



**ASIAN INFRASTRUCTURE
INVESTMENT BANK**

P000474-UZB
June 10, 2021

**Project Document
of the Asian Infrastructure Investment Bank
Sovereign-backed Financing
Republic of Uzbekistan
Medium-size Cities Integrated Urban Development Project**

Currency Equivalents

As of May 14, 2021

Currency Unit – Name

UZS1.00 = USD0.000095

USD1.00 = UZS10,545.23

Borrower's Fiscal year

January 1- December 31

Abbreviations

AIIB	Asian Infrastructure Investment Bank
CBA	Cost-Benefit Analysis
CO ₂	Carbon Dioxide
CERC	Contingent Emergency Response Component
CEA	Cost Effectiveness Analysis
COVID-19	Coronavirus 2019
EIRR	Economic Internal Rate of Return
E&S	Environmental and Social
ESIA	Environmental and Social Impact Assessment
ESMF	Environmental and Social Management Framework
ESMP	Environmental and Social Management Plan
ESSP	Environment and Social Safeguard Policies
ESP	Environmental and Social Policy
FM	Financial Management
FUA	Functional Urban Area
GoU	Government of Uzbekistan
GRM	Grievance Redress Mechanism
IDA	International Development Association
IFR	Interim Financial Report
MCA	Multi-Criteria Analysis
MDB	Multilateral Development Bank
MIFT	Ministry of Investment and Foreign Trade
MoF	Ministry of Finance
MSCIUDP	Medium-size Cities Integrated Urban Development Project
MSCs	Medium-size Cities
NMSCP	National Medium-size Cities Program
NPV	Net Present Value
O&M	Operations and Maintenance
OP on IR	Operational Policy on International Relations
PPM	Project affected People's Mechanism
PIA	Project Implementation Agency
PIU	Project Implementation Unit
POM	Project Operations Manual
RPF	Resettlement Policy Framework
RSPIU	Regional Staff of the PIU
WASIS	Water Services and Institutional Support
WB	World Bank

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1. Summary Sheet

Project No.	P000474
Project Name	Medium-size Cities Integrated Urban Development Project
AIIB Member	Republic of Uzbekistan
Borrower	Republic of Uzbekistan
Project Implementation Agency	Ministry of Foreign Investment and Trade (MIFT)
Sector	Urban
Sub-sector	Urban Infrastructure
Project Objective	The Project Objective is to: (a) improve access to selected urban infrastructure (including public spaces) and services in Participating Cities; and (b) strengthen the institutional capacity of the Borrower's relevant agencies to deliver and manage local infrastructure.
Implementation Period	Start Date: July 1, 2021 End Date: June 30, 2027
Expected Loan Closing Date	December 31, 2027
Cost and Financing Plan	Project cost: USD240 million <u>Financing Plan:</u> AIIB loan: USD100 million WB/IDA loan: USD100 million Government of Uzbekistan: USD40 million
Size and Terms of AIIB Loan	USD100 million. 30-year maturity, including a 5-year grace period, capitalized front-end fee.
Cofinancing (Size and Terms)	WB/IDA: USD100 million
Environmental and Social Category	WB Category B (equivalent to Category B if AIIB's ESP were applicable)
Risk (Low/Medium/High)	Medium
Conditions of Effectiveness	<ul style="list-style-type: none"> PIU shall hire and maintain a regional safeguards representative, a financial management specialist, and a procurement specialist; Project Operations Manual, including Financial Management arrangements, revised to reflect required changes for the scaling-up of activities to additional regions and cities; The Loan Agreement between the Borrower and WB has been executed and is effective; and The Co-Lenders' Agreement between AIIB and WB has been executed.
Key Covenants	<ul style="list-style-type: none"> Upgrade its existing accounting software of the PIU in a manner acceptable to the Bank.
Policy Waivers Requested	None

Policy Assurance	The Vice President, Policy and Strategy, confirms an overall assurance that AIIB is in compliance with the policies applicable to the Project.
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2. Project Description

A. Project Overview

1. **Rapid urbanization of medium-size cities.** Uzbekistan is experiencing rapid urbanization, driven by rural-to-urban migration and a young and growing population, with a rising share of jobs being created in cities (e.g., manufacturing, construction, services). While more than 40 percent of the urban population lives in cities with more than 100,000 inhabitants, the fastest population growth rates are observed in medium-size cities (defined as cities with a population of between 50,000 and 100,000). From 1990 to 2017, secondary cities of medium size grew by 54 percent.

2. **Infrastructure gaps hamper growth and job creation.** Medium-size cities, often located in proximity to larger cities or along strategic logistic corridors, have the potential to become important secondary economic hubs and enhance job creation and economic growth outside larger cities, including service jobs for surrounding rural regions. However, gaps in urban infrastructure and basic services hinder this potential. Medium-size cities are largely unprepared to manage their rapid urbanization, resulting in unmet demand for infrastructure and poor utility services.

3. **Scale-up of investments in medium-size cities to manage urban growth.** The proposed Project is envisioned to scale up the World Bank's (WB) Medium-size Cities Integrated Urban Development Project (MSCIUDP) to address the challenges of rapid urbanization of secondary cities. The MSCIUDP has been conceived as a programmatic approach and constitutes the first project in a Series of Projects. The Project is contributing to Government of Uzbekistan (GoU)'s vision to roll-out a National Medium-size Cities Program (NMSCP).¹ The Ministry of Investment and Foreign Trade (MIFT) has requested AIIB to participate in the financing of the scale-up of the WB-led MSCIUDP alongside Additional Financing by the WB.²

4. **Project Objective.** The Project Objective is to: (a) improve access to selected urban infrastructure (including public spaces) and services in Participating Cities; and (b) strengthen the institutional capacity of the Borrower's relevant agencies to deliver and manage local infrastructure.

5. **Expected Results.** The Project is expected to improve urban living conditions in the project areas of the targeted medium-size cities. The expected results will be monitored through the following indicators:

- (i) Number of people provided with improved urban living conditions (of which female);
- (ii) People provided with access to improved public spaces (within 15 minutes walking distance from the place of residence);
- (iii) Number of municipalities with improved real estate and infrastructure assets operation, management and maintenance practices, and with trained municipal officials.

6. **Expected Beneficiaries.** The main beneficiaries of this Project are the population of Participating Cities which will benefit from improved urban infrastructure

¹ NMSCP is a vision of the government to address urban development of secondary cities. Separate WB technical assistance under the parent project and other WB projects is being carried out to support the Government in developing NMSCP further into a national program to address the needs of secondary cities.

² The WB is processing the scale-up of the activities as Additional Financing (IDA) to the MSCIUDP.

and improved general living conditions. Based on the selection of Participating Cities, the total number of beneficiaries are expected to be 4,083,000 people (19 percent are direct beneficiaries of new or improved urban services and the remaining 81 percent are indirect beneficiaries of an improved urban environment). Direct beneficiaries are expected to total 783,000 people, of which 307,000 live in the Surkhandariya region and 476,000 live in the Kashkadariya region. Indirect beneficiaries are estimated at around 3.3 million, of which 1.86 million live in Surkhandariya (representing 80 percent of the region's population) and another 1.43 million live in Kashkadariya (comprising 59 percent of the region's population).

B. Rationale

7. **Strategic fit for AIIB.** The Project is aligned with the Corporate Strategy's thematic priority on green infrastructure and contributes to AIIB's climate target by supporting investments related to climate change mitigation, adaptation, and resilience. The Project contributes to the strategic pillars of promoting integrated development and improving basic infrastructure and city resilience of AIIB's Sustainable Cities Strategy, and supports the Strategy's objectives on green, resilience and accessibility. The Project also supports rural-urban linkages (i.e., linkages between medium-size cities and their rural peripheries) as well as urban-regional connectivity. Further, the Project has a multi-sectoral approach and supports medium-size cities' access to basic infrastructure under other strategies (e.g., water).

8. **Value addition by AIIB.** In alignment with the AIIB strategy, providing additional finance to close a financing gap where such finance is not offered by other banks, or the private sector, will make it possible to implement this Project. Further, the Bank team is closely working with the WB, the lead multilateral development bank (MDB) for this joint co-financed operation, to contribute to the conceptual design and strategic focus of the Project, through the selection of Participating Cities and activities for the Project. It is anticipated that water supply and sanitation activities will be financed; lessons from the existing AIIB water portfolio with respect to sustainability, technology-enabled infrastructure and innovation will be reflected where appropriate.

9. **Value addition to AIIB.** This would be AIIB's first investment to address infrastructure gaps in secondary cities with an integrated urban development approach. By working with the WB, which has been engaged in the urban sector for a long time, the Project will provide AIIB with an opportunity to gain related experience in Uzbekistan with an integrated urban development approach and identify solutions to apply in other countries/cities under similar conditions. This will also position AIIB to independently prepare similar future projects in the urban sector focusing on secondary cities, which face unique challenges in terms of urban planning and development.

10. **Lessons learned.** Early lessons from the implementation of the MSCIUDP parent project³ demonstrate the importance of the integrated urban development approach, to focus on functional urban areas (FUAs) rather than administrative

³ The parent project has a total cost of USD 120 million, of which USD 100 million is financed by the WB with the Government of Uzbekistan (GoU) financing USD 20 million as counterparty contribution. The Medium-size Cities Integrated Urban Development Project (MCIUDP) loan agreement was signed between GoU and WB on April 11, 2019. This agreement became effective on July 12, 2019 and is currently under implementation. Implementation progress is rated moderately satisfactory by the World Bank and described in paragraph 35.

boundaries, and the need for the strong involvement of regional and local governments in project implementation. An integrated urban development approach allows for better urban planning and prioritization of activities, whereas the focus on FUAs allows to design complementary activities within a FUA (but sometimes outside the administrative boundary of a specific municipality) to maximize the impact of investments. A stronger involvement of local governments has been found important to ensure alignment with the local development planning process. Global experiences also show that multi-agency coordination is critical in increasing efficiencies in urban service delivery and infrastructure as well as in systematically addressing critical challenges in cities. In addition, lessons from the early implementation of the parent project have also been drawn for the preparation of the proposed Project. The parent project experienced delays in procurement. In response to those delays, specific measures have been agreed to speed up the investments under the proposed Project (see para 43-44 and para 5 in Annex 2).

C. Components

11. **Component 1 - Improvement of Urban Services and Enhancement of Public Urban Spaces (USD212.40 million).** This component will finance selected infrastructure investments that improve urban functionality and livability in Participating Cities (referred to as specific activities). Fast track investments to commence during the year 1-2 of the Project are expected to include rehabilitation / extension of water supply and sanitation infrastructure and energy efficiency measures. Strategic urban investments will be identified based on urban regeneration studies and may include upgrading of public spaces, street networks, and associated infrastructure; upgrading of vehicular, pedestrian and multi-modal accesses; restoration of selected heritage buildings⁴ improvements to selected basic infrastructure and services (water supply, sanitation, sewerage, sidewalks, roads) on a case-by-case basis to complement the long-term functionality and increase the effectiveness of area-specific urban improvements. Feasibility studies (if required), detailed design, construction supervision, and other services associated with the investments may also be financed under this component.

12. **Component 2 - Institutional Strengthening and Capacity Building (USD21.60 million).**

(i) **Subcomponent 2.A: Institutional strengthening and capacity building of project municipalities and their regions.** This subcomponent will support the institutional strengthening and capacity building of Participating Cities and their respective regional governments. The activities will be tailored to the specific needs of the Participating Cities and focus on the improvement of asset management and maintenance capacity as well as design of safe roads. This component also includes the procurement of municipal maintenance equipment and the construction/upgrading of maintenance facilities to store and maintain municipal equipment, if needed.

⁴ The rehabilitation of selected heritage buildings will be limited in scope and only undertaken to the extent that it contributes to the objective of the Project. The selected rehabilitation of heritage buildings is expected to contribute to economic growth and livelihood improvements through tourism development.

(ii) **Subcomponent 2.B: Support for GoU policy and reforms for sustainable urbanization.** This component will complement the support provided under the WB's parent project through activities to support sustainable and resilient urbanization, including i) the national urbanization study, ii) development of procedures and regulations to mobilizing private investments in solid waste management, and iii) support the respective water companies in mobilizing private investments and increasing efficiency in water supply. Technical assistance and capacity building may be provided in the areas of land privatization, housing, road safety, and other areas, as needed. In addition to directly supporting Participating Cities, the component will also support the Academy of Public Administration (a government body responsible for training of public servants) in developing a new system of trainings and capacity building for local governments.

