

**PROJECT INFORMATION DOCUMENT (PID)
APPRAISAL STAGE**

Report No.: PIDA542

Project Name	Alat and Karakul Water Supply Project (P118197)
Region	EUROPE AND CENTRAL ASIA
Country	Uzbekistan
Sector(s)	Water supply (100%)
Lending Instrument	Specific Investment Loan
Project ID	P118197
Borrower(s)	
Implementing Agency	
Environmental Category	B-Partial Assessment
Date PID Prepared	21-Aug-2012
Estimated Date of Appraisal Completion	17-Aug-2012
Estimated Date of Board Approval	01-Nov-2012
Decision	

I. Project Context

Country Context

A growing nation at the heart of Central Asia. Uzbekistan is a resource-rich, fast-growing lower middle-income country, strategically located in Central Asia. Its 29.2 million inhabitants, of which 49.7 percent live in rural areas, represent half of Central Asia's population. Following independence in 1991, the Government of Uzbekistan's (GOU) home-grown, gradualist, state-led development strategy has delivered consistent economic growth, as well as gradual reforms. In contrast to many other former Soviet Union countries, this approach has eased the social costs of transition and reduced the vulnerability to external shocks. Poverty has been steadily declining, from 27.5 percent of the population in 2001 to 19.5 percent in 2010.

Robust growth since the mid-2000's. Gross domestic product (GDP) growth has been robust since the mid-2000s—averaging 8 percent annually through 2011, thanks to favorable terms of trade for the country's key export commodities—copper, gold, natural gas and, since 2010, cotton; and to the GOU's effective macro-economic management, and limited exposure to international financial markets. The impact of recent increases in global food and energy prices is expected to be limited because of GOU's policy of self-sufficiency in both food grains and energy. Until the crisis, the economic growth was largely fueled by booming commodity prices and manufactured exports. In 2008, the industrial sector contributed 22 percent of GDP, down from 33 percent in 1991; construction contributed 6.0 percent and services 43 percent. Agriculture remains an important sector, accounting for about 18 percent of GDP, 27 percent of employment, and close to 22 percent of export income.

A MIC vision. Uzbekistan's vision is to become an industrialized, high middle-income country (MIC) by mid-century. The keys for such a transformation include: (a) increasing the economy's efficiency and competitiveness; (b) strengthening the financial sector to support private sector activity; (c) diversifying production towards higher value-added activities; (d) creating jobs for the rapidly growing population; and (e) improving governance. Achieving these goals implies continued gradual transition to a more market-oriented economy, equitable distribution of growth between regions, enhance competitiveness, increase efficiency of infrastructure and improve access to social services as reflected in their five-year Industrial Modernization and Infrastructure Development Program (2011-15).

II. Sectoral and Institutional Context

Shared water resources. Straddling the Amu Darya and Syr Darya international river basins, Uzbekistan has access to significant, but unevenly distributed water resources. Both surface water and groundwater were aggressively developed under the Soviet Union for the needs of agriculture, industry, mining and hydropower, within a broader regional context. Such resources must today be managed more conservatively, in the face of conflicting riparian demands, depletion and salinization of aquifers and looming climate change impacts. As Uzbekistan's economy is highly dependent on water flows originating in Tajikistan and the Kyrgyz Republic, plans to increase usage or storage by upstream neighbors are a concern.

A degraded infrastructure legacy. Uzbekistan benefits from extensive and robust water supply and sanitation (WSS) infrastructure built in the Soviet era, including major regional water transfer aqueducts and well developed networks in urban and rural areas. Although the country has been more proactive than most of its neighbors in attending to infrastructure needs through the economic transition, over time, the limited capacity of sector institutions to maintain, renew and expand such assets has led to an effective degradation of access to WSS services. Because of network and equipment disrepair, existing WSS capacity is vastly underutilized: According to official data, about 88% and 79% of the urban and rural population respectively receive piped water supply, but only 17% of users have continuous service, and over 65 percent of users have less than 6 hours of service per day. The situation is particularly dire in rural areas, where previously served communities often cope with chronic service breakdown or no service at all. Demand management and operational efficiency are poor, with average hydraulic losses estimated at 42%, and only about 33% of user connections metered. Installed technology and systems operations are inefficient from an energy-use perspective. Adding to the sustainability challenge, the capital and operating costs of new infrastructure are seldom optimized, as a result of obsolete design and service standards. Compared to water supply, urban sewerage service is substantially less developed, with an estimated 17 percent effective coverage ratio, limited to about 70 cities and towns. Built in the 70's and 80's and largely neglected since then, sewerage infrastructure is in very poor condition, locally collapsing. Wastewater treatment capacity is also highly degraded, often only ensuring marginal

pollution abatement. The status of rural sanitation is not well documented, its development being left to the initiative of households and communities.

