

Report No. 25923-UZ

# Uzbekistan

## Living Standards Assessment

### Policies To Improve Living Standards

(In Two Volumes) Volume I: Summary Report

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Human Development Sector Unit  
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## CURRENCY AND EQUIVALENT UNITS

(Exchange Rates effective April 1, 2003)

*Currency Unit = Soum*

*US\$1 = Soum 968.42 (official exchange rate)*

*US\$1 = Soum 969.64 (OTC exchange rate)*

*US\$1 = Soum 1,000.00-1,020.00 (consumer goods/exchange bureau exchange rate)*

*US\$1 = Soum 1,120.00 – 1,140.00 (parallel market exchange rate)*

## ACRONYMS AND ABBREVIATIONS

AIDS	Acquired Immune Deficiency Syndrome	GDP	Gross Domestic Product
BEEPS	Business Environment and Enterprise Performance Survey	ILO	International Labor Organization
CEE	Central and Eastern European	IMF	International Monetary Fund
CIS	Commonwealth of Independent States	LFS	Labor Force Survey
CTS	Common Tariff Schedule	MAWR	Ministry of Agriculture and Water Resources
DHS	Demographic and Health Survey	NGO	Non-Governmental Organization
EBRD	European Bank for Reconstruction and Development	PPP	Purchasing Power Parity
EU	European Union	PTA	Production and Trade Association
FSU	Former Soviet Union	SME	Small and Medium-Size Enterprises
FBS	Family Budget Survey	TB	Tuberculosis

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## UZBEKISTAN LIVING STANDARDS ASSESSMENT: POLICIES TO IMPROVE LIVING STANDARDS

### I. INTRODUCTION

1. Poverty was not unknown in Uzbekistan prior to the transition. At independence, the poverty rate in Uzbekistan was much higher than most of the other Former Soviet Republics: a reflection of Uzbekistan's low gross per capita income and relatively high levels of inequality. However, as a result of its socialist legacy, Uzbekistan's education and health achievements compared favorably to countries with similar levels of income.

2. Since independence, Uzbekistan has followed a distinct economic strategy, entailing gradual transformation of the economy, while emphasizing social stability. The "Uzbek Model" of development has focused on developing industrial and manufacturing capacity in a predominantly agricultural economy, using direct and substantial state guidance. An important objective of the strategy has been to raise living standards and expand employment opportunities, while protecting vulnerable groups against abject poverty.

3. Has this approach alleviated the problems of poverty inherited by the country? This report provides the first national level picture of living standards in Uzbekistan since independence. It has three main goals: (i) to examine the current status of living standards in Uzbekistan (ii) to identify key challenges and constraints to improving living standards, and (iii) to suggest priority policy actions that are needed for broad based improvements in living standards in the country. The report was prepared in close collaboration with a working group from the Government of Uzbekistan, to ensure the relevance of the findings and to build capacity for analytical evaluation of living standards using household survey data.

4. The report is based on the recently improved and nationally representative Family Budget Survey (FBS) (2000/01) carried out by the Uzbek statistical authorities. Since 2000/01 was the first year of implementation of the revised nationally representative survey, the new survey is considered by the Statistical Authorities to be a pilot. This is also the first time the data have been used for poverty analysis, and the exercise has yielded important feedback for further strengthening the survey. Despite these important caveats, the FBS does provide the first comprehensive information on living standards in the country, and represents the best available information at this time. Results that appear to contradict conventional wisdom cannot be rejected a priori, since they represent the responses of about 10,000 households. They must be verified with future rounds of the survey as well as special studies. In addition to the FBS, the report uses other sources of information, including surveys of firms, farms, institutions and individuals, as well as administrative data. The study also uses international evidence to compare and contrast Uzbekistan's living standards and policy outcomes relative to other countries, including CEE (Central and Eastern European) countries and other CIS (Commonwealth of Independent States) countries.

5. A broad measure of household welfare encompassing both income and non-income dimensions of poverty is used in this report. To determine *income* poverty, the report uses an income threshold, or poverty line, that reflects minimum subsistence (see Box 1). Households with income below this threshold are considered poor; and those with income above it, non-poor. The report also uses two key poverty measures: the first measure, the *poverty rate (or incidence of poverty)*, is the proportion of a particular group that is income poor, and represents the risk of poverty faced by the group. However, a group may have a low poverty rate, but because of its large population share may comprise a large share of the total poor population. Therefore, *the proportion of poor in a particular group relative to the total poor population* is the second main indicator used in this report. The *non-income* well-being indicators used in the report include capabilities, such as health and education, basic services (sanitation, water), the vulnerability to risks and shocks, as well as voice and participation in the society.

6. This report comprises two volumes. This first volume provides a summary of the findings and key policy recommendations of the report, preceded first by a brief overview of the key messages. The second volume contains the more detailed technical analysis on which this first volume is based.

**Box 1: Measuring Poverty in Uzbekistan**

To measure material well-being, typically a measure of welfare based on total consumption is used. The data from the Family Budget Survey only permitted the construction of a reliable food consumption aggregate, not a total consumption aggregate. This food consumption aggregate (adjusted for regional and monthly differences in prices) was compared with two food poverty lines to provide estimates of total poverty and extreme poverty. The analysis drew on the findings of Olson Lanjouw and Lanjouw (2001) which establish that under certain theoretical assumptions the poverty rate as measured by a head count measure would be the same under the case where a measure of food poverty is compared to a food poverty line and one where a total consumption measure is compared to a total poverty line. This approach was found to yield reasonable results both for the headcount index and for the profile of poverty in several practical cases in Latin America and Asia. Its reliable empirical performance was further established for Kazakhstan and the Kyrgyz Republic (Scott and Mehra, 2002). The approach permits the best possible use of FBS data to understand the extent of poverty in Uzbekistan and the characteristics of the poor. It does not, however, permit estimates of inequality, depth and severity of poverty. Moreover, the profile of poverty may yield less pronounced differences between groups than would otherwise be the case.

The food poverty line was established by estimating the cost of a consumption basket that would provide 2100 calories per person per day. The consumption basket is based on actual consumption patterns of the poor population and is converted into soums using the prices faced by the poorer population. A second poverty line, to characterize extreme poverty, was computed based on a caloric intake of 1500 calories per person per day. The value of the food poverty line thus obtained, in October 2000 prices, is 3601 soums per month, which is 50% higher than the value of the minimum wage in 2000, while the extreme poverty line (2572 soums) is quite close (just 5% higher) than the minimum wage in October 2000.

It is important to note that all poverty estimation was done jointly with the Government's inter-ministerial working group for the Living Standards Assessment. In addition the sensitivity of the profile to assumptions on the differences in needs of different household members was tested using weights developed by the Ministry of Labor and Social Protection.

References: Olson-Lanjouw and Lanjouw, 2001, "How to compare apples and oranges" Poverty Measurement Based on Different Definitions of Consumption", Review of Income and Wealth, Series 47, Number 1, March 2001.  
Scott and Mehra, "A Description of Poverty in Uzbekistan," Background paper prepared for Living Standards Assessment

## Brief Overview of Main Findings

7. *There have been improvements in some indicators of well-being as a result of recent economic growth; but poverty remains a serious challenge for Uzbekistan.* According to administrative data, some indicators of well-being (for example, life expectancy, infant and child mortality rates, enrollment rates in basic education) have recovered or improved substantially with the resumption of economic growth; illiteracy has been eliminated; many households now own their dwelling; and rural households have access to household plots. However, income poverty remains a problem, *over a quarter of the population (27.5%) can be characterized as poor and a third of them extremely poor.* As discussed below, some non-income dimensions of well being are also of concern: survey data show much higher infant mortality rates compared to administrative sources<sup>1</sup>, infectious diseases such as tuberculosis and AIDS are increasing, and some educational achievements are at risk.

### 1. Income Poverty

8. *Poverty is predominantly rural, with higher concentration in particular regions.* Like other CIS countries, a large share—nearly 70 percent of all poor—reside in rural areas. Among regions, *Kashkadarya*,

<sup>1</sup> 75% higher in survey relative to administrative data in 1996. This is not uncommon in FSU republics. Discrepancies are even higher in some other republics such as Azerbaijan and Tajikistan.

*Namangan and Karakalpakstan* have poverty rates that are much higher than the national average, and their inhabitants comprise almost 40 percent of all poor.