13. **Component 3 - Implementation Support (USD5.75 million).** This component will support project implementation, including implementation of the project monitoring and evaluation system, communication strategy, application of safeguard instruments as well as training and financing of incremental operating costs of the Project Implementing Unit (both at central and regional levels).

14. **Component 4 - Contingent Emergency Response Component (CERC, USD0).** This provisional component will allow for rapid reallocation of Project funds from other Components to provide immediate response capacity to the Government following an eligible crisis or emergency in Uzbekistan. The criteria for determining an eligible crisis and process for CERC activation will be defined in the Project Operations Manual (POM) prior to project effectiveness.

Programmatic Approach and Integrated Urban Planning

15. **Selection of Participating Regions.** The Project employs a regional approach to account for inter-city dynamics when addressing urbanization challenges. In coordination with MIFT, and in consultation with relevant ministries and stakeholders, Surkhandariya and Kashkadariya regions are identified as the Project regions based on the following reasons: Both regions: i) are among the three poorest regions in the country, ii) present a good mix of opportunities to develop industry and service sectors, iii) have unique and fragile ecosystems which are now being affected by continued sprawl, iv) border with neighboring countries and project activities may enhance cross-border connectivity, and v) Kashkadariya is the third most populated region in Uzbekistan.

16. **Selection of Participating Cities** While the objective is to reach a large number of beneficiaries, the Project also aims to demonstrate the application of an integrated urban development approach to unlock the potential for economic growth for cities, which face different sets of challenges. Table 1 shows the selection of cities within the two Participating Regions. The selected cities can be classified based on their economic conditions as regional hubs (economic hubs, large magnets for migration and commuting), fast-growing medium-size agglomerations, lagging towns/cities and cities that primarily depend on tourism activities. The detailed criteria for the selection of the participating cities are described in Annex 2.

Table 1: Selected Participating Cities⁵

Type of Settlement	Surkhandariya Region	Kashkadariya Region
Regional hubs	<ul style="list-style-type: none"> • Denau 	<ul style="list-style-type: none"> • Shakhrisabz
Fast-growing medium-size agglomerations	<ul style="list-style-type: none"> • Sariosiyo-Shargun system • Shurchi • Jarqurgan 	<ul style="list-style-type: none"> • Kitab system • Guzar (Pachkamar) • Kasan
Lagging	<ul style="list-style-type: none"> • Sherobod • Kumkurgan 	<ul style="list-style-type: none"> • Karashina-Dehqonobod system • Muglan-Yangy-Mirishkor
Tourism	<ul style="list-style-type: none"> • Boysun 	<ul style="list-style-type: none"> • Miroqi (Shakhreizab)
Unallocated⁶	<ul style="list-style-type: none"> • Altansay 	<ul style="list-style-type: none"> • Chirakchi (with FEZ)

17. The **project activities** in the Participating Cities follow two tracks: **1) Fast-track investments** are designed to achieve early implementation results, follow an opportunity-driven approach, and are expected to commence during the first and second year of project implementation. These activities are proposed by the Participating Cities and confirmed based on abbreviated feasibility studies. **2) Strategic urban investments** are identified based on urban regeneration studies, which will be conducted during the early stages of project implementation. The identification of activities through urban regeneration studies will ensure that investments are fully aligned with the Project Objectives, are catalytic for economic growth and consider urban-region linkages. Strategic urban investments are expected to start implementation from year three onwards. The selection process is described briefly in the next paragraph and is outlined in detail in Annex 2.

18. **Eligibility criteria and selection of activities.** The strategic activities under the Project will be selected successively based on the following criteria: 1) activities identified through analysis of local needs for services and infrastructure, consultations with authorities and other local actors, and feasibility studies, 2) correspond to one of the defined categories of urban activities in the ESMF, 3) cannot be classified as ES category A and comply with the environmental and social exclusion list, and 4) contribute to the Project Objective. The activities will be assessed based on the above eligibility criteria and prioritized according to their contribution towards the Project Objective. Cost-Benefit Analysis (CBA) will be conducted for each activity. Only activities with high economic viability (Economic Internal Rate of Return, EIRR > 5 percent) can be selected. As evidenced by the CBA of typical activities in Annex 3, the EIRR is expected to significantly exceed the hurdle rate in most instances. For activities for which CBA cannot be conducted, other methods of economic assessment such as Cost Effectiveness Analysis and Multi-Criteria Analysis will be carried out.

19. **Climate change.** Close attention will be given to climate change adaptation activities in these investments, e.g., using weather resistant paving material in road

⁵ The proposed list includes the following: (i) settlements demonstrating agglomeration effects and act as local industries and trade centers; (ii) settlements located on the periphery of regional capital cities; and (iii) groups of smaller urban and rural settlements adjacent or nearby each other.

⁶ The cities of Altansay and Chirakchi have been preliminarily selected and will require further confirmation during the inception phase of the Project.

rehabilitation projects, undertaking structural retrofits to withstand climate hazards in bridge rehabilitation projects. Climate change mitigation activities will also be considered, such as energy efficiency measures, integrating renewable energy in retrofitting and reconstruction of buildings and investing in non-motorized transport through planning and implementation of bicycle lanes, sidewalks, and pedestrian crossings. As project activities are progressively identified during project implementation, the climate co-benefit of the Project is targeted at 40 percent or higher.

20. **Investments are expected to support the economic recovery.** Coronavirus 2019 (COVID-19) has severely impacted the local economy. While unforeseen in the original design of the Project, the proposed Project can be a critical tool to aid in the recovery process of the municipalities concerned. In the short- and medium-term, the Project will support economic recovery through the employment generated by its fast-track investments and construction works, and the strategic investments are expected to unblock economic growth potential for long-term development.

D. Cost and Financing Plan

21. The GoU through MIFT has requested the Bank to co-finance the scale-up of the WB-financed project. AIIB and WB/IDA will provide Sovereign-backed Loans in the amount of USD100 million each. GoU will provide USD40 million as counterparty financing, including taxes and customs fees and land acquisition costs, if any. The total project cost is estimated at USD240 million.

22. **Co-financing arrangements.** The Project will be financed in a joint co-financing arrangement with the WB as lead MDB.⁷ The co-financing arrangements for the Project will follow the Co-Financing Framework Agreement between AIIB and WB as of April 2016, which has been extended on an annual basis. An updated Co-Financing Framework Agreement is currently being negotiated and is expected to be concluded shortly. WB's policies and procedures on safeguards, procurement, financial management, project monitoring, reporting and investigative services for harmonized sanctionable practices⁸ will be used for the project activities to be financed out of the loan proceeds (including activities to be financed by the Bank).

23. **Financing Terms.** The loan size is USD 100 million. The loan will have a final maturity of 30 years including a five-years grace period. The Borrower chose the fixed-spread loan product. The pricing will follow the standard terms for Sovereign-backed Loans. The front-end fee will be capitalized as requested by the Borrower.

⁷ For WB, the scaling-up of the Project is processed as Additional Financing to the parent project.

⁸ The Bank will reserve its right to investigate any allegations on the non-harmonized sanctionable practices of "theft" and "misuse of resources".

Table 2: Project Cost and Financing Plan

	Project Cost (USD million)	Financing					
		(USD million and %)					
		AIIB		WB		GoU	
Component 1: Improvement of Urban Services and Enhancement of Public Urban Spaces	212.40	88.50	41.67%	88.50	41.67%	35.40	16.67%
Component 2: Institutional Strengthening and Capacity Building	21.60	9.00	41.67%	9.00	41.67%	3.60	16.67%
Component 3: Implementation Support	5.75	2.25	39.13%	2.50	43.48%	1.00	17.39%
Component 4: Contingent Emergency Response Component	0.00	0.00	50.00%	0.00	50.00%	0.00	0.00%
Capitalized front-end fee	0.25	0.25	100.00%	0.00	0.00%	0.00	0.00%
Total	240.00	100.00	41.67%	100.00	41.67%	40.00	16.67%

E. Implementation Arrangements

24. **Implementation Management.** The Ministry of Investment and Foreign Trade (MIFT, the Project Implementing Agency, PIA) has the overall responsibility for the implementation of all project activities, including coordination with relevant sector authorities, procurement (tendering for works, goods and services), financial management, construction monitoring and supervision, monitoring compliance with environmental and social instruments and reporting.

25. **Project Implementation Unit (PIU).** Under the parent project, a PIU has been established under the PIA to coordinate and implement the Project in accordance with its objectives and design, with acceptable quality, on time and within budget. Its key role is to oversee all aspects of project implementation and the work of other agencies and Participating Cities involved in the Project. The national level PIU deploys its representatives in the regions of the Participating Cities, under the general oversight of the regional representative of the PIA. The national level PIU also organizes capacity building, and training of all PIU staff, both in the central and regional locations. The current PIU will fulfill its role in the parent project as well as expand its responsibility to implement activities in the Participating Cities of the Project. The PIU will be strengthened with additional experts⁹ for the scaling-up of activities.

26. **Regional Staff of the PIU in project regions (RSPIU).** Regional staff are assigned to strengthen local presence and improve the local coordination and

⁹ The PIU will be strengthened with an additional regional safeguards' representative, a procurement specialist and a financial management specialist prior to project effectiveness.

performance of project implementation. RSPIUs work closely with the respective city/district *khokimiyats* (which are expected to facilitate interregional coordination and project activities), report to the central PIU, and work under the general oversight and facilitation of the regional representative of the PIA. RSPIUs are responsible for the project management at the local level, such as local-level coordination among agencies and monitoring of progress of works, ensuring quality and timeliness of deliverables, among others. With experience in project implementation built at the local level, RSPIUs may be expected to carry more fiduciary and safeguard responsibilities depending on mid-term assessment of the centralized implementation arrangements.

27. **Coordination with Project Stakeholders.** The PIA leads the coordination of other Project stakeholders at the national level, including the Ministry of Construction, the Ministry of Housing and Communal Services, the Ministry of Culture, the State Committee for Tourism Development, the Ministry of Economy and Industry, the Ministry of Finance and the *khokimiyats* (cities/districts) and the Participating Cities at the regional and local levels. Given the cross-sectoral nature of the Project, the PIA's role in ensuring coordination with the competent sector authorities is crucial.

28. **Procurement.** WB will play the leading role and cooperate with the AIIB team for procurement preparation and implementation in accordance with the Co-financing Framework Agreement between WB and AIIB. All procurement of contracts will be conducted through the procedures as specified in the World Bank's Procurement Regulations for Investment Project Financing Recipients - Procurement in Investment Project Financing Goods, Works, Non-Consulting and Consulting Services, dated July 2016, revised November 2017, August 2018 and November 2020. The Guidelines on Preventing and Combating Fraud and Corruption in projects financed by IBRD loans and IDA credits and Grants, dated October 15, 2006 and revised January 2011 and as of July 1, 2016, shall apply to this Project. The procurement and contract management processes will be tracked through the Systematic Tracking of Exchanges in Procurement system. The PIU will be responsible for all the project procurement.

29. **Financial Management.** The PIU will be responsible for project financial management. The project accounting records will be maintained on a cash basis and the PIU will prepare project financial reports in accordance with the Cash Basis of International Public Sector Accounting Standards. The Financial Management (FM) section of the existing POM will be updated to reflect the proposed Project FM arrangements. The PIU will submit quarterly interim un-audited financial reports (IFRs) within 45 days after the end of each quarter. The PIU will submit audited project financial statements for each fiscal year and at the closing of the Project within 6 months after the end of such period.

30. **Disbursements.** The loan will adopt a combination of direct payment, advance and reimbursement methods for payments. The Borrower will submit the withdrawal applications to the WB with appropriate documentation. The WB will review the requests and forward them to the Bank for further processing. The expected disbursements are presented in Table 3.

Table 3: Expected Disbursements (USD million)

Fiscal Year	2021	2022	2023	2024	2025	2026	2027
Annual	0.5	5	10	20	30	25	9.5
Cumulative	0.5	5.5	15.5	35.5	65.5	90.5	100

31. **Implementation period.** The Project is planned to be implemented over six years, from July 1, 2021 to June 30, 2027.