A huge investment challenge. Overall, WSS rehabilitation, renewal and expansion needs represent a huge investment challenge for Uzbekistan. GOU estimates urgent priorities at USD 5.4 billion through 2020, of which USD 4.1 billion for water supply and USD 1.3 billion for wastewater management.

Weak institutional framework and leadership. Starting from a highly centralized, State-run sector organization, GOU has since independence sought to strengthen and reform the legal and institutional foundation of municipal services. In 1996, local governments were made responsible for WSS service, with control over regional, municipal or district Vodokanals in charge of service provision. Introduction of private sector participations (PSP) was attempted as early as 2002, and a partial corporatization reform was successfully enacted for the Tashkent Vodokanal. The institutional framework of the WSS sector remains however weak, impaired by incomplete decentralization, inconsistent ownership of assets, fragmented responsibilities and legislation, inefficient financing and regulatory mechanisms, and low institutional capacity. Local governments and utilities do not have adequate autonomy and capacity, and lack effective policy support and regulatory incentives from the central administration. No adequately funded and staffed ministry-level entity is responsible within GOU for communal services such as WSS service. Sector development and oversight are entrusted to the Uzbek Communal Services Agency (UCSA), or Uzkommunkhizmat, an unfunded agency focused on implementation of investment programs and on the operation of regional aqueducts, with limited capacity to lead sector planning, policy or performance agendas.

Sector financing is inefficient. Tariffs apply to either water consumption norms or to actual metered usage. At the hands of the Antimonopoly Commission, tariff regulation is mostly driven by social concerns, somewhat disconnected from utility cost-recovery and investment imperatives. By any international yardstick, water service is inexpensive and affordable, with a median price of USD 0.06/m³, and an average cost of WSS utility service estimated below 1 percent of household expenditures. For most utilities, this results in an insufficient revenue base, further eroded by unsatisfactory collection levels. As GOU's policies rule out any operating subsidy, utilities cope with extremely constrained operating budgets, which cannot afford competitive salaries or adequate maintenance, let alone capital improvements. On the other hand, if their investment needs are retained among GOU's priorities, utilities can benefit from substantial capital subsidies, in the form of debt service support flowing through local government budgets. The level of such debt service subsidies can be as high as 90% and is adjusted annually, in order to meet the utility's minimal cost-recovery obligations, after accounting for any approved tariff increase or other changed condition. While helpful on a year-to-year basis, this mechanism fails to provide clear incentives for improved performance, and keeps utilities in a subordinated position, unable to plan their own development. The sustainability of this extensive capital subsidy approach is also questionable.

Sector challenges are also rooted in capacity and governance issues. With exceptions, the performance of administrations and utilities is low, due to weak technical and managerial capacity, and a yet limited culture of efficiency and customer service. Technical capacity limitations also affect the local engineering-design and construction market. With unattractive compensations and an aging workforce, the sector is in fact not effectively motivating performance nor renewing its skills base. Along with obsolete design standards and rigid procurement rules, this is delaying the overdue introduction of modern management practices, efficient designs and innovative technology to the sector. In such context also, transparency and governance failings are common, impacting the quality of procured studies, designs and works.

A growing awareness of inefficiencies and reform needs. GOU is increasingly aware of sector deficiencies, and intent on addressing them more proactively with donor help. With support from the Swiss Secretariat for Economic Affairs (SECO), GOU will pilot Public Service Contracts (PSC) with utilities in Bukhara, Samarkand and Syrdarya. This promising initiative aims at designing and testing a contract model that may help clarify roles and regulate the performance of service providers. The Swiss Agency for Development Cooperation (SDC) is helping demonstrate community based approaches for the autonomous development of rural water supply in selected villages of the Ferghana Valley. A "2020 Strategy" effort is underway by Uzkommunkhizmat as part of an Asian Development Bank (ADB) funded project aimed at updating capital improvement programs and assessing institutional and financing constraints to sector development.