9. ***Employment has not protected individuals against poverty.*** Nearly half of all households with employed household heads are poor the rural poor are heavily involved in agriculture, while the urban poor work disproportionately in industry, where state ownership is high. The poor are also more likely to work in the informal sector. Very low and irregular wages and high wage inequality (much higher than CEE Countries, and similar to some CIS countries) is the main reason for poverty among workers. The problem is most severe in agriculture and explains the high incidence of rural poverty<sup>2</sup>. Low and irregular wages are the result of continued state subsidization and lack of restructuring of insolvent enterprises. Low agricultural wages also reflect implicit taxation of agriculture, and heavy state involvement in agricultural product and input markets. The private sector, essential for employment and wage growth, is heavily constrained by a poor business climate, inflation, large administrative and regulatory burden, limited financing opportunities and informal payments. As in other CIS countries, excessive wage inequality is explained only to a small extent by productivity differentials among workers, and reflects wage arrears, regional differences, and informal activity. *Low and uncertain remuneration for employment is one reason that poverty rates among the employed are very similar to households with inactive heads.*

10. ***Basic and secondary education do not protect against poverty; only higher education pays.*** Most of the poor have heads who have completed basic or secondary education. Consistent with evidence from other CIS countries, the Family Budget Survey shows that only higher education is correlated with low poverty rates, while households headed by secondary and basic education graduates have rates of poverty that are no different than the national average. This reflects an early transition labor market where earnings differences do not fully reflect productivity differences. Only higher education graduates command a significant wage premium in the labor market. In contrast, in CEE countries, secondary education does command a wage premium and is therefore associated with lower poverty. Insufficient demand for the skills of secondary graduates could additionally explain the lack of a wage premium.

11. ***Many poor are inactive, reflecting insufficient employment opportunities and incentives to retire early.*** The inactive are mainly pensioners and working age women. Inactivity among women is very high, comparable to Turkmenistan and Azerbaijan, and is mainly attributable to a lack of higher education, more young children and cultural factors. According to official data, the employment rate (employed/working age population) has declined steadily over the last decade, despite the recent growth. Job opportunities for the growing working age population have been limited. Most inactive poor have coped with poverty through informal sector activity, access to plots, and social benefits.

12. ***The unemployed are a particularly vulnerable group.*** The unemployment rate in Uzbekistan is about 6 percent<sup>3</sup>, with a high rate of unemployment among youth. Though they comprise a small share of the poor, the unemployed have the highest poverty rate among the working age population.

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<sup>2</sup> All sources indicate that agricultural wages are low. The Family Budget Survey reports that the incidence of wage arrears is highest in agriculture, followed by construction and industry. Gini coefficients for wages according to the Family Budget Survey were over 0.5; international comparisons are based on latest available data

<sup>3</sup> According to the FBS. According to official statistics, registered unemployment at the end of 2001 was 0.4% of economically active population, and survey based unemployment from the new labor force monitoring surveys carried out by the Ministry of Labor and Social protection is nearly 4%.

## 2. Non-Income Poverty

13. *Health outcomes show vulnerability, for the poor, but also for the non-poor.* There have been recent improvements in the incidence of infectious diseases; however, the incidence of some preventable infectious diseases (tuberculosis and AIDS) have increased. Death rates from chronic diseases increased until the mid-1990's, and remain high<sup>4</sup>. Poor households, particularly in rural areas, face a higher incidence of infectious disease and worse nutritional outcomes. The reduction in public spending on health, its disproportionate targeting to the non-poor (through high spending on hospitals), increasing formal and informal costs of health care, the uneven quality of the health care system, and low household income are possible explanations. Despite reportedly improved coverage of rural populations with running water, the lower access to basic sanitation and safe water also contributes to the low health status of rural populations.

14. *Some educational achievements have eroded, although recent trends are encouraging.* The net enrollment ratios in basic education increased after the mid-1990's to about 95% in 2000/01. However, coverage rates at other levels—even in higher education (in contrast to other transition countries), remain below pre-transition levels. In very recent years these negative trends have started to reverse. Educational outcomes, particularly at these levels are worse for the poor households and in particular regions. As in the case of health, the reduction in public spending for education, its disproportionate targeting to the non-poor (particularly at higher levels of education), increasing formal and informal costs of education; uneven quality and lower perceived relevance of education, and low household incomes (and higher opportunity costs of education) are possible explanations.

15. *Social protection programs show mixed success in protecting against risks.* The Government has an extensive social protection system, to protect the most vulnerable groups. The pension system, the largest (in terms of expenditure and coverage) of all social protection programs, has helped alleviate poverty among pensioners. However, this protection has come at large current costs, e.g. high payroll taxes, and incentives to early retirement, and the system faces large future fiscal costs due to population aging. The targeting of cash assistance programs by the Mahallahs shows mixed results and can be strengthened, while the privileges and subsidies largely benefit the non-poor. Unemployment benefit programs have very little impact (given low coverage) and most expenditures are skewed towards cost-ineffective active labor market programs.

## 3. Policies to Improve Living Standards

16. Policies to improve living standards in Uzbekistan will need to focus on five key areas.

**A. Sustained economic growth** will require facilitation of private sector growth and, given large rural poverty, agricultural sector reforms:

- *Facilitation of private sector and SME development.* Key actions include macroeconomic stability and proceeding with fundamental structural reforms (such as liberalization of the foreign exchange and trade regimes, financial sector reforms), imposition of hard budget constraints on state enterprises, reducing the burden of tax and regulations. Restructuring of the state sector and easing of barriers to private sector development is critical for improving the allocation of labor and capital, and promoting growth in productivity and employment.
- *Improvements in agricultural productivity and incomes.* Key actions include improving the incentive structure in agriculture through price liberalization and reduced state intervention in product and input markets, and increasing equity of land reforms. The recent experience of the Kyrgyz Republic, shows that

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<sup>4</sup> The Government reports no further increases in the incidence of chronic diseases in the past five years.

major agricultural reforms in the area of land policy, the incentive framework, credit, irrigation and agricultural services, lead to significant agricultural growth and reduction in rural poverty.

- **Distributional impact of reforms.** The above set of reforms will significantly improve the living standards of the country as a whole (including the poor) though some groups may be adversely impacted in the short run. These individuals will need to be protected by a well targeted safety net (see below).

**B. Improving capabilities in health and education** will be important for improving welfare of the population and will also allow households to benefit from economic growth. Policies to improve capabilities include:

- Improving **education outcomes**, will require the provision of relevant, transferable and general skills to the population and targeted actions to improve access among the poor and in poor regions. Implementation of these policies will require increased resource allocation to poorer regions, as well as continuation of ongoing efforts to provide textbooks and educational materials to needy families. It will also be important to increase women's enrollments in higher levels of education.
- Improving **health status** will require continued actions to reduce infectious diseases and improve nutritional outcomes, with a particular focus on prevention, by increasing relative allocations to primary health care (particularly in poorer regions) through acceleration of hospital restructuring efforts; strengthening the monitoring and targeting of existing exemptions to the poor for care at all levels (including actions to reduce informal payments); and continued attention to improving access of the rural poor to water and sanitation services. It will also be important to introduce mechanisms to protecting the non-poor from impoverishment due to catastrophic or chronic illness.

**C. Providing effective social protection** will require reducing the employment and future fiscal costs associated with the social insurance system and improving incentives to work (through pension reform), strengthening unemployment programs, and further improving the targeting of cash social assistance and child allowance programs, and phasing out privileges. To reduce **social costs of restructuring and other reforms**, labor redeployment programs could be used to assist laid off workers, and existing social assistance delivery models could be strengthened and used to target subsidies to individuals who may face cost of living increases from economic reforms.

**D. Building inclusive institutions** and reducing informal payments (which constitute a disproportionate burden for the poor), will allow a larger share of the population to benefit from economic and social policies. Actions include increasing accountability of state institutions (through improved quality of regulations, introduction of performance based salary structures, and strengthened oversight and monitoring), increasing transparency and access to information, strengthening the voice of communities, and encouragement of civil society organizations.

**E. Improving poverty monitoring** will require continued implementation of household based surveys such as an improved Family Budget Survey, to track changes in household welfare, the implementation of regular Labor Force Surveys to measure labor market developments, the updating of the population census. It will be important to provide data access to the public and to strengthen the capacity of poverty analysis within and outside the government. A well organized and regular system for gathering, disseminating and evaluating data will help create sound policies and programs for improving living standards in the country.

We now turn to a more detailed discussion of these results.



## II. LIVING STANDARDS IN UZBEKISTAN

### 1. Growth and Living Standards

17. *Uzbekistan realized the “mildest” transition recession which may have prevented large real income declines in the early transition years.* Although comparable data are not available over time to assess income poverty, the smaller fall in incomes was likely associated with smaller declines in living standards compared to many other CIS countries. Recently, Uzbekistan has seen six consecutive years of positive GDP growth, averaging 4% per year according to official figures.<sup>5</sup>

18. *Some indicators of well-being show improvements associated with Uzbekistan’s recent growth.* According to administrative data, some indicators of well-being (for example, life expectancy, infant and child mortality rates, participation rates in basic education) have recovered or improved substantially with the resumption of economic growth. Other gains that had started in earlier decades, seem to have continued since independence: illiteracy has now been completely eliminated, and gender gaps in educational achievement have been closing and remain primarily at higher levels. Reflecting the early privatization of housing, 95% of all households own their dwellings, and the majority of rural households have access to household plots for cultivation.