32. **Monitoring and Evaluation.** Project progress and performance will be monitored based on the project outcome indicators and intermediate results indicators, which are defined in the Results Monitoring Framework. The project-level monitoring and reporting will be conducted by the PIU, with support from the RSPIU. The PIU will prepare semi-annual progress reports that will include complete information on procurement, contracts, disbursements, financial management, beneficiaries and other outputs. Annual independent audit reports will be prepared to monitor the use of funds.

33. **AIIB's Implementation Support.** The Bank team will conduct regular joint supervision missions together with the WB team when the travel ban is lifted. As long as travel is not possible, implementation support and supervision missions will be carried out virtually. The frequency of the missions will depend on implementation progress and complexity.

3. Project Assessment

F. Technical

34. **Project Design.** The Project will support key infrastructure gaps in the Participating Cities. All selected investments will: (i) be fully aligned with the Project Objectives; (ii) be prioritized and selected to support the development vision of each of the selected urban centers, ensuring complementarity and avoiding fragmentation; (iii) have high economic impact; and (iv) be consistent with the eligibility criteria and selection process described in paragraphs 15-18 and in more detail in Annex 2.

35. The proposed Project builds on the early project implementation experience in the pilot cities of Chartak (Namangan region), Kagan (Bukhara region) and Yangiyul (Tashkent region), which have been selected under the WB's parent project. Progress towards the achievement of the project objectives is rated satisfactory by the WB. Overall implementation progress is rated moderately satisfactory due to COVID-19 and procurement related delays (lockdown, initial delay in identifying and mobilizing experienced Project Director and key PIU personnel, and delays in procurement and detailed design preparation). Current implementation activities include the preparation of feasibility studies for the fast-track investments (comprising 35 percent of the loan), the selection process for studies to prioritize the investments for the integrated urban upgrading (under the final stage, comprising about 45 percent of the loan). The contracts for the procurement of equipment for municipal maintenance have been recently awarded.

36. Further analytical studies to support the design of the NMSCP and scaling up of MSCIU DP have been carried out by WB in coordination with the PIA. The findings from the WB analytics and early lessons have been reflected in the project design and implementation arrangements of this Project. The WB's analytics confirmed: (i) the unique role of Medium-size Cities (MSCs) as critical but mostly underperforming elements of the system of cities, needing special attention and support to be enabled to materialize their full potential; (ii) that integrated urban planning requires to go beyond the limited definition of MSCs based on their current administrative boundaries and

population within such boundaries, but rather understand MSCs in relation to agglomerations and urban regions, that include multiple administrative units, which form FUAs, and (iii) the need for scaling-up of the MSCIU DP to address infrastructure gaps in fast growing secondary cities, and (iv) project design adjustments to consider linkages and complementarities between urban centers and FUAs.

37. The PIU, established under the current WB project, is currently finalizing the required documents for the selection process of consultants for the preparatory studies (including urban regeneration studies, feasibility studies, and detailed design studies, as necessary). The selection process of consultants to carry out such studies is expected to be ready to start by loan signing.¹⁰ It is anticipated that the selected activities would include water supply, sanitation, power distribution networks, municipal maintenance equipment and storage structures, energy and seismic retrofitting of selected municipal buildings and rehabilitation and improvement of roads/bridges.

38. **Operational sustainability.** Operation and maintenance requirements will be assessed as part of the feasibility studies prior to the confirmation of specific activities and will be reflected in the design and implementation arrangements of the specific activities. Further, the Capacity Building component focuses on improving the Participating Cities' capacity in asset management, and operation and maintenance of municipal assets. This includes training for municipal staff, asset management systems (if needed), and equipment for municipal maintenance. These measures are expected to contribute to the long-term sustainability of the Project. The Project also supports the Academy of Public Administration in developing a training course/curriculum for municipal maintenance, which will benefit municipalities beyond the Participating Cities. Further national-level reforms and capacity building are supported under the parent project. To avoid overlap, the Capacity Building under this Project focuses on the strengthening of the Participating Cities and their regional governments.

G. Economic and Financial Analysis

39. **Economic Analysis.** The Project is expected to improve overall living conditions of Participating Cities by providing improved access to urban infrastructure, public spaces, and services. Improved urban infrastructure may lead to improved health through increased access and quality of water and sanitation services, a reduction of vehicle operating costs through road rehabilitation activities, improved urban livability (e.g., reduced criminal activities), increased safety of movement for residents and increased revenue from tourists. The planned investments are also expected to contribute to climate change mitigation, given reductions in greenhouse gas emissions due to improved energy efficiency.

40. All investments that will be selected for financing under the Project will be screened for economic and financial viability as part of the urban regeneration studies and/or feasibility studies. Economic analysis, i.e., CBA is used as a screening device and to optimize the technical design for the strategic urban investments. All investments are required to demonstrate economic returns above the social discount rate (IRR>5%). For relatively small investments, where data is not readily available and benefits are difficult to monetize, a Cost Effectiveness Analysis (CEA) or Multi-Criteria Analysis (MCA) may be carried out in place of a CBA.

¹⁰ TORs for the feasibility studies and detailed designs, and related draft Requests for Expression of Interests (REOI) for at least 30% of investments will be completed by loan signing and ready to be advertised.

41. To demonstrate the economic viability of the expected types of investments, Cost-Benefit Analyses of similar investments in Uzbekistan are reviewed and discussed in Annex 3. The CBA of the assessed investments under the parent project demonstrate that the EIRR hurdle rate of at least 5 percent is significantly exceeded in most instances¹¹: For energy efficiency investments, EIRRs range between 10 percent and 23 percent. For wastewater treatment investments, EIRRs of 6 percent to 12 percent are observed. For water and sanitation investments, an EIRR of 17 percent was observed. For urban upgrading initiatives, EIRRs of 7.7 percent to 20 percent are estimated. The above estimates can be considered as a lower-bound estimate as only part of the benefits have been quantified for the purpose of the mentioned assessments.

42. **Financial Analysis.** Financial assessment of the specific activities to demonstrate financial viability will be carried out, if applicable, as part of the urban regeneration studies and the feasibility studies.¹² The requirements for the financial assessments will depend on the specific activities. Generally, for revenue generating activities, the assessment shall demonstrate the financial viability of adequate operation and maintenance of the investments. Financial assessments will not be applicable for non-revenue generating activities (e.g., rehabilitation of a sidewalk).

H. Fiduciary and Governance

43. **Procurement.** A procurement capacity assessment was carried out by the WB and some of the key risks identified during the assessment are related to systemic weaknesses in: i) procurement capacity at the national level; (ii) accountability of procurement decision-making in the MIFT; (iii) the technical expertise in preparing the technical specifications for equipment and the terms of references for consultancy assignments; (iv) the implementation capacity of the Project due to the complexity of internal decision-making process that involves a large number of approval steps. The proposed risk mitigation measures are: (i) capacity building for development of technical specifications and Terms of Reference; (ii) training for new and current staff on WB Procurement Guidelines; (iii) update of POM with a detailed chapter on procurement, including description of decision-making processes and accountability for procurement decisions; (iv) putting in place an efficient contract management mechanism, and (v) hiring additional procurement specialists. The Project Procurement Strategy for Development including a procurement plan has been prepared by the PIA with the WB's assistance. AIIB collaborated closely with the WB to review and finalize the Project Procurement Strategy for Development and procurement plan.

44. The lessons from the early implementation of the parent Project will allow to speed up the preparation and procurement of the planned investments under the proposed Project. It was agreed that the PIU will implement a set of agreed measures to avoid delays in project implementation, including streamlining of the procurement process by reducing iterative and redundant approval steps and strengthening the contract management capacity. The agreed measures are presented in detail in para 5 in Annex 2.

¹¹ The WB assumes a discount rate of 5% for MSCIUDP and similar projects in Uzbekistan.

¹² This may include an assessment of the town's ability to generate sufficient tax revenues to cover the O&M requirements of non-revenue generating activities, if needed.

45. **Financial Management (FM).** A project financial management assessment was carried out by the WB and reviewed by AIIB. The assessment showed that the existing FM arrangements in the POM do not define in detail the flow of funds, relevant documents and approval process, internal control procedures to be followed for managing project resources as well as the disbursement and reporting procedures and formats specific to the Project. The current finance staff may not be able to cope with the increased workload from the Project and the existing accounting software will not track the proposed Project's activities without further upgrade. As a result, the FM risk is assessed as High, and the following mitigation measures have been proposed: (i) The FM Chapter of the existing POM will be updated to reflect the increased scope and co-financing arrangements prior to Loan Effectiveness¹³; (ii) The PIU will be strengthened with an additional Financial Specialist by Loan Effectiveness; and (iii) The existing accounting software will be upgraded to enable it to track project accounting within two months after Effectiveness. The FM arrangements are assessed as adequate given the proposed mitigation measures.

46. The PIU is familiar with the practice of submission of quarterly IFRs and a similar approach has been adopted under the proposed Project. The PIU will submit quarterly IFRs within 45 days after the end of each quarter. The current practice of external auditing for projects financed by MDBs is as follows: the project financial statements are audited: (i) by independent private auditors, on the terms of reference acceptable to the WB and AIIB, and (ii) in accordance with the International Standards on Auditing. A similar approach has been adopted under the Project. The PIU will submit audited project financial statements for each fiscal year and at the closing of the Project to AIIB and the WB within 6 months after the end of such period.

47. **Allocation of counterpart funds.** The GoU will provide counterpart financing in the amount of USD40 million. This amount will cover the expected payments of indirect taxes (like VAT and customs duties) as well as the costs for land acquisition, if any. Previously counterpart funds were provided in the form of tax and customs exemptions. With the recent revision of the tax code, the GoU through the Ministry of Finance (MoF) would be required to allocate adequate counterpart funds for payments of taxes and customs duties. During the assessment it was observed that the GoU has not yet established the exact mechanism for such proposed allocation for payments of indirect taxes. MoF and MIFT clarified that such mechanism would be established timely.

48. **Disbursements.** It is expected that disbursements will mainly be processed through Advance and Direct Payment methods. The PIU will open a pooled Designated Account at a financial institution acceptable to the Bank, which will be shared by the IBRD and AIIB and will be used only for the financing of eligible expenditures. Considering the joint co-financing approach, all project disbursements would be handled by the WB according to its disbursement procedures using the WB's Client Connection System. The details of this arrangement and other disbursement specifics will be finalized through the issuance of the Disbursement and Financial Information Letter by the WB.

49. **Governance and Anti-corruption.** AIIB is committed to preventing fraud and corruption in the projects it finances. For this Project, the WB's Anti-corruption

¹³ The updated POM will define in detail the flow of funds, relevant documents and approval process, internal control procedures to be followed for managing project resources as well as the disbursement and reporting procedures and formats specific to the Project.

Guidelines shall apply which are materially consistent with AIIB's Policy on Prohibited Practices (2016). However, 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 or coercive practices relating to the Project and to take necessary measures to prevent and redress any issues in a timely manner, as appropriate.

50. **Financial Crime and Integrity and Counterparty Due Diligence / Know Your Counterparty.** A screening has been conducted by an external service provider mandated by Risk Management Department. The key findings are as follows: i) No sanctions reported on the country, heads of state (elected and administrative), PIU and its head and authorized signatory, ii) no adverse news reported on heads of state (elected and administrative), PIU and its head and authorized signatory.

I. Environmental and Social

51. **Environmental and Social Policy and Categorization.** The Project will be co-financed with the WB, as the lead MDB, and its environmental and social (E&S) risks and impacts have been assessed in accordance with WB's Environment and Social Safeguard Policies (ESSP). To ensure a harmonized approach to addressing the E&S risks and impacts of the Project, and as permitted under AIIB's Environmental and Social Policy (ESP), the WB's ESSP will apply to the Project in lieu of AIIB's ESP. AIIB has reviewed WB's ESSP and is satisfied that: (a) it is consistent with AIIB's Articles of Agreement and materially consistent with the provisions of AIIB's ESP and the relevant E&S Standards; and (b) the monitoring procedures that are in place are appropriate for the Project. In accordance with WB's ESSP, the Project is classified as Category B (equivalent to Category B if AIIB's ESP were applicable), since the E&S risks and impacts are relatively limited, localized and can be easily mitigated by applying best construction practices and relevant precautionary measures.

