**. The Program provided an opportunity for AIIB to collaborate closely with various international development partners to address Uzbekistan's specific needs and collectively work towards achieving common climate objectives. This partnership is expected to enable AIIB to accomplish its corporate objectives and garner valuable insights and experience in supporting Uzbekistan's national climate plans through the utilization of the new CPBF instrument. Moreover, the insights and expertise gained from the development of this Program will significantly aid the Bank in establishing a strong foundation for similar CPBF initiatives in other AIIB members. To facilitate this process, the Bank will implement a series of internal knowledge-sharing sessions, where team members can exchange best practices and lessons learned. This will enhance the capacity of staff involved in the preparation of similar operations, ensuring that the necessary skills and resources are readily available for successful implementation across different contexts. The policy and institutional reform agenda supported within this Program holds significant importance, as it will also help shape subsequent downstream investment opportunities for the Bank in Uzbekistan.

29. **Lessons Learnt**. To date, AIIB has approved 14 projects in Uzbekistan, five of which are through non-sovereign-backed financing. These projects span a range of sectors, including energy, water, urban development, transport (road and railway), and health. The diversity of sectors reflects AIIB's comprehensive approach to supporting Uzbekistan’s development goals. The AIIB co-financed two development policy operations with the World Bank in Uzbekistan in 2023 and 2024. The knowledge and experience gained from these projects, along with insights from the review of lessons learned from development policy loans provided to Uzbekistan by other development partners, significantly enhanced AIIB's understanding of the country's development landscape and the specific challenges faced in various sectors. This accumulated expertise has not only contributed to the successful implementation of projects but has also deepened AIIB’s policy dialogue with the government and other development partners.

30. The main lessons learned include:

a. *Strong government ownership*: In the course of the Bank's preparation and implementation of the two previous policy-based operations in Uzbekistan, supported by AIIB and co-financed by the WB, as well as AIIB-financed regular investment operations in climate-sensitives sectors, the GoU has consistently shown its

dedication to the national development goals of transitioning to a market-oriented, inclusive, and resilient economy. Despite the substantial progress achieved during the initial phases of reforms, the GoU has reaffirmed its strong commitment to economic transition under the national development strategy for 2030. After ratifying the Paris Agreement in 2018 and committing to a 10% reduction in greenhouse gas (GHG) emissions by 2030 based on 2010 levels, the government has raised its GHG reduction target in the updated Nationally Determined Contributions (NDC) from 2021 to 35%. Uzbekistan is unwavering in its commitment to furthering its efforts toward climate change adaptation and mitigation and reducing the risk of adverse climate change impacts on various economic sectors.

b. *Programmatic approach*: This approach allows the Bank to better support the government's reform agenda with forward-looking, tailored analytical and advisory work while maintaining flexibility in program implementation to reflect changing circumstances. It is essential for formalizing medium-term reform commitments. Both subprograms focus on the same reform areas and include complementary actions to address the specific constraints of the core development problem in a sequenced manner. Subprogram 2 will continue the reform efforts initiated under Subprogram 1. In Uzbekistan, capacity building within government agencies and technical institutions has been essential in improving project design, monitoring, and evaluation. This approach is vital to ensure the effective execution of climate projects.

c. *Coordination with development partners*. Climate action requires integrated approaches across sectors (energy, water, transport, etc.). Development partners, including AIIB, have found that cross-sector coordination among ministries and international agencies can enhance project success and ensure climate resilience. The Bank has taken proactive steps to actively engage with and will continue to enhance its collaboration with ADB and the WB, and International Monetary Fund (IMF) for effective design and implementation of a policy-based support program. This collaborative effort will ensure alignment and coherence in policies, leading to a more significant impact and successful outcomes.

d. *Upstream Policy Engagement*. A clear and supportive policy framework is crucial for climate finance. Extensive policy dialogue under Subprogram 1 and much earlier, as part of the preparation of regulation operations in the transport, water, and energy sectors with the Government of Uzbekistan, line ministries, and sector-responsible agencies, has been critical in informing the Program. Sector diagnostics and studies underpinned the selection and design of crucial reform measures needed to tackle institutional and policy constraints to climate-resilient infrastructure development. AIIB is committed to deepening its upstream engagement through various donor coordination platforms and considering technical assistance to enhance the policy reform actions. These efforts show the importance of aligning national policies with global climate goals, such as the Paris Agreement, to secure financing and foster coherent implementation.

## C. Policy Actions and Expected Results

31. **Policy Actions**. In line with the Strategic Framework of Transitioning to a Green Economy until 2030, the updated NDC, and the Uzbekistan Development Strategy for 2022–2026, the Program responds to strategic priorities and addresses some of the critical binding constraints to help achieve resilient, inclusive, and low-carbon economic growth. The proposed Program reform areas are: (i) strengthening the institutional framework, planning, budgeting, and monitoring mechanisms; (ii) enhancing climate resilience in water and land resources management, agriculture, SOE climate and sustainability risk disclosure, and social protection systems; and (iii) accelerating transitioning to a low-carbon economy, particularly in the climate-critical sectors of transport and energy.

a. **Reform Area 1: Enabling environment and institutional setup for implementation of climate change actions created**. Reform Area 1 aims to establish clear institutional responsibility and coordination for cross-cutting climate change policy, adaptation and mitigation. Under the Reform Area 1, Subprogram 1 supports: (i) the establishment of the Climate Council chaired by the President of the Republic of Uzbekistan to approve all climate policies and regulations; (ii) the establishment of the National Government Agency for Green Transformation and Adaptation to Climate Change under the Ministry of Ecology, Environmental Protection and Climate Change to develop and implement climate policies across government and consult with the public, private stakeholders and non-government organizations; and (iii) the adoption of a National Climate Policy and Climate Change Gender Action Plan (CCGAP). Subprogram 1 also supports mainstreaming climate risks and gender priorities through: (i) integration into the medium-term fiscal strategy; (ii) mainstreamed climate and gender priorities into medium-term budget framework; (iii) adoption of program-based budgeting incorporating climate and gender related outcome indicators; (iv) public investment management regulations requiring climate impacts to be assessed for project screening, appraisal and approval process; and (v) incorporating and disclosing climate fiscal risks into the fiscal risk statement.

   Under Subprogram 2, to enhance resilience and support climate adaptation and mitigation actions and protect vulnerable populations, the government is expected (i) approve and implement a national strategy on adaptation and mitigation until 2030, (ii) implement the CCGAP, and (iii) establish an intergovernmental climate change monitoring and evaluation (M&E) system. Additionally, to strengthen the implementation of climate policies in fiscal decision-making, the government will (i) require ex-ante impact assessment and performance indicators of green fiscal measures for national budget proposals; (ii) publish ex-post spending reviews to assess program performance in relation to integrating climate and green priorities into budget decision making; (iii) require that climate risks are assessed and allocated in the preparation, design, and implementation of all public-private partnership projects; and (iv) implement a fiscal risk management strategy to guide

climate-resilient planning covering assignment of risks and investments in risk reduction, transfer, and retention strategies. To support a just transition and create and maintain jobs in the emerging green economy, the government will prioritize green skills and jobs legislation, adopting institutional, regulatory, and financing frameworks for green jobs across industries, scaling up a promotional campaign for green jobs workforce through education institutions (public and private), and attracting investments towards reskilling and training programs, ensuring equal opportunities and access for women and girls.

b. **Reform Area 2: Climate change adaptation priorities strengthened**. The Reform Area 2 is aimed at strengthening climate change adaptation priorities by enhancing water resource management through legislative reforms and investments in irrigation modernization, promoting sustainable soil management practices, increasing agriculture productivity, and mitigating the impact of livestock on pastures. In line with the Concept for the Development of the Water Sector of the Republic of Uzbekistan, 2020–2030, Subprogram 1 supports: (i) the adoption of the Water Code which is intended to unify legal acts and norms in the field of water resource use and protection; and (ii) adoption of the Water Resource Management and Irrigation Sector Development Strategy, 2024–2026. Subprogram 1 also supports the establishment of the institutional responsibilities for soil management, rights and obligations of landowners, land users, and land tenants brought by the Law on Soil Protection and Increasing Its Productivity. The law set the legal foundation for: (i) curbing excessive chemical usage and promoting regenerative agricultural practices to increase soil fertility for irrigated land; and (ii) the adoption of a unified methodology for classifying and mapping degraded pasture lands.

Under Subprogram 2, to implement the Water Resources Development Concept, 2020–2030 and strengthen water resource management, investment, and cost recovery, the government is expected to (i) implement procedures for screening and prioritizing climate- and gender-relevant investments in irrigation modernization; (ii) develop a climate-resilient framework and asset management system; and (iii) revise cost recovery mechanisms to support more sustainable management, operation, and maintenance of irrigation systems. Additionally, to support subsidy reform that incentivizes a productive and climate-resilient agricultural economy, the government will (i) implement a system to evaluate the allocative efficiency of current subsidies; (ii) adopt a unified policy and budget oversight mechanism for the design and implementation of subsidy schemes; (iii) establish a M&E system to track public fund usage by individuals and organizations to evaluate performance against operational, socioeconomic, and climate objectives; and (iv) adopt reform actions based on the review for a more effective and efficient subsidy framework. Further, to ensure that adaptation measures are fair and inclusive, the government will establish an adaptive social protection system that enhances resilience to climate change and expands coverage of social

protection measures to the most vulnerable, including women, children, older persons, disabled people, and those in the informal sector.

c. **Reform Area 3: Climate change mitigation actions accelerated**. Reform Area 3 aims to accelerate climate change mitigation actions and reduce GHG emissions in line with the updated NDC. To unlock green finance for SOEs and improve the availability of reliable and comparable information on sustainability risks and opportunities, Subprogram 1 supports the adoption by SOEs of the National Sustainability Standards Framework comprising of (i) IFRS-S1 on sustainability-related financial disclosures; (ii) IFRS-S2 on climate-related disclosures; and (iii) Global Reporting Initiative framework for ESG reporting. Subprogram 1 also supports the adoption of a National Strategy on e-Mobility encompassing the regulatory frameworks, infrastructure development, technology adoption and upskilling, research and development and a gender action plan. Furthermore, in line with the greening of the tax system, Subprogram 1 supports Prior Actions to implement the amendment of the Law on Tax and Budget Policy 2024, which incentivizes behavior towards a more sustainable green transition and achieve climate goals. Subprogram 1 also supports the adoption of the Law on Rationale Use of Energy, Increasing Energy Efficiency and Energy Conservation 2024 that sets out a framework and outlines obligations for energy consumers and suppliers to enhance energy conservation and efficiency across economic sectors.

Under Subprogram 2, in line with the Law on Limiting the Emissions of Greenhouse Gases and the Law on Rationale Use of Energy, Increasing Energy Efficiency and Energy Conservation, and to implement a just transition while moving further toward a low-carbon economy, the government is expected to (i) adopt a long-term decarbonization strategy; (ii) adopt a carbon price framework, implementation strategy, and roadmap that consider the distributional impact on vulnerable groups; (iii) establish a national carbon credit registry and a monitoring, reporting, and verification digital platform; and (iv) implement energy-efficient standards and labeling for energy-saving technologies, products, and equipment.

32. **Expected Results**. The outcome indicators of the proposed policy actions are provided in Table 1.

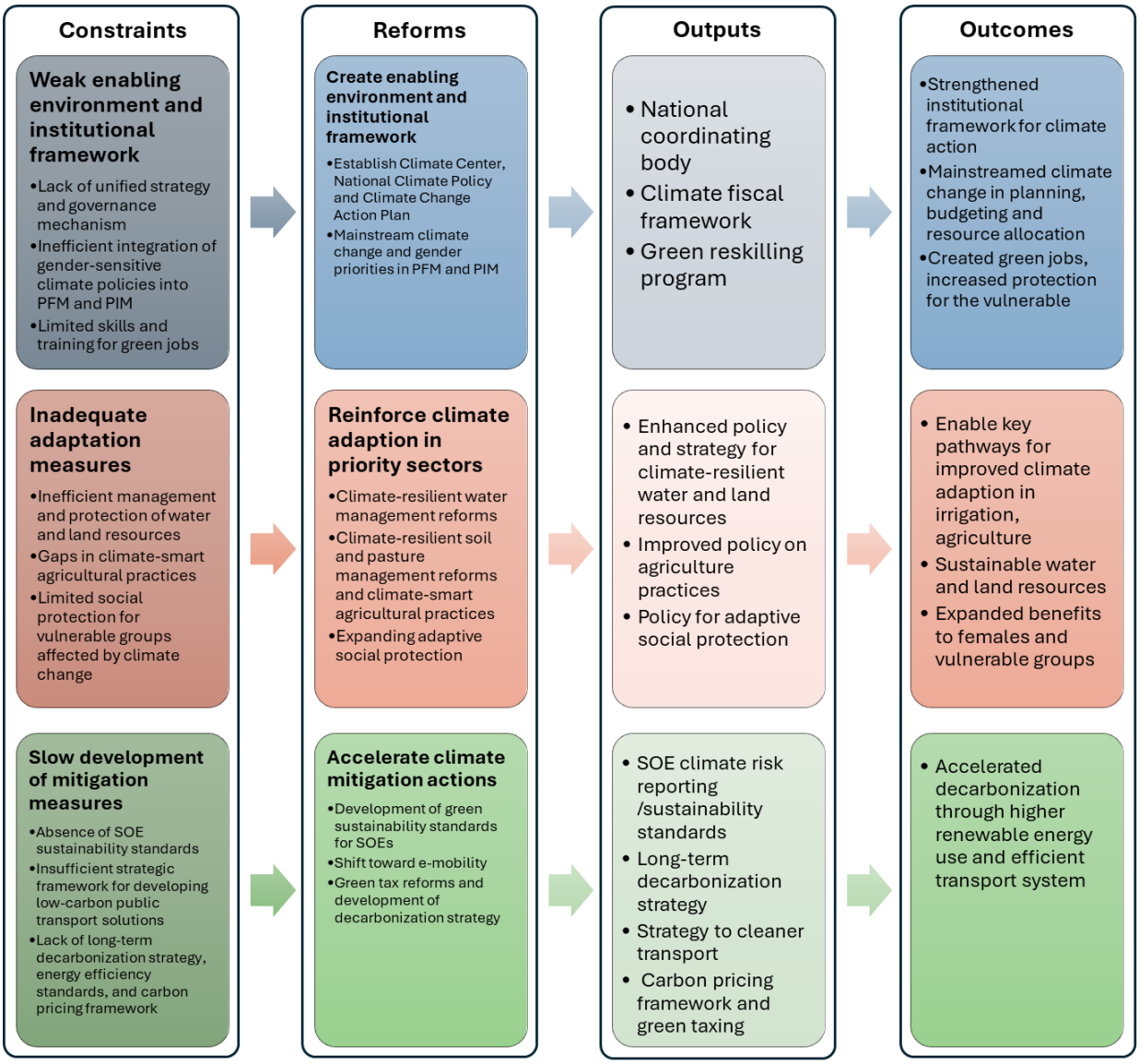
**Table 1. Program outcome indicators**

| Indicator name | Baseline | Target (by 2027) |
|---|---|---|
| **Reform Area 1: Enabling environment and institutional setup for implementation of climate change actions created** | | |
| The projected average annual economic losses due to climate change disasters | USD3 billion (2017) (Source: MoEF) | By 20% |