19. *However, serious challenges remain.* Growth has not generated sufficient employment opportunities or substantially improved incomes of the population:

20. *The growth rate in Uzbekistan lags behind most other CIS countries.* Since the end of the transition recession in CIS countries, Uzbekistan’s average GDP growth has been the lowest, and cumulative growth in per capita GDP has been the second lowest. Growth has not been broad based; according to official statistics, during the period from 1996-2002, real value added in agriculture grew on average at about 3.3% per annum, and in industry it grew at only 2.0% per annum. Growth was higher in the trade sector, which however, accounts for only a small share of employment. Thus, incomes and wages remain low. In 2001, GDP per capita at purchasing power parity was \$2,440, third lowest among CIS countries, and the average monthly wage was \$29 at the official exchange rate (or \$17 at the parallel market rate)<sup>6</sup>.

21. *The growth in productivity has been limited.* Labor productivity<sup>7</sup> in industry has grown at only 0.8% per annum in 1996-2002, in agriculture at about 5.5% per annum, and services at 1.6% per annum. The limited productivity growth reflects insufficient restructuring (particularly outside of agriculture) and associated movement of resources to high productivity activities in the private sector and in services and trade. Although some restructuring has been initiated in the agricultural sector, Uzbekistan has not seen the dramatic sectoral shifts in output or employment witnessed in Central and Eastern European countries, and public services still dominate the services sector. Private sector share of GDP is among the lowest in transition countries and over 60% of investments come from the state sector. Foreign direct investment flows have been falling steadily, and at an average of \$3 per capita in 2000-2002 are among the lowest in CIS countries. Box 2 shows the importance of productivity growth for increases in incomes and wages of workers.

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<sup>5</sup> Alternate IMF estimates of growth have been lower, at about two thirds of this rate.

<sup>6</sup> Dynamics of US dollar-denominated income indicators varied between 1996 and 2001/2002. GDP per capita in PPP terms steadily increased (from \$2,000 in 1996) while US\$ GDP per capita at current exchange rates declined (from \$601 in 1996 to \$384 in 2002 at the official exchange rate, and from \$409 to \$226 at the black market rate). Average wage during the same period declined from \$54 at the official exchange rate and from \$37 at the black market rate

<sup>7</sup> Labor productivity figures are World Bank staff calculations based on official national accounts and employment statistics.

**Box 2: Economic Growth, Productivity and Living Standards during Economic Take-off**

The experience of countries that have successfully industrialized while achieving substantial improvement in living standards demonstrates the importance of intensive, productivity-led economic growth. For example, as the table below shows, Spain and Korea whose income levels and agriculture-dominated economies in mid-1960s were not dissimilar to those of Uzbekistan today, achieved and sustained remarkable GDP growth rates. They achieved these not only by encouraging high levels of savings and investment, but also by opening up their economies and pursuing export-oriented development strategies which increased competition and efficiency as well as stimulated high productivity growth. Productivity growth was particularly strong in industry, the sector most open to foreign competition. This enabled the industrial sector both to absorb labor released from agriculture as its productivity grew, and to ensure steady improvement in living standards throughout the economy as the benefits of better manufacturing wages was transmitted to other

Average annual growth rates (unless indicated otherwise)	Spain 1964-74	Korea 1965-80	Korea 1980-89	Memo: Uzbekistan 1996-2002
Total GDP:	6.4	9.9	9.7	4.0
Agriculture	2.5	3.0	3.3	3.3
Industry	9.1	18.7	13.1	2.0
Services	5.4	9.6	9.1	4.5
Value added per worker				
Agriculture	8.4	0.5	19.0	5.5
Industry	8.7	16.6	16.3	0.8
Services	2.7	11.8	12.5	1.6

sectors. As a result, during the 10-15 year take-off period in the two countries, employment generation exceeded population growth rates and per capita incomes (as measured by Atlas GNI per capita) rose by 4-14 times.

In contrast, Uzbekistan's more inward-oriented development approach, while ensuring steady if modest overall economic growth during 1996-2001, has been less successful in creating environment for productivity growth. Although investment in Uzbekistan has been high (averaging 30 percent of GDP during 1996-2001), its efficiency – payoff in terms of higher productivity and economic growth – has been relatively low, as the domestic producers' incentives to improve have been blunted behind the wall of protection through foreign exchange and trade restrictions. Productivity performance in industry, a major recipient of investment and subsidies, compares particularly unfavorably with other industrializing countries during their "take-off" periods. Productivity growth in industry has also been considerably lower than that in agriculture, which itself has been below potential, in part due to an implicit resource redistribution by the state away from agriculture during most of the period. This lack-luster productivity performance is an important reason why Uzbekistan has not seen a marked improvement in living standards despite economic growth since mid-1990s, and why employment growth still lags behind population growth. A decisive policy shift towards a more open economy, removal of barriers to foreign trade, competition and private sector development as well as macroeconomic stability would be required for Uzbekistan to realize its economic potential and achieve income gains similar to those of Spain, Korea and other countries that successfully industrialized.

Source: World Bank, Uzbekistan national statistics authorities.

**22. Growth has not generated sufficient employment opportunities for the growing population.**

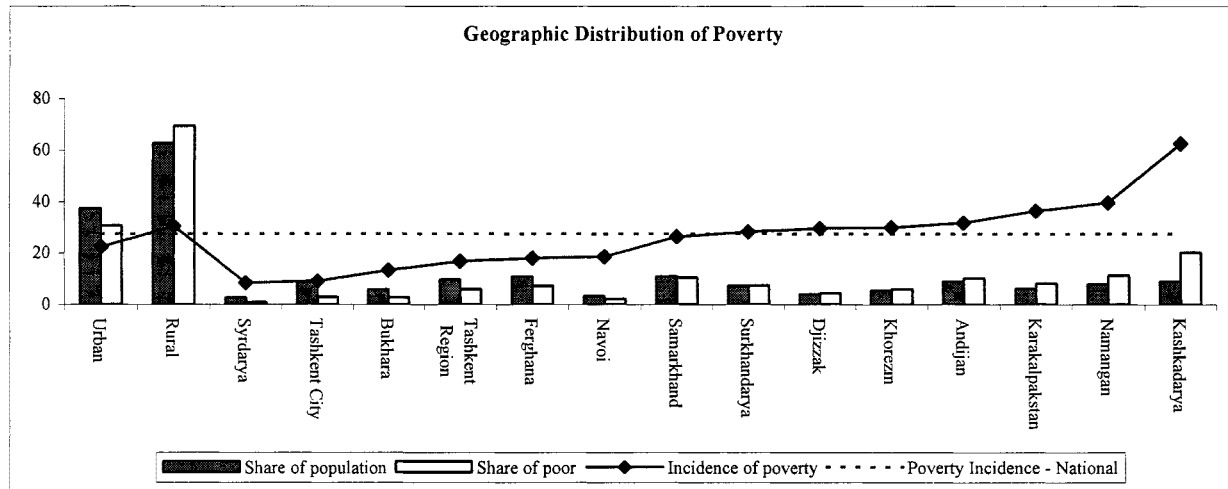
Although employment in absolute terms has increased according to official statistics, recent economic growth has not translated into a sufficient number of productive jobs for the growing working age population. *The employment rate* (ratio of employment to working age population), based on official statistics, has declined steadily since independence (by 12 percentage points between 1991 and 2002), and recent growth has not reversed this trend. Activity rates are particularly low among women (only 33%, comparable to Turkmenistan, Tajikistan, and Azerbaijan). Open unemployment (6%), high youth unemployment (13%), underemployment, the significance of temporary work arrangements, and informal sector employment are all additional manifestations of inadequate utilization of labor resources<sup>8</sup>. The experience of East Asian countries, where a growing workforce was accompanied by faster GDP growth per capita, demonstrates the importance of tapping the potential of a growing workforce.

**23. Income inequality has increased and has prevented a higher impact of growth on poverty reduction.** As in the case of poverty, comparable data on income inequality are not available over time for Uzbekistan. However, wage inequality has increased, particularly between workers in the agricultural sector

<sup>8</sup> Numbers quoted here are from Family Budget Survey which differ quantitatively, although not qualitatively, from official labor force monitoring.

and all other workers, suggesting that rural-urban disparities have widened<sup>9</sup>. While the average agricultural wage was comparable to that in industry in 1991, by 2002 it was only 21%. Unlike the initial increases in inequality in Central European transition countries, this increase in inequality has not been a result of alignment of wages with productivity, as agricultural productivity growth has been higher than that in industry. Levels of wage and income inequality in Uzbekistan today are comparable or higher than those observed in other CIS countries, and significantly higher than those in countries of Central and Eastern Europe and the Baltics.

