

## EvD country evaluation: Moving the needle? The EBRD in Uzbekistan (2017-2022)

### Management Comments

#### 1. Summary

Management welcomes the EvD's timely study "Moving the needle? The EBRD in Uzbekistan (2017 – 2022)". Management is pleased to note that the evaluation recognizes the Bank's timely re-entry for sound banking, its high strategic relevance to clients and their priorities, coherence with other IFIs, and distinct additionality.

Management agrees with the report's acknowledgements that PFI support has contributed to systemic change in Uzbekistan's financial markets and that more opportunities exist (e.g., RSF). Regarding EBRD's contribution to the development of local, private SME, Management has suggested at the draft stage that the report include references to the credit lines such as GEF and Women in Business that have been accompanied by technical assistance – adding scale to our support to SME development beyond risk sharing facility and ASB. EvD may also wish to refer to EBRD's gender policy dialogue related women entrepreneurship (e.g. definition of women-led SMEs in legal acts).

The report correctly notes that the TFP support has been critical during the re-entry phase and that Uzbekistan is undergoing transformations while managing two overlapping crises. Cumulatively, this makes client reforms even more challenging. This challenge is partly reflected in the slower disbursements in a reform-dependent sectors like energy and water infrastructure.

Management disagrees with the report's assertion that "the Bank's position is fragile" in Uzbekistan. This is too early to judge for the following reasons: First, the Uzbekistan reform started only 6 years ago and the second wave of structural reforms slowed down since 2020, in particular due to the more complex and painful nature of such reforms (tariff setting, privatisation) during the Covid-19 crisis, but also due to challenges around increasing private sector share beyond privatisation (e.g. mid-term objectives and related work on PPPs, SME strategy, attraction of FDI). Second, in general EBRD's role, exposure and portfolio are subject to political economy development within the countries of operations. The portfolio has not yet matured in terms of disbursements level or projects' implementation. It is proposed to go through the paper again to identify and acknowledge those inferences, which should be treated with caution, given their underlying limitations.

Management notes that EvD clarified the interview approach in this study and that the only interviewed party mentioned that they were unwilling to pursue additional projects with EBRD due to disbursement rates (page VI). Given the nature of these statements, management believes that it is important that EvD verifies the validity of such claims with great care, for their potential to have a long-lasting negative effect, and implications for the Bank's reputation. This is also important to clarify in the context of clients and authorities continuing to approach EBRD for sovereign project financing which would contradict the perceived unwillingness to pursue new projects with EBRD.

More detailed comments on recommendations and key issues are below. These include some comments provided to the EvD for the draft version of the study, having not seen how they are reflected in the final version given the EvD time pressure to finalise the study in time for the discussion. Management suggested that the evaluation team take a closer look at several statements in the report related to public-sector support, systemic change, and sector issues that are not exceptions in the case of Uzbekistan but are standard operating procedures.

## 2. Recommendations

Management agrees with EvD on one out of the four recommendations and partly agrees with the other three recommendations.

**Recommendation 1.** *“Focus efforts on strategic priorities where potential impact and additionality are clear. If the Bank continues prioritising regional connectivity, given the lack of delivery so far in this area, propose a targeted and evidence-based approach in the new strategy laying out where the Bank sees feasible opportunities to deliver and additionality in doing so.”*

Management **Partly Agrees** with the first recommendation. Management disagrees with the part of recommendation that states the Bank does not focus on strategic priorities where the potential impact and additionality are clear. We believe strategies assess the “realism” of our strategic priorities and our additionality (the three key principles of CS preparation), including through discussions with key external stakeholders. The strategy preparation process includes discussions with the authorities and the private sector clients on their key priorities and risks to assess feasibility of delivery. The challenges and difficulties in the past in the area of regional integration are well known and recognised. The Bank did not deliver on ‘integrated’ fully as there were no or very limited investment opportunities with Uzbekistan just opening up to neighbours in 2017-2019, and such efforts picked up post Covid-19 crisis.

The current CS identifies regional connectivity as a strategic priority based also on EBRD and other organisation analytical work on the CA challenges and opportunities in the next few years. Analytical work has been done by EBRD (funded by EU) for Europe – Central Asia Transport Connectivity (published in June 2023). Regional connectivity will be prioritised in the new strategy given the importance of cross-regional systems integration – a pertinent conclusion now that Central Asian countries are embarking on ramp up of renewables, especially Uzbekistan and Kazakhstan, and need to ensure national grids can absorb intermittent wind and solar, as well as projects focused on the Information and Communications Technology (ICT) connectivity. Other IFIs have been doing analytical work for energy connectivity and EBRD is of course using such studies. Ongoing projects such as Sarimay-Dzhankeldy transmission line (regional energy interconnection between Khorezm and Bukhara regions) and Khorezm Roads are examples of EBRD support.