| | | |
|---|---|---|
| (without the program) reduced | | |
| Percentage of public budget allocated to climate-relevant expenditures increased | 10% (2022) (Source: MoEF) | By at least 15% (of which 35% of the increase are for gender-specific spending) |
| All public investment project appraisals are subject to climate-related risks identification and assessment. | N/A (Source: MoEF) | 100% |
| **Reform Area 2: Climate change adaptation priorities strengthened** | | |
| Amount (in billion cubic meters) of water losses from irrigation systems reduced | 36% (2023) (Source: Ministry of Water Management) | By at least 5% |
| Climate and gender screening conducted for all national irrigation modernization projects. | NA (Source: Ministry of Agriculture) | 100% |
| Soil salinity of agricultural land | 55.8% (2022) (Source: Ministry of Agriculture) | No higher than 45% |
| The share of degraded land to total land area (land degradation indicator) reduced | 29.0% (2024) (Source: Ministry of Agriculture) | By at least 6% |
| Adaptive social protection programs designed and implemented | NA (Source: National Social Protection Agency) | Designed and implemented in at least three climate vulnerable regions (with at least 35% of program funding dedicated to gender-specific intervention) |
| **Reform Area 3: Climate change mitigation actions accelerated** | | |
| Enhancing ESG and climate risk accounting to support green and thematic bond issuances in global and local markets | NA (Source: UzAssets) | ESG and climate risk accounting enhanced to support at least 3 green and thematic bond issuances |
| Share of renewable energy in the national energy mix | 8% (2022) (Source: Uzbekistan Statistics Agency) | At least 20% |
| Energy intensity (national primary energy consumption as a proportion of GDP | 7.54 gigajoule /USD1,000 [2017 prices] (2020) (Source: International Energy Association database) | By 5% from 2020 level |

| | | |
|---|---|---|
| measured at purchasing power parity) reduced | | |

**Figure 1. Theory of change**




33. **Policy Actions and Resulting Infrastructure Investment**. The proposed Program aims to support policy and institutional reform actions in infrastructure sectors that align with AIIB's core strategic focus. For instance, climate adaptation measures in the water sector are crucial in shaping infrastructure investments in both water and irrigation systems. By implementing strategies such as enhanced water management practices and resilient irrigation technologies, the GoU can foster greater efficiency and sustainability. These measures not only mitigate the impacts of climate change but also attract investment by showcasing the potential for long-term economic viability and risk reduction. Recent analyses[17] indicate that Uzbekistan faces a significant annual financing shortfall in the water and sanitation sector, estimated at approximately USD 826 million per year, totaling nearly USD 5 billion for the period from 2025 to 2030. AIIB has

[17] Eurasian Development Bank, Drinking Water Support and Sanitation in Central Asia, 2024

already approved over USD 600 million in sovereign-backed financing for water sector projects in Uzbekistan (Bukhara Region Water Supply and Sewerage Project I and II), directly contributing to achieving adaptation goals outlined in Reform Area 2 and is currently supporting the GoU in the development of a new pipeline of water sector projects to fill the financing gap in collaboration with other development partners.

34. Uzbekistan's investment needs in the transport sector (including vehicles) are estimated at around USD 46 billion for the period from 2023 to 2030 and over USD 120 billion for the period from 2031 to 2060[18], with significant potential for private sector financing ranging between 90-95%. Policy reforms under Reform Area 3 support the adoption of a national e-mobility strategy and green tax reforms that can enhance investment in sustainable transport infrastructure by promoting electric vehicle use and encouraging shifts in public and private transport behaviors. This will facilitate the further expansion of AIIB's existing portfolio of transport sector projects in Uzbekistan, totaling more than USD 270 million, and encourage the deployment of various financing mechanisms. The sector, which remains heavily concentrated in SOEs (such as Uzbekistan Railway (UTY)) and faces challenges in attracting private-sector investment, will benefit from institutional and regulatory strengthening. Improvements in the sector may lead to new investments and amplify the expected benefits from AIIB's Bukhara-Miskin-Urgench-Khiva Rail Electrification Project, co-financed by ADB, which aims to enhance the logistical and economic efficiency of national rail transport while reducing GHG emissions through a transition towards rail electrification.

35. Furthermore, under Reform Area 3 (Climate change mitigation actions), the long-term decarbonization strategy will guide both domestic and foreign investors. It will provide clear economic signals regarding market and technological trends and guidance on priority investment areas. Moreover, adopting ESG and IFRS standards will aid in mitigating climate risks, attracting international support, and securing green financing. To facilitate the net-zero transition, Uzbekistan's investment needs are projected to exceed USD 100 billion[19]. Currently, Uzbekistan's power sector is the second largest recipient of AIIB financing in the country. AIIB approved financing, in the total amount of USD 490 million, has been directed toward building renewable energy and highly efficient power generation capacities, as well as investments in green bonds. The Program will promote greater diversification toward renewable energy, particularly through the Bank's new pipeline investments in distributed solar power generation, utility-scale renewables, battery storage, and upgrading the power grid upgrades.

36. **Policy Actions to Enable Private Capital Mobilization.** To ensure fiscal sustainability amid climate costs, a blend of public and private financing is essential. To meet the need for private sector investment, policy reforms and regulations will be required to foster an enabling environment for private sector development. In this regard, (i) strategies, such as the long-term decarbonization strategy, are important to provide direction to domestic and foreign investors, showing clear economic signals on market and technological trends and prioritizing the areas for investments, and thus preventing fossil fuel-intensive investments and stranded assets; (ii)

[18] WBG, Uzbekistan Country Climate and Development Report, November 2023
[19] WBG, Uzbekistan Country Climate and Development Report, November 2023

adoption of international green reporting standards, such as IFRS and ESGs, will be critical for SOEs to access the green financing toolbox to attract green financing and mitigate climate risks; and (iii) fiscal incentives and investments in human capital to promote renewable energy and green skills development, ensuring a skilled labor force to attract private investment in the green sector.

37. **Development Financing Needs and Budget Support**. The government's development financing needs are estimated from fiscal deficit to be USD 4,142 million for 2024, USD 3,387 million for 2025, and USD 3,558 million for 2026. The projected annual external borrowing is USD 2,500 million in 2024–2026, with the balance being funded through domestic sources. Uzbekistan seeks budget support from AIIB and other development partners to fund its medium-term financing needs, which will require strong collaboration among its development partners.

38. Under the program, AIIB will provide a USD 250 million loan for subprogram 1 in 2024, which represents 6.0% of the estimated 2024 fiscal deficit. The AIIB loan will have a final maturity of 16.5 years, including a grace period of 3 years and an average maturity of 9.84 years. The ADB Financing will comprise a concessional loan of USD125 million, and a regular loan of USD125 million, both from ADB's ordinary capital resources to help finance the Program. The concessional loan will have a 25-year term, including a grace period of 5 years and an interest rate of 2% per year during the grace period and thereafter. The regular loan will have a 15-year term, including a grace period of 3 years; an interest rate determined in accordance with ADB's Flexible Loan Product; a commitment charge of 0.15% per year; and such other terms and conditions set forth in the draft loan agreement.

39. **Implementation Arrangements**. The MoEF will be the executing agency; there will be several implementing agencies, with the MOEF being the nodal agency. The key implementing agencies are MOEF; the Committee for Family and Women under the Cabinet of Ministers; the Ministry of Agriculture; the Ministry of Ecology, Environmental Protection, and Climate Change; the Ministry of Employment and Poverty Reduction; the Ministry of Energy; Ministry of Higher Education, Science and Innovations; Ministry of Transport; the Ministry of Water Resources; and the National Agency for Social Protection under the President of the Republic of Uzbekistan.

40. **Sustainability**. The sustainability of the reforms is anchored in the government's strong ownership of the Program. Mainstreaming climate change priorities through a whole-of-government approach and through government planning, budgeting, and resource allocation, complemented by a robust monitoring and evaluation system, strengthens sustainability. Mainstreaming gender equality through the CCGAP and SOE climate and sustainability disclosure standards to attract climate finance also facilitates sustainability. The country's development coordination platform increases sustainability by mobilizing climate finance, developing climate projects, creating a climate knowledge platform, and facilitating policy dialogues across multiple layers of ministries and agencies, the private sector, and development partners. Institutional capacity building, knowledge-sharing work, and communications and awareness initiatives under the post-program partnership framework will provide strategic direction and implementation tools for ministries to enhance climate change interventions.

## D. Macroeconomic Policy Framework and Outlook

41. **Economic Growth**. Uzbekistan has shown remarkable resilience to recent shocks, including the Covid pandemic, spillovers from the geopolitical tensions in the region, and tight global financing conditions. Growth in 2020 was still positive, followed by a strong rebound in 2021, and further robust growth of around 6 percent in 2022 and 2023, driven by an improved domestic and external environment, fiscal support, and high remittances. The unemployment rate stands at around 8 percent. Real wages have been growing fast, contributing to poverty reduction. Potential growth remains strong, at around 5-6 percent per year. Uzbekistan aims to become an upper-middle-income country by the early next decade, transitioning to a private-sector-led market economy, which will raise incomes and improve living standards.

42. **Risks to the Outlook** include slower growth in trading partners, especially Russia, Uzbekistan's major trading partner and source of remittances, which are a major support to livelihoods and external finance. Domestically, risks include contingent liabilities from SOEs, and potential slippages in reforms. An important long-term challenge is climate change, which could hinder Uzbekistan's sustainable growth potential.

43. **Economic Reform Program.** Uzbekistan has undertaken extensive reforms in recent years, liberalizing various sectors of the economy and enhancing opportunities for private sector development. For example, private sector credit as a share of GDP tripling since 2016. The large energy subsidies are being reduced (gas tariffs hikes for businesses in 2023 and households in 2024) with cost recovery planned by end-2026, which will support long-term public finances, reduce contingent liabilities, and contribute to decarbonization. Plans to phase out subsidized lending and privatize large banks are moving more slowly than planned. Large SOEs and state-owned banks still contribute to more than 50 percent of GDP. A key long-term challenge for Uzbekistan is to create sufficient quality jobs for its large, young and fast-growing labor force.

44. **Green Agenda.** Uzbekistan has made significant strides in advancing its green agenda, focusing on improving vehicle emission standards, setting more ambitious environmental goals, and developing a new pollution control system and a national green taxonomy. The high greenhouse gas (GHG) emissions per unit of GDP highlight the need for significant improvements in energy efficiency. In 2021, Uzbekistan strengthened its Nationally Determined Contributions (NDCs), raising its target to a 35 percent reduction in emissions intensity by 2030, versus the 2010 baseline. The government has intensified its efforts to develop alternative energy sources. According to EBRD, preliminary data indicate a substantial increase in electricity generated by solar plants, albeit from low levels. The government also unveiled ambitious renewable energy investment plans and adopted a Long-term Carbon Plan (LCP) for the power sector.

45. **Fiscal Policy.** In 2023, Uzbekistan's budget deficit reached 5.0 percent of GDP, exceeding the 3 percent target, due to higher spending on wages and social assistance, still high energy subsidies, delays in tariff adjustments and slower reductions in policy lending. Gradual fiscal consolidation is envisaged, with a plan for a 4.0 percent of GDP deficit in 2024, and a return to the 3.0 percent target in 2025. According to Fitch, cuts to energy subsidies made in late 2023, mid-2024 and those planned for 2025 are expected to reduce spending by 1.5 percentage points

of GDP. At the same time, higher social spending could slow the progress of fiscal consolidation and deficit reduction. Further progress on the broadening of the tax base, modernization of the tax administration and better efficiency of spending is needed.

46. **Monetary Policy, Inflation, the Financial Sector.** Inflation in Uzbekistan has been relatively high, due to price liberalization, structural adjustment, and high consumption growth. Dollarization has declined but remains relatively high (at around 30-40 percent). The central bank has been operationalizing the newly introduced inflation targeting mechanism. Inflation fell from a peak of 18.7 percent in early 2018 to around 10 currently. The monetary policy is relatively tight, with consistently positive real rates, meant to further reduce inflation to the 5 percent target, expected by 2027, according to the IMF. The exchange rate has been depreciating steadily, at around 8-10 percent per year, in line with inflation. The banking sector is stable and well-capitalized, but financial intermediation is low as most banks remain state-owned (accounting for two-thirds of assets). Privatization ongoing, but progress is relatively slow.

47. **Debt Sustainability.** Public debt remains sustainable despite increases in recent years. It has risen to 36.3 percent of GDP by 2023 (still low by peer standards) and is expected to gradually decline in the medium term, thanks to high economic growth and fiscal prudence. Key risks to the debt profile include potential devaluation, given the high FX component (90 percent). Risks are mitigated by the large share of official borrowings at concessional rates and long maturities (nine years), robust growth outlook, ample fiscal space, and substantial FX reserves (nine months of imports). Fiscal limits, including an external borrowing limit, a debt ceiling of 60 percent of GDP, and a budget deficit target of 3 percent of GDP, further strengthen debt sustainability. Uzbekistan's sovereign credit is rated at BB-/Ba3 with a stable outlook.

48. **Macroeconomic Adequacy.** Uzbekistan's macro policy framework is adequate and consistent with growth and macro stability, including debt sustainability. Monetary policy is anchored in the inflation target, with an appropriately tight stance. The authorities are generally committed to fiscal prudence. Fiscal policy operates within the guardrails of the deficit, debt and borrowing limits/targets. An ambitious, credible, and feasible fiscal consolidation is planned, while retaining space for investment and social protection. The planned reduction in fossil fuel subsidies will strengthen the overall consistency of macro policies with energy transition. Macro stability and the reform program underpin the robust medium- and long-term potential.