52. WB's Environmental Operational Policy (OP) 4.01 is triggered as the Project will generate some adverse environmental and social impacts, as well as OP 4.12 (Involuntary Resettlement) and OP 4.11 (Physical Cultural Resources) in view of potential impacts and risks to livelihoods and cultural resources.

53. An Environmental and Social Management Framework (ESMF) which includes an outline of an Environmental and Social Management Plan (ESMP), a standalone Resettlement Policy Framework (RPF) along with an Entitlement matrix, an outline for an Abbreviated Resettlement Action Plan and a Resettlement Action Plan (RAP) were prepared for the MSCIUDP and publicly disclosed in October 2018. The ESMF and RPF were updated to include the new regions covered by the proposed Project. They will provide guidance on the assessment of specific environmental, social, including resettlement risks and impacts applicable to the proposed Project and provide guidance to mitigating them. Investments with moderate impact will require the development of a site-specific Environmental and Social Impact Assessment (ESIA) and/or a simple ESMP, while those with anticipated minor impacts can be screened according to the standard ESMP Checklist included in the ESMF. The ESMF also includes E&S screening and assessment guidelines that limit eligibility to investments that are not expected to have significant environmental and social impacts. No Category A investments that may impact sensitive and valuable ecosystems, major historical sites

of cultural and social significance, or those requiring extensive resettlement will be eligible for support under the proposed Project.

54. The team has worked closely with the WB to include specific selection criteria to enhance environmental and social sustainability and inclusive accessibility for all (summarized in Annex 2) of the investments. Thus, the Project is expected to have an overall positive impact on environment and communities of the targeted medium-size cities.

55. **Environmental Aspects.** The proposed Project will focus on improving, upgrading and limited extension of existing infrastructure in urban areas. No natural habitats, forested, or protected areas will be impacted. The anticipated adverse environmental impacts are mainly related to typical small-scale civil works, such as dust and waste generation (which may include asbestos dust pollution and transformer oil), air, noise, water pollution and vibration, limited tree felling, health hazards and labor safety issues (including child and forced labor). A site-specific ESIA and/or EMSP will be used for assessment and mitigation of subproject environmental impacts and risks. If a subproject envisions the rehabilitation, restoration, or repair of historical sites, a dedicated Environmental and Social Assessment will be undertaken in line with national regulations and OP 4.11 - Physical Cultural Resources. Any investment that may involve handling of asbestos will develop an Asbestos Containment Material Management Plan (an example of which is included in the ESMF).

56. **Social Aspects.** The Project is expected to have significant positive social impacts including: (a) improved civic amenities; (b) strengthened local governance; and (c) enhanced livelihood opportunities. Key adverse social risks relate to inadequately inclusive local-level participation, occupational health and safety, temporary and / or permanent limited resettlement, economic displacement and access restrictions. Site-specific ESIA and/or a simple ESMP will provide dedicated mitigation measures for these risks. Impacts on livelihoods will be mitigated according to the provisions of RAPs or Abbreviated Resettlement Action Plans, to be developed based on the RPF for each investment.

57. **Gender.** Women will be given equal access to resources and services and provided with opportunities that would empower them to participate in the selection of investments. Specifically, the Project will require that each mahala (local community association) delegates representatives (including women) to be closely involved in consultations and decision-making process regarding the planned investments benefiting the mahala.¹⁴ The social management and resettlement instruments shall mainstream gender and social inclusion. During project implementation a gender assessment study will be conducted and if necessary, additional mitigation measures may be undertaken, such as the preparation and implementation of a dedicated Gender action plan.

58. **Stakeholder Engagement, Consultation and Information Disclosure.** The proposed Project's ESMF and RPF are disclosed on the WB's project webpage¹⁵. Both instruments and their Russian translation are also disclosed on the AIIB dedicated page¹⁶. Hardcopies are available on project sites.

¹⁴ A dedicated indicator in the Results Framework is included to monitor these gender considerations.

¹⁵ <https://projects.worldbank.org/en/projects-operations/document-detail/P173259>

¹⁶ <https://www.aiib.org/en/projects/details/2021/proposed/Uzbekistan-Medium-size-Cities-Integrated-Urban-Development-Project.html>

59. **Project Grievance Redress Mechanism.** The MSCIUDP's Grievance Redress Mechanism will be used to address grievances and receive feedback from all stakeholders, including Project workers in a timely manner. Depending on the dynamic COVID-19 situation, it may be adjusted to include channels where physical presence is not required to lodge a complaint.

60. **Bank's Project-Affected People's Mechanism (PPM).** Pursuant to AIIB's agreement with the WB, WB's ESSP will apply to this project instead of AIIB's ESP. The WB's corporate Grievance Redress Service, and its independent accountability mechanism, the Inspection Panel, which reviews the WB's compliance with its policies and procedures, will handle complaints relating to E&S issues that may arise under the Project. In accordance with AIIB's Policy on the PPM, submissions to the PPM under this Project will not be eligible for consideration by the PPM. Information on WB's corporate Grievance Redress Service is available at <http://www.worldbank.org/en/projects-operations/products-and-services/grievance-redress-service>. Information on WB's Inspection Panel is available at <http://www.inspectionpanel.org>.

61. **Proposed follow-up.** The team will work with WB's counterparts to support PIU in identifying eligible sub-projects, evaluate their E&S risks and propose appropriate mitigation measures.

J. Operational Policy on International Relations

62. **Operational Policy on International Relations/Policy Waivers.** AIIB's Operational Policy on International Relations (OP on IR) is triggered because some of the proposed activities under the Project include rehabilitation of existing sewerage systems and potable water supply involving possible use of two international waterways: the Amu Darya and the Syr Darya rivers or their tributaries. The riparians of these waterways include: Afghanistan, Kazakhstan, Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan. Pursuant to Section 2.3 of the OP on IR, AIIB may, instead of carrying out its own assessment, rely on the assessment of the co-financier if the Bank is satisfied with the assessment capacity and process of the co-financier, as well as the assessment itself.

63. In this case, the WB's OP 7.50 on International Waterways is applicable to this Project, which requires an assessment of the Project's impact on the riparians to these two international waterways and the impact of the riparians' potential use of these waterways on the Project, in order to determine if notification to the riparians would be required. In its assessment, the WB determined that the activities to be financed would be limited to rehabilitation, modifications and minor additions or alterations to existing schemes in ways which would not increase the amount of water abstracted or lead to appreciable impact on the water sources or local hydrological regime. It concluded that these works would not: (i) adversely change the quality or quantity of water flows to the other riparians; or (ii) be adversely affected by the other riparians' possible water use as they are expected to contribute to a more efficient sewer collection system due to reduction of leakages and rehabilitation of wastewater network, resulting in improvement of wastewater discharge in the two main river basins of Amu Darya and Syr Darya or their tributaries. Consequently, the WB determined that notification to the riparians was not required under its OP 7.50.

64. AIIB's OP on IR provides that riparian notification is not required if the Project is "expected to have minimal or no effect on any of the other riparians." Since AIIB is

satisfied with the WB's assessment capacity and process and concurs with its assessment, notification under the OP on IR is similarly not required under paragraph 3.3(c)(i) of the OP on IR.

K. Risks and Mitigation Measures

65. In line with the WB's assessment, the project team has assessed the overall project risk as "Medium".

Table 4: Summary of Risks and Mitigating Measures

Risk Description	Assessment (H/M/L)	Mitigation Measures
Technical Design Low alignment of activities with urban planning objectives and low technical quality of design.	Medium	Selection of investments in Participating Cities will be based on a rigorous selection process based on urban studies. Detailed designs will be prepared under the Project with ToRs and selection of consultants acceptable to the Bank.
Implementation Capacity Existing PIU may not be able to cope with increased workload.	Medium	Experienced staff will be hired to increase existing PIU's capacity.
Fragmented Sector and Policy Framework Overlapping sector responsibilities will complicate the process of getting required approvals and clearances from multiple sector authorities, thus leading to delays.	High	MIFT will coordinate with local governments and competent sector authorities to obtain the required clearances.
Procurement Redundant iterative internal procurement-related approvals may lead to delays.	Medium	Streamlining of the procurement processes, based on lessons from parent project, was agreed to accelerate procurement
Financial Management Existing finance staff may be overburdened with additional project activities; existing accounting software does not support the proposed operation, which may lead to irregular and unreliable financial reporting.	High	The FM Chapter of the existing POM will be updated prior to Loan Effectiveness. The PIU will be strengthened with an additional Financial Specialist by Loan Effectiveness; and the existing accounting software will be upgraded to enable it to track project accounting within two months after Effectiveness.
Environmental and Social	Medium	The E&S instruments include appropriate and/or decentralized

Monitoring multiple subprojects that are geographically widespread may be logistically challenging.		measures for E&S monitoring to enable effective knowledge sharing among RSPIUs.
Financial Additional operation and maintenance requirements may strain local Government budgets.	Medium	Project activities aim to unlock potential for economic growth and improve revenue generation of the Participating Cities. Financial viability will be assessed as part of urban regeneration studies / feasibility studies.
Counterpart Contribution The establishment of a mechanism to ensure timely availability of counterpart funding may lead to delays in project implementation.	Medium	MIFT will liaise with MoF to establish such mechanism in a timely manner.
Stakeholders Weak coordination among local and regional governments	Medium	MIFT will coordinate with various stakeholders at different governmental levels.

Annex 1: Results Monitoring Framework

Project Objective:	The Project Objective is to: (a) improve access to selected urban infrastructure (including public spaces) and services in Participating Cities; and (b) strengthen the institutional capacity of the Borrower's relevant agencies to deliver and manage local infrastructure.										
Indicator Name	Unit of measure	Base-line Data	Cumulative Target Values ¹⁷						End Target	Frequency	Responsibility
		Year	YR1	YR2	YR3	YR4	YR5	YR6			
Project Objective Indicators:											
1. Number of people provided with improved urban living conditions (of which female)	Number	0	0					200,000	200,000	Mid-term and closure	MIFT through PIU
2. People provided with access to improved public spaces (within 15 minutes walking distance from the place of residence)	Number	0	0					66,000	66,000	Biannual	MIFT through PIU
3. Number of municipalities with improved real estate and infrastructure assets operation, management and maintenance practices, and with trained municipal officials (Number)	Number	0	0					6	6	Mid-term and closure	MIFT through PIU
Intermediate Results Indicators: Component 1: Improvement of Urban Services and Enhancement of Public Urban Spaces											
1. Urban Roads rehabilitated	Kilometers	0	0					20	20	Biannual	MIFT through PIU
2. Streets with improved street lighting in selected municipalities	Kilometers	0	0					16	16	Biannual	MIFT through PIU
3. New or rehabilitated pedestrian walkways in selected municipalities	Kilometers	0	0					33	33	Biannual	MIFT through PIU
4. Length of water transmission and distribution, and wastewater pipes replaced or laid (Kilometers)	Kilometers	0	0					343	343	Biannual	MIFT through PIU

¹⁷ The cumulative progress target values will be determined during the inception phase of the Project depending on the identified activities. The attribution of end targets between parent project and scaling-up of activities in the additional two regions will also be re-assessed during inception. The indicated targets account for 2/3 of the combined target, proportionately reflecting the split in financing amounts.