While the Bank actively supported grid reinforcement /extension in Uzbekistan through a number of projects with NEGU, stronger regional cooperation between the four Central Asian countries is needed as Uzbek, Kazak, Kyrgyz and Tajik transmission and system operators need to balance growing RES. The Bank will continue supporting the respective national TSOs with projects and policy work but stronger cross-regional cooperation between the neighbouring countries of Central Asia. From a climate perspective investments in grids is equally important to investments in RES.

**Recommendation 2.** *“Identify and promote systemic change mechanisms as part of both direct financing to the private sector and the ASB programme. These may include focusing on aggregators, targeting strategic sub-sectors with the greatest potential for fostering systemic change and promoting market-building activities.”*

Management **Partly Agrees** with the second recommendation. Management acknowledges the importance of focus on broader impact and promoting systemic change mechanisms but believes that such efforts have been operationalised, in particular for the ASB programme.

Currently, in the ASB support programme, the impact at the sector (macro) level is pursued through: (i) creating demonstration/signalling effect of project-level outcomes, especially through the Blue Ribbon (BR) programme (growth of a select number of high potential local companies that are leaders in specific markets e.g. Agromir Juice LLC or ERMAK Group); (ii) a range of awareness raising and visibility events, as well as through the “word of mouth” among the market participants; (iii) integration into the SME banking activities (both direct and indirect -PFIs, so far WiB but with potential to expand to YiB).

Additionally, the study needs to acknowledge progress made (especially after the COVID-19 pandemic) in scaling up the digital advisory tools, to increase the outreach of the ASB activities via online platforms. Digital outreach increased through joint online activities with consultants, associations, banks, and academia; digital skills assessment tools to help WSMEs identify their digital literacy level and guide their learning/development decisions; online training and e-learning modules in local language; online mentoring programmes for WSMEs, etc.

Management agrees with the report’s insight that market platforms (for ASB) and aggregators are promising opportunities to capture systemic change. The suggested emphasis on demonstration effect and building up markets for consultancy services are already embedded in our model/approach. The focus on the work with/through aggregators is also there, although such aggregator models are not applicable to every industry and therefore this model can be used only where such sector structure allows.

Management suggests that the report adds references to FDI, privatisation and non-SME local corporates as well as tailored credit lines (GEFF, Women in Business) as contribution to progress with systemic change in private sector development. Given the nature of EBRD support, it is more difficult to achieve a systemic change through direct financing in a few companies in a particular sub-sector.

**Recommendation 3.** *“Explore mechanisms to address political economy risks in the preparation of MEI projects and factor in better such risks when specifying project timelines.”*

Management **Agrees** with this recommendation broadly. Management will continue to explore new models around project preparation before signing and reconsider project timelines presented to Board adding a time buffer given the political economy risks in Uzbekistan. Other MDB models (e.g. ADB in Uzbekistan) use sovereign loans as an alternate funding mechanism to TC support via Donors, and as such may become a costly exercise for this Bank and may not be feasible.

**Recommendation 4.** *“Explore and address barriers that are restricting PFIs from bringing potential transactions under the Risk-Sharing Framework to the EBRD.”*

Management **Partly Agrees** with the recommendation. Management notes that while the PFIs have brought a limited number of clients to EBRD, the pipeline of signed RSF transactions up until today were developed and brought to the PFIs by the Bank. The RSF product is still relatively young in Uzbekistan; the premise that PFIs prepare and bring clients to EBRD requires time and a continuous development of relationship with the PFIs. Providing them with constant support and training, as well as streamlining the RSF processes internally, will improve the PFI capacity to understand the benefits of RSF financing and to identify the appropriate clients.

### 3. Other comments

### 3.1 Disbursements

On the issue of slower disbursements in some sectors, Management has already indicated it partly disagrees with the report's characterisation that this issue is solely under Management's responsibility. On the contrary, conditionality exists for reasons of risk management and motivating client' commitments. If certain KPIs are not met, or if political will does not exist, disbursements cannot happen. Similarly, if the client is revising the scope of work due to exogenous factors, the Bank must demonstrate flexibility, which comes at the expense of efficiency. Such trade-offs tend to be contextual.

All investment projects were prepared as required with proper feasibility studies. As the EBRD project implementation support was structured to be funded from loan proceeds, EvD may wish to consider two issues: 1. the significant delays with reaching effectiveness of the loan agreements – under Government control, while EBRD actively pushed its counterpart to proceed quicker; 2. The reorganisation/restructuring of the direct counterpart for the investment project, taking one year. All water investment projects are effective and now under procurement.

Management strongly suggested that the report could nuance its findings on this issue further with more detailed explanations (e.g., 11 MEI projects). Management had suggested that EvD compare the existing portfolio signed since 2017 to-date in Uzbekistan to a comparable portfolio of another country (e.g. Egypt, spanning the same number of operational years from the start of EBRD's operations). Variables, which could be used to perform the exercise include portfolio type, number of deals signed, level of disbursement per deal, lifetime of a project, country threshold level and when was it changed in terms of project preparation for signing sovereign infrastructure projects, etc. However, such analysis is missing in the report.