**Figure 1: The poor are predominantly rural, and poverty rates differ significantly across regions.**



## 2. A Profile of Living Standards

24. **Poverty remains a significant problem and an estimated 27.5% of the population, or 6.8 million people in Uzbekistan are unable to meet basic consumption needs.** Approximately one-third of all poor households can be classified as extremely poor. As discussed below, income poverty is associated with other forms of deprivation, and some non-income dimensions of welfare are under stress.

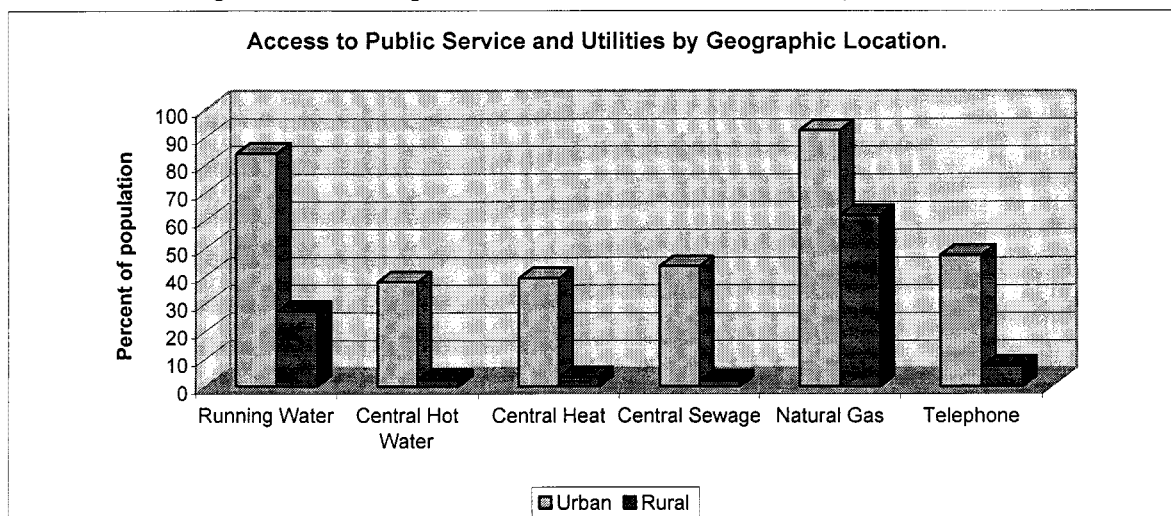
### A. Rural and Regional Poverty

25. **Poverty is predominantly a rural phenomenon.** Approximately 4.5 million poor people, or 70% of Uzbekistan’s poor live in rural areas. Rural populations are 35% more likely to be poor and 58% more likely to be extremely poor than their urban counterparts.

26. **There are large regional pockets of poverty: Kashkadarya and Namangan have the highest rates of poverty and extreme poverty.** Individuals living in Kashkadarya are seven times more likely to be poor than those living in Tashkent city. Kashkadarya itself accounts for a fifth of Uzbekistan’s poor and nearly 40% of its extreme poor (Figure 1). While education, health and employment account for some of these regional differences, they do not account for all of them. Other factors, such as differences in infrastructure or other endowments, policies or institutions are likely to be important.

<sup>9</sup> Workers in agricultural cooperatives additionally receive a share of profits- when these are made – as well as in-kind payments; to that extent wage figures alone may overstate disparities.

**Figure 2: Rural Populations have limited access to many basic services**



27. *Rural and some regional populations have lower access to basic services and amenities* such as systems for running water, central heat, hot water, and sewerage. Official data show an increase in access to water supply for rural populations and is, at present 78% for the republic. The Family Budget Survey, however shows that rural populations have low access to many basic services. For example, only a quarter of the rural population has access to running water and less than 2% to central sewerage (Figure 2). Moreover, households in particular regions (such as Karakalpakstan, Khorezm) have been affected by limited water availability and drought; the poor are likely the hardest hit<sup>10</sup>. The capabilities of the population, such as health and education status, are worse in rural areas, and in particular regions

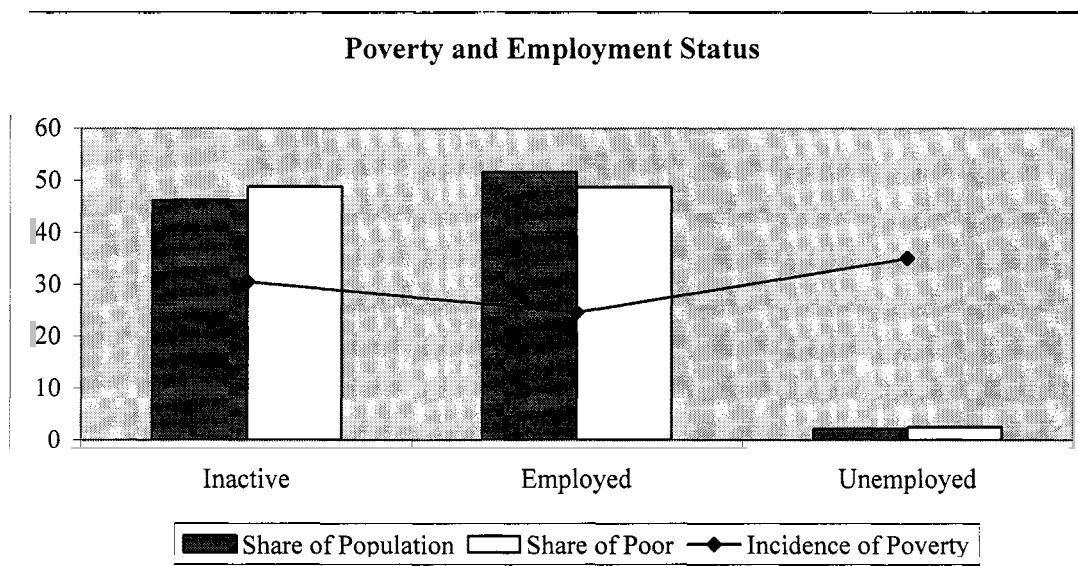
## B. Labor Markets and Poverty

### *The Working Poor*

28. *The employed have a lower incidence of poverty than the inactive or unemployed, but this difference is not very large* (Figure 3). In contrast, in the more advanced transition countries in Central and Eastern Europe and the Baltics, the employed have a much lower rate of poverty than the inactive; and poverty is much more closely related to unemployment and inactivity. About half of the poor are employed. A large share of the *rural poor* (more than half) are employed in agriculture; this share is substantially higher when employment in agricultural industries and processing is included. Private, non-farm employment accounts for less than 10% of rural non-agricultural employment. The *urban poor* work disproportionately in industry where state ownership is high.

<sup>10</sup> Government data show a steady increase in water supply provision to some of these ecologically disadvantaged areas relative to the early 1990's.

**Figure 3: The poor are equally divided between the inactive and the working**



29. **Wages are low and uncertain, and wage inequality is high.** Rural agricultural workers have the lowest wages among all sectors and have a very high incidence of wage arrears. The gini coefficient of median hourly wages is 0.59 in the private sector and 0.52 in the public sector. High wage inequality in Uzbekistan likely reflects the significance of informal employment and wage arrears. There is a strong association between poverty and the incidence of wage arrears, seasonal variation in employment opportunities, and casual or temporary work arrangements. *Thus the poor face greater vulnerability in labor market outcomes.*

30. **Participation in the informal sector is linked to poverty.** Estimates of the size of the informal sector (20% to 50% depending on the definition) are similar to Kazakhstan and higher than in the Kyrgyz Republic, but lower than in the Caucasus (Armenia, Azerbaijan, Georgia). Although the informal labor market is an important source of employment, it is typically associated with greater insecurity in labor market status, reduced transparency, and with exclusion from government social programs. It is also associated with lower productivity<sup>11</sup> and with increased difficulties in tax collection and therefore fewer resources available for redistribution or basic social services.

### ***The Unemployed and Inactive***

31. **The unemployed have the highest incidence of poverty, but constitute a small share of all poor.** The unemployment rate is generally higher in poorer regions, although the correlation is not perfect. Unemployment was highest in Samarkhand, Dzizhak and Surkhandarya. Combined with substantially higher population pressure in rural areas, limited availability of employment opportunities has manifested itself in higher rural unemployment, greater youth unemployment, and greater seasonality of employment.

32. **The inactive poor are mainly pensioners.** Half of the poor live in households whose heads are not active in the labor market. The majority of the “inactive” group are pensioners: households headed by pensioners account for just under a third of the inactive poor. The inactive poor also include working age population, and especially women.

<sup>11</sup> ILO 2002, “Decent Work in the informal economy”

33. ***High inactivity rates, especially among women, in poor households lead to higher dependency rates.*** Poor households have a higher share of dependents relative to working members, reflecting lower utilization of their labor resources. This is in large part due to the much lower labor force participation rates among poor women: while poor males are 8% less likely to participate in the labor market, poor women have 25% lower participation rates compared to the non-poor. Higher female inactivity is linked primarily to lower educational attainment of women, particularly of technical and higher education, but may also be due to cultural factors and the presence of very young children.