49. **IMF's Views.** The most recent Article IV staff report[20] serves as the Assessment Letter, in line with Fund policies. IMF notes Uzbekistan's significant progress in transforming its economy, with rapid growth and poverty reduction, despite major shocks. It commends authorities' reform efforts, most notably the energy price reform and privatization of SOEs, while emphasizing the need for continued reforms. IMF also notes that planned policies are appropriate to maintain robust public finances and facilitate external adjustment while supporting monetary policy. Furthermore, the report's conclusions are consistent with the reforms in the Program, aiming to reduce the state's role in the economy, promote women's participation in the labor market,

[20] July 2024; Republic of Uzbekistan: 2024 Article IV Staff Report

advance decarbonization and climate adaptation initiatives, and enhance governance and transparency, building on progress already made.

## E. Public Financial Management, Disbursement, and Auditing Aspects

50. **PFM Legal Framework.** The GoU has made significant progress in strengthening PFM systems over the past decade. The recently completed 2024 Public Expenditure and Financial Accountability (PEFA) assessment highlighted the modernization of the Public Financial Management (PFM) legal framework as a key factor contributing to the improvement of the PFM system. Notable advancements include the passing of the 2013 Budget Code and the 2023 constitutional revision, both aimed at improving fiscal transparency, accountability and governance. The revised constitution has strengthened Parliament's role in budget oversight, while the Budget Code has facilitated a shift towards a medium-term, results-oriented fiscal policy framework.

51. A new public procurement law was enacted in 2021, which provides for MoEF to have regulatory oversight for public procurement and for public agencies to be responsible for procurement execution. An electronic procurement portal accessible to domestic and international tenderers has been launched that provides for competitive tendering as the default approach. The public procurement system is undergoing significant improvements. Recent amendments to the law approved by Parliament, expected to be signed soon, aim to enhance transparency, ensure fair competition, and strengthen regulatory criteria for contracts.

52. **Planning and Budgeting.** Uzbekistan has a structured budgetary system, in which the draft budget is approved by Parliament before the new financial year. The consolidated budget includes the state budget, budgetary funds of government organizations, and programs funded by international financial institutions. Since 2020, budget coverage has been expanded to include previously classified extra-budgetary funds, such as state trust funds and the Uzbekistan Fund for Reconstruction and Development (UFRD). The state budget is divided into two levels: (i) the republican budget, and (ii) budget of the Republic of Karakalpakstan, local budgets of regions and city of Tashkent.

53. With IMF technical assistance, a new budget calendar was established to outline procedures for the Medium-Term Budgeting Framework (MTBF), with further improvements expected under the 2025 PFM Reform Strategy. The macroeconomic and fiscal forecasting has been implemented and a fiscal strategy has been adopted and translated into a medium-term expenditure framework for FY 2025. The framework will also be further strengthened under Sub-program 2.2 which requires of ex-ante and ex-post assessments of green fiscal measures for budget proposals, in particular to gender and climate.

54. **Treasury and Cash Management**. The PFM practices demonstrate strong commitment control and cash management. The 2024 PEFA assessment revealed no significant deviations in budgetary outcomes over the past three years. This favorable outcome can be partly attributed to the centralized processing of revenues and expenditures through the Treasury Single Account (TSA). Previously classified extra-budgetary funds are now being processed through the TSA.

MoEF will be leading the development of a procedure to further reduce extra-budgetary accounts of ministries and agencies. The TSA is supported by the Government Financial Management Information System (GFMIS), which is primarily utilized for planning and commitment control, along with UzASBO for accounting and reporting. Despite the use of two separate systems, quarterly budget execution reports are prepared timely, and there are no major concerns noted regarding data accuracy.

55. The shift to the GFSM 2014 framework has enhanced Uzbekistan's budget classifications by incorporating administrative, economic, and functional classifications at all stages of the budget cycle. This system is aligned with the OECD Classification of the Functions of Government (COFOG) and tracks funding sources. However, integrating program-based classifications remains crucial. Although a system is in place to track and report climate related expenditures, the 2024 PEFA Climate Assessment also emphasizes the need to adopt program-based classifications and strengthen regulations to better link climate-related spending to measurable outcomes.

56. Furthermore, IMF has indicated that while progress has been made in public investment practices, further improvements are needed. Specifically, the public investment process, including project selection and appraisal, should be unified across all financing sources, with a single project pipeline established. Reform Area 1 of this Program will focus on the adoption of program-based budgeting that incorporates climate and gender-related outcome indicators. Additionally, with joint efforts from the IMF, WBG and ADB, there will be amendments to the public investment management regulations to strengthen project screening and appraisal by requiring climate impact assessment into the public investment management approval processes.

57. Uzbekistan is making steady progress in adopting International Public Sector Accounting Standards (IPSAS), with full implementation targeted for 2030, supported by the Asian Development Bank (ADB). Financial reporting is expanding its scope to comprehensively cover revenues, expenditures, and other obligations, with information on guarantees and long-term commitments currently included in statistical reports.

58. **Oversight and Scrutiny of Budget**. To enhance internal controls and oversight of the budgetary process, Government has transitioned to a risk-based internal audit system, establishing internal audit departments in most ministries. Further enhancements are being supported by the WB, which includes improving the internal control system in the public sector, introducing a risk management system in ministries and agencies, and developing a draft law on internal audit and internal control.

59. Additionally, the Chamber of Accounts (CoA), responsible for auditing government financial reports, has its functions, responsibilities, and operational procedures defined by law. In 2019, the CoA's status and independence were reinforced through expanded powers and functions, with ongoing improvements to its operations. However, the IMF have advised that the independence of the CoA should be further enhanced to ensure its rules are consistent with international standards for Supreme Audit Institutions, regarding removal of its Head. The CoA conducts audits in accordance with the National Audit Standards, which align with the

International Standards for Supreme Audit Institutions (ISSAIs). Over the past three years, the audit reports have been presented to Parliament in a timely manner and are made publicly available on its website.

60. Overall, public access to budgetary information has improved. Legislative debates on the budget are now available through various media channels. Aside from the official budget documents, the government publishes an annual 'Budget for Citizens' report. Additionally, quarterly budget execution reports are made accessible to the public.

61. **Central Bank of Uzbekistan (CBU)**. According to Article IV of the IMF's Articles of Agreement dated July 2024, CBU has made strides in strengthening its operations and governance, through an established investment committee, approved charter and guidelines, and adopted a roadmap for risk-based internal audits. The first IFRS-compliant financial statements are expected by the end of 2024. The IMF urges CBUs continued progress with legal reforms, aligning oversight with international best practices, and establishing an enterprise risk framework.

62. **Risk Assessment**. Based on the assessment conducted in alignment with the Operational Policy on Financing (June 2024), the program risk is assessed as Medium.

63. Key areas identified for improvement include strengthening the integration between budgeting and strategic planning, implementing program-based budgeting at all levels of government, enhancing the public investment process, fully adopting IPSAS, and improving the operational framework of the CBU.

64. The 2024 core PEFA assessment highlights significant progress compared to previous evaluations, reflecting the Government's strong commitment to enhancing its PFM systems. Both the core PEFA and climate-focused assessments have served as essential benchmarks in shaping the new PFM Reform Strategy for 2025-2030. The strategy aims to address key areas identified as needing improvement within the PFM system. With continued advancements in these areas, the PFM system should ensure that loan proceeds are allocated and utilized against productive activities aligned with national development priorities.

65. **Disbursement Process.** Loan proceeds will be disbursed in a single tranche. Funding under Subprogram 1 would be made available to the government upon the effectiveness of the Loan Agreement and the submission of a withdrawal application, provided the Borrower has carried out Subprogram 1 satisfactorily, and its macroeconomic policy framework is adequate. The proceeds of the loan will be disbursed into a Foreign Currency Dedicated Account that will form part of the country's official foreign exchange reserves held by the Central Bank of Uzbekistan (CBU) and be opened in the name of the MoEF. Within five business days after depositing the loan amount into the reserve account, the MoEF will transfer the loan amount into the Treasury Single Account (TSA) in Uzbekistan som, which will become available to finance budgeted expenditures. MoEF, within 30 days after the withdrawal of the loan from the dedicated account, will report to the Bank: (i) the exact sum received into the reserve account; (ii) the details of the account to which the equivalent of the proceeds of the loan was credited; and (iii) the record that an equivalent amount has been accounted for in the Borrower's budget management systems.

If the proceeds of the loan or any part thereof are used for ineligible purposes, as defined in the Loan Agreement, the AIIB will require the MoEF to promptly return such amount. The amount refunded shall be cancelled from the Loan. No specific audit of the deposit of the loan proceeds will be required. However, AIIB reserves the right to request such an audit at its discretion.

## F. Environmental And Social

66. The Program will be co-financed with ADB as the lead co-financier. To ensure a harmonized approach to addressing the E&S risks and impacts of the Program, and as permitted under AIIB's Environmental and Social Policy (ESP), the ADB's Safeguards Policy Statement (SPS) will apply to the Program in lieu of AIIB's ESP. AIIB has reviewed the ADB's SPS and is satisfied that: (i) it is consistent with the Bank's Articles of Agreement and materially consistent with the ESP, relevant Environmental and Social Standards; and (ii) the monitoring procedures that are in place are appropriate for the Program**.** In addition to the ADB Prohibited Investment List, the loan proceeds may not be used to finance AIIB Excluded Expenditures. As a result, the ESEL will apply to the project, notwithstanding the ADB Safeguard Policy Statement.

67. Based on the E&S assessments carried out according to the SPS requirements, the Program is classified as category C for the environment, involuntary resettlement, and indigenous peoples. Program activities will be confined to policy and institutional reforms. No civil works are envisaged under the Program. No direct or indirect activities under policy reforms will result in or lead to involuntary resettlement or negatively affect indigenous peoples or the environment. Program proceeds will not be used for any activities resulting in physical or economic displacement. A matrix of potential environmental, involuntary and social safeguards impacts has been prepared to assess each policy action (see Annex 4)**.**

68. **Poverty and Social Consideration.** Real income growth and the expansion of the safety net contributed to a decline in Uzbekistan's headcount poverty rate from 17% in 2021 to 11% in 2023. This reduction aligns with decreasing inflation and rising household consumption, though income equality has slightly worsened, as indicated by the Gini coefficient's increase from 0.262 in 2017–2019 to 0.288 in 2023. The relationship between poverty and climate change in Uzbekistan is evident, with climate change posing a threat to economic growth and potentially increasing poverty levels. However, proactive climate adaptation and mitigation strategies can address environmental concerns while promoting economic development and poverty alleviation. The Program aims to enhance climate governance, adaptation, and mitigation policies by implementing the National Climate Policy and the CCGAP.

69. **Gender.** The Program is categorized as effective gender mainstreaming. Under the Program the government will approve a National Climate policy and CCGAP. This plan will contribute to a reduction in the number of people (including women) vulnerable to climate shocks by addressing the gender dimension of climate and supporting vulnerable populations. To address gender and climate integration in budgetary decision-making processes, the Program will integrate gender into PFM and PIM regulations and promote resource allocation for climate action tailored to address the specific needs of women and other vulnerable populations. The value addition of this approach will be to integrate climate change and gender into medium-term budget

parameters and annual budgets, comprising budgets of the state, off-budgetary entities, ministries, and local governments. By implementing procedures for screening and prioritizing climate and gender relevant investments in irrigation modernization, women can have greater access to water resources and participate more effectively in water management decisions. Incorporating gender considerations into the e-mobility strategy is promoting inclusive, eco-friendly transportation solutions for its major cities and empowering women's participation in e-mobility transport and promoting equal opportunity.

## G. Monitoring, Evaluation, and Accountability.

70. **Monitoring and Evaluation**. The MoEF, as the executing agency, will report to AIIB and ADB against each of the indicators and targets included in the Policy and Results Matrix (Annex 1). ADB and AIIB will jointly conduct Program monitoring semiannually. A single program completion report for the entire Program will be prepared by ADB and AIIB after 12 months of Subprogram 2 closure.

71. **Governance and Anti-corruption**. AIIB's Policy on Prohibited Practices applies to the Program. The Bank reserves the right to investigate, directly or indirectly through its agents, any alleged corrupt, fraudulent, collusive, coercive or obstructive practices, and misuse of resources and theft relating to the Program.

72. **Independent Accountability Mechanism**. ADB's SPS applies to this Project. All complaints relating to compliance with ADB's SPS under this Program will be handled by ADB's Independent Accountability Mechanism. In accordance with AIIB's Policy on the Project affected People's Mechanism (PPM), submissions of such complaints to the PPM will not be eligible for consideration by the PPM. Information on ADB's Accountability Mechanism is available at: Accountability Mechanism | Asian Development Bank (adb.org).

## H. Risks and Mitigation Measures.

73. Table 2 summarizes major risks and mitigating measures.

**Table 2: Summary of Risks and Mitigating Measures**

| Risks | Mitigation Measures |
|---|---|
| **Macroeconomic risk:** Impact of external economic volatility, including due to the geopolitical tensions spill overs to government revenue and its ability to fund climate expenditures. | Uzbekistan has already demonstrated resilience to these shocks. Nonetheless, with support from development partners, Government is committed to prudent monetary and fiscal policies and to support for green transition, while safeguarding vulnerable groups. |
| **Institutional risk**: Limited technical and institutional capacity, overstretched staff with multiple roles & responsibilities, and inadequate inter-agency coordination, as well as the absence of a unified climate policy framework, hinder effective policy development and implementation. | The technical assistance support from development partners (directly to ministries and other agencies) will support institutional capacity building, strategic knowledge work, and interministerial coordination. |
| **Public financial management risks**: Delayed implementation of the medium-term fiscal planning and budgeting could cause misalignment between government priorities and budget allocation. Thereby resulting in inadequate budgetary allocation for prioritized climate change program.<br><br>Weaknesses in public investment management process could adversely impact the screening and selection of climate-change related projects and the overall intended climate-change impact.<br><br>Inadequate accounting and reporting standards increase the risk of inaccurate financial reports, affecting the reliability of reported climate-related expenditures and revenues. Overall, such can lead to misrepresentations of the government's fiscal position and potentially obscure fiscal risks.<br><br>Lack of program-based classification may impede the process of tracking and reporting on climate related expenditures throughout the budget cycle. | In addition to the Government's strong commitment to continually implementing the MTBF, several development partners are actively supporting the strengthening of this process.<br><br>The public financial management reforms are supported across programs of various development partners, including enhancing fiscal policies and regulations needed for climate public investment management.<br><br>With support from the ADB, a roadmap for transitioning to IPSAS was adopted in 2019. Progress is being made, with the goal of achieving full alignment by 2030.<br><br>Sub-program 1.2 and 2.2 will focus on the adoption of program-based budgeting that incorporates climate and gender-related outcome indicators, and ex-post reviews of program expenditures. Program-based budgeting is being supported by several development partners. |