For example, the district heating projects were cancelled at the request of the government, who decided to do the projects through a PPP with Veolia. The solid waste projects that were on hold are now resumed; the delay was caused by a change of Minister of Environment, who requested a change in scope, before reverting to the original structure. Therefore, changes like these have been driven by the authorities, which is not something the Bank can forecast. In terms of actual project preparation, MEI projects followed a standard preparation path: international consultants prepared feasibility studies, which have been reviewed by the EBRD water engineer and verified by the government's design institutes.

Projects approved in 2017-2018 anticipated upcoming difficulties with the disbursement and that was discussed and (hopefully) recorded as part of the Board-approval process. Compared to other IFIs, EBRD may have stricter procurement rules, and this is for justifiable business-related reasons.

### 3.2 Sector issues and progress to date

Management suggested changing the heading for 2.1.2. The evaluation team has not presented sufficient evidence to claim mixed results. The text in the report acknowledges the difficulty in assessing this issue, and the availability of key informants. Management, however, agrees that there is limited space for civil society to engage and operate in. As is, the heading is misleading in this section.

Section 2.1.5 heading is misleading, and Management strongly recommended editing this headline. All development projects in the energy space will require an offtake agreement or an implicit/explicit guarantee from the state. In the case of World Bank, every World Bank Guarantee issued to the Sovereign to allow for private sector participation requires an explicit counter-guarantee from the Sovereign to the World Bank insuring public sector' contingent liability. This is not an exception in

Uzbekistan but a norm. Political will and public sector commitment is critical in every development intervention and should not be a surprise in Uzbekistan' context.

In terms of banking sector issues, Uzbekistan faces several supply-side constraints such as high collateral requirements, and high costs to collateral registrations. For example, by global averages, collateral was required in an average of 78.9% of all SME loans, and in Uzbekistan, collateral was required in 96.5% of loans (international practice is 80% of loans), with an average of 175% loan to value ratio compared with 128% for larger firms. Many state-owned banks have inadequate expertise in analysing undocumented cash flows of businesses, so their lending processes and products are not adapted for the pattern of those cash flows. The supply side is not the only source of constraints limiting access to finance. On the demand side, low financial literacy skills and lack of information on business development services hinder SME credit growth. Management agrees on the greater emphasis on the supply and demand side constraints in the FI sector, via the ASB support coupled with policy dialogue related to Credit Registries and Collateral Registries.

Management suggests nuancing section 3.2.2 and its associated headlines. With regards to energy efficiency projects and GEF financing, EE support is highly scattered by design. As such energy savings are not easy to track even in developed markets let alone in Uzbekistan. The systemic change in energy efficiency is about achieving broader socioeconomic outcomes and say improvements in health (e.g., reduced pollution) and firm-level productivity. Such outcomes at the system level cannot be observed in short evaluation periods.

Page 10: there is a reference to "...other IFIs expressed some scepticism on the approach the Bank has employed..., in particular on the viability of using a PPP model..." Management believes that this is a misleading statement, considering that: (i) Road PPPs using availability payment mechanism are common in many countries; (ii) the WB is preparing a separate road PPP – Tashkent to Andijan – that is larger in scale and financial commitment (1.5x), compared to the Bank's infra road deal – Tashkent to Samarkand; and (iii) the Bank's mandate is different to other IFIs (some of which focus overwhelmingly on public sector). EBRD's approach to road sector financing is not unique and, in fact, supporting private sector participation in road sector is one of the government's and EBRD's priorities.

### 3.3 Systemic Change

Management would note two interrelated points:

- i. Systemic change, if properly defined as market level outcomes or impacts, are not easy to /observe within 3-5 years. In some cases, such changes could take 10-15 years or more. On average, most sovereign-operations (e.g., MEI type projects) of other IFIs tend to be 10 years or longer to be able to achieve 'closure' by understanding systemic change at the end- phase of the intervention. For example, World Bank interventions take 10 years to implement and is a good yardstick for systemic effects to be observed. IFC projects do not claim to have systemic change unless they are large-infrastructure, MEI type projects with multi-year programmatic approach with a single client. Even so, the systemic effects can be observed only after 10 years. Evaluations are typically conducted many years after the project approval process to be able to observe such effects (positive or negative). As per above, Management agrees with the report's insight that market platforms (e.g., ASB) and aggregators are promising opportunities to capture systemic change. Management would however caution against making deterministic statements even in such cases due to negative externalities. For example, a ban on YouTube could completely change the way an ASB program is delivered in the country.

- ii. Management notes that EvD chooses much shorter timelines for its studies, like in this case. Management would submit that even project-level outcomes and impacts cannot be observed in this period let alone systemic change at the sector level. Absence of evidence is not necessarily evidence of absence. Management broadly agrees with the report' sentiments that understanding systemic change at the country level is important. Management is currently in the process of exploring conceptual frameworks to better address the systemic change issues, within the context of the six transition qualities. This is work in progress.