### C. Health and Poverty

34. ***Despite some achievements in health indicators, the levels and trends of some health and nutrition outcomes are of concern.*** Low children's nutritional status could have serious long-term development consequences. The latest household survey results available unfortunately coincide with the lowest point of the transition recession, in 1996. At that time, malnutrition among children was high (31% of children under 3 years of age were stunted and 19% were under-weight in 1996)<sup>12</sup>. As in other republics of the Former Soviet Union, the infant mortality rate based on survey data is much higher (76% higher) than reported in administrative data for the same year<sup>13</sup>. Anemia rates among very young children and women of reproductive age are also among the highest in the region. There have been recent improvements in preventable infectious diseases. However some infectious diseases are a major concern and remain the most important cause of death and morbidity among children. Tuberculosis incidence has increased by nearly 30% between 1990 and 1998 and AIDS is rising exponentially<sup>14</sup>

35. ***The poor are the most affected by inadequate health status.*** The incidence of malnutrition and infectious diseases tend to be higher in poorer and more rural regions, although this correlation between poverty rates in regions and health outcomes is not perfect (Figure 4). Karakalpakstan is particularly vulnerable, and the incidence of anemia and tuberculosis in this region is the highest in the country. Malnutrition is high in Namangan and Surkhandarya, among other regions. Poor health and nutrition status reflects differences in access and quality of services (including water and sanitation, health services), but also economic barriers (low incomes, high formal and informal costs of care) and cultural influences.

36. ***But many non-poor but chronically ill are also at risk of falling into poverty.*** While the burden of out of pocket payments is disproportionately high for the poor, many non-poor households are at risk of falling into poverty as a result of substantial health expenditures occurring due to catastrophic or chronic illnesses. For households with chronically ill or disabled members, average health care expenditures as a proportion of food expenditures were two and a half times that for the average household and constituted between half to 60% of food consumption for the second and third income quintiles. Faced with high costs, many poor and near poor employ counterproductive coping strategies – they deplete savings, borrow money, sell assets, reduce expenses including on food, and delay or avoid seeking care.

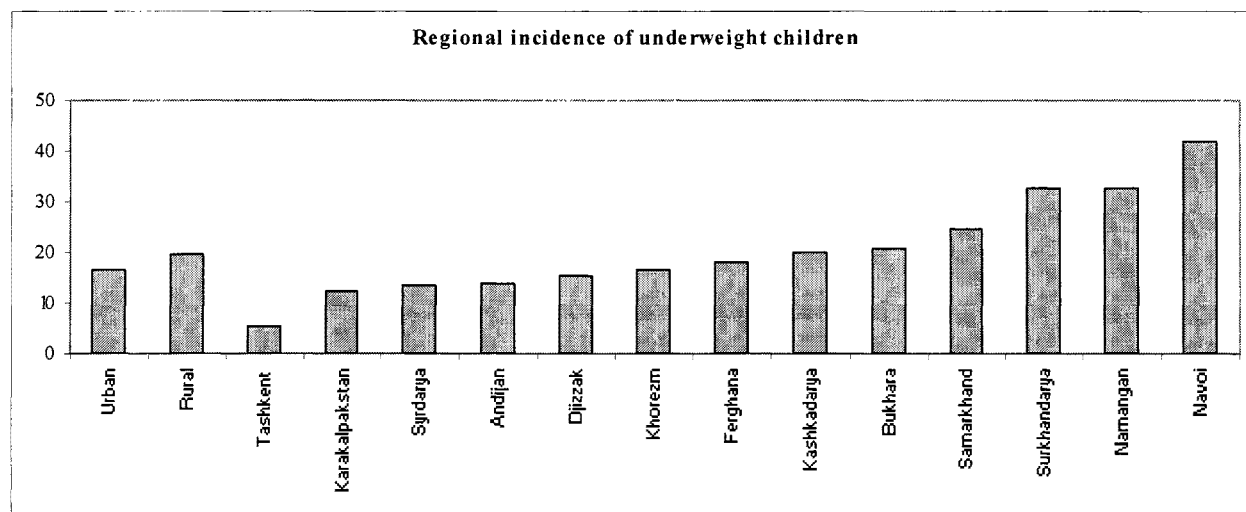
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<sup>12</sup> From the 1996 Demographic and Health Survey. Although not available for citation when this report was going to press, preliminary results from the 2002 Demographic and Health Survey indicate significant improvements in indicators of stunting, wasting and underweight children under 3 years of age, but not in anemia rates.

<sup>13</sup> The discrepancies in survey and administrative data are not unique to Uzbekistan but are found in other former Soviet Union Republics: they arise in part from differences in definition, but largely from differences in design (household based versus registry or institution based) and implementation of the survey.

<sup>14</sup> Officially there are less than 2,000 cases, but recent UNAIDS statistics suggest that the number could be more than 6,000.

**Figure 4: Nutritional outcomes are worse in rural areas and particular regions**



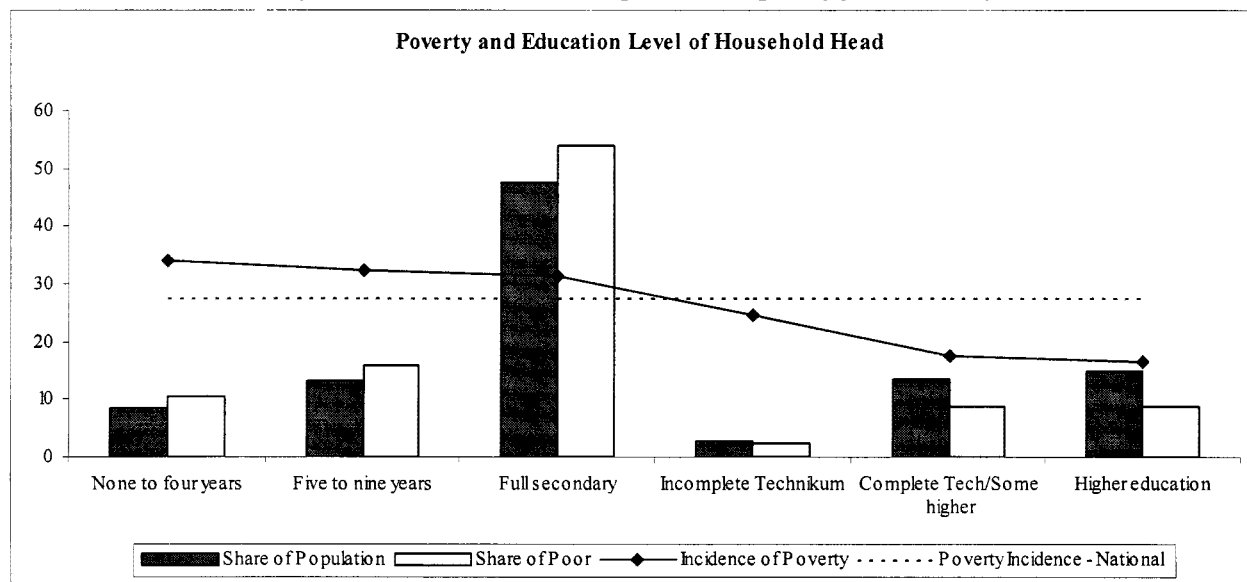
#### D. Education and Poverty

37. **Some educational achievements are at risk.** Official data show impressive gains in basic education enrollments since the mid-1990's, with the net enrollment ratio at 95% in 2000-01. At all other levels, however, the educational achievements inherited at transition now appear to be at risk. In 2000/01, absolute enrollments at pre-schools and higher education institutions were only about 50% of 1991/92 levels. The substantially lower enrollment ratios at all levels other than basic education suggest that a much smaller fraction of the school age population are now covered by the education system at pre-school, secondary and higher levels. The fall in higher education enrollments in Uzbekistan is in contrast with other transition countries. It is important to note, however, that very recent years have seen important reversals of this negative trend.

38. **There are disparities in attendance between regions, income groups and gender.** The poor have lower enrollment rates particularly at *teknikum* and higher levels of education. Significant disparities also remain between men and women at higher levels of education, particularly university education: female students constitute only a third of enrollments. Enrollment rates at these levels are highest in Tashkent City and Navoi, and lowest in Karakalpakstan, Surkhondarya, and Kashkadarya. As in the case of health outcomes, regional differences in enrollment reflect differences in access and quality, but also economic barriers (low incomes, high costs), and cultural influences.