## 3. NEXT STEPS

| Milestones | Actual or Expected Completion Dates |
|---|---|
| Screening | September 16, 2024 |
| Concept Review | October 10, 204 |
| Appraisal Review | November 7, 2024 |
| Negotiation | November 11, 2024 |
| Board Approval | December 11, 2024 |
| Loan Signing | Q4 2024 |
| Effectiveness | Q4 2024 |
| Disbursement | Q4 2024 |

**Annex 1: Policy and Results Matrix**

| **Prior Policy Actions: Subprogram 1**<br>(January 2023–November 2024) | **Indicative Policy Actions: Subprogram 2**<br>(December 2024–November 2026) | **Outcome Indicators** |
|---|---|---|
| **Reform Area 1: Enabling Environment and Institutional Setup for Implementation of Climate Change Actions Strengthened** | | |
| 1.1. To establish clear institutional responsibility and coordination for climate change policy, adaptation and mitigation through a whole of society approach, the Government: (i) established the Climate Council under the President of the Republic of Uzbekistan; (ii) established the National Government Agency for Green Transformation and Adaptation to Climate Change (Climate Center) under the Ministry of Ecology, Environmental Protection and Climate Change; and (iii) adopted a National Climate Policy and Climate Change Gender Action Plan. | 2.1. To enhance resilience and support climate adaptation and mitigation actions and protect vulnerable populations, the government will: (i) approve and implement a National Strategy on Adaptation and Mitigation until 2030; (ii) implement the Climate Change Gender Action Plan; and (iii) establish an intergovernmental climate change monitoring information and evaluation system. | **By December 2027**<br>The projected average annual economic losses due to climate change disasters (without the program) are reduced by 20%. (Baseline: 2017, USD3 billion)<br>(Source: MOEF Report) |

| **Prior Policy Actions: Subprogram 1**<br>(January 2023–November 2024) | **Indicative Policy Actions: Subprogram 2**<br>(December 2024–November 2026) | **Outcome Indicators** |
|---|---|---|
| 1.2. To integrate climate into public financial management, the government: (i) integrated gender and climate into the medium-term fiscal strategy; (ii) mainstreamed climate and gender priorities into medium-term budget framework; (iii) adopted program-based budgeting incorporating climate and gender related outcome indicators; (iv) required climate impacts to be assessed for public investment management encompassing project screening, appraisal and approval process; and (v) incorporated and disclosed climate fiscal risks in the Fiscal Risk Statement. | 2.2. To further integrate climate budget practices into public financial management, the government will: (i) require ex-ante impact assessments and performance indicators of green fiscal measures for national budgets proposals; (ii) publish ex-post spending reviews to assess program performance in relation to integrating climate and gender priorities into budget decision making; (iii) require that climate risks are assessed and allocated in the preparation, design and implementation of all public-private partnership projects; and (iv) implement a fiscal risk management strategy to guide climate-resilient planning covering assignment of risks and investments in risk reduction, transfer and retention strategies. | Percentage of public budget allocated to climate-relevant expenditures increased by at least 15% (of which 35% of the increase are for gender-specific spending).<br>(Baseline: 2022, 10%)<br>(Source: MOEF Report)<br><br>All public investment project appraisals are subject to climate-related risks identification and assessment.<br>(Baseline: NA)<br>(Source: MOEF Report) |
| | 2.3. To create and maintain jobs in the emerging green economy, the government will prioritize Green Skills and Jobs legislation adopting institutional, regulatory, and financing frameworks for green jobs across industries, scaling up a promotional campaign for green jobs workforce through education institutions (public and private), and attracting investments towards reskilling and training programs that will ensure, among others, equal opportunities and access to jobs for women and girls. | A green skills certification and accreditation system (with gender considerations specifically embedded in the system) is established to create and maintain a skilled workforce green jobs for the emerging green |

| Prior Policy Actions: Subprogram 1<br>(January 2023–November 2024) | Indicative Policy Actions: Subprogram 2<br>(December 2024–November 2026) | Outcome Indicators |
|---|---|---|
| | | economy.<br>(Baseline: NA)<br>(Source: MOEF Report) |
| **Reform Area 2: Climate change adaptation priorities strengthened** | | |
| 1.3. In line with the Water Resources Development Concept (2020–2030) for an integrated approach to climate smart water resource management and conservation, the government: (i) submitted to Parliament the Water Code unifying legal acts and norms in the field of water resource use and protection; and (ii) adopted the Water Resource Management and Irrigation Sector Development Strategy, 2024–2026. | 2.4. To implement the Water Resource Management and Irrigation Sector Development Strategy, 2024–2026 to strengthen water resource management, investment, and cost recovery, the government will: (i) implement procedures for screening and prioritizing climate and gender relevant investments in irrigation modernization; (ii) develop a climate resilient framework and asset management system; and (iii) revise cost recovery mechanism to support sustainable management, operation and maintenance of irrigation systems. | Amount (in billion cubic meters) of water losses from irrigation systems reduced by at least 5%.<br>(Baseline: 2023, 36%)<br>(Source: Ministry of Water Management)<br><br>Climate and gender screening conducted for all national irrigation modernization projects.<br>(Baseline: NA)<br>(Source: Ministry of Agriculture) |
| 1.4. To address the deficiency in soil management to combat the negative impact of climate change, land degradation, and increase agricultural productivity the government (i) enacted the Law About Soil Protection and Increasing Its Productivity (2023) establishing the institutional responsibilities for soil management; the rights and obligations of landowners, land users and land tenants; and the legal foundation for curbing excessive chemical usage, and promoting regenerative agricultural practices to increase soil | 2.5. To reduce the pressure of livestock on pastures and protection against pasture degradation, the government will: (i) submit to Parliament amendments to the 2019 Law On Pastures; (ii) adopt a long-term Pasture Management Strategy encompassing development and adoption of drought-resilient fodder crop varieties for climate change adaptation and resilience, and (iii) operationalize a geoportal to monitor the manage degraded | Soil Salinity of agricultural land will be no higher than 45%.<br>(Baseline: 2022, 55.8%)<br>(Source: Ministry of Agriculture)<br><br>The share of degraded land to total land area |

| **Prior Policy Actions: Subprogram 1** (January 2023–November 2024) | **Indicative Policy Actions: Subprogram 2** (December 2024–November 2026) | **Outcome Indicators** |
|---|---|---|
| fertility for irrigated land; and (ii) adopted a unified methodology for classifying pastures and assessing degradation of pasture lands. | lands comprising of integrated data on pastures and croplands. | (land degradation indicator) is reduced by at least 6% (Baseline: 2024, 29.0%) (Source: Ministry of Agriculture). |
| | 2.6. To support subsidy reform that incentivizes a productive and climate resilient agricultural economy, the government will: (i) implement a system to evaluate the allocative efficiency of agricultural subsidies; (ii) adopt a unified policy and budget oversight mechanism for the design and implementation of subsidy schemes; (iii) establish a monitoring and evaluation system to track public fund usage by individuals and organizations to evaluate performance against operational, socioeconomic, and climate objectives; and (iv) adopt reform actions based on the review for a more effective and efficient subsidy framework. | Unified oversight system for agricultural subsidies implemented (Baseline: NA) (Source: Ministry of Agriculture). |
| | 2.7. The government will establish an adaptive social protection system that enhances resilience to climate change and expands coverage of social protection measures to the most vulnerable including women, children, older persons, disabled people and those in the informal sector. | Adaptive social protection programs designed and implemented in at least three climate vulnerable regions (with at least 35% of program funding dedicated to gender-specific intervention). (Baseline: not applicable) |

| **Prior Policy Actions: Subprogram 1** (January 2023–November 2024) | **Indicative Policy Actions: Subprogram 2** (December 2024–November 2026) | **Outcome Indicators** |
|---|---|---|
| | | (Source: National Social Protection Agency) |
| **Reform Area 3: Climate change mitigation actions accelerated** | | |
| 1.5. To unlock green finance for state-owned enterprises (SOEs) and improve the availability of reliable and comparable information on sustainability risks and opportunities, the government required SOEs under the supervision of UzAssets to adopt a National Sustainability Standards Framework comprising of (i) the International Financial Reporting Standard (IFRS) S1 on sustainability-related financial disclosures, (ii) IFRS S2 on climate-related disclosures; and (iii) Global Reporting Initiative framework for Environmental, Social and Governance (ESG) reporting. | 2.8. In line with the National Sustainability Reporting Framework, at least 25% of SOEs under the supervision of UzAssets will report (i) sustainability related risks and climate related risks in accordance with IFRS S1 and S2; and (ii) publish environmental, social, and governance (ESG) implementation road maps. | Enhancing ESG and climate risk accounting to support at least 3 green and thematic bond issuances in global and local markets. (Baseline: not applicable)<br>(Source: UzAssets) |
| 1.6. To reduce greenhouse gas emissions through catalyzing a sustainable shift towards e-mobility in public transport, the government approved a National Strategy on e-Mobility encompassing the regulatory frameworks, infrastructure development, technology adoption and upskilling, research and development and a gender action plan. | 2.9. In line with the Concept of E-Mobility Development, the government will adopt an e-Mobility Strategy, including approval of (i) technical e-mobility regulations and operational frameworks for the nationwide deployment of charging stations and establish charging station specifications; and (ii) end-of-life regulations structured around extended producer responsibility of battery waste to reduce scrappage-related climate problems. | Complete implementation of the e-mobility strategy, including its gender action plan, in 3 major cities. (Baseline: not applicable)<br>(Source: Ministry of Transport) |

| **Prior Policy Actions: Subprogram 1**<br>(January 2023–November 2024) | **Indicative Policy Actions: Subprogram 2**<br>(December 2024–November 2026) | **Outcome Indicators** |
|---|---|---|
| 1.7. To encourage energy conservation and reduce GHG emissions, the Law on Tax and Budget Policy 2024 was amended to (i) implement advance disposal fees for tires with high environmental disposal costs; (ii) apply a heavy vehicles use tax on freight vehicles and trailers on highways responsible for emitting a rising amount of greenhouse gases and (iii) to introduce the "green energy" certificates for confirming the production of electricity through renewable energy sources; and the 2024 Law on Rationale Use of Energy, Increasing Energy Efficiency and Energy Conservation, which set out the framework for energy conservation and efficiency across economic sectors. | 2.10. In line with the Law on Limiting the Emissions of Greenhouse Gases and Law on Rational Use of Energy, Increasing Energy Efficiency and Energy Conservation, the government will: (i) adopt a long-term decarbonization strategy; (ii) adopt a carbon price framework, implementation strategy and roadmap considering the economic, fiscal and distributional impact on vulnerable groups; (iii) establish a National Carbon Credit Registry and a Monitoring, Reporting and Verification (MRV) digital platform; and (iv) implement energy efficient standards and labeling for energy-saving technologies, products, and equipment. | Share of renewable energy in the national energy mix achieves is least 20%.<br>(Baseline: 8% in 2022)<br>(Source: Uzbekistan Statistics Agency)<br><br>Energy intensity (national primary energy consumption as a proportion of GDP measured at purchasing power parity) is reduced by 5% from 2020 level.<br>(Baseline: 7.54 gigajoule /USD1,000 [2017 prices] in 2020)<br>(Source: International Energy Association database) |

## Annex 2: The Draft Borrower's Development Policy Letter (to be updated by Appraisal)

**O'ZBEKISTON RESPUBLIKASI**
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Mr. Jin Liqun
President
Asian Infrastructure Investment Bank
Beijing, China

Subject: Accelerating the Climate Transition for Green, Inclusive, and Resilient Economic Growth Program (Subprogram 1)

Dear Mr. Liqun,

We would like to express our appreciation to the Asian Infrastructure Investment Bank (AIIB) for its strong and ongoing support to the Government of Uzbekistan's (GoU's) reform efforts towards green, inclusive, and resilient economic growth. This letter supports our request for an AIIB Climate Policy-Based Financing (CPBF) loan of USD250 million for Accelerating the Climate Transition for Green, Inclusive, and Resilient Economic Growth Program (Subprogram 1), which will be the first in a programmatic series of two CPBF loans in co-financing with ADB, with the second CPBF loan of USD250 million for Subprogram 2 to be envisaged in the following years.

Uzbekistan is actively working to mitigate and adapt to climate change challenges, but the combined impact of rising temperatures, increasing water scarcity, and land degradation is endangering people's livelihoods, the environment, and the economy. Modernizing irrigation systems and infrastructure is crucial to improve water use efficiency and bolster the country's resilience to these ongoing challenges. Although Uzbekistan contributes relatively little to global greenhouse gas emissions, its emissions are rising, driven largely by its reliance on fossil fuels. Projections of international organizations indicate that Uzbekistan might experience further increases in temperature, leading to accelerated land degradation, stretching the country's economic capacity and resources, and eroding hard-earned development gains. Prompt actions are needed to implement effective climate adaptation and mitigation strategies to prevent environmental degradation and reap the benefits of a green economy.

Between 2017 and 2022, Uzbekistan's economy grew at an average annual rate of 5.5%, with GDP per capita increasing by 3.5% annually. This growth outpaced that of other emerging economies in Europe, Central Asia, and lower-middle-income countries, driven by structural reforms implemented since 2017. Continued growth in services and industry sectors supported the economy, with GDP increasing by 6.3% in 2023, up from 6.0% in 2022. To further strengthen the macroeconomic stability, the government has set a goal to maintain the fiscal deficit at 4% of GDP in 2024, with plans to reduce it to below 3% by 2025. Public debt remains stable at 33,2% of GDP as of 2Q2024, projected to stay at moderate levels around 35% in 2024-2025. Despite ambitious reforms aimed at achieving upper-middle-income status through private-sector-led green growth,

several major challenges, mainly driven by external factors, remain. A potential slowdown in the growth of its key trading partners could reduce external demand for our export goods and services. Additionally, the long-term impact of climate change presents further risks to the sustainability of the country's economic progress.

