PROJECT INFORMATION DOCUMENT (PID)
CONCEPT STAGE

Report No.: AB3616

Project Name	RURAL ENTERPRISE PROJECT PROJECT PHASE II
Region	EUROPE AND CENTRAL ASIA
Sector	Irrigation and drainage (40%);Agro-industry (35%);Crops (15%);Agricultural extension and research (10%)
Project ID	P109126
Borrower(s)	REPUBLIC OF UZBEKISTAN
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Implementing Agency	
	Ministry of Agriculture and Water Resources Uzbekistan
Environment Category	[ ] A [X] B [ ] C [ ] FI [ ] TBD (to be determined)
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1. Key development issues and rationale for Bank involvement

Agriculture is an important sector of Uzbek economy, accounting for 28% of GDP, 33% of foreign exchange receipts, and 41% of employment. In the rural areas, agriculture and the processing of agricultural products is by far the main source of employment and incomes for the rural population. Irrigation is vital under the prevailing arid climatic conditions. The irrigated areas are located in the valleys and plateaus of the Amu Darya and Syr Darya and cover about 4 million ha.

During the last century, irrigation in Uzbekistan was extended to cover an area of about 4 million hectares. The non-irrigated areas remain for the most part a desert, and as such irrigation is the backbone of agriculture in Uzbekistan. Most of the current irrigation and drainage infrastructure was constructed in the 1960s and 70s. With the collapse of the Soviet Union, the funding for operations, maintenance and rehabilitation dropped and it is now estimated that only 40-50% of the required operation and maintenance costs are covered. As a result, irrigation and drainage infrastructure is deteriorating. The first is causing a reduction in irrigation efficiency (increased water losses) while the latter is causing a rise in water tables and consequent salinization. It is estimated that crop losses due to salinity cost the country around US$ 1.0 billion annually. The policy to increase wheat production to assure wheat self-sufficiency is putting added strain on the irrigation system. Because of the difference of the cotton and wheat irrigation periods, the period available to close canals and allow maintenance has been reducing.

Agricultural policies.

The main objectives of Uzbekistan's agricultural policy in recent years have been to (i) maximize and stabilize export revenues from agricultural outputs; (ii) achieve food security/self-sufficiency in wheat production and (iii) improve rural standards of living.

Some of these objectives have been achieved. For instance, since independence Uzbekistan became self-sufficient in wheat production. This has been achieved through significant increases in area cultivated under wheat and also substantial yield improvements. However this multi-objective strategy is challenging. Two main examples show conflicts among some of the above objectives and wider economic policies:

- The continued net taxation of agriculture negatively affects the standards of living of the rural population. In addition, such taxation also reduces farmers' production incentives, which adversely impacts on yields and therefore runs counter to the objective of maximizing export revenues; and
- In large parts of Uzbekistan (mainly due to climatic conditions), wheat is not the most profitable irrigated crop. Self-sufficiency in wheat, therefore, conflicts with the objective of maximizing export revenues and agricultural incomes.

In order to implement these conflicting objectives, the Government fixes a target volume for the production of two strategic crops (cotton and wheat) that farmers have to produce. Cotton is the main export crop, contributing to around 25 percent of foreign exchange revenues and also a significant source of tax revenue. Wheat is considered to be essential to achieve food security and also offers an easy rotation with cotton (although cotton-wheat is not necessarily the best rotation to maintain soil fertility). The conflicting objectives have thus also slowed down the transition from a centrally planned to a market economy.

A recent World Bank study[1] concluded that cotton is over-taxed relative to other crops, therefore creating disincentives for farmers to produce cotton relative to other crops. The Government procures the bulk of the cotton harvest from producers at a fixed procurement price, calculated every year by subtracting official costs from export revenues. However, due to overstated costs, the price received by farmers typically lies considerably below export parity under market conditions. This, in addition to direct taxes, represents the main source of tax revenue from agriculture. However, counter to this, the Government provides significant subsidies for irrigation, financing and other inputs to rural producers. It should also be noted that the value of the procurement price (in comparison with the export parity price) has improved considerably in the past 5 years. Currently (2007) approximately 85% of the export parity price is received by farmers, almost a 70% increase on 2002 levels.

Initial faming sector reform was introduced in order to replace the liquidated, insolvent and loss-making agricultural cooperatives (shirkats). From 2006 this reorganization was applied not only to cereals and cotton-farming shirkats but also to producers of fruits and vegetables. The special programme converting these shirkats into private farms was due to finish in 2007. As a result of these reforms as of January 1, 2007 the total number of active farms in 2006 was 189,200 in comparison with 87,500 in 2003. Average land endowment per farm is 26.2 hectares. About 1.8 million workers are currently employed in private farms and they produced more than 32% of gross agricultural output. Private farms account for 86.3% of raw cotton and 73% of grain crops.

The original Government system of service and inputs supply is also undergoing reform in order to react to the new demands of these independent farmers. Private companies providing plowing, planting,

[1] Cotton Taxation in Uzbekistan. Opportunities for Reform. ECSSD Working Paper No 41. August 26, 2005

veterinarian, and insurance services, as well as chemical, fertilizer, fuel suppliers and mini-banks are being established throughout the Republic. As a result, the access of private farmers to these services improved significantly, but still require further improvement.