39. **However education does not protect completely from poverty.** Consistent with evidence from CIS countries, poverty rates are not different across households heads with basic and secondary education. More than half of the poor have household heads who have completed secondary education. However, *higher levels of educational attainment are strongly correlated with lower levels of poverty.* Families where the head of the household has higher education are half as likely to be poor as those where the head has nine or fewer years of education (Figure 5). These findings are indicative of a transition labor market where earnings differences do not yet fully reflect productivity differences. Only higher education graduates command a significant wage premium in the labor market. The lack of a premium to secondary education relative to basic education in the non-state sector, is in contrast to countries in Central and Eastern Europe and the Baltics, and may also reflect insufficient demand for the skills of its graduates.

**Figure 5: Education does not protect completely from Poverty**



### III. KEY CHALLENGES TO IMPROVING LIVING STANDARDS

40. Low living standards are thus linked to insufficient job opportunities, low and uncertain incomes, particularly in rural areas, low returns to education, and lower capabilities (health and education) of the poor. What are the main factors that contribute to these outcomes? What is the role played by Government policies and programs? How effective are the Government's extensive poverty alleviation programs (i.e. public social protection programs) in protecting the poor?

#### 1. Constraints to Job and Income Growth

##### A. Limited Private Sector

41. *The SME sector remains limited in Uzbekistan, despite recent Government reforms.* Unlike the more advanced transition countries, the private and small firm sector have not yet emerged as significant providers of employment opportunities. The Government initiated, in 2000, several reforms to encourage the SME sector. These include the streamlining of business registration procedures, elimination of exchange surrender requirements, reductions in business inspections and simplification of tax and reporting requirements<sup>15</sup>. The SME sector appears to have responded to these reforms, with an increase in the official number of registered SMEs. Nevertheless, in 2001 formal SMEs accounted for only 15 percent of GDP and 9 percent of total employment while individual entrepreneurs, many of them informal, and small *dehqan* (household plot) farmers accounted for 19 percent of GDP, as much as 41 percent of total employment<sup>16</sup>. These latter groups also accounted for most of the growth in the SME sector, which may be indicative of the increasing informal sector.

42. *The private and SME sector faces an unfavorable investment climate.* The provision of privileges to the SME sector in isolation of an overall improvement to the environment for private sector development has

<sup>15</sup> In the second half of 2002 and early 2003 some reversals, which raise concern, took place. These include a clamp-down on individual traders, sharp tightening of import procedures, attempts to centralize wholesale trade, a threat to re-privatize some trading enterprises and more pervasive control over financial transactions of enterprises.

<sup>16</sup> Source: World Bank, Country Economic Memorandum, 2003.



limited impact on firm entry and development, and can provide small firms with the incentive to remain small or large firms to fragment. The following are top constraints to the environment for private sector development:<sup>17</sup>

43. ***Inflation, restrictions on access to foreign exchange, and related trade restrictions are the most significant barriers*** identified by SMEs and private firms in Uzbekistan (much more so than in other countries)<sup>18</sup>. Although recent reforms have reduced the surrender requirements of SMEs, all other exports are still subject to heavy foreign exchange surrender requirements, and access to foreign exchange remains limited by import contract registration requirements, and other formal and informal restrictions. Moreover, despite recent steps towards unification of its multiple exchange rates, Uzbekistan still had two legal exchange rates and a gap of some 10-15% between the official/over the counter and curb market rate remained in April 2003.

44. ***Major financing constraints include high cost of funds and difficulties in accessing bank loans.*** These constraints can be directly related to macroeconomic and structural distortions which raise the cost of funds to the private sector. They can also be attributed to the significant state intervention in the banking system which undermines its credibility and diminishes its ability to channel resources to productive investments. Limitations on access to – and usage of – cash, and underdeveloped legal institutions to support credit markets are additional reasons for financing constraints, especially for SMEs.

45. ***Soft budget constraints to state enterprises contribute to an uneven playing field for SMEs.*** Large enterprises benefit from substantial explicit and implicit subsidies, payment arrears, budget offsets, tax exemptions, publicly guaranteed loans, and preferential access to inputs such as foreign exchange and credit. Excessive state intervention also occurs through controls in production, prices, marketing, and allocation of inputs (exercised through Production and Trade Associations, PTAs), high state ownership in key sectors, and limited effectiveness of the Anti-Monopoly Committee.

46. ***Taxes and tax administration practices are costly, and regulatory requirements are still burdensome.*** Although they are gradually being reduced, taxes are still high<sup>19</sup> and are accompanied by various tax exemptions and privileges. These taxes, their collection through the banking system, and onerous reporting requirements combine with a narrowing tax base (as a result of the proliferation of tax breaks to strategic enterprises and, recently, small firms) to contribute to a vicious cycle of increasing informality and high taxes. The tax exemptions and privileges reduce transparency and create disincentives for firm growth. Although there has been progress particularly on streamlining entry; licensing requirements and inspections are still dramatically higher than in OECD countries.

47. ***Corruption and informal payments constitute a heavier burden for SMEs.*** Heavy state intervention and discretion in the tax and regulatory regimes provide officials with opportunities for direct contact with firms, greater discretion, and therefore more possibilities to extract informal payments from entrepreneurs. Within transition countries, Uzbekistan ranks third in the frequency of informal payments, behind Azerbaijan and Romania. SMEs are disproportionately affected: 66% of small firms in Uzbekistan report making bribes compared to 23% for large firms or 43% for all firms. Poor regulatory quality and limited transparency are important contributors to poor governance and lower accountability of state institutions. Institutions to support access to information are weak and the media is almost entirely state owned and restricted by tight

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<sup>17</sup> These findings are drawn from two surveys: a survey of 125 firms in 1999 (conducted by the EBRD and the World Bank), and surveys of 4000 entrepreneurs and managers of SMEs as well as private and dehqan farms conducted by the Center for Public Opinion (*Jitimoiy Fikr*), on behalf of the Government of Uzbekistan in 2000 and 2001.

<sup>18</sup> For a more detailed discussion of Uzbekistan's macroeconomic and structural policies see World Bank, Country Economic Memorandum, 2003.

<sup>19</sup> They include a profit tax of 20% for 2003, value added tax (VAT) of 20% and a complex array of other taxes (local, property, etc.).

licensing and defamation laws. As in other transition countries, civil society groups and alternative business associations are still nascent, and therefore play a limited role in increasing the voice and participation of businesses in policy formulation and in enhancing accountability of state institutions.

48. ***Rigidities in some labor market institutions may raise the cost of labor in the formal sector and disproportionately affect labor market outcomes for marginal workers.*** Flexible labor market institutions are essential for job creation and labor market efficiency. Uzbekistan has relatively flexible labor market legislation. However, the use of the Current Tariff Scheme for wage setting and high taxes on labor (including payroll taxes<sup>20</sup>) induce rigidities in the labor market by raising the cost of formal employment, particularly for youth, unskilled workers and workers in poorer regions. Other constraints to a flexible labor market are possible barriers to mobility arising from policies within the labor market (e.g. propiska) or outside (e.g. housing market). These may contribute to regional differences in unemployment rates.

## B. Constraints to Rural Incomes

49. ***Agricultural productivity growth and incomes are constrained by significant state intervention in output markets, particularly in the cotton and grain sectors.*** The state intervenes through pricing, exchange rate and procurement policies, and mandatory cropping patterns. While the implicit taxation of agriculture has been reduced, mainly by a narrowing in the gap between the prices paid for state procurement and international prices, and represents considerable progress, it still remains significant. Currently, taxation takes place primarily through exchange rate policies. A sizeable amount of tax revenues are returned to the agriculture sector in the form of subsidies, the most substantial being irrigation subsidies and periodic debt write-offs.<sup>21</sup> However, agricultural enterprises, particularly those involved in cotton, still regularly incur losses. Price distortions combined with mandatory cropping plans lead to inefficient output mix and land use.

50. ***State interventions in input markets reduces the quantity and quality of inputs available to all farmers, with adverse impact on agricultural productivity.*** Farmers have limited options (outside of state input suppliers) for input purchases, and limited access to capital. The provision of working capital through the Fund for State Agricultural Purchases (through accounting adjustments between input suppliers), limits the access of farmers to cash and precludes the development of private sector input suppliers. Direct provision of water by the state, poor maintenance of the irrigation and drainage system, and subsidization through inadequate water charges contribute to inefficient and wasteful water use, reducing agricultural productivity. It also increases the vulnerability of the rural population to periodic droughts.

**Table 1 - Relative Productivity Levels, 2000**

	Farm Enterprises	Private Farms	Dehqan Farms
Share of Total Value of Crop Output	48%	9%	43%
Share of Total Land	72%	16%	12%
Ratio	0.67	0.56	3.58

Source: Authors' Calculations from official data from MAWR

51. ***The ongoing process of transformation of shirkats into large private farms raises equity concerns.*** In the current phase of land reform and restructuring, unprofitable shirkats are being liquidated, and their land is being used for the creation of new large private farms. After an initial expansion in household (dehqan)

<sup>20</sup> Social security taxes were 39.7% in 2003, among the highest in the region, and significantly higher than the average for EU and OECD countries. Payroll taxes payable to the Pension Fund only include a 35% payroll tax from employers and a 2.5% mandatory insurance fee levied on employees' wages.