Aligned with ongoing structural reforms, ensuring a successful climate transition and green economic growth while maintaining fiscal sustainability, resilience to climate and external shocks, and promoting inclusive and sustainable growth requires continued deepening policy reforms to address long-standing climate constraints. The proposed reforms under Accelerating the Climate Transition for Green, Inclusive, and Resilient Economic Growth Program (the Program) aim to: (i) strengthen institutional framework, public financial management, and monitoring mechanisms; (ii) enhance climate resilience in water and land resource management, agriculture, and social protection systems; and (iii) accelerate the transition to a low-carbon economy in critical sectors such as transport, energy, and state-owned enterprises, with a focus on climate and sustainability risk disclosure. Given that policy reforms inherently require long-term implementation, support from development partners, such as AIIB, is essential to consolidate and strengthen the climate transition towards green and inclusive economic growth.
The Program aligns with Uzbekistan's national development strategy for 2030, the updated 2021 Nationally Determined Contribution, and the Uzbekistan Strategic Framework for Transitioning to a Green Economy until 2030. It will cover the following key policy and institutional reforms:

**Reform Area 1: Enabling Environment and Institutional Setup for Implementation of Climate Change Actions Strengthened.** This reform area aims to establish clear institutional responsibility and coordination for cross-cutting climate change policy, adaptation, and mitigation. Under Subprogram 1 the government has defined the institutional responsibility and coordination for climate change policy, adaptation and mitigation through a whole-of-government approach through the following reform actions: (i) establishing the Climate Council chaired by the President of the Republic of Uzbekistan to approve key climate policies and regulations; (ii) establishing the National Government Agency for Green Transformation and Adaptation to Climate Change (hereinafter the Climate Center) under the Ministry of Ecology, Environmental Protection and Climate Change to develop and implement climate policies across government and consult with the public, private stakeholders and non-government organizations; and (iii) adopting a National Climate Policy and Climate Change Gender Action Plan (CCGAP).

To ensure that climate and gender policies are effectively reflected in budgeting and investment decision-making, we, under Subprogram 1, mainstream climate risks and gender priorities through: (i) integration into the strategic planning, fiscal, and budgeting frameworks; (ii) adoption of program-based budgeting incorporating climate and gender-related outcome indicators; (iii) implementation of public investment management regulations requiring climate impacts to be assessed during the project screening, appraisal, and approval processes; and (iv) incorporation of climate fiscal risks into the fiscal risk statement.

Under Subprogram 2, to enhance resilience and support climate adaptation and mitigation actions while protecting vulnerable population, we will focus on: (i) the National Strategy on Adaptation and Mitigation through to 2030; (ii) the Climate Change Gender Action Plan; and (iii) an intergovernmental climate change monitoring, information, and evaluation system. To further integrate climate budget practices into public financial management (PFM), we will aim to: (i) require performance indicators for ex-ante impact assessment of green fiscal measures for national government budget proposals; (ii) prepare ex-post spending reviews to assess program performance in relation to integrating climate and gender priorities into budget decision making; (iii) ensure that climate risks are assessed and allocated during the preparation, design, and

implementation of public-private partnership projects; and (iv) work on a fiscal risk management strategy to guide climate resilient planning, including the assignment of risks and investments in risk reduction, transfer, and retention strategies.

**Reform Area 2: Climate Change Adaptation Priorities Strengthened.** The policy actions in this reform area are aimed at strengthening climate change adaptation priorities by enhancing water resource management through legislative reforms and investments in irrigation modernization, promoting sustainable soil management practices, increasing agriculture productivity, and mitigating the impact of livestock on pastures.

Under Subprogram 1, in line with the Concept for the Development of the Water Sector of the Republic of Uzbekistan, 2020–2030 for an integrated approach to climate-smart water resource management and conservation, (i) the government submitted to Parliament the Water Code unifying legal acts and norms in the field of water resource use and protection; and (ii) the Ministry of Water Resources approved the Water Resource Management and Irrigation Sector Development Strategy, 2024–2026. To address the deficiency in soil management, reclaim degraded land and increase agriculture productivity, the Law on Soil Protection and Increasing Its Productivity was enacted, establishing the institutional responsibilities for soil management, rights and obligations of landowners, land users, and land tenants. The law sets the legal foundation for curbing excessive chemical usage and promoting regenerative agricultural practices to increase soil fertility for irrigated land and approving a unified methodology for classifying and mapping degraded lands.

Under Subprogram 2, in alignment with the Water Resources Development Concept 2020–2030, the government will focus on strengthening water resource management, investment, and cost recovery through actions such as: (i) implementing procedures for screening and prioritizing climate and gender-relevant investments in irrigation modernization; (ii) developing a climate-resilient framework and asset management system; and (iii) revising cost recovery mechanisms to support more sustainable management, operation, and maintenance of irrigation systems. Building on the existing law on soil protection, actions to reduce livestock pressure on pastures and combat pasture degradation may include: (i) submitting amendments to the Law on Pastures to the government, with further submission to Parliament; (ii) adopting a long-term pasture management strategy, including the development and promotion of drought-resilient fodder crop varieties for climate change adaptation and resilience; and (iii) operationalizing a geoportal to monitor and manage degraded lands, integrating data on pastures and croplands.

To support subsidy reforms aimed at incentivizing a productive and climate-resilient agricultural economy, initiatives involve: (i) evaluating the allocative efficiency of current subsidies; (ii) adopting a unified policy and budget oversight mechanism for subsidy design and implementation; (iii) establishing a monitoring and evaluation system to track public fund usage by individuals and organizations, assessing performance against operational, socioeconomic, and climate objectives; and (iv) adopting and implementing reform actions based on the review for a more effective subsidy framework. Additionally, the establishment of an adaptive social protection system could enhance resilience to climate change and expand social protection coverage for vulnerable populations, including women, children, older persons, disabled people, and those in the informal sector.

**Reform Area 3: Climate Change Mitigation Actions Accelerated.** The objectives of this reform area are to accelerate climate change mitigation actions and reduce carbon emissions in line with the updated NDC.

Under Subprogram 1, to unlock green finance for State-Owned Enterprises (SOEs) and improve the availability of reliable and comparable information on sustainability risks and opportunities,

the government mandated: (i) all SOEs under the supervision of UzAssets to adopt the National Sustainability Standards Framework comprising of the IFRS-S1 on sustainability-related financial disclosures; (ii) IFRS-S2 on climate-related disclosures; and (iii) Global Reporting Initiative framework for ESG reporting. Under Subprogram 2, 70% of SOEs under the supervision of UzAssets will (i) disclose sustainability-related risks and climate-related risks in accordance with IFRS S1 and S2 and (ii) publish independent ESG ratings.

Under Subprogram 1, to reduce greenhouse gas emissions through catalyzing a sustainable shift towards e-mobility in public transport, the Ministry of Transport approved the Concept of e-Mobility Development encompassing the regulatory frameworks, infrastructure development, technology adoption and upskilling, research and development and a gender action plan. The government also takes steps to operationalize and implement the e-mobility strategy through a range of policy and technical regulations.

Under Subprogram 1, in line with the greening of the tax system, the government amended the Law on Tax and Budget Policy 2024 to incentivize behavior towards a more sustainable green transition and achieve climate goals through: (i) the introduction of advance disposal fees for products with high environmental disposal costs; (ii) heavy vehicle use tax on freight vehicles and trailers on highways responsible for emitting a rising amount of greenhouse gases; and (iii) renewable energy production including on “green energy” certificates used to confirm the production of electricity using renewable energy sources. The Law on Rational Use of Energy, Increasing Energy Efficiency and Energy Conservation was enacted that sets out a framework and outlines obligations for energy consumers and suppliers to enhance energy conservation, efficiency, and the rational use of energy resources, thereby reducing greenhouse gas (GHG) emissions.

Under Subprogram 2, in line with the Law on Limiting the Emissions of Greenhouse Gases and the Law on Rational Use of Energy, Increasing Energy Efficiency and Energy Conservation, possible actions to support a just transition toward a low-carbon economy include: (i) approving a long-term decarbonization strategy; (ii) conducting a Carbon Tax Impact Assessment framework and implementation strategy, considering the distributional impact on vulnerable groups; (iii) establishing a national carbon credit registry and a digital platform for monitoring, reporting, and verification; and (iv) developing energy efficiency standards and labeling for energy-saving technologies, products, and equipment.

**Concluding Statement**

The proposed AIIB Climate Policy-Based Financing Loan will be instrumental in helping implement our national climate objectives and priorities outlined in Uzbekistan’s national development strategy for 2030, the updated 2021 Nationally Determined Contribution, and the Uzbekistan Strategic Framework for Transitioning to a Green Economy until 2030. We confirm that we have completed prior policy actions under Subprogram 1 as outlined in the Program’s Policy and Results Matrix. These actions are reflective of, and fully consistent with, our public sector reform, climate change, and green growth agenda. The Program is designed to improve the policy, institutional and fiscal framework for the sustainable growth of the green economy, enhance climate resilience through the widespread use of energy-efficient and water-saving technologies for irrigation and land reclamation, and mitigate the impacts of climate change while reducing greenhouse gas emissions and transitioning to a low-carbon economy.

We note that the policy and institutional reforms under Subprogram 2 are currently indicative and subject to change during future missions. We look forward to working with AIIB, ADB and other partners on Subprogram 2 and are prepared to make necessary adjustments to ensure successful achievement of our climate and development goals.

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We extend our gratitude to AIIB for its close collaboration in developing this Program. We also look forward to AIIB's continued partnership and support to our efforts to strengthen climate governance and implement critical climate reforms to accelerate the country's transition towards a resilient and low-carbon economic growth and climate-resilient future.

Yours Sincerely,

**Ilkhom Norkulov**
**First Deputy Minister of Economy and Finance**
**of the Republic of Uzbekistan**

## Annex 3: International Monetary Fund Assessment Letter

PRESS RELEASE

PR 24/2740

# IMF Executive Board Concludes 2024 Article IV Consultation with the Republic of Uzbekistan

FOR IMMEDIATE RELEASE

**Washington, DC – June 26, 2024:** On June 13, 2024, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Republic of Uzbekistan[1] and considered and endorsed the Staff Appraisal on a lapse-of-time basis without a meeting.[2]

Uzbekistan's growth has remained strong. While remittances fell to the pre-2022 trend, expansionary fiscal policy, buoyant private consumption, and a surge in fixed investment boosted real GDP growth to 6 percent in 2023. In the first quarter of 2024, growth remained robust at 6.2 percent year-over-year (yoy). With a relatively high real policy rate and falling international food and energy prices, consumer price inflation fell from 12.3 percent (yoy) at the end of 2022 to 8.1 percent in April 2024. In 2023, Uzbekistan's current account deficit widened to 8.6 percent of GDP compared to 3.5 percent of GDP in 2022. An increase in imports of machinery and equipment (some of which is temporary), declining remittances, higher interest payments on foreign debt, and repatriation of earnings by foreign-owned enterprises more than offset buoyant gold exports. International reserves fell by $1.2 billion in 2023 but remained high at close to 9 months' worth of imports at end-April 2024.

The outlook is broadly positive. The authorities' strong reform efforts, most notably the energy price reform and privatization of state enterprises, have improved economic prospects. Supported by strong domestic demand, real GDP growth is projected to remain robust at 5.4 percent in 2024 and rise slightly to 5.5 percent in 2025. Continued efforts to reduce the fiscal deficit, ongoing moderation in bank lending growth, and a slowdown in import growth will reduce the current account deficit this year and next. Inflation is projected to temporarily rise by end-2024 as administered energy prices increase, but continuing tight macroeconomic, macroprudential, and structural policies will reduce the inflation rate towards the Central Bank of Uzbekistan's (CBU) target over the medium term.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

[2] The Executive Board takes decisions under its lapse-of time procedure when the Board agrees that a proposal can be considered without conveying formal discussions.

Given the uncertain global environment, external risks include geoeconomic spillovers, commodity price volatility, and an abrupt global slowdown. Domestic risks include slower-than-planned fiscal consolidation, weaker bank balance sheets, or materialization of contingent liabilities—from state banks, state-owned enterprises (SOEs), and public-private partnerships (PPPs). On the upside, an acceleration of structural reforms, greater inflows of income and capital, or higher export prices could improve the outlook.

**Executive Board Assessment**

In concluding the Article IV consultation with the Republic of Uzbekistan, Executive Directors endorsed the staff's appraisal as follows:

Uzbekistan continues its steadfast progress toward transforming its economy. The economy has experienced rapid growth and declines in poverty in recent years despite headwinds and uncertainty from the pandemic and Russia's war in Ukraine. Growth is expected to remain robust this year—despite a deceleration in trading partner growth and the withdrawal of the 2023 fiscal stimulus—and over the medium term, supported by the completion of fiscal consolidation, ongoing structural reforms, and continuing capital inflows. These achievements are a testament to the authorities' efforts to advance Uzbekistan's economic development through market-oriented reforms. However, challenges still remain from a large state footprint in the economy and last year's expansionary fiscal policy, and the authorities are determined to persevere in their reform efforts to address them and advance sustainable and inclusive growth. The positive economic outlook provides a unique opportunity for the implementation of reforms to deepen the foundations for a dynamic, open, and private sector-led economy.

The planned fiscal policy adjustment is appropriate to maintain robust public finances and facilitate external adjustment while supporting monetary policy in containing inflation. The size and pace of consolidation are ambitious but achievable, and the main consolidation measures are relatively growth-friendly given their efficiency-enhancing nature combined with protection of the vulnerable. There is scope to broaden the tax base, modernize the tax system, and increase the efficiency of public spending through rationalizing the wage bill, phasing out SOE support, and improving the targeting of social protection programs while eliminating overlaps and reducing administrative costs. Advancing pension reform is important to ensure long-term fiscal sustainability and effective social protection for workers. Efforts should also continue to improve fiscal institutions by strengthening core budget processes, unifying the public investment process, improving the identification and management of fiscal risks, ensuring full transition to GFS standards for fiscal monitoring and reporting, and continuing to develop the domestic debt market in coordination with monetary policy.

Monetary policy has managed to lower inflation and should remain focused on reducing it further to the CBU's target. Sustaining a high real policy rate, along with tight fiscal and macro-prudential policies and supportive structural reforms, would gradually reduce inflation to the CBU target by

end-2027. The CBU should stand ready to increase its policy rate if the energy price reform results in broader price pressures and raises inflation expectations.

Minimizing the state's involvement in the financial sector while strengthening financial sector supervision will support sustainable financial deepening while protecting financial stability. This involves modernizing the governance of state banks, mandating them to operate commercially, and expediting and expanding privatization efforts to all systemic financial institutions. While higher financial intermediation is welcome, and the recent macroprudential measures were appropriate, the impact of the measures that will come into force in July should be closely monitored to ensure sustainable financial deepening. Enhancing prudential supervision to align it with international standards and conducting AQRs and robust stress tests are also important to facilitate timely interventions and safeguard financial stability. Deposit-taking microbanks, if established, should be subjected to proper governance and capital requirements and adequate supervision.

Capitalizing on progress already achieved, sustained reform efforts will magnify their impact and make growth more sustainable, inclusive, and green. Careful sequencing of reforms would help expedite implementation, while reduced ad-hoc state intervention would enhance resource allocation efficiency. The government should continue efforts to accelerate the restructuring and privatization of state enterprises. It should also eliminate preferences for SOEs and unbundle large enterprises to increase competition and improve the business environment. The authorities are correctly accelerating their efforts for WTO accession and taking measures to bolster external competitiveness and export diversification, opening markets, and reducing monopolies would boost growth and help reduce inflation. Initiatives to increase women's labor participation and phase out energy subsidies would stimulate growth while supporting decarbonization and climate adaptation efforts.