Towards an updated sector strategy. Significantly, at a high-level meeting in June 2012, GOU signaled to the Bank its intent to more proactively develop Uzbekistan's water supply infrastructure and institutions. A vision was shared of safe water supply as a basic human right, for which GOU is committed to develop, modernize and reform the sector, taking into account growing human water demands, mounting water resource stress, uneven efficiency of institutions, and substantial gaps in access to service (especially in rural areas). GOU asked for a substantial technical assistance grant to design a new sector strategy and assist its implementation. Support to such strategy development and enactment is seen as a new priority in the GOU-WB partnership. Needs analyses and a grant proposal are being developed towards initiating the assistance in the fall of 2012.

World Bank involvement. Along with ADB, KfW and the Swiss Cooperation, the Bank is one the main donors in the sector. The Bank has so far financed infrastructure rehabilitation projects, such as the Water Supply, Sanitation and Health Project (1997-2008, IBRD \$75m) for urban and rural water supply in the Karakalpakstan and Khorezm regions, and the Bukhara and Samarkand Water Supply Project (BSWSP, 2002-2010, IBRD \$20m, IDA \$23m) for urban water supply with establishment of PSPs. The projects have substantially achieved their infrastructure and service objectives, albeit with delays and quality issues, but their institutional outcomes have been uneven. On-going projects include the Bukhara and Samarkand Sewerage Project (BSSP, 2009, IDA \$55m), and the Syrdarya Water Supply Project (SWSP, 2011, IDA \$88m), also focused on infrastructure rehabilitations. AKWSP will be the fifth in Uzbekistan's WSS sector, and the first to combine rehabilitations with substantial development of new coverage. Openings for policy dialogue and support to institutional reforms have until now been limited. It is expected that following the June 2012 GOU request, a partnership on a new sector strategy will lead to the design of operations that also address sector-wide policy and institutional weaknesses, while also aiming for improved quality of implementation and outcomes. Beyond AKWSP, it is thus envisioned that future operations may be structured as tranches of a program loan, also aimed at supporting selected sector-wide institutional strengthening and capacity building activities.

The urgent Alat and Karakul water challenge. The two southern districts of Alat and Karakul in the Bukhara region feature one of the most precarious water supply situations in the country. In the 70's, with the growing depletion and salinization of local groundwater resources, a trunkline system was built to mobilize freshwater from the Amu-Bukhara canal, and provide potable water service to Alat-town and Karakul-town. Network coverage of rural areas was however not implemented at the time, for reasons understood to include the high investment costs. Today, after two decades of "shoestring" operations and maintenance, the trunkline and urban systems are in a deep state of disrepair, functioning well below capacity, with no effective water treatment. Distribution networks cover 23% of Alat district's population (100% in Alat-town, 9% in rural

areas), and only about 15% of Karakul district's population (61% in Karakul-town, 5% in rural areas). Piped water supply, where available, is of extreme low quality, with turbid unfiltered water reaching customers discontinuously in the two towns, and a few peri-urban villages in their immediate vicinity. Nearly 80 percent of the districts' population still lives in rural areas, and remain with no piped water supply, relying on unsafe water drawn from irrigation channels and saline wells, or bought at high cost from tanker trucks. The lack of access to potable water is having crippling effects on human and economic development in both the urban and rural areas of the districts, and AKWSP is understood as urgently needed to alleviate them. AKWSP will therefore combine the rehabilitation of existing water production, transmission and distribution infrastructure built in Soviet times for the two towns of Alat and Karakul (combined population 37,000 people), with the development of new networks to cover unserved rural areas in the Alat and Karakul districts (180,000 people).

An evolving investment scope. Started in the fall of 2010, AKWSP preparation experienced delays and setbacks due to suboptimal scoping and feasibility study (FS). With high sunk costs for the renewal of the trunkline system, an investment scope originally limited to rehabilitation of urban water supply service was found hard to justify. Phased investment alternatives (phase 1: urban, phase 2: rural) were explored, but could not be firmed within the limitations of the FS consultancy. As Project appraisal and approval were not reached within the IDA 15 cycle, the Bank and GOU agreed to a substantial investment scope update and extension of FS services, towards preparing a single-phase project integrating urban and rural investment needs, with a substantial funding increase under IDA 16.

III. Project Development Objectives

The proposed project development objective (PDO) is to improve the coverage, quality and efficiency of public water supply service in the two districts of Alat and Karakul in the Bukhara region. The objective will be achieved through the rehabilitation and expansion of water production, transmission and distribution infrastructure in urban and rural areas.