Intermediate Level Results Indicators. Component 2: Institutional Strengthening and Capacity Building											
5. Number of people, of which female, provided with trainings in selected municipalities	Percentage/Number	0	0					200	200	Biannual	MIFT through PIU
Intermediate Level Results Indicators. Component 3: Implementation support Urban Spaces											
6. Share of beneficiaries of the Project (%) who agree that interventions supported by the Project have addressed their needs	Percentage	0	0					70	70	Start, Mid-term and closure	MIFT through PIU
7. Number of mahalas (community associations) where public hearings and consultations were held to inform design of urban infrastructure improvements	Number	0	0					90	70	Start, Mid-term and closure	MIFT through PIU

Annex 2: Detailed Project Description

1. The proposed Project contributes to GoU's vision to roll-out a National Medium Size Cities Program (NMSCP), which supports its long-term objective of achieving an "integrated and balanced socio-economic development of regions, districts and cities" of Uzbekistan.¹ The NMSCP aims to improve quality of life, functionality, and attractiveness of medium-size cities in Uzbekistan by addressing major infrastructure barriers, and bottlenecks to long-term development. In doing so, it will also contribute to building capacities of relevant government agencies to carry out strategic and integrated territorial planning, operate and maintain infrastructure, deliver municipal services, and generate the necessary revenues for sustainable long-term development.
2. The NMSCP, supported by a WB-led Series of Projects, to assist medium-size cities is expected to include financing from GoU, various development partners, including the World Bank, AIIB, and the potential leverage of private sector capital. NMSCP employs a framework approach whereby tailored investment programs are identified to support the strategic urban development vision of various cities in the country.
3. The WB's **Medium-size Cities Project (MSCIUDP, parent project)** is the first project in the Series of Projects and targets the three selected cities of Chartak (Namangan region), Kagan (Bukhara region) and Yangiyul (Tashkent region), playing a demonstration and catalytic role. Considering the high demand for urban investments in secondary cities, the proposed Project is scaling up the MSCIUDP's activities in additional regions whereby the regions of Surkhandariya and Kashkadariya have been selected in consultation with MIFT. Both regions i) are among the three poorest regions in the country, ii) present a good mix of opportunities to develop industry and service sectors, iii) have unique and fragile ecosystems which are now being affected by continued urban sprawl, iv) border with neighboring countries and activities may enhance cross-border connectivity and v) Kashkadarya is the third most populated region in Uzbekistan. The scaling-up of activities under MSCIUDP is processed as a new project for AIIB and as an Additional Financing to its parent project for the World Bank.
4. **Progress of WB-financed MSCIUDP parent project.** Progress towards the achievement of the project objectives is rated satisfactory by the WB. Overall implementation progress is rated moderately satisfactory due to COVID-19 related delays (lockdown, initial delay in mobilization of a Project Manager and key PIU personnel, and delays in procurement and detailed design preparation). The project is experiencing serious delays in disbursement, still at negligible levels of 1.7%, albeit WB expects disbursement to accelerate. Current implementation activities include the preparation of feasibility studies for the fast-track investments (comprising 35% of the loan) and the selection process for studies to prioritize the investments for the integrated urban upgrading (under the final stage, comprising about 45% of the loan). The tender award for equipment for maintenance of municipal assets has been concluded. The lessons from this process will allow to speed up preparation of future investments in the project participating cities and will also be used for the AF supported investments.

¹ Presidential Decree dated February 7, 2017, on Action strategy on five priority directions of the Republic of Uzbekistan in 2017-2021.

5. **Lessons Learned for Project Delivery.** The PIU will implement a set of agreed measures to accelerate the procurement process. At its initial stage, the MSCIUDP suffered from the systemic delays in the procurement of consultancies to prepare detailed designs and tender documents that affected the speed of project implementation. Key bottlenecks identified have included: (i) slow review and approval of Terms of References and reports by relevant government agencies, (ii) lack of reliable and predictable business standards for the approval of procurement documents by the Procurement Committee, and (iii) redundant and iterative internal procurement-related approvals. To address these challenges, it has been agreed, that the PIU will: (i) further streamline the procurement processes (including removing duplication of approval steps for long-listing and short-listing; removing approval step of combined technical and financial evaluation reports); and (ii) strengthen contract management capacity of its team so that it matches the risk/complexity of contracts. Additionally, the Project Procurement Strategy for Development has been updated as a part of the preparation of this proposed Project, which will allow to account for changed market conditions and adequately adjust selection methods, requirements, evaluation methods and types of contracts – all of which should allow for more efficient procurement process going forward.

6. The components under the proposed Project are largely similar to those of the parent project with a few notable differences: i) The Capacity Building activities focus on the regional and local level in the proposed Project (except activities with Academy of Public Administration), while the parent project included significant Capacity Building at the national level, and ii) a CERC has been added.

7. **Component 1 - Improvement of Urban Services and Enhancement of Public Urban Spaces (USD212.40 million).** This component will finance selected infrastructure investments that improve urban functionality and livability and contribute to the enhancement of selected public urban spaces in project cities (referred to as specific activities). These may include (i) upgrading and/or construction of potable water supply and sewerage systems, (ii) replacement of outdated power equipment in public areas with the goal of increasing efficiency and reliability of power supply, (iii) upgrading of public administrative buildings (e.g., thermal retrofitting and other modern energy efficiency technologies), (iv) area-based urban upgrading of targeted public spaces (e.g. street networks), and (v) feasibility studies (if required), detailed designs, construction supervision, and other services associated with the investments are also envisaged to be financed by this component.

8. Fast-track investments (to start in year 1-2 of the project) have already been identified and will be validated based on the results of the abbreviated feasibility studies. The envisaged strategic urban investments, expected to be implemented in years 3-5, will be identified and prioritized based on urban regeneration studies, taking into consideration consultations with the MIFT, regional government and Participating Cities and subject to meeting the investment selection criteria (described in detail in this Annex).

9. **Component 2 - Institutional Strengthening and Capacity Building (USD21.60 million)**
Subcomponent 2.A. - Institutional strengthening and capacity building of project municipalities and their regions

This subcomponent will support the institutional strengthening and capacity building of project municipalities and their respective regional governments with a focus on the improvement of their asset management and maintenance capacity. Specifically, the subcomponent will include activities to improve capacities of municipalities in using GIS systems, in coordination and cooperation with relevant central government agencies and other ongoing Bank and IFIs' supported initiatives. Many municipalities lack a systematic approach towards asset management and need appropriate software and equipment for asset management (e.g., GIS-based systems) and/or training of municipal officials in the use of those systems. Municipal equipment for maintenance is also foreseen to be procured under this component to strengthen the Participating Cities' Capacity for appropriate maintenance of municipal assets.

Subcomponent 2.B. - Support for GoU policy and reforms for sustainable urbanization.

This subcomponent will complement activities under the parent project and support sustainable and resilient urbanization. The focus will be on the support of decentralization reforms through strengthening and empowering local governments (capacity building of local governments). Specifically, this component will finance institutional strengthening and capacity building activities aimed to support (i) the finalization and/or operationalization of the national urbanization strategy, (ii) development of procedures and regulations to mobilize private investment in solid waste management sector, (iii) support to the respective water companies on mobilizing private investments and increasing efficiency in water supply. Technical and capacity building assistance may also be provided in other areas including (but not limited to) land privatization, housing policy and road safety. The component will also support the Academy of Public Administration (a government body responsible for training of public servants) in developing a new system of trainings and capacity building for local governments. This will include (i) the design and piloting of institutional systems and innovative tools to strengthen local governments in support of a gradual long-term process of decentralization of responsibilities and decision-making in delivery of local infrastructures and services, and (ii) design and roll-out of a program for strengthening and building capacities of local governments in sustainable delivery of municipal services and infrastructures.

10. **Component 3 - Implementation Support (USD5.75 million).** This component will support project implementation, including implementation of the project monitoring and evaluation system, communication strategy, training, and incremental operating costs of the Project Implementing Unit (both at central and regional levels).

11. **Component 4 - Contingent Emergency Response Component (CERC) (USD0).** This provisional component will allow for rapid reallocation of Project funds from other Components to provide immediate response capacity to the Government following an eligible crisis or emergency in Uzbekistan. A specific annex for the CERC will be added to the POM to lay out the provisions for activating and implementing the CERC, including definition and criteria (evidence) for eligible crisis, the process for CERC activation, potential activities/positive list to be financed, implementation arrangements, coordination mechanisms, and summary of key requirements.

Selection of Participating Cities and Activities

12. The Project is conceived with a regional lens to allow to address issues of urbanization in consideration of urban-regional linkages and inter-city dynamics. Within the selected regions, two

spatial typologies have been identified through urban diagnostics: A corridor of cities in Surkhandariya and a cluster of cities in Kashkadariya. These include dynamically growing cities and lagging cities. The urban area development vision that informs the selection of project activities is expected to contribute to the broader regional development of Kashkadariya and Surkhandariya regions.

13. The proposed Project is conceived as a demonstration project to support integrated urban development in Uzbekistan. While the objective is to reach a large number of beneficiaries, the selection process also aims to pilot an integrated urban development approach to unlock potential for economic growth. Hence, the selected Participating Cities include different types of medium-size cities to allow the demonstration of the approach for a typology of cities.

14. The basic criteria for the selection of Participating Cities are the following: (a) city or urban area that has at least 50,000 inhabitants (this could be an agglomeration of several small towns and/or urban type settlements (UTS)), (b) growing towns (in terms of population) with clear infrastructure gaps and economic growth potential, (c) lagging towns that are economically or physically connected to secondary hubs, and (d) cities with urban-region linkages (local connectivity). These cities display any of the following economic conditions:

- (i) **Regional hubs:** These cities are economic hubs, large magnets for migration and commuting, and/or are larger towns (which itself are a secondary center of the urban region);
- (ii) **Fast-growing medium-size agglomerations:** These agglomerations consist of a cluster of small towns and UTSeS that demonstrate rapid population growth trends;
- (iii) **Lagging towns:** These towns and medium size cities are located in proximity of larger cities and are functionally dependent on and connected with these larger cities. Residents may live in these lagging towns/cities but travel for employment, services and shopping activities to these larger cities.
- (iv) **Tourism cities:** These cities significantly depend on tourism activities as part of their economic development and growth.

Table 2.1: Participating Cities based on the above typologies

Type of Settlement	Surkhandariya Region	Kashkadariya Region
Regional hubs	<ul style="list-style-type: none"> • Denau 	<ul style="list-style-type: none"> • Shakhrisabz
Fast-growing medium-size agglomerations	<ul style="list-style-type: none"> • Sariosiyo-Shargun system • Shurchi • Jarqurgan 	<ul style="list-style-type: none"> • Kitab system • Guzar (Pachkamar) • Kasan
Lagging towns	<ul style="list-style-type: none"> • Sherobod • Kumkurgan 	<ul style="list-style-type: none"> • Karashina-Dehqonobod system • Muglan-Yangy Mirishkor
Tourism	<ul style="list-style-type: none"> • Boysun 	<ul style="list-style-type: none"> • Miroqi (Shakhrizab)

Unallocated ²	• Altansay	• Chirakchi (with FEZ)
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Selection Criteria for activities

15. The available funds will be split equally between the two regions. The allocation of funds to the Participating cities and specific activities will be agreed with MIFT, regional Governor, mayors of Participating Cities based on the process outlined in detail in the POM. Given that the Regional hubs are characterized by better basic municipal services, it is envisaged that the funding allocation is proportionally lower as compared to the cities, which have a higher need for investments in basic municipal services.

16. To achieve early implementation progress, fast-track investments to start in years 1-2 are identified. For years 3-5, strategic urban investments will be identified based on urban regeneration studies. The criteria for the selection of 1) fast-track investments and 2) strategic urban investments are described below in more detail:

- (i) Fast-track investments: The selection of fast-track investments follows an opportunity-driven approach to achieve quick wins, accelerate early implementation progress and deliver high and inclusive impact. These investments are expected to commence implementation within 1 to 2 years of the commencement of the Project. This will include basic investments with high technical readiness (feasibility studies preferably already being prepared by the municipalities) and low E&S and resettlement risks. The activities are proposed by local governments. Envisioned priority investments in this phase include the following activities with high environmental and social sustainability impact: water supply and sanitation rehabilitation/extension; energy efficiency of municipal buildings; and municipal equipment to strengthen operation and maintenance capacity. Abbreviated feasibility studies will be carried out to ensure economic and financial viability and that activities contribute to the Project Objective. Also, feasibility studies are expected to include E&S screening, whereby activities categorized as E&S Category A and activities on the E&S exclusion list cannot be financed by the Project.
- (ii) Strategic urban investments: These investments are expected to commence implementation within 3 to 5 years of the start date of the Project. Investments will be selected based on strategic urban regeneration studies (conducted by qualified consulting firms and funded by the parent project). The objective of the studies is to identify urban upgrading investments that would contribute to the Project Objective, are catalytic for economic growth and consider functional connections with other cities in the urban region (connectivity). A screening process will be applied at the stage of identification of the investment program in the participating cities, including for their compatibility with the Project Objectives, technical feasibility, accessibility for all, environmental and social risks, impacts and sustainability, economic and financial viability and their

² The cities of Altansay and Chirakchi are included on a preliminary basis and will require confirmation during project inception.

contribution to managing integrated urban growth (i.e. foster local identity, economic development, increase connectivity and quality of public spaces, foster residential functions, provide public/green spaces, increase human scale mobility). Also, CBA will be used to prioritize investments and optimize technical design. All investments should demonstrate high economic returns (IRR>5%). For relatively small investments, where data is not readily available and benefits are difficult to monetize, a CEA or MCA may be carried out to demonstrate economic viability in place of a CBA. Investments in this phase are expected to include public spaces and streetscapes, roads, bridges, sidewalks, urban lighting, public buildings and facilities. Investments contributing to unlocking local development (e.g., tourist visitor center) will be prioritized. Other urban infrastructure and rehabilitation of cultural heritage as far as it contributes to the Project Objective can be considered for inclusion.