The momentum on anticorruption efforts should be sustained, building on significant improvements in governance and rule of law indicators. Staff recommends enacting the asset declaration, conflict of interests, and whistleblower protection laws. The government should implement additional measures to improve the independence of prosecutors, judges, and the Chamber of Accounts. Finally, the government should take steps to further enforce access to government information which would improve accountability and trust in public administration.

**Annex 4: Paris Alignment and Climate Finance Assessment**

1. The project is considered Paris Agreement (PA) aligned based on the joint MDB methodology for Policy-based lending under both mitigation (BB1) and adaptation (BB2). The project is consistent with the national climate commitments of Uzbekistan, and proposed policy actions will directly contribute to decarbonization efforts of the economy as well as reduce the impacts climate change has on key sectors, such as water and transport. The detailed step by step assessment of how it is aligned with PA is provided below.

2. **Step 1: Consistency of proposed operation with the country's climate commitments.** In its latest NDC submission to UNFCCC, Uzbekistan intends to reduce specific greenhouse gas emissions per unit of GDP by 35% by 2030 from the level of 2010 instead of 10% as specified in its first NDC. The updated NDC lists the following areas where actions are required that will help to implement the NDCs:

1) increasing the share of renewable energy in power generation to 25%, through construction of solar, wind and small hydropower plants;
2) further introducing energy-saving technologies in industry, construction, agriculture and other sectors of the economy;
3) **introducing alternative fuels in transportation;**
4) improving productivity of agricultural land;
5) improving the solid waste management system;
6) **improving the water management system**;
7) expanding forest areas;
8) **introducing effective incentives for resource mobilization**

3. The reforms area #3 will be supporting the implementation of the NDC and help to achieve the intended GHG emissions through policies related to introducing of alternative fuels in transportation via e-mobility regulatory frameworks and introducing effective incentives for resource mobilization through specific actions linked to unlocking green finance for SOEs.

4. In terms of climate adaptation, the NDCs explicitly states particular actions linked to adaptation for strategic infrastructure, where, among other actions, it is suggested that adaptation criteria should be introduced into public investment projects for construction, modernization, operation and maintenance of infrastructure in various sectors of the economy. Those are aligned with the project's policy action area #1: *Enabling environment and institutional setup for implementation of climate change actions created",* where one of the activities will be required for climate impacts to be assessed for public investment management encompassing project screening, appraisal and approval process; and incorporated and disclosed climate fiscal risks in the Fiscal Risk Statement.

5. While the national adaptation plan is currently under finalization, the draft provides for the achievement of the following results are consistent with the proposed policy actions related to

institutional coordination of climate actions under Policy area (1) *Strengthened coordination mechanism for intersectoral adaptation planning and implementation of adaptation measures and actions at different levels*, supported through the establishment of the Climate Council and establishment of the Water code, which will be part of unifying legal acts and norms to regulate water resource use and protection.

6. **Step 2. Assessment of specific policy actions against mitigation and adaptation goals of the PA**. This alignment is evidenced through the program's explicit climate policy actions that address both adaptation to and mitigation of climate change. The reform area #1 (Enabling environment and institutional setup for implementation of climate change actions) will contribute to both mitigation and adaptation through the (i) creation of central climate change coordination mechanism (Creation of National Climate Council), and adopting and implementing a national climate policy, national strategy on adaptation and mitigation until 2030, (ii) integrating climate into public financial management.

7. Mitigation goals will be achieved by directly supporting decarbonization through reform area #3 (Climate change mitigation actions accelerated) by (i) supporting the policy implementation related to reducing greenhouse gas emissions through catalyzing a sustainable shift towards e-mobility in public transport, (ii) the Government approved a National Strategy on e-Mobility encompassing the regulatory frameworks, infrastructure development, (iii) introduction of new taxes to be applied to heavy vehicles use tax on freight vehicles and trailers on highways responsible for emitting a rising amount of greenhouse gases; (iv) approval of "green energy" certificates used to confirm the production of electricity using renewable energy sources; and (iv) setting up framework for energy conservation and efficiency across economic sectors and (v) unlocking green finance for state-owned enterprises (SOEs) and improving the availability of reliable and comparable information on sustainability risks and opportunities.

8. The project climate policy actions within the program are not directly sensitive to climate conditions, and the level of activities exposure to physical climate risk of the project is low; however, the proposed policy actions will directly reduce the risks the country is facing from the temperature increase, droughts associated with increased water scarcity and associated heat waves. The following policy actions are specifically targeting improvement of climate resilience:

| **Climate risks affecting Uzbekistan** | **Proposed policy actions addressing the hazard indirectly** |
|---|---|
| Increased temperature, heatwaves, draughts, increased water scarcity | Policy action 1.2.1.2. will seek to integrate climate risks into public financial management, the government: (i) integrated gender and climate into the medium-term fiscal strategy; (ii) mainstreamed climate and gender priorities into medium-term budget framework; (iii) adopted program-based budgeting incorporating climate and gender related outcome indicators; (iv) required climate impacts to be assessed for public investment management encompassing project screening, appraisal and approval |

| | |
|---|---|
| | process; and (v) incorporated and disclosed climate fiscal risks in the Fiscal Risk Statement.<br><br>1.3 an integrated approach to climate smart water resource management and conservation<br><br>Policy action 1.4 will support enactment of the Law About Soil Protection and Increasing Its Productivity establishing the institutional responsibilities for soil management; the rights and obligations of landowners, land users and land tenants; and establishing the legal foundation for curbing excessive chemical usage and promoting regenerative agricultural practices to increase soil fertility for irrigated land. |

9. **Climate finance**. The Program is considered 100 percent climate finance, which is accounted using the joint MDB methodology for tracking mitigation and adaptation finance.[21] The Program's vulnerability context is explained in detail through the program document, particularly and direct linkages to the expected program policy actions are demonstrated through the number of reform areas. The table below provides a breakdown between climate mitigation and adaptation finance. Total climate mitigation for the project is USD239.30 million, of which AIIB financing is USD119.65 million, and total adaptation finance is estimated at USD260.7 million, of which AIIB adaptation finance amount stands at USD130.35 million.

| **Climate finance estimation** | **Total Project Finance** | **Climate Finance** | | | |
|---|---|---|---|---|---|
| **Source** | **Amount** (USD million) | **Adaptation** (USD million) | **%** | **Mitigation** (USD million) | **%** |
| **Asian Development Bank** | 250.00 | 130.35 | | 119.65 | |
| **Asian Infrastructure Investment Bank (AIIB)** | 250.00 | 130.35 | | 119.65 | |
| Reform area 1 (enabling environment) | | **44.65** | 62.4% | **26.79** | 37.6% |
| Reform area 2 (climate adaptation actions) | | **67.85** | 95% | **3.57** | 5% |
| Reform area 3 (climate mitigation actions) | | **17.85** | 25% | **89.29** | 75% |
| **TOTAL AIIB Climate finance** | | **130.35** | **52.2%** | **119.65** | **47.8%** |

[21] Joint methodology for tracking climate change adaptation finance (eib.org)

## Annex 5: Matrix of Potential Environmental and Social Impacts and Measures

| Reform Areas to be Supported by the Program | Environmental Impacts | Social Impacts | Mitigating Measures/ Remarks |
|---|---|---|---|
| **Reform Area 1: Enabling Environment and Institutional Setup for Implementation of Climate Change Actions Strengthened** | | | |
| 1.1. To establish clear institutional responsibility and coordination for climate change policy, adaptation and mitigation through a whole of society approach, the Government: (i) established the Climate Council under the President of the Republic of Uzbekistan; (ii) established the National Center for Green Transformation and Adaptation to Climate Change under the Ministry of Ecology, Environmental Protection and Climate Change; and (iii) adopted a National Climate Policy and Climate Change Gender Action Plan (CCGAP). | Policy actions under reform area 1 will not result in any direct or indirect environmental impacts. No adverse impact on the environment, community health or safety is anticipated as there is no physical work involved. The policy actions will not support any activities listed under the ADB Prohibited Investment Activities List. | Policy actions under reform area 1 will not result in any direct or indirect involuntary resettlement and indigenous peoples impacts. No adverse impact is expected as there is no physical work involved. | AIIB ESEL will apply to the project. |
| 1.2. To integrate climate into public financial management, the government: (i) integrated gender and climate into the medium-term fiscal strategy; (ii) mainstreamed climate and gender priorities into medium-term budget framework; (iii) adopted program-based budgeting incorporating climate and gender related outcome indicators; (iv) required climate impacts to be assessed for public investment management encompassing project screening, appraisal and approval process; and (v) incorporated and disclosed climate fiscal risks in the Fiscal Risk Statement. | | | |
| **Reform Area 2: Climate change adaptation priorities strengthened** | | | |
| 1.3. In line with the Water Resources Development Concept (2020–2030) for an integrated approach to climate smart water resource management and conservation, the government: (i) submitted to Parliament the Water Code unifying legal acts and norms in the field of water resource use and protection; and (ii) adopted the Water Resource Management and Irrigation Sector Development Strategy, 2024–2026. | Policy actions under reform area 2 will not result in any direct or indirect environmental impacts. No adverse impact on the environment, community health or safety is anticipated as there is no physical | Policy actions under reform area 2 will not result in any direct or indirect involuntary resettlement and indigenous peoples impacts. No adverse | AIIB ESEL will apply to the project. |

| Reform Areas to be Supported by the Program | Environmental Impacts | Social Impacts | Mitigating Measures/ Remarks |
|---|---|---|---|
| 1.4. To address the deficiency in soil management to combat the negative impact of climate change, land degradation, and increase agricultural productivity the government (i) enacted a Law On Soil Protection establishing the institutional responsibilities for soil management; the rights and obligations of landowners, land users and land tenants; and establishing the legal foundation for curbing excessive chemical usage, and promoting regenerative agricultural practices to increase soil fertility for irrigated land; and (ii) adopted a unified methodology for classifying pastures and assessing degradation of pasture lands. | work involved. The policy actions will not support any activities listed under the ADB Prohibited Investment Activities List. | impact is expected as there is no physical work involved. | |
| **Reform Area 3: Climate change mitigation actions accelerated** | | | |
| 1.5. To unlock green finance for state-owned enterprises (SOEs), and improve the availability of reliable and comparable information on sustainability risks and opportunities, the government required SOEs under the supervision of UzAssets to adopt a National Sustainability Standards Framework comprising of (i) the International Financial Reporting Standard (IFRS) S1 on sustainability-related financial disclosures, (ii) IFRS S2 on climate-related disclosures; and (iii) Global Reporting Initiative framework for Environmental, Social and Governance (ESG) reporting. | Policy actions under reform area 3 will not result in any direct or indirect environmental impacts. No adverse impact on the environment, community health or safety is anticipated as there is no physical work involved. The policy actions will not support any activities listed under the ADB Prohibited Investment Activities List. . | Policy actions under reform area 3 will not result in any direct or indirect involuntary resettlement and indigenous peoples impacts. No adverse impact is expected as there is no physical work involved. | AIIB ESEL will apply to the project. |
| 1.6. To reduce greenhouse gas emissions through catalyzing a sustainable shift towards e-mobility in public transport, the government approved a Strategy on e-Mobility encompassing the regulatory frameworks, infrastructure development, technology adoption and upskilling, research and development, and a gender action plan. | | | |
| 1.7. To encourage energy conservation and reduce GHG emissions, the Law on Tax and Budget Policy 2024 was amended to (i) implement advance disposal fees for tires with high environmental disposal costs; (ii) | | | |

| Reform Areas to be Supported by the Program | Environmental Impacts | Social Impacts | Mitigating Measures/ Remarks |
|---|---|---|---|
| apply a heavy vehicles use tax on freight vehicles and trailers on highways responsible for emitting a rising amount of greenhouse gases; (iii) approval of "green energy" certificates used to confirm the production of electricity using renewable energy sources; and (iv) government approved the Law on Rationale Use of Energy, Increasing Energy Efficiency and Energy Conservation that sets out a framework for energy conservation and efficiency across economic sectors. | | | |

## Annex 6. Donor Reform Programs of Development Partners

| Reform Areas | ADB/AIIB | World Bank | IMF | AFD | UNDP |
|---|---|---|---|---|---|
| **Reform Area 1: Enabling Environment and Institutional Setup for Implementation of Climate Change Actions Strengthened** | | | | | |
| **Strengthening Policies and institutions** | Support establishing the institutional framework (e.g., National Climate Council and National Center for Green Transformation and Adaptation to Climate Change) and enacting the national climate change policy, strategy, and action plan.<br><br>Support the Central Bank of Uzbekistan approval of strategy on the management and supervision of climate-related financial risks in the banking sector. | Support long-term decarbonization strategy; climate policy design and implementation; economy-wide GHG target and green targets in energy, water, waste, and industry sectors; establishing a green taxonomy and green finance mechanisms. | Support for strengthening macroeconomic monitoring and assessment frameworks. | Steering and coordination for the Green Growth Strategy Framework — establish a council under the Ministry of Economy and Finance with consultation with the private sector to achieve Green Growth Strategic Framework targets and support for the long-term decarbonization strategy. | International Labour Organization UNESCO, UNDP (with other development partners support) for Just Transition policies. |
| **Mainstreaming Climate Change Agenda in PFM and PIM**<br><br>Note: All five development partners are actively supporting the preparation of PFM Strategy 2025-2030 and Fiscal Risk Statement (incorporating impact of macroeconomic shocks, climate change, PPP, SOE liabilities, among others). | Support in mainstreaming climate and gender priorities into the strategic planning, fiscal and budgeting frameworks, program-based budgeting incorporating climate-related outcome indicators, PIM requiring climate impacts to be assessed for project screening, appraisal, and approval process. | Supporting Public Procurement Law to strengthen integrity, transparency, and openness of the system; enhanced fiscal risk management: evaluating, monitoring and reporting on contingent liabilities in PPP project and defining the methodology; program-based budgeting, PEFA, and Climate PEFA. | Support for PFM Strategy and IMF PIMA with support from ADB and WBG. | Support for Green Tagging and Sustainable Procurement<br><br>Conducted the Climate Expenditure and Institutional Review for Uzbekistan with UNDP | Support for gender relevant program-based budgeting with ADB, AFD, EU, and WBG. |