The main rationale for Bank involvement is that it builds on the successful experience and outcomes of the first Rural Enterprises Support Project (RESP). RESP will close in December of 2007 and is considered a successful operation by both the World Bank and the Borrower. Although the final ICR is still under preparation, project monitoring and evaluation have already provided important elements to satisfactorily assess the project.

2. Proposed objective(s)

The proposed project would scale up the Rural Enterprise Support Project (RESP) and adhere to the original project's main objectives of increasing the productivity and sustainability of agriculture and agribusinesses in project areas. This will be achieved by directly supporting the newly independent farmers in other regions of the country, who did not benefit from the original project.

The original project contained a number of policy objectives in the areas of the ability of farmers to sell using marketing channels other than to the Government, enabling them to raise their farm gate prices and hence profitability. As mentioned in section 1, the government procurement price for cotton has increased dramatically during the period of RESP (equally the price for wheat has increased and percentage required to be sold to the Government reduced). Despite the changing economic environment, RESP was able to implement a number of these objectives (through the use of a Government Decree {153} enabling the private sale of cotton).

Under RESP 2 the farmers in the new project regions will also be able to benefit from the potential beneficial provisions of Decree 153, the provisions of which will be extended to them through amendment of the original Decree. The degree to which the farmers will be able to benefit from this will be, as with RESP 1, subject to wider Republic developments in the increase (or decrease) of the percentage of export parity price which is offered through the government procurement system.

To support the objectives of profitability and sustainability, the new project will provide direct support to farmers to enable them and private sector service/input suppliers to purchase agricultural machinery (and engaging in other agri-business related activities), thus reducing their dependence on Government owned service/input providers. Equally, the project will directly address the institutional and operational problems currently being encountered by WUAs by providing them finance and technical assistance in project areas.

For monitoring purposes, the following preliminary outcome indicators have been identified:

a) A comparative increase in yields for farmers in project areas (based on baseline information at the time of preparation)
b) A comparative increase in profitability for farmers in project areas (based on baseline information at the time of preparation
c) An increase of farmers' access to agricultural mechanization (based on the amount of new equipment purchased)
d) An increase of farmers' access to business advisory services (based on the number of business plans completed and advisory services provided)
e) An increase of farmers' access to non government sources of finance (based on the amounts and types of credit extended by the project to farmers direct)

3. Preliminary description

The project will be mostly financed by an IDA concessional Credit. The amount of the Credit is still to be defined in the range of $25-40 million. The final project area coverage still remains to be defined on the basis of the available IDA funds. However an agreement in principle with the Borrower has been achieved that the Irrigation and Drainage component will concentrate on a set of administrative districts, while other project activities, including the Rural Finance component, will cover a much larger region. The project would comprise the following four components:

Component A: ***Rehabilitation of Irrigation and Drainage System*** This component will cover investments for (i) inter-farm works ; (ii) support to Water User Associations, including equipment, material, and training for the maintenance of on-farm canals and drainage; and demonstration plots. This component will be implemented in a specifically selected number of districts which were selected according to the needs for rehabilitation of I&D works.

Component B: ***Rural Finance.*** This component will have the objective of facilitating access to credit to the newly independent farmers which originated from the Shirkat reform. The component will finance a credit line for Participating Financial Institutions (PFI – commercial banks, leasing companies and microfinance institutions) to on-lend to farmers and rural business related to farming (including but not limited to provision of farming services such as farm mechanization, storage and distribution facilities, financing of agricultural inputs and investments in tree-crops). The component will also finance leasing transactions, to allow access to much needed financing for rural businesses with collateral constraints. A complementary training program to the PFIs will be provided, to upgrade their skills in agricultural investment project appraisal.

Component C: ***Rural Advisory Services.*** This component has two objectives: (i) help potential borrowers to develop business plans in order to increase their business and financial skills, thereby reducing the risks that the final borrowers will face difficulties in repaying the sub-loans (thus reducing potential defaults); (ii) provide advisory services and training to the newly independent farmers in various topics such as legal, accounting, business, technical aspects including agronomy, water management, pesticide handling, IPM, etc.

Component D: ***Project Management.*** The component will cover the overall coordination of project activities including fiduciary aspects of project management and monitoring and evaluation. The project will be managed by the Rural Restructuring Agency, an institution which significantly developed its capacity during the Rural Enterprises Development

4. Safeguard policies that might apply

RESP-II is not expected to have any significant or irreversible environmental impacts, and is classified as Environmental Category "B". Environmental Assessment (OP 4.01) and International Waterways (OP 7.50) will likely apply to the project. The environmental impact of the proposed project is expected to mainly derive from the Irrigation and Drainage component and is expected to be small, but positive. The RESP documentation includes an Environmental Management Plan Framework (EMPF), which provides a screening checklist and mitigating measures for the minor impacts that could occur as a result of the investments.

5. Tentative financing

Source:		($m.)
BORROWER/RECIPIENT		6
International Development Association (IDA)		30
	Total	36

6. Contact point

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