Investment Packages

17. Based on the typology of activities mentioned under the fast-track and strategic urban investment phases, the aggregate investments in Participating Cities are expected to collectively align with the following investment packages:

- (i) Basic investments: These include investments in basic municipal services (e.g., water, sanitation, replacing outdated equipment for increasing energy efficiency and reliability of power supply) to improve urban livability. This package is expected to absorb up to 30-35% of the loan to cover the basic needs of the population required to enhance the development outcomes of the Project.
- (ii) Strategic investments: These address key areas / bottlenecks through area-based advanced urban upgrading (e.g., street upgrade, junctions, public space) and/or catalytic investments to support growth and job creation (e.g., bazaar improvement, tourism attractiveness/beautification, cultural heritage assets and attractions rehabilitation, targeted infrastructure required to unlock economic potential, like specific roads, or network infrastructure connections).
- (iii) Integrated package: This is a combination of basic infrastructure investments and strategic investments.

18. Given that regional hubs are generally characterized by a better provision of basic services, it is envisaged that they will be primarily targeted with strategic investments and will not receive investments in basic services. Fast-growing medium size agglomerations are in a strong need of both basic and strategic investments to address their rapid urbanization and are envisaged to receive an integrated package of investments, including both basic and strategic investments. For lagging cities and cities dependent on tourism, it is foreseen to focus the investments on improving the basic service provision. While the focus of investments is expected to be as described in this paragraph, the investment activities will be identified as per the process described in this Annex and the focus of investments as compared to the classification of cities may be adapted depending on the outcome of the urban regeneration studies.

Annex 3: Economic Analysis

Economic Analysis integral to the selection of activities

1. Economic analysis will be an integral part of the selection process for the investment activities. A full economic screening process will be conducted as part of the strategic urban regeneration studies and/or feasibility studies, confirming the economic and financial viability of each investment. Cost benefit analysis (CBA) will be used to ensure only high impact activities are selected and to optimize the technical design for the strategic urban investments. All investments are required to demonstrate economic returns above 5% (social discount rate). CEA or multi-criteria analysis (MCA) may be carried out in place of a CBA for relatively small investments and where data is not readily available, and benefits are difficult to monetize.

Economic Analysis of expected types of activities

2. While economic analysis will be conducted for each project activity to be selected as described above, the remainder of this annex presents the results of Cost-Benefit Analyses of typical investments, which are expected to be financed under the scaling-up of activities under the proposed Project. The purpose is to illustrate the economic viability of the expected types of project activities in Uzbekistan.

3. CBA was conducted by the WB during the appraisal stage of the parent project for three types of activities, namely: energy efficient investments (refurbishment of public buildings and streetlighting improvements), wastewater treatment (rehabilitation of sewerage network) and urban upgrading. While these investments are generally still under early implementation (design phase), the key assumptions of the analysis still hold, and thus the conclusions remain relevant. Further results from a CBA of a WB-financed water and sanitation project in Uzbekistan are also considered.³ The Project Team has reviewed and discussed the analyses with the WB team. The results of the analysis are presented below.

Data and Methodology

4. **Data:** Secondary data form the main source used for the economic analysis, such as preliminary studies (e.g., TRACE and City Energy Savings Action Plans), pre-feasibility studies or official/in-country statistics. This data was complemented with key assumptions for the specific contexts and investments.

5. **Methodology:** A cost-benefit analysis was carried out for each of the three types of activities and the economic viability was assessed by comparing “with-” and “without-project” scenarios. The Economic Internal Rate of Return (EIRR) and Economic Net Present Value of the Project was estimated based on a discounted cashflow analysis considering economic costs and benefits. The WB generally applied a discount rate of 5% in Uzbekistan. For the additional considered Cost-Benefit Analysis of a WB-financed water and sanitation project in Uzbekistan, a discount rate of 6% was considered.⁴

6. **Benefits of urban investments.** In general, investing in urban infrastructure can lead to overall improved living conditions (e.g., improved health through increased access and quality of

³ The project is called Water Services and Institutional Support Project (P162263).

⁴ The project is called Water Services and Institutional Support Project (P162263).

water and sanitation services, safer movements of residents and tourists, reduced criminal activities, reduced pollution) as well as contribute to climate change mitigation due to improved energy efficiency and avoided greenhouse gas emissions. To capture the economic benefits of the above-mentioned three types of investments, the analysis quantified only a part of the full range of possible benefits, which can hence be interpreted as a conservative or lower estimate of the net economic benefit of the assessed project activities. Specifically, the considered project benefits from investing in retrofitting of public buildings and street-lighting are cost savings due to energy efficiency and related reductions in carbon emissions, plus lower cost of maintenance for streetlighting. With regards to investments in wastewater treatment infrastructure, the benefits considered are avoided pollution costs from two key pollutants (biochemical oxygen demand (BOD) and chemical oxygen demand (COD)). The considered benefit from investments in urban upgrading is the increase in property values.

Estimation of benefits

7. **Estimation of benefits from energy efficiency investments in street lighting.** The quantified benefits of streetlights include energy cost savings, lower cost of maintenance and carbon emissions reductions. Taking the example of Chartak, one of the pilot cities of the parent project, energy savings from street lighting is assumed to be 145 MWh per year, which is equivalent to USD34,754 at USD0.24/kWh. Maintenance savings for streetlights is calculated at 714 USD per year. In terms of emissions savings, the annual energy saving of 145 MWh is converted into tons of carbon dioxide (CO₂) based on the carbon dioxide emissions factor of 0.558 tons CO₂ per MWh. This result is multiplied by the social value of carbon price following WB guidelines of USD35 per ton CO₂ equivalent to arrive at a USD2,828 social value in 2020.

8. **Estimation of benefits from energy efficiency investments in buildings.** The quantified benefits from retrofitting public buildings include energy cost savings and carbon emissions reductions. Taking the example of Chartak once again, energy saving from retrofitting of a school building and an administrative building is cumulatively calculated at 378 MWh per year, which is equivalent to USD90,702 at USD0.24/kWh. In terms of CO₂ savings, annual energy saving of 378 MWh is converted into tons of CO₂ based on CO₂ emission factor of 0.558 tons CO₂ per MWh. This result is then multiplied by the social value of carbon price following WB guidelines to arrive at a USD7,138 social value in 2020.

9. **Estimation of benefits from rehabilitation of full sewerage network.** The activities include the rehabilitation of a wastewater treatment plant, pumping stations and sewerage network. Taking Kagan, one of the pilot cities of the parent project, as an example, the main benefit considered are the avoided pollution costs. Specifically, the common pollutants considered are *biochemical oxygen demand* (BOD) and *chemical oxygen demand* (COD). Other pollutants, such as nitrogen and particulate matter are not considered. The following assumptions were considered: 21.9 kg per year of BOD pollutants; 49.3 kg per year of COD pollutants; 16,563 persons equivalent of pollution load eliminated through wastewater treatment and 4,220 social customers (per year); EUR0.033 per kg as shadow price of BOD and 70% (minimum percentage reduction of BOD pollutant); EUR0.98 per kg as shadow price of COD and 75% (minimum percentage reduction of COD pollutant); an exchange rate of 1 USD per euro; and an annual growth of persons equivalent of 3% for subsequent years beyond 2020. Based on these two

pollutants, the social value of avoided cost of pollution because of rehabilitation of the Kagan sewerage infrastructure was USD117,524 in 2020.

10. **Benefits from urban upgrading investments.** Urban upgrading benefits are derived from the increase in property values, associated with proposed investments in public spaces and urban infrastructure. Taking Yangiyul as an example, the total number of dwellings that are expected to benefit is 7,024. Assuming an average rent of UZB1,000,000 monthly, an assumed 15% increase in property prices, an exchange rate of UZD8,115 per USD, the annual value added to property prices is USD1,588,048 per year.

11. **Project Costs.** The investment cost for the above considered typical investments are estimated at a total of USD15.7 million whereby the present value of economic costs are as follows: streetlighting (USD219,812), building retrofits (USD565,069), sewerage rehabilitation (USD1.8 million) and urban upgrading (USD13.4 million). Annual operations and maintenance (O&M) costs for building retrofits are assumed to be 5% of the capital investment cost. O&M costs for rehabilitation of full sewerage network and urban upgrading are assumed an annual 0.1% and 1% of the capital investment cost. No O&M cost is assumed for streetlighting investments (except for the electricity costs). To convert financial costs to economic costs, VAT has been removed and a standard conversation factor of 0.85 has been applied to correct for other taxes and distortions in the economy.

Estimation of benefits for the WB-financed Water Services and Institutional Support (WASIS) Project

12. **Estimation of benefits from water supply and sanitation.** The benefits considered include time savings for beneficiaries, who would no longer need to access water from relatively distant sources; reductions in direct costs of treating existing water sources; reduced health costs related to reduced burden of disease (diarrhea and infectious hepatitis); and reduced pollution resulting from sewage discharge. The annual benefits in Karakalpakstan, Syrdarya and Samarkand (project locations) are estimated at USD48.1 million in 2025 (start year when all investments are operational).

13. **Project Costs.** The investment costs include estimated capital expenditures and operating costs. Capital investments are estimated to be USD218.2 million and expensed over a five-year construction period, while annual O&M costs are assumed to be USD3.8 million per year.

Results of Economic Analysis and discussion

14. Using the economic analysis results for the four investments analyzed during the appraisal stage of the parent project, the analysis shows that the EIRR is estimated at 7.5 percent, exceeding the social discount rate of 5 percent. The Economic Net Present Value is estimated at USD0.79 million, based on a 5 percent discount rate. For the WASIS project, the EIRR is estimated at 17 percent, with an Economic Net Present Value of USD255.1 million using a social discount rate of 6 percent. The results are summarized in Table 3A below, grouped by type of investment. The considered investments yield a positive Net Present Value (NPV) and an EIRR above 5 percent. A sensitivity analysis was conducted for three investments under the parent project assuming a 10 and 20 percent increase in project costs. No sensitivity analyses were conducted for urban upgrading activities in Yangiyul. Column 3 and 4 present sensitivity analysis

results for a 20 percent increase in project costs. As observed, 2 out of 3 investments continue to demonstrate positive NPVs and an EIRR beyond the 5 percent threshold.

15. Based on the analysis of the above-mentioned types of investments, the range of EIRRs calculated for the cities in the parent project and the WB-funded WASIS Project are as follows:

- (i) Energy efficient investments: between 10 and 23% in all project cities in the parent project;
- (ii) Wastewater treatment investments: at least 6% in Kagan (a project city in the parent project); at least 12% for the considered activities in the WASIS project;
- (iii) Urban upgrading investments: 7.7% for a project in Yangiyul; 20% for an ecotourism trail project in Chartak; and
- (iv) Water supply and sanitation investments: 29% for a sewerage project in Karakalpakstan; 8.4% for a water supply project and a sewerage project in Syrdarya; 6.9% for a water supply project and a sewerage project in Samarkand; 17% for the combined locations.

Table 3.1: Economic Evaluation Results for a sample of investments under WB projects

Investment Type	NPV USD million	EIRR %	Sensitivity analysis – 20% increase in investment costs	
			NPV USD million	EIRR %
Chartak Energy Efficiency investments in street-lighting	0.14	13	0.10	10.0
Chartak Energy Efficiency investments in buildings	0.66	20	0.54	16.0
Kagan rehabilitation of full sewerage network in project area	0.25	6.2	-0.10	4.6
Yangiyul urban upgrading investments	3.7	7.7	N/A	N/A
Karakalpakstan sewerage investment	225.5	29	N/A	N/A
Syrdarya water supply and sewerage investments	15.2	8.4	N/A	N/A
Samarkand water supply and sewerage investments	4.8	6.9	N/A	N/A

Note: No sensitivity analyses were conducted for Yangiyul urban upgrading investments and the water supply and sanitation investments in Karakalpakstan, Syrdarya and Samarkand.