IV. Project Description

Component Name

Component A: Improvement of Water Supply Infrastructure (US\$108.6 million)

Component B: Institutional Strengthening and Capacity Building (US\$2.21 million)

Component C: Studies for Future Investments (US\$0.37 million)

Component D: Project Management (US\$2.34 million).

V. Financing (in USD Million)

For Loans/Credits/Others	Amount
BORROWER/RECIPIENT	38.50
International Development Association (IDA)	75.00
Total	113.50

VI. Implementation

The implementing agency for the Project is the Bukhara Region Water Utility, or Bukhara Region Vodokanal (BVK). An internationally recruited Implementation Consultant will support BVK in all aspects of Project implementation, including project management, engineering-design, works supervision, reporting, and technical assistance to operations. As part of the WSS sector, the Project is placed under the planning and oversight responsibility of the Uzbek Communal Services Agency (UCSA) or Uzkomunkhizmat. Within Uzkomunkhizmat, a Project Coordination Unit (PCU) established since 2002, is responsible for managing and overseeing Bank-financed projects, and for ensuring coordination of project activities by implementing agencies. The PCU is staffed with a director, as well as engineering, procurement, financial management (FM) and translation staff. A Bukhara branch of the PCU (BBPCU), resident within BVK, was established to support implementation of BSWSP (completed) and of BSSP (ongoing). BBPCU has technical, FM and procurement staff, with experience of Bank-financed projects. Although reporting to Uzkomunkhizmat and to the PCU, BBPCU staff are recruited to be fully integrated in BVK operations, providing comprehensive project implementation support to BVK. The Project is set to benefit from the substantial experience already acquired by BVK and BBPCU with day-to-day implementation of Bank-funded projects. BBPCU will handle all the Project requirements in terms of developing the procurement plan and documents, managing the procurement process and interacting with consultants and contractors. BBPCU will also be responsible for the financial management of the Project. BBPCU will handle all responsibilities for payments to contractors, suppliers and consultants, process disbursements applications, manage the special account and record all transactions in BBPCU accounting systems. BBPCU will also be responsible for generating FM and progress reports. In addition, BBPCU will be responsible for coordination with BVK and other relevant government agencies to obtain all necessary permits and clearances, and for overseeing and coordinating the implementation of the Project in accordance with the Project Operational Manual (POM), the Environmental Management Plan (EMP), the resettlement Policy Framework (RPF) as well as the Financing Agreement (FA), the Project Agreement (PA) and the Subsidiary Agreement (SA). This arrangement is expected to streamline processing needs, benefit from local knowledge of the sector, and avoid delays in implementation. BBPCU will need to increase its procurement, FM and technical capacities to be able to undertake the increasing workload brought by AKWSP. BBPCU will continue to report on its activities to the PCU and through the PCU to Uzkomunkhizmat and to GOU.

The PCU further reports to the Inter-Ministerial Coordination Council (ICC) responsible for overseeing internationally-financed projects. ICC includes representatives from local governments and key agencies of the central Government (Cabinet of Ministers, Ministry of Finance, Ministry of Foreign Economic Relations and Trade, State Committee of Architecture and Construction, Ministry of Environment and Uzkomunkhizmat).

The Alat and Karakul districts of the Bukhara region will be the beneficiary districts of the Project. The current district vodokanals, AVK and KVK have very limited capacities, and cannot implement or operate the Project. Their assets and current operations will be merged to form an independent division of BVK. The objective of this merger is to obtain a better platform for Project implementation and operation, as well as to ensure provision of the improved water supply services to the districts' residents. BVK will as such be responsible for owning and managing Project assets. The overall responsibility for procurement and contract monitoring will as such remain with BVK, assisted by BBPCU and the Implementation Consultant.

VII. Safeguard Policies (including public consultation)

Safeguard Policies Triggered by the Project	Yes	No
Environmental Assessment OP/BP 4.01	X	
Natural Habitats OP/BP 4.04		X
Forests OP/BP 4.36		X
Pest Management OP 4.09		X
Physical Cultural Resources OP/BP 4.11		X
Indigenous Peoples OP/BP 4.10		X
Involuntary Resettlement OP/BP 4.12	X	
Safety of Dams OP/BP 4.37		X
Projects on International Waterways OP/BP 7.50	X	
Projects in Disputed Areas OP/BP 7.60		X

VIII. Contact point

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