| Reform Areas | ADB/AIIB | World Bank | IMF | AFD | UNDP |
|---|---|---|---|---|---|
| **Reform Area 2: Climate Change adaptation reinforced: economy-wide and priority sectors** | | | | | |
| **Developing SOE Green Finance** | Adopt the National Sustainability Reporting Framework comprising the IFRS standard on sustainability-related financial disclosures, IFRS standard on climate-related disclosures, and Global Reporting Initiative framework for environmental, social and governance reporting.<br><br>Finance PBL support on strengthening state-owned banks. | Development of green taxonomy for use by SOEs and private sector to increase green investment environment.<br><br>Improve conditions for private sector in the selected sectors, and support infrastructure PPPs. | Broad work on developing climate-related stress tests to assess financial stability. | Implement the green SOEs road map, carrying out sustainable governance assessment and carbon footprint evaluation of pilot SOEs.<br><br>Adoption of a Corporate Social Responsibility Charter for key SOEs in the water, energy and/or industrial sectors. | |
| **Improving Water and Land Resources Management** | Adoption of (i) Water Code unifying legal acts and norms to regulate water resource use and protection; and (ii) adopted the Water Resource Management and Irrigation Sector Development Strategy, 2024–2026 with support from the Swiss Agency for Development and Cooperation.<br><br>ADB's macro econometric modeling to analyze the impacts of climate-induced drought and water scarcity on the agriculture sector, and support adaptive | Support for Public Expenditure Reviews in the agricultural sector, climate-smart agriculture and social protection programs. | | | National adaptation plans in agriculture, construction, disaster risk management and water sectors. ADB is supporting climate adaptation investment plan in selected priority sectors. |

| Reform Areas | ADB/AIIB | World Bank | IMF | AFD | UNDP |
|---|---|---|---|---|---|
| | social protection measures. | | | | |
| **Promoting Climate-Resilient Agricultural Practices** | Support for Law on Soil Protection establishing the institutional responsibilities for soil management; the rights and obligations of landowners, land users and land tenants; and establishing the legal foundation for curbing excessive chemical usage and promoting regenerative agricultural practices to increase soil fertility for irrigated land.<br><br>Support subsidy reform that incentivizes a productive and climate resilient agricultural economy (ADB, EU and World Bank). | Support in the following initiatives: large reduction in cotton and/or wheat-growing areas; increase in wheat and cotton farmgate prices to equalize with international benchmarks; removal of almost all horticulture export barriers; liberalization of bread prices; ending mandatory cotton production targets for farmers; and abolition of crop placement system for all crops and incentivize climate-smart agriculture. | | Pilot climate/green budgeting with the Ministry of Agriculture in the draft 2025 budget and publish the results in the Citizen Budget for citizen and Parliament | Improving extension services for climate-resilient production of fruits and vegetables and introduce greater knowledge about climate variability into horticulture planning in Fergana Valley. |
| **Reform Area 3: Climate change mitigation actions accelerated** | | | | | |
| **Improving e-transport** | Strategy for the development of public transport in the regions until 2030 incorporating e-mobility and considering growing urbanization and private sector involvement.<br><br>Gender-inclusive strategy and action plan to ensure equal access, safety, and security of public transportation. | Adoption of new air quality standards to reduce particulate matter and transport emissions. | | | Design, implementation, and operation of a pilot green urban transport corridor in Tashkent with a fleet of electric buses to be deployed as public transport (Global Environment Fund and UNDP). |

| Reform Areas | ADB/AIIB | World Bank | IMF | AFD | UNDP |
|---|---|---|---|---|---|
| **Promoting Green Taxation to Reduce GHG Emissions and Social Protection** | Incentivize behavior towards a more sustainable green transition by excise duties on gasoline with high content of harmful GHGs and heavy fright vehicles.<br><br>Adopt a long-term decarbonization strategy and carbon price framework, implementation strategy and road map and adoption of adaptive social protection. | Support to the long-term decarbonization strategy, carbon market development, and strengthening the regulatory framework and environmental impact assessment regulations, and new air quality standards, and targets particulate matter and transport emissions and strengthening social protection. | Technical assistance support on drafting the Medium-Term Revenue Strategy and green tax reforms. | Introduction of a tax package incentivizing energy efficiency, especially in construction and circular economy.<br><br>Establish a national carbon credit registry and a monitoring, reporting, and verification digital platform with ADB and the World Bank. | |

**Annex 7. Policy Actions and Analytical Underpinnings**

| Policy Actions | Analytical Underpinnings |
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| **Reform Area 1: Enabling environment and institutional setup for implementation of climate change actions created.** | |
| Strengthen the institutional responsibility for coordination for cross-cutting climate change policy, adaptation, and mitigation, as well as national climate policy and climate change gender action plan through a whole government approach. | *World Bank and ADB. 2021. Climate Risk Country Profile: Uzbekistan; World Bank. 2023. Uzbekistan: Country Climate and Development Report; ADB. 2024. Uzbekistan Country Gender Assessment 2013-2023*<br><br>Uzbekistan is facing substantial climate risks, with a projected increase in temperatures by 4.8°C by the 2090s under the highest emissions pathway (RCP8.5), leading to more frequent droughts and severe water shortages that jeopardize agriculture and food security. These changes will disproportionately affect vulnerable populations, particularly the economically disadvantaged, exacerbated by natural hazards such as heatwaves and flooding. The country's water resources are anticipated to experience significant strain, particularly in the Syr Darya and Amu Darya basins, with unmet demand predicted to rise by 35% to 50% by the 2050s due to factors like glacial melt and inefficient irrigation practices.<br><br>In response to these challenges, Uzbekistan is implementing climate adaptation strategies to enhance water management and agricultural resilience, such as optimizing irrigation efficiency, improving disaster management, and upgrading deteriorating infrastructure. Effective policy changes are necessary, including integrating climate considerations into planning processes, strengthening water management regulations, and promoting sustainable agricultural practices. Additionally, adopting integrated water resource management approaches and enhancing data collection will be vital for informed decision-making and long-term sustainability.<br><br>The Country Climate and Development Report (CCDR) for Uzbekistan outlines Uzbekistan's institutional challenges that pose significant obstacles to effective climate action. The key challenges include: i) fragmented governance and legal framework, ii) lack of national climate change strategy, iii) insufficient interagency and cross-sector coordination, which is necessary to integrate climate objectives into broader policies, |

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| | and iv) resource constraints that restrict investment in climate measures, highlighting the need for innovative financing mechanisms. The CCDR recommends streamlining institutional roles and establishing a national climate change law, strengthening interagency collaboration, investing in capacity building for officials, developing a national green taxonomy, integrating climate criteria into public investments, improving climate data infrastructure, and fostering public awareness. Implementing these measures aims to improve Uzbekistan's governance framework and tackle climate change challenges effectively. The CCDR also underscores the need for gender-responsive approaches in climate change policies and actions to ensure that women are not only protected from the adverse impacts of climate change but also empowered to participate in and benefit from the transition to a greener economy. |
| Mainstreaming climate and gender priorities PFM, strategic planning, fiscal and budgeting frameworks, public investment management regulations and reporting on climate fiscal risks. | *UNDP, AFD. 2023. Climate Public Expenditure and Institutional Review: Uzbekistan; ADB. 2024. Governance Framework for Climate-Relevant Public Investment Management; World Bank PEFA Assessment of Climate-Responsive Public Financial Management, 2024*<br><br>The Climate Public Expenditure and Institutional Review (CPEIR) for Uzbekistan from 2020 to 2022 revealed an upward trend in climate-positive expenditures, which increased from 10.3% of the state budget in 2020 to 11.1% in 2022, with over 95% allocated towards adaptation efforts, primarily in agriculture and forestry. Conversely, climate-negative expenditures decreased from 0.9% to 0.6%, indicating a shift away from harmful allocations. Despite these developments, integration of climate policy into public financial management remains limited, as reflected in a low Climate Change Budget Integration Index score of 14 out of 100, suggesting a need for improved frameworks to better incorporate climate considerations into fiscal policies. To effectively incorporate climate considerations into Uzbekistan's fiscal and policy frameworks, key improvements include developing a comprehensive climate policy framework, strengthening intersectoral coordination through an inter-agency council, and implementing a climate budget tagging system. Additionally, enhancing budget performance reporting, integrating climate considerations into sectoral policies, and providing training for stakeholders are essential. Increasing public participation and |

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| | establishing robust monitoring, reporting, and verification systems, along with incorporating international climate finance and devising a long-term decarbonization strategy, will further support effective climate action and resilience in the country.<br><br>ADB's report on Governance Framework for Climate-Relevant Public Investment Management outlined key principles for designing climate-informed public investment management (PIM) processes, emphasizing the importance of good governance. It highlights the need for strong institutional capacity, whole-of-government coordination, standardized evaluation criteria for climate-related projects, and mechanisms for transparency and accountability to build public trust. Stakeholder participation is crucial for integrating diverse perspectives and fostering ownership of climate initiatives. Additionally, independent scrutiny through evaluations and audits is necessary to assess the effectiveness of climate policies. Finally, consistency and predictability in applying rules are essential to ensure fairness and equitable access to resources, thereby enhancing trust in climate-informed PIM systems.<br><br>ADB's report on Governance Framework for Climate-Relevant Public Investment Management underscored that significant infrastructure deficiencies exacerbated by climate change pose serious threats to human welfare and economic growth, creating a combined investment and climate gap. Effective public financial management (PFM) and public investment management (PIM) are essential for preparing and implementing climate-relevant investments to address this gap. A "green" PFM system seeks to integrate climate considerations within traditional budgeting processes, emphasizing governance principles like transparency, accountability, and stakeholder participation. However, meeting the climate and investment gap requires not only public resources but also substantial private investment, particularly in developing countries where challenges such as high financing costs and a lack of viable projects hinder progress. Enhancing governance in PIM is crucial to improve investment quality and maximize resource efficiency. As infrastructure inefficiencies lead to a significant loss of potential impacts, better governance could alleviate many of these losses, ensuring projects are well-planned, prioritized, and executed to achieve sustainable outcomes. The report highlighted the need for strong institutional capacity, whole-of-government coordination, |

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| | standardized evaluation criteria for climate-related projects, and mechanisms for transparency and accountability to build public trust. Stakeholder participation is crucial for integrating diverse perspectives and fostering ownership of climate initiatives. Additionally, independent scrutiny through evaluations and audits is necessary to assess the effectiveness of climate policies. Finally, consistency and predictability in applying rules are essential to ensure fairness and equitable access to resources, thereby enhancing trust in climate-informed PIM systems.<br><br>The WB's Climate PEFA assessment for Uzbekistan revealed that while Uzbekistan has made some strides in addressing climate change through policy development, there is a need for more systematic integration of climate considerations into PFM processes. Key findings show limited mainstreaming of climate policy in core PFM processes, insufficient alignment of climate strategies with budgeting, and nascent methods for tracking climate-related expenditures. Additionally, poor legislative scrutiny, lack of climate-responsive investment guidelines, and inadequate management of non-financial assets hinder effective climate action. Fiscal decentralization arrangements do not incorporate climate considerations, and there is a notable gap in climate-related performance evaluations. Overall, many assessed areas received low ratings, indicating a need for substantial improvements in integrating climate considerations into PFM processes. |
| Reform Roadmap for Decent Jobs and Just Transition consistent with the International Labor Organization initiative of the Global Accelerator on Jobs and Social Protection for Just Transitions, and a Financial Framework for Decent Jobs and Social Protection for Just Transition. | *ADB. 2022. Skills Development in Uzbekistan Sector Assessment.*<br><br>The report emphasizes the importance of adapting to new technologies and approaches that contribute to sustainability and economic recovery, particularly in the context of the COVID-19 pandemic. It highlights the need for skills development that aligns with modern economic demands, including job creation in green sectors. The government's new industrial policy strategy prioritizes energy efficiency for economic recovery, reflecting an awareness of the significance of green initiatives. |
| **Reform Area 2: Climate change adaptation priorities strengthened** | |

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| Development of national legal and policy frameworks for the implementation of integrated water resource management | *ADB. 2024. Climate Risk Assessment Report for Amu Darya River basin; Central Asia Regional Cooperation (CAREC) Program: Developing the Water Pillar, 2021; ADB. 2023. Decarbonizing the Water Sector in Asia and the Pacific: Best Practices, Challenges, and Opportunities for Practitioners*<br><br>According to ADB's Climate Risk Assessment Report for Amu Darya River basin, climate change is profoundly affecting water resources in Uzbekistan, particularly in the Amu Darya River basin, vital for agriculture and water security. Key impacts include altered water availability due to changes in glacier and snowmelt patterns, increased frequency of extreme events like droughts and flooding, and rising temperatures leading to more heatwaves. These factors elevate drought risks, exacerbate soil salinization, and heighten erosion and landslide risks, all of which threaten agricultural productivity and rural livelihoods. The ecological balance is also at risk, potentially harming biodiversity. The socio-economic implications include heightened competition for water resources and increased potential for conflicts. In response, initiatives, such as an ADB-funded project, are focused on improving climate-adaptive water resource management and resilient irrigation systems in the region. The report for the Amu Darya River basin in Uzbekistan outlines key recommendations to strengthen climate resilience in water management. Key strategies include adopting a river basin perspective for upstream-downstream linkages, conducting socio-economic surveys to identify rural livelihood vulnerabilities, and prioritizing climate-resilient investments in high-risk districts. Further recommendations involve enhancing water management infrastructure, improving agricultural practices, mitigating sedimentation and flood risks, establishing robust monitoring systems, engaging local communities, and integrating climate adaptation strategies into water management policies. Together, these measures aim to address the challenges of climate change effectively.<br><br>The 2021 Scoping Report on the Water Pillar of the CAREC Program emphasizes that water resources in Central Asia are significantly impacted by various factors including population growth, economic development, and changes in agricultural practices, which all increase water demand. Climate change further complicates the situation by introducing variability in water supply, leading to more frequent extreme weather events. |