Annex 4: Sovereign Credit Fact Sheet

Uzbekistan is a lower-middle-income country with income per capita of around USD1,700 and a population of 33.6 million. Since taking office in 2016, the new government is pursuing 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 (including the exchange rate), reforms to the tax system, public financial management as well as land and agricultural policies.

The modernization agenda has made Uzbekistan an attractive destination for investment, both foreign and domestic. Between 2016 and 2020 the country climbed from 87th to 69th place in the

World Bank's Doing Business ranking. 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. That said, the state continues to dominate the economy. State-owned enterprises account for almost a half of GDP and more than three quarters of tax revenues. State banks control 85 percent of banking assets.

Growth was robust pre-pandemic, at around 5-6 percent, driven by investment, industry (including construction), and services. Inflation remained in double digits, due to high growth, continued liberalization of prices, and currency depreciation. The elevated current account deficit reflected high investment rates. Fiscal policy was relatively prudent, with moderate deficits.

Selected Economic Indicators	2017	2018	2019	2020	2021*	2022*
GDP growth 1/	4.5	5.4	5.8	1.6	5.0	5.3
Inflation (CPI, average) 1/	13.9	17.5	14.5	12.9	10.0	11.2
General government fiscal balance	-1.9	-2.1	-3.9	-4.4	-5.5	-4.0
Gross public debt	20.2	20.3	29.3	37.8	42.1	44.2
Gross public financing need	3.1	2.6	11.6	11.1	7.7	8.0
Current account balance	2.5	-7.1	-5.8	-5.4	-6.4	-5.9
Gross external debt	34.1	34.3	43.9	58.4	62.3	63.8
Gross external financing needs	-0.1	10.4	9.3	10.1	14.4	12.4
International reserves (USD billion)	28.1	27.1	29.2	34.9	34.5	35.2
Exchange rate (UZS/USD) 2/	8,120	8,340	9,508	10,477	10,515	..

Source: IMF Country Reports No. 21/85 and 20/171; in percent of GDP unless indicated otherwise; '*' denotes projections.

Notes: 1/ percent change year-on-year, average 2/ data from the central bank, end-of-period, for 2021: as of Apr 29

Recent developments

The COVID-19 pandemic, with around 90,000 reported cases and around 650 deaths as of April 2021, has impacted Uzbekistan significantly, particularly in the second quarter of 2020. Tight lockdown measures imposed in March and July 2020, and a decline in economic confidence have led to a sharp economic slowdown. The shock has been compounded by lower oil prices, which impacted the gas sector, an important export revenue source.

The economic response, worth around 4 percent of GDP, has been timely, targeted, and relatively large. Spending increased on healthcare, expansion of social assistance to low-income families, and lifeline support to affected businesses (subsidies, tax relief, etc.). The central bank reduced the interest rate by 200bps and provided liquidity to banks, which in turn allowed banks to offer loan repayment holidays or maturity extensions to their affected clients.

Thanks to the above, the economic impact has been less than feared. Starting in the second half of 2020, with new infections falling, restrictions have been gradually lifted and businesses have

reopened. For the whole 2020 economic growth was still positive, at 1.6 percent, supported by agriculture, manufacturing, construction and stable remittances. The 4.4 percent of GDP fiscal deficit in 2020 was lower than budgeted and almost unchanged from 2019, thanks to the faster-than-expected recovery, higher gold revenues and some postponed capital spending.

Outlook and risks

Going forward, growth is expected to increase to around 5 percent in 2021. The recovery is dependent on the successful roll-out of the vaccine, the containment of the virus at home, the pace of global recovery, and the level commodity prices. In this regard, a vaccination campaign has started in March 2021 (some 0.5 million doses delivered as of April 2021) with an aim to inoculate the population by mid-2022. The outlook for global recovery and oil prices has improved since the beginning of 2021. The 2021 budget remains accommodative, with higher expenditures on healthcare, social assistance, and policy support. Inflation should moderate slightly due to the still weak demand.

Notwithstanding the pandemic and the oil shock, Uzbekistan's debt remains sustainable. Public debt has seen a rapid increase in the past few years, to 38.7 percent of GDP in 2020, on account of externally financed investment projects, and, most recently, the COVID-19 impact. Debt is still low by peer standards, though. According to the IMF, over the medium term, public debt is expected to peak at around 44 percent of GDP in 2022 and then gradually decline to below 40 percent, once the pandemic recedes, growth returns to potential, and a moderate fiscal consolidation kicks in. Public debt is vulnerable to the exchange rate, due to high dollarization, and to an export shock (e.g., commodity prices). Total external debt has grown in parallel, but remains moderate, at 58 percent of GDP in 2020.

There are important mitigants to debt vulnerabilities. Thanks to diversified commodity exports Uzbekistan has substantial buffers, with international reserves of USD35 billion (equivalent to over 60 percent of GDP). According to Fitch, the country and the government remain net creditors. Some 90 percent of public debt is official, concessional, and long term, which limits rollover risks. Official support was strong in 2020. Also, to reinforce debt sustainability, the government plans to introduce a set of fiscal rules, including debt and deficit ceilings.

Uzbekistan's creditworthiness has been sustained through the pandemic. After an initial spike, yields have returned to pre-pandemic levels, and the authorities have successfully issued a USD750 million international bond in late 2020. All three major rating agencies have affirmed Uzbekistan's sovereign credit rating (BB- for S&P and Fitch, B1 for Moody's), except that in mid-2020 S&P changed the outlook from stable to negative on higher-than-expected fiscal borrowing.

In the medium term, the government remains commitment to the reform agenda. However, the more complex and sensitive reforms, such as privatization, competition and a level playing field for the private sector, are yet to be implemented. A comprehensive banking sector reform was initiated in October 2019. A presidential decree from October 2020 charts a path for a wide-ranging privatization of state assets, including banks. Monopolies in the energy sector are being unbundled. Reform fatigue in face of opposition from vested interest or potential social discontent remain key risks.

In the longer run, given large and growing working-age population, creating more and better jobs is the country's overarching priority. That will depend on the conducive environment for private-sector-led growth, better institutions, and improved infrastructure.

Annex 5: Member and Sector Context

Member Context

1. Tight lockdown measures imposed in March and a collapse in economic confidence have led to a severe economic slowdown in the first half of 2020. The shock is compounded by a decline in oil prices, energy and oil products export dropped around 70 percent in 2020, which account for over 10 percent of total exports. This resulted in Uzbekistan posting overall growth in 2020 at a rate of 1.6 percent, which is around 4 percentage points less than the growth rate projected before the pandemic.
2. Uzbekistan's economy is expected to recover quite strongly from the current pandemic growing by about 5 percent in FY2021.⁵ Although the COVID-19 pandemic hit the economy hard in 2020, economic slow-down was taken under control by timely and effective containment and support measures, such as immediate health care response and a set of effective fiscal and monetary measures. Strong policy reaction and well-targeted support packages allowed for a rebound in economic activity in the second half of the year. This resulted in Uzbekistan remaining as one of the few countries that achieved a positive economic growth in 2020.
3. The unemployment rate increased sharply from 9.4 percent in the first quarter of 2020 to 15 percent in the second quarter. According to the Central Asia Labor Skills Survey (CALISS), at least 46 percent of all workers in Uzbekistan are employed in the informal sector, and the employment rate is relatively low for women – many of them either self-employed or casual workers.⁶ According to ILO's recent estimations, between 56,000 (direct effect) to 155,000 (indirect effect) workers face the risk of being adversely affected by the disruptions caused by the COVID-19 pandemic.⁷ Relevant state agencies are currently drafting "Poverty Reduction and Employment Strategies," which aims to define further measures the Government will take until 2030.
4. Uzbekistan does not have a formal definition of social protection or a dedicated institution to design, coordinate, and manage the currently existing programs. The total number of beneficiaries of all social protection programs also dropped from 8.1 million (2012) to 6.4 million (2017). The total expenditure on social protection amounted to 6 percent of GDP in 2018, placing Uzbekistan in the lower range of the European and the Commonwealth of Independent State (CIS) countries.
5. Growth is expected to be assisted by improvements in the business climate as evidenced by Uzbekistan's ranking of 69th globally in 2019, having moved up from 166th place in 2011 in the World Bank's Ease of Doing Business Index. The government has embarked on a number of

⁵ IMF (2021), *Republic of Uzbekistan: 2021 Article IV Uzbekistan Staff Concluding Statement of the 2021 Article IV Mission* [Available at <https://www.imf.org/en/News/Articles/2021/02/17/mcs-021721-uzbekistan-staff-concluding-statement-of-the-2021-article-iv-mission>]

⁶ The World Bank (2016), *Systematic Country Diagnostics for Uzbekistan* [Available at <http://documents1.worldbank.org/curated/en/304791468184434621/pdf/106454-REVISED-PUBLIC-SecM2016-0167-1.pdf>]

⁷ ILO (2020), *Assessment of the impact of COVID-19 on the socio-economic situation in Uzbekistan: Income, labour market and access to social protection. Overview of crisis measures and ways to improve state policy.* [Available at https://www.ilo.org/wcmsp5/groups/public/---europe/---ro-geneva/---sro-moscow/documents/publication/wcms_759842.pdf]

major reforms aimed at improving the investment climate including i) facilitating tax payments by merging infrastructure tax with corporate income tax, ii) strengthening minority investor protections, iii) facilitating contract enforcement, and iv) making cross-border trade easier by introducing risk-based inspections and simplifying the documentary process.⁸

6. Bridging the infrastructure gap is vital for Uzbekistan to achieve rapid and inclusive growth sustainably. Considering that Uzbekistan has the largest population in Central Asia and increasingly requires greater urban development and social infrastructure investment, including residential buildings, the country faces one of the most serious infrastructure investment gaps in the region.

7. Uzbekistan currently faces the most extensive infrastructure capacity needs in the region to maintain adequate network performance. Uzbekistan has adopted and implemented a 5-year development strategy “The Action Strategy on Five Priority Directions for the Development of the Republic of Uzbekistan 2017-2021”, which sets out a clear vision for Uzbekistan’s development over the next five years. It includes specific sectoral plans in transport, energy, and industry. Aligning current investment plans with long-term development and environmental challenges would require Uzbekistan to plan for the long term now and adopt a longer-term economy-wide development strategy to articulate its plans further into the future.

Sectoral Context

8. Population growth and migration from rural areas to towns and cities are an increasing challenge for Central Asian countries like Uzbekistan. In 2013, the entire region’s population surpassed 65 million with close to 50% living in urban areas. Uzbekistan as the region’s most populous country has recorded over 50% population in urban areas since 2011⁹ According to the Center for Economic Research data,¹⁰ the regional population will exceed 80 million by 2050, with over two thirds living in urban areas. This urbanization trend will likely be further accelerated due to economic reforms, reclassification of land systems and other social factors.

9. Over the past 20 years, urban infrastructure development did not keep up pace with the rural-urban migration and growth of urban centers. Centrally controlled utilities (energy, water, gas, sewerage) depend on allocations from the Government budget to ensure the operation and maintenance and lack funding for the required extension of service areas or service improvements. The Centre for Economic Research found that most of Uzbekistan’s cities and towns suffer from deteriorating infrastructure and service quality (gas, water, electricity and sewerage) and face a shortfall of infrastructure upgrade and investments.

10. More recently, urban studies by World Bank (2018)¹¹ and the European Commission (2020)¹² have reaffirmed that urbanization in Uzbekistan is taking place faster than what was previously predicted and much of the under-reported growth has been taking place in medium-sized cities or their surroundings. As these built-up areas in the peripheries of cities merge with

⁸ The World Bank (2019, Doing Business 2020: Reforms propel Uzbekistan to place among World’s Top 20 Business Climate Improvers [Available at <https://www.worldbank.org/en/news/press-release/2019/10/24/doing-business-2020-reforms-propel-uzbekistan-to-place-among-worlds-top-20-business-climate-improvers>]

⁹ World Bank Data 1960 – 2019 - [Urban population \(% of total population\) - Uzbekistan | Data \(worldbank.org\)](https://data.worldbank.org/UY.UR.URVS)

¹⁰ Centre for Economic Research (2013) Urbanisation in Central Asia: Challenges, Issues and Prospects, Tashkent

¹¹ World Bank (2018) Cities in Europe and Central Asia, Washington D. C.