<sup>21</sup> Implicit taxes and subsidies balanced off in 2001, and when debt write-offs are taken into account there was a net transfer of resources to the sector

plots in 1991, the acreage of land in the household sector has expanded very slowly. Thus poor households, who are less likely to be awarded land for private farming, are less able to expand their land assets. Although access to household plots is widespread, the average size of dehqan plots is only about 0.16 hectares.

52. *The dynamism of the dehqan farm sector suggests that agriculture could be more productive with improvements in incentives and increased flexibility in production.* Table 1 shows that dehqan farms are the most efficient: their contribution to output is three and a half times greater than the share of land used by such farms. Improved incentives (higher prices and incomes), as well as flexibility to set their mix of output are key. Moreover, the smaller size of their land holding is not necessarily associated with lower land productivity, at least at the current allocations of land between farm types. These plots also remain important source of income for poor households, thus playing an important role in rural poverty reduction.

## 2. Challenges to Improving Capabilities

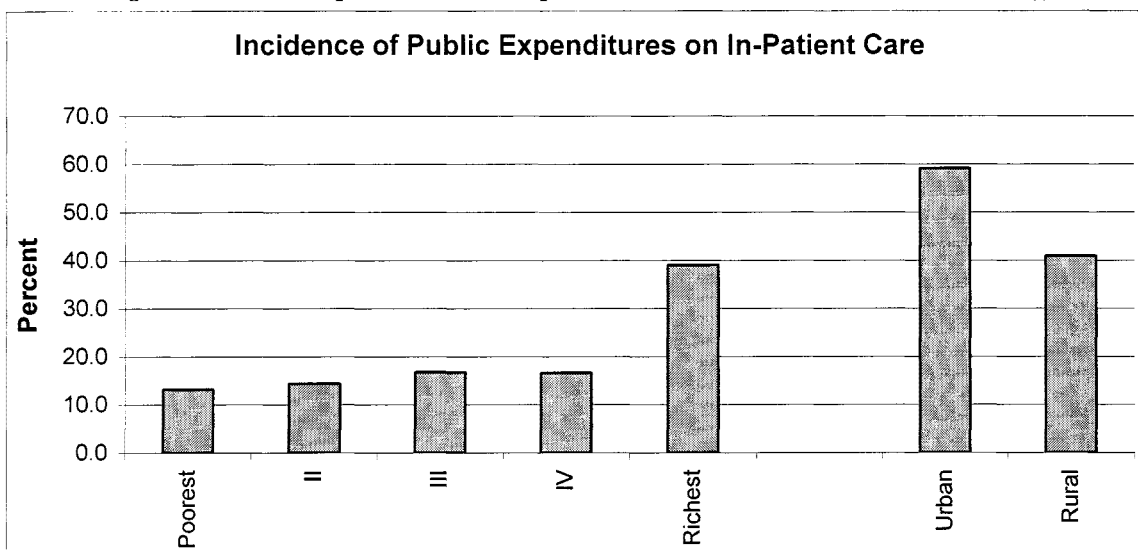
### A. Health Care

53. *To ensure the continued provision of health care, particularly for rural and poor populations, the Government has been implementing, a comprehensive health care reform program.* Public expenditures on health care fell from about 6% of GDP prior to independence to about 2.6% of GDP in 2000. As a result, health services suffered considerably, particularly in the initial years of transition. As a response, the new Government program, aimed at improving efficiency, emphasizes the development of primary health care, reduced reliance on higher end and specialized care, introduction of formal charges for inpatient and tertiary care, and gradual increase in private provision of health care. Implementation progress has been mixed, with faster pace of development of emergency care facilities and slower progress on rationalization of higher end facilities. Early reforms to strengthen primary care facilities benefited better off regions, although this is now changing.

54. *Private payments for health (formal and informal) which have increased as public financing has declined, constitute a significant burden for the poor.* The fall in public payments has been accompanied by an increase in the incidence of private charges for health care (both formal and informal). Taking these into account, total health expenditures equal to 6-8% of GDP in 2000. Informal payments are significant—more than two thirds of health users interviewed in a qualitative survey reported paying for health services informally. Informal payments were more likely (and higher) for complex services for which formal payment is required, compared to those widely recognized as free (such as immunization). While better off-populations are able to by-pass referral systems and access higher end care, the poor are less able to make private payments. They are thus less able to purchase higher quality care, or benefit from hospital care, although private payments are disproportionately higher as a share of income for the poor.

55. *Public expenditures in health do not favor the poor.* Most rural poor frequent less costly public primary care clinics, as well as rural clinics and hospitals, while higher income urban groups seek more expensive publicly financed hospital care in towns and large cities. Since hospital expenditures constitute the majority of public expenditures on health care, the well off and urban populations consume the majority of public health resources (Figure 6). The high level of funding required by the new emergency facilities may further crowd out public budget resources for primary health care and outpatient services for the poor.

**Figure 6: Public Expenditures on In-patient Care Favor the urban and better off**



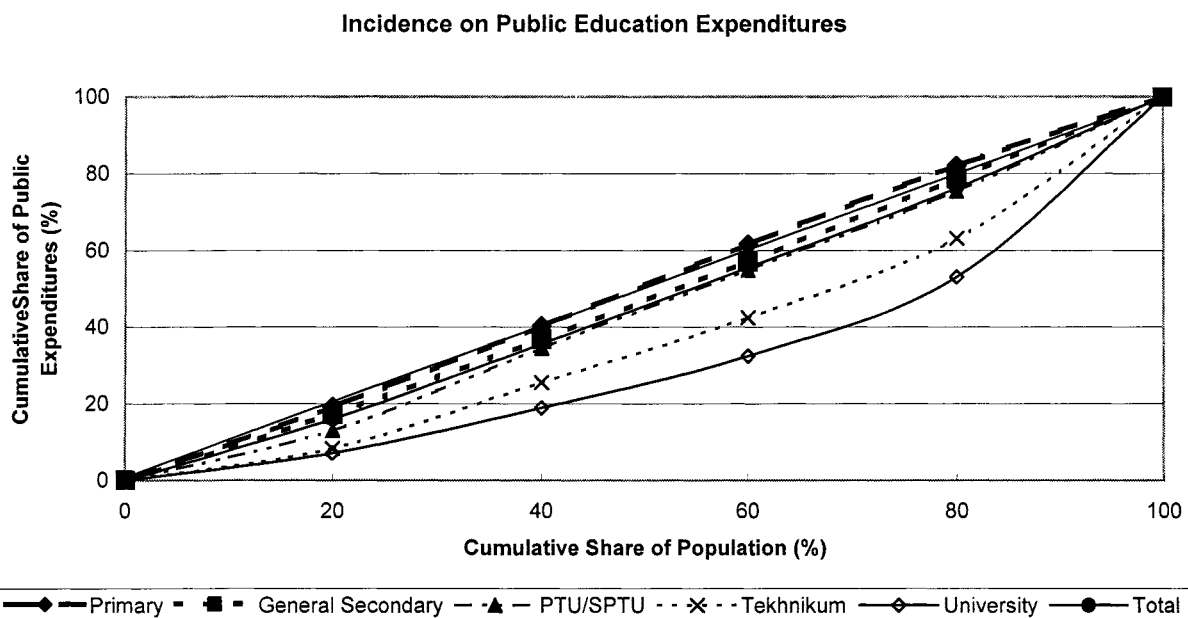
56. ***Policy provisions to allay costs of higher formal charges do not adequately protect the poor.*** To protect vulnerable groups, many legal provisions have been introduced that exempt certain individuals from payments for medical services, pharmaceuticals and equipment. However, consumers may not always understand entitlements and enforcement is uneven. Second, the exempt groups as specified are defined on the basis of broad categories and do not correlate very strongly with poverty status. This may partly explain the high burden of private expenditures for the poor despite formal efforts at protection.

57. ***The emerging model of private provision of health care raises additional equity concerns.*** Privatization of health care provision can be important for improving the quality and efficiency of health care services. However, the emerging model for privatization of health care raises the following concerns.

- Informal provision of private health care by doctors employed at public facilities seems to be emerging as a significant mode of private delivery. The majority of private providers are either unlicensed, do not have formal contracts with or do not reimburse the public facilities for private provision.
- The privatization of care envisions specific facilities of specialized care being privatized. Without adequate protection to protect access to these services, privatization (once completed) may result in the poor (particularly in small urban areas) being deprived of these services.