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| | The development of hydropower projects affects irrigation availability, while expanding urbanization demands improved infrastructure. Environmental needs and geopolitical dynamics add to the complexity, making effective water management essential for sustainable and equitable resource distribution in the region. The report presents several recommendations for Uzbekistan aimed at improving water resource management. Key suggestions include modernizing irrigation infrastructure, liberalizing agricultural markets, restoring ecosystems, reducing environmental impacts, ensuring universal access to safe drinking water, increasing private sector involvement, adopting climate resilience measures, engaging in regional cooperation on transboundary water issues, valuing water economically, and enhancing capacity building and knowledge sharing. Collectively, these recommendations advocate for a more integrated and sustainable approach to managing water resources in Uzbekistan.<br><br>The Asian Development Bank's November 2023 publication, "Decarbonizing the Water Sector in Asia and the Pacific: Best Practices, Challenges, and Opportunities for Practitioners," highlights the water sector's significant contribution of 1.8% to 5% of global greenhouse gas emissions and the urgent need for decarbonization strategies. To support decarbonization in the water sector, key policy recommendations include implementing water efficiency standards for technology, restructuring tariffs to encourage conservation, and providing financial incentives for advanced wastewater infrastructure. Additionally, regulatory standards for wastewater treatment should mandate best available technologies, while integrated water resource management and support for renewable energy can facilitate sustainable practices. Education and awareness programs are also vital for engaging stakeholders, alongside fostering international cooperation and developing monitoring mechanisms for tracking emissions and progress. |
| Addressing the deficiency in soil management to combat the negative impact of climate change, land degradation, and to increase agricultural productivity | *World Bank. (2021). Uzbekistan - Second Agricultural Expenditure Review.*<br><br>The Uzbekistan Agricultural Public Expenditure Review (AgPER) reveals that the country's agricultural expenditures, which constituted 2.3% of GDP and 8.9% of total public spending in 2019-2020, are significantly higher than in many OECD countries. |

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| | Although recent economic reforms have spurred growth and resilience in the sector, particularly during the COVID-19 pandemic, inefficiencies in spending and persistent price taxation on essential crops hinder sustainable development. The analysis highlights a focus on traditional irrigation and crop subsidies with minimal investment in agricultural innovation. Although positive shifts in expenditure towards small farms and research have been noted, the review calls for strategic reforms, including ensuring market prices for farmers and improving planning frameworks, to enhance the effectiveness of agricultural spending and ensure food security moving forward. The agricultural sector in Uzbekistan faces significant climate-related challenges, primarily driven by water scarcity, as it relies heavily on irrigation with nearly 90% of freshwater withdrawals. Climate change exacerbates issues such as increased temperatures and altered precipitation, leading to higher crop water demand and reduced glacial mass, threatening irrigation sources. To address these vulnerabilities, the country must modernize its energy-intensive irrigation systems, adopt water-efficient technologies like drip irrigation, and diversify crops while developing comprehensive strategies that integrate improved practices and support for farmers. Recent steps to enhance climate resilience through public expenditure in agricultural innovation are vital, but further investment is required to achieve sustainable growth amid these challenges. |
| **Reform Area 3: Climate Change mitigation actions accelerated** | |
| Unlocking green finance for state-owned enterprises (SOEs) and improving the availability of reliable and comparable information on sustainability risks and opportunities. | *ADBI, 2020, State-Owned Enterprises in Uzbekistan: Taking Stock and Some Reform Priorities; ADB, 2023, Green Finance for State-Owned Enterprises; IMF, 2021, State-Owned Enterprises in Middle East, North Africa, and Central Asia: Size, Role, Performance, and Challenges.*<br><br>ADBI's paper highlights the significance of state-owned enterprises (SOEs) for Uzbekistan's economy; they dominate key sectors such as energy, manufacturing, and agriculture. Despite some privatization efforts, major SOEs remain under state control, posing challenges for the development of a vibrant private sector. Governance has improved to foster accountability, but government oversight often restricts operational autonomy, necessitating careful management amidst ongoing economic reforms. The governance of Uzbek SOEs features a complex mix of corporate structures, government |

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| | control, and regulatory oversight. Large SOEs operate as joint-stock companies with government representation, which can hinder accountability. Performance monitoring and government directives heavily influence operations, leading to potential conflicts of interest. Although governance practices have improved, independence and accountability challenges persist. Recommendations for enhancing SOE governance include reducing state involvement in non-essential sectors, separating regulatory and ownership functions, improving corporate governance, decreasing direct government control, enhancing performance monitoring, fostering competition between SOEs and private sectors, and expanding privatization efforts.<br><br>ADB's report on Green Finance for State-Owned Enterprises (SOE) discusses that as major contributors to greenhouse gas emissions, accounting for about 15% of global emissions through fossil fuel operations, SOEs have a public responsibility to adopt sustainable practices to enhance economic resilience. Green finance provides significant advantages for SOEs as they transition to sustainable practices, including lower financing costs through green instruments, improved corporate governance, and enhanced investor confidence. It attracts a diverse range of investors focused on environmental, social, and governance (ESG) criteria, stimulates economic growth and job creation through investments in green technologies, and helps develop local capital markets. Additionally, engaging in green finance mitigates the risk of stranded assets, boosts the credibility of SOEs in capital markets, and aligns their operations with broader national and global sustainability goals, ultimately contributing to a more resilient future.<br><br>IMF paper also talks about SOEs as being crucial to the economies of the Middle East, North Africa, and Central Asia, yet they face significant challenges related to climate change and sustainability risks due to their involvement in resource-intensive sectors. Their operations often contribute to greenhouse gas emissions and environmental degradation, exacerbated by quasi-fiscal activities that promote inefficient resource use. The financial strain on SOEs limits government investment in sustainable initiatives, and weak governance hampers effective sustainability practices. Comprehensive reforms, including diversification towards renewable energy, investment in green technologies, better regulatory frameworks, and public-private partnerships, are essential for |

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| | transforming SOEs into contributors to sustainable development and climate resilience, particularly in the post-COVID-19 recovery phase. |
| Catalyzing a sustainable shift towards e-mobility in public transport | *World Bank. 2023. Uzbekistan: Country Climate and Development Report; ADB, 2023, Accelerating Low-Carbon Pathways through E-Mobility: Perspectives for Developing Economies.*<br><br>The CCDR highlights that Uzbekistan's transport sector is grappling with substantial challenges as it seeks to transition towards a greener economy, contributing 25% of end-use sector emissions in 2019, projected to rise to 32% by 2060 without significant decarbonization. Rapid growth in private vehicle ownership over the past five years, alongside a heavy reliance on natural gas and oil, exacerbates congestion and air pollution, particularly in urban areas like Tashkent. As domestic gas production is expected to decline, there is an urgent need for sustainable alternatives.<br><br>To achieve a net-zero emissions scenario by 2060, Uzbekistan plans to electrify transport, aiming for 3.5 million electric vehicles by 2040, and introduce hydrogen-fueled vehicles for heavy-duty transport. This transition will require an estimated investment of USD20 billion by 2030 and USD106 billion by 2060, emphasizing the importance of a clear policy framework that includes fuel efficiency standards and promotes public transport. Enhancing public transit and urban design to foster walkable cities is essential for reducing emissions and improving air quality, positioning the sector for a sustainable future.<br><br>ADB's paper on Accelerating Low-Carbon Pathways through E-Mobility recommends various strategies governments can employ to facilitate the transition to electric mobility. Key approaches include offering financial incentives, such as subsidies and tax reductions, to make EVs more financially appealing. Additionally, investing in charging infrastructure is crucial, as establishing a network of public charging stations and developing fast-charging facilities will encourage the use of EVs, especially for commercial purposes. |

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| | Regulatory measures, such as banning fossil fuel vehicles and creating preferential policies for EVs, can accelerate the shift toward electric alternatives. Public awareness campaigns are also essential to educate consumers about the environmental benefits and cost savings associated with EVs. Supporting research and development, electrifying public transport fleets, and fostering partnerships with the private sector further enhance this transition. By implementing these comprehensive strategies, governments can significantly contribute to reducing greenhouse gas emissions and improving air quality. |
| Unlocking green finance for state-owned enterprises (SOEs) and improving the availability of reliable and comparable information on sustainability risks and opportunities. | *ADBI, 2020, State-Owned Enterprises in Uzbekistan: Taking Stock and Some Reform Priorities; ADB, 2023, Green Finance for State-Owned Enterprises; IMF, 2021, State-Owned Enterprises in Middle East, North Africa, and Central Asia: Size, Role, Performance, and Challenges.*<br><br>ADBI's paper highlights the significance of state-owned enterprises (SOEs) for Uzbekistan's economy; they dominate key sectors such as energy, manufacturing, and agriculture. Despite some privatization efforts, major SOEs remain under state control, posing challenges for the development of a vibrant private sector. Governance has improved to foster accountability, but government oversight often restricts operational autonomy, necessitating careful management amidst ongoing economic reforms. The governance of Uzbek SOEs features a complex mix of corporate structures, government control, and regulatory oversight. Large SOEs operate as joint-stock companies with government representation, which can hinder accountability. Performance monitoring and government directives heavily influence operations, leading to potential conflicts of interest. Although governance practices have improved, independence and accountability challenges persist. Recommendations for enhancing SOE governance include reducing state involvement in non-essential sectors, separating regulatory and ownership functions, improving corporate governance, decreasing direct government control, enhancing performance monitoring, fostering competition between SOEs and private sectors, and expanding privatization efforts. |

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## Annex 8: Sovereign Credit Fact Sheet

**Background**. Uzbekistan is a lower-middle-income country with income per capita of around USD2,600 (around USD11,000 in purchasing power parity), and population of 37 million. Since 2016, the new government has pursued a reform agenda to transform Uzbekistan from a state-led to a market-based economy. Reforms included introduction of market mechanisms, liberalization of trade and prices, reforms to the tax system, public financial management, privatization of state banks and enterprises, as well as land and agricultural policies.

The modernization agenda has made Uzbekistan an attractive destination for investment, both foreign and domestic. The robust growth potential is supported by young and abundant labor supply, diversified export base, macroeconomic stability, and modest debt levels. Investment rates have been remarkably high, at around 40 percent of GDP.

Growth has been robust, at around 5-6 percent, driven by investment, industry, construction, and services. Inflation remains high, due to high growth, continued liberalization of prices and the gradual currency depreciation. However, despite high growth, incomes are still comparatively low. The state continues to have a large footprint in the economy, with state enterprises accounting for more than half of the GDP and nearly half of total revenue. Furthermore, state banks control around two-thirds of banking assets.

| Key Economic Indicators | 2020 | 2021 | 2022 | 2023 | 2024* | 2025* | 2026* | 2027* |
|---|---|---|---|---|---|---|---|---|
| Real GDP growth 1/ | 2.0 | 7.4 | 5.7 | 6.0 | 5.4 | 5.5 | 5.5 | 5.5 |
| Inflation (average, in percent) 1/ | 12.9 | 10.8 | 11.4 | 10.0 | 10.9 | 10.3 | 7.8 | 5.9 |
| Fiscal balance | -4.4 | -6.0 | -4.0 | -5.5 | -4.0 | -3.0 | -3.0 | -3.0 |
| Public debt | 37.1 | 35.3 | 33.9 | 36.3 | 35.7 | 34.7 | 32.5 | 31.7 |
| Gross public financing needs | 11.1 | 7.1 | 5.0 | 8.6 | 7.1 | 5.7 | 6.8 | 5.9 |
| Current account balance | -5.0 | -7.0 | -3.5 | -8.6 | -7.6 | -7.1 | -6.2 | -5.4 |
| External debt | 58.0 | 57.6 | 54.6 | 61.3 | 60.9 | 59.1 | 57.0 | 55.2 |
| FX reserves (USD billion) 2/ | 34.9 | 35.1 | 35.8 | 34.6 | 39.2 | .. | .. | .. |
| Exchange rate, UZS/USD 2/ | 10,477 | 10,838 | 11,225 | 12,339 | 12,725 | .. | .. | .. |

Source: IMF country report No. 24/210, country authorities; in percent of GDP, unless indicated otherwise; '*' indicates projections
Notes: 1/ percent change, year-on-year; 2/ data from central bank, most recent as of September 22, 2024

**Recent Developments**. Uzbekistan has shown remarkable resilience through the shock of the past few years. The economic impact of the pandemic has been less than feared, with positive growth in 2020, and a strong rebound 2021. Likewise, negative spillovers from the geopolitical tensions in the region, since 2022, have not materialized, despite significant exposure to Russia—which is Uzbekistan's top export destination, the second biggest source of imports and a destination for millions of Uzbeks work migrants. The authorities focused on supporting livelihoods and safeguarding macroeconomic stability. The economy has also been supported by favorable export prices, increase in wages, further increases in remittances, and an expansionary fiscal stance. Unlike for other economies, price pressures have been moderate. Overall, growth in 2022 and 2023 was around 6.0 percent. For 2024, growth is on track to reach 5.4 percent, driven by continued strong domestic demand.

**Outlook and Risks**. Geopolitical tensions continue to create challenges and risks for the Uzbek economy. Other external risks include weaker growth in key trading partners. Remittances have already normalized from the high levels.

The medium-term potential growth is expected at around 5-6 percent. The authorities remain committed to sound macroeconomic management and reforms. Fiscal consolidation is planned, while monetary policy will remain relatively tight, in the face of strong domestic demand, energy price increases, and in line with their inflation targeting regime. Disinflation is expected to be gradual. Following a spike in 2023, on account of strong machinery imports related to capital investments, the current account deficit is expected to gradually normalize to around 5 percent of GDP.

Uzbekistan's public debt remains sustainable. Debt has increased rapidly recently, to around 36 percent of GDP, due to externally financed investment and the impact of the covid pandemic. However, debt is low by peer standards and on a downward trend with growth and fiscal prudence. External debt has grown in parallel to 61 percent, but risks are mitigated by the long maturities concessional rates. The predominantly state-owned financial system is stable, with adequate capitalization and strong liquidity.

Key risks to the debt profile are a potential devaluation (due to high dollarization) and the volatile commodity prices. These are mitigated by a robust growth outlook, ample fiscal space, and substantial reserves (nine months of imports). To reinforce debt sustainability, the government has recently introduced a set of fiscal rules, including an external borrowing limit, a debt ceiling of 60 percent of GDP and a budget deficit target of 3 percent of GDP.

Uzbekistan's creditworthiness has been sustained through the recent shocks. S&P and Fitch have affirmed Uzbekistan's sovereign credit rating at BB- and Moody's has recently upgraded Uzbekistan from B1 to Ba3. All three rating agencies have kept the outlook stable and appreciate the gradual progress with key structural reforms.

Longer-term growth requires progress on the reform agenda. However, the more complex and sensitive reforms, such as privatization or competition, are still in the early stages or yet to be implemented. A banking sector reform was initiated in October 2019, and the law on Competition became effective in October 2023. A comprehensive privatization program has been started, with some progress already achieved. Monopolies in the energy sector are being unbundled and an independent energy regulator has been created. Additionally, plans for unbundling the railway sector have been revealed. Reform fatigue in the face of opposition from vested interest or potential social discontent remain a risk.

Given the large and growing working-age population, creating more and better jobs remains the country's top priority. Achieving this goal will depend on fostering a conducive environment for private-sector-led growth, strengthening institutions, and enhancing infrastructure.