¹² European Commission (2020) Atlas of Human Planet 2019: Uzbekistan Country Brief, Brussels

neighboring cities, sprawling agglomerations are formed. These urban areas grow without proper urban planning and are largely under-served in terms of infrastructure and urban services, according to the World Bank (2018). The following common bottlenecks were identified across the agglomerations in Uzbekistan:

- Centralized urban planning scuppers potential for cross-agency, sub-national coordination;
- Lack of a shared strategic vision and plan for the region;
- Urban sprawl;
- Over dependence of sub-national agencies on central budget funding and planning;
- Little motivation to find local sources of revenue;
- Aging and dilapidated infrastructure, and
- Largely weak capacity of sub national agencies.

11. As population growth is largely concentrated in agglomerations, urban centers are facing the cost of rapid congestion, pollution, traffic, spiraling property prices – ingredients that are making it difficult for cities to offer their residents better quality of life, adequate and affordable services. Further, medium-sized cities and their peripheries, although often located along strategic logistics routes or in proximity of larger cities, find it challenging to transform into vibrant economic hubs to support job creation and long-term economic growth. Hence, they are facing common problems of low economic productivity and unsustainable growth patterns. Despite these hurdles, each of these cities have potential for economic development that can be further tapped. A comprehensive, integrated urban development would allow these cities, to maximize their economic potential (e.g., in logistics, tourism) that will support the creation of local employment and contribute to long-term economic growth.

Institutional Context

12. At the national level, The Ministry of Investments and Foreign Trade (MIFT) serves as the de facto coordinator of investments for urban development and responsible for regional and sectoral development programs and investment programs as well as the management of foreign direct investments and cooperation with international financial institutions.

13. The Department of Urbanization Policy Development within the Ministry of Economic Development and Poverty Reduction is tasked with coordination and overseeing the effective development and management of urbanization processes in Uzbekistan.¹³ Pending approval from the Cabinet of Ministers, the key mandates of the Department are expected to include the following: regulating the urban development works of design institutes; ensuring consistency in master planning processes; and establishing development programs for medium size cities in the country.¹⁴ At present, the institutional framework and implementation arrangements in urban development remain fragmented: there are various line Ministries tasked with the respective

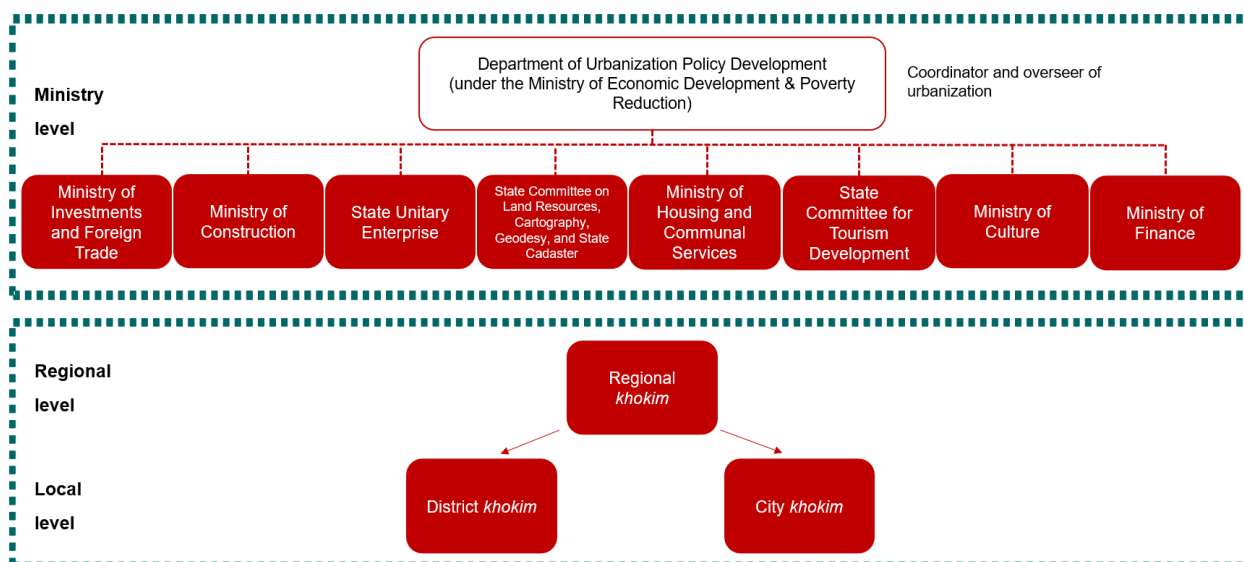
¹³ This Department supersedes the Agency of Urbanization created under the previous Ministry of Economy and Industry based on Presidential Decree 5623 in January 2019. The Agency of Urbanization was dissolved in March 2020 following a reorganization that transformed the Ministry of Economy and Industry into the Ministry of Economic Development and Poverty Reduction.

¹⁴ See Presidential Decree 5623 dated January 10, 2019 “Measures on cardinal advancement of urbanization processes”.

sectoral aspects related to urban development, such as water and sanitation, road development, tourism, and housing. Investment projects generally follow a sectoral logic and fall under the sectoral responsibility of the respective line Ministry.

14. The key stakeholders in urban development include the Ministry of Investments and Foreign Trade, Ministry of Construction, State Committee on Land Resources, Cartography, Geodesy, and State Cadaster, Ministry of Housing and Communal Services, State Committee for Tourism Development, Ministry of Culture, and the Ministry of Finance. The Ministry of Construction oversees national urban planning policy, develops regulatory frameworks, and designs and approves master plans and other urban planning documentation. Along with the Ministry of Construction, the State Unitary Enterprise (SUE “O’zshaxarsozlikLITI”) is the urban planning institute tasked with developing and issuing masterplans for all regions in Uzbekistan except in the capital city, Tashkent.¹⁵ The State Committee on Land Resources, Cartography, Geodesy, and State Cadaster is responsible for implementing and monitoring rational land use and planning, with its Research and Design Institute (“O’zdavyerloyiha”) involved in identifying urban land use and city masterplan development. The Ministry of Housing and Communal Services is the key agency for activities related to water and wastewater, housing, heating as well as solid waste. The State Committee for Tourism Development is the line agency responsible for tourism development including tourism infrastructure. The Ministry of Culture is responsible for activities linked to cultural heritage involving, for example, restoration or upgrading of cultural heritage sites, while the Ministry of Finance is responsible for the financing of urban development investments and intergovernmental fiscal relations.

¹⁵ See Presidential Decree 3502 dated February 2, 2018.

Figure 1: Overview of the Government Stakeholders in the Urban Planning Development Sector

16. Below the national level, regional governments (*khokimiyats*) and local governments at the district and city level play a critical role in local development. However, all administrative decisions (for example, those related to local taxes, local development programs, attraction of private sector financing) are taken by the chief executives of each region (regional *khokim*), who are appointed by the President, and there is little independence on decision-making processes for district and city *khokims*.¹⁶ Nonetheless, district and city *khokims*' responsibilities include overseeing the local economic and social development process, providing support to small and medium enterprises, and addressing concerns related to cultural issues, public services and infrastructure, public security, environmental protection, disaster risk management and public health. District and city *khokims* historically rely heavily on central budget transfers and planning. Thus, while tasked with significant service delivery responsibilities, there is often insufficient funding at the district and city level. District and city *khokims* also face capacity weaknesses across many areas, such as in capital investment planning, local revenues generation and collection, increased voice and responsibility in urban planning and local development as well as modernization of instruments for engagement with the private sector.¹⁷ Nevertheless, a gradual fiscal decentralization has been rolled out starting in 2020, allowing local governments greater authority over revenue collection and spending. This is seen as a first step towards decentralization in GoU's public administration reform process.¹⁸

17. The ministries and regional/local governments with respect to urban development are illustrated in Figure 1. Currently, the institutional coordination mechanism for the sector remains ad hoc and highly centralized. Service delivery remains piecemeal rather than comprehensive and integrated.

¹⁶ Regional, district and city *khokhims* exercise their powers on the principle of undivided authority and are personally responsible for the decisions and activities of government bodies subordinate to them.

¹⁷ This is based on the ICD conducted by the WB in consultation with local stakeholders for Chartak, Kagan and Yangiyul.

¹⁸ For further details on the decentralization reform, please see "Action strategy on five priority development directions of the Republic of Uzbekistan in 2017-2021" approved by the Decree of the President of 7th of February 2017.

18. Based on recently conducted World Bank urban diagnostics and considering the early formation stages of the Department of Urbanization Policy Development, the existing configuration of sectoral responsibilities among various ministries has resulted in the following: (i) an uncoordinated urban planning system, (ii) absence of a shared strategic vision and plan for the localities (i.e., sectoral plans of ministries are not coordinated with master plans of cities and districts and are implemented in a fragmented manner), and (iii) weak local government capacity to handle the urbanization process given lack of local autonomy. This institutional fragmentation exacerbates a myriad of challenges faced by Uzbekistan's cities and urban areas, such as urban sprawl leading to unsustainable growth and poor quality of life for their population (due to aging and inefficient infrastructure, among others).

19. Recognizing these institutional challenges, the GoU developed the NMSCP¹⁹ under MIFT which aims to create an “integrated and balanced social-economic development of regions, districts and cities”²⁰. The NMSCP embodies the overall vision and direction for development of medium size cities in the country by addressing major infrastructure barriers and bottlenecks as well as building government agency capacities to increase the level of decentralization to local governments in Uzbekistan cities. Specific details of the NMSCP are currently being developed by the MIFT.²¹ The NMSCP has a strong ownership from the MIFT and benefits from the support of both central and local/regional governments. The Program is expected to contribute to job creation and local economy development in the long run. The Program is also in line with GoU's Strategy for Development (2017-2021).

20. Further, the GoU is implementing a series of institutional reforms that could affect how cities develop, such as reforms related to the highly centralized urban planning system, land privatization, *propiska* household registration reform and housing affordability policies.²² These reforms recognize the need for gradual decentralization, combining greater accountability of local governments with increased financial and economic self-sufficiency.

- **Urban planning system:** The Ministry of Construction is leading the redrafting of the effective urban planning code (dates back to 2002) that standardizes urban planning procedures and documentation for local authorities. An urbanization decree has also been introduced to modify urban planning procedures.
- **Land privatization:** The 2019 law “On Privatization of Non-agricultural Land Plots” (#522) introduced private land ownership, which may become a potential source of local government revenues and unlock urban infrastructure investments from private sources.
- ***Propiska* household registration reform:** GoU relaxed the *propiska* resident permit policies. These policies put restrictions on people who do not have permanent registration in certain locations, such as on places to work, register a business, set up a residence,

¹⁹ This is also in line with another national urban program titled “Obod Makhallas”. This program seeks to upgrade neighborhoods in all cities of Uzbekistan (Presidential Decree No.UP-5467 dated June 27, 2018).

²⁰ See Presidential Decree dated February 7, 2017, on Action strategy on five priority development directions of the Republic of Uzbekistan in 2017-2021

²¹ Specifics are being drafted under the leadership of the newly created “Agency for the Management of Public Investments” under MIFT and in coordination with the Ministry of Economic Development and Poverty Reduction and Ministry of Construction.

²² World Bank (2020). “Urbanization in Urbanization: Spatial analysis and policy implications”.

etc. In 2019, the Presidential Decree on Urbanization allowed job applications without permanent *propiska* and announced the launch of the gradual *propiska* liberalization reform. These reforms can enable migration flows, potentially to cities. However, it may further add pressure on existing urban infrastructures.

- **Housing affordability policies:** To address the concern on undersupply of housing in major urban areas,²³ the GoU is supporting housing construction and mortgage market development. For example, it is planning to pilot subsidies to housing developers in the Andijan, Namangan, Fergana, Bukhara, Samarkand, and Tashkent regions. GoU also created the Housing Assistance Unit under the Ministry of Finance and Uzbekistan Mortgage Refinancing Company, which have mandates related to public housing and supporting the development of the private mortgage market.

²³ GoU estimates that about 145,000 apartments must be built yearly to satisfy the country's housing demand.