58. ***Informal payments and practices in the health care system are associated with lack of clarity in regulation, and underdeveloped mechanisms to ensure accountability of health sector institutions.*** Informal payments and practices divert resources away from the system, reducing resources available for improving public services, and undermining public service delivery. Lack of clarity and understanding by doctors and patients on who should receive free services and from which facilities, or what constitutes paid services, or on setting tariffs for paid services is an important contributor to informal payments. The lack of formal oversight mechanisms to monitor provider charges or performance and to enforce policies contributes to low accountability of health service institutions. Like other transition countries, civil society organizations are still nascent and play a limited role in increasing the voice and participation of health users. Mahallahs play an advocacy role in some areas, but tend not to be substantially involved in health care.

Figure 7: Public expenditures on education are slightly regressive



## B. Education

59. *Although smaller than other CIS countries, the decline in public expenditures on education were accompanied by decentralization of financing and likely reduced the quality of education in poorer communities.* The expenditures on education declined less than in other CIS countries from about 10% of GDP to 6.7% between 1990 and 2000, reflecting the Government's commitment to education. Still, the fall in resources was significant especially in the first half of the 1990's. Declining public resources were initially accompanied by the decentralization of financing and management for most educational programs to oblast governments. While these reforms are intended to increase the flexibility and reduce costs of the public education system, they may have led to a disproportionate decline in quality of education in communities that were unable to supplement public financing with additional private resources.

60. *Private payments for education (both formal and informal) have also increased, and constitute a disproportionate burden for the poor.* Increased formal payments (e.g. textbooks are now only provided free of cost to grade 1, formal cost recovery has been introduced in specialized secondary and higher educational institutions) also accompanied the reduction and decentralization of public finances in education. However, these higher payments (e.g. an average annual tuition fee for higher education is now 300,000 soms), are burdensome for the poor. Private education spending constitutes 16% of food expenditures for poor households, compared to 9% for the non-poor. Informal costs also appear to be important, particularly in higher education, where over a fifth of all households reported making unofficial payments or providing gifts to staff. Low or falling incomes, combined with increased private costs and lower perceived quality or relevance (for example lack of employment opportunities for young graduates) may be important reasons for declining education enrollments, particularly for the poor.

61. *The overall distribution of public education expenditures slightly favors the non-poor (is slightly regressive)* (Figure 7). While primary education expenditures are distributed equally across all income groups, public expenditures on technical and university education disproportionately benefit the better off households. This is not surprising: public subsidies per child are larger, and disparities in participation of

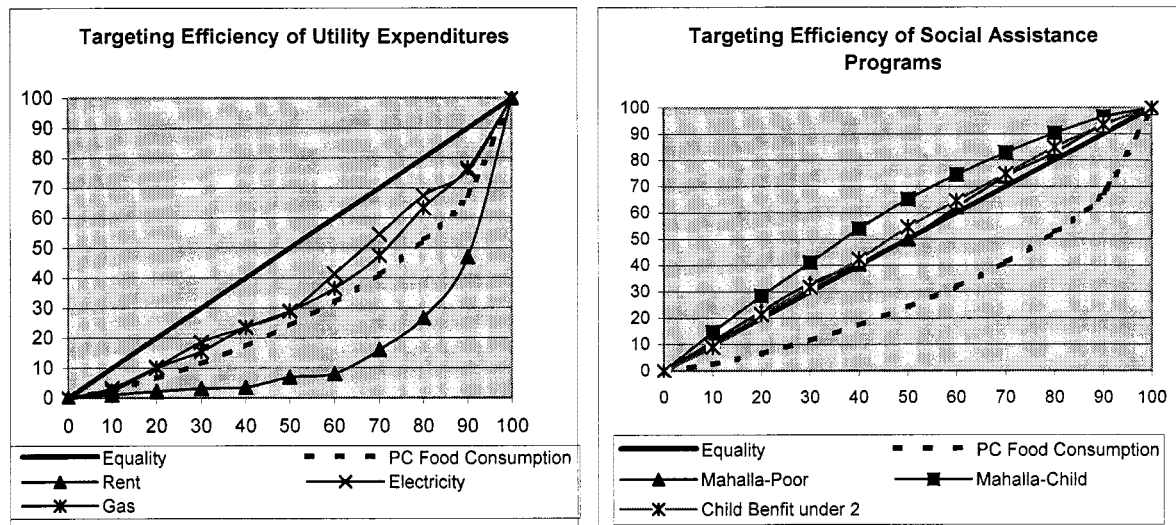
children from higher (vs. lower) income households is greater at higher (vs. lower) levels of education. Moreover, public subsidies to cover the high formal costs of higher education are provided on the basis of merit, without consideration of means.

62. *Government efforts to improve the quality and market relevance of public education serve some crucial needs particularly at basic education, but some other aspects pose risks.* In 1997, the government launched a major program to improve the quality and relevance of the education system. Many crucial inputs are being supplied, starting from the base of the education pyramid, addressing some key needs of the system. However, the program’s heavy focus on upgrading secondary and higher education (for example the substantial investment in infrastructure for establishing the large network of professional secondary schools), and the associated recurrent cost requirements, risks drawing resources away from basic education. There is also a risk that the emphasis on occupation specific training at the secondary and higher levels may prove too rigid for the needs of a market economy, while the channeling of a small fraction of secondary education students into academic lycea attached to universities may prove to be elitist and increase disparities in opportunities.

### 3. Challenges to Providing Effective Social Protection

63. *Uzbekistan’s social protection programs are extensive, for its level of income, but expenditures have declined in recent years.* Uzbekistan has in place an extensive social protection program to protect individuals against life cycle risks and poverty. As in OECD and other transition countries, the main programs are pensions, unemployment benefits, social assistance (including child allowances and poverty benefits), and privileges. In 2000, Uzbekistan spent over 8.24% of GDP on pension programs, employment programs and means-tested poverty benefits. However, spending levels have declined over time, reducing average benefit levels and number of beneficiaries for some social programs, particularly poverty benefits.

*Figure 8: Child allowances are the best targeted, housing privileges were poorly targeted*



64. *Pensions provide old-age security to many elderly but at high costs to formal employment.* The pension system provides extensive coverage of the elderly and is the most generous of all social protection systems. It has had a substantial impact on poverty reduction among pensioners and their households. However, the fiscal and incentive costs of this system are substantial: high payroll taxes discourage formal

employment, while incentives for early retirement likely reduce labor supply, particularly for women. Higher dependency ratios in the future will adversely impact the future sustainability of the system

65. *Unemployment benefits have limited impact on protecting the unemployed while most expenditures go to costly active labor market programs.* The coverage of unemployment programs is very low (only 8% of unemployed register and only a fifth of these draw unemployment benefits), and much lower than coverage in most OECD and CEE countries. More than half of employment fund expenditures are devoted to costly active labor market support (particularly subsidized micro-credit schemes). International experience indicate that direct job-creation schemes have limited impact on creation of private sector employment opportunities, while programs such as job-search assistance and counseling can be very effective in a market economy. Although administrative data suggest high success rate associated with active employment programs, the best way to gauge success of active labor market programs (ALMPs) is to undertake impact evaluations.

66. *The Government has achieved a measure of success in targeting child allowances and poverty benefits, but there is scope to improve targeting efficiency across and within regions.* Child allowances delivered in a decentralized fashion through Mahallahs cover a quarter of the poorest quintile, while the coverage of the Mahallah low income benefit is much lower. Child allowances also have better targeting efficiency, but errors of inclusion and exclusion can be improved for both programs (Figure 8). Targeting of these programs across regions can also be significantly improved.

67. *Social privileges provided generous benefits but were poorly targeted.* Just under 1% of GDP (higher than expenditure on poverty benefits in 2001) was spent until recently on social privileges to education and health care workers, primarily in the form of discounts on utility tariffs and maintenance fees. These subsidies were quite generous and intended, by design, to reward particular occupations, and not to protect the poor. Not surprisingly, these subsidies were poorly targeted (Figure 8), and the better off and urban residents benefit disproportionately. In a significant policy initiative, more or less at the time this report was going to press, these subsidies have now been largely abolished.

#### **IV. POLICY PRIORITIES FOR IMPROVING LIVING STANDARDS**

68. Five priority areas are thus suggested for a strategy to improve living standards in Uzbekistan: (1) promoting income and employment opportunities through economic growth (2) improving capabilities, particularly of the poor; (3) providing security through social protection; (4) building inclusive institutions and facilitating empowerment; and (5) strengthening poverty monitoring. The strategy should place particular emphasis in rural areas and poorer or needier regions. Key actions are discussed below.

##### **1. Promoting Opportunities through Growth**

69. The primary pillar of a strategy to improve living standards in Uzbekistan is sustained private sector led economic growth: through reforms to encourage growth and employment generation by the private sector (including SMEs), and to increase agricultural growth. These reforms will benefit the entire population, including the poor, but some groups may be adversely affected by the reforms in the short term. These groups will need to be protected through well targeted social protection programs. Sustained growth and poverty reduction will also require attention to flexible labor market policies, that allow labor to be allocated to its most productive use.

##### **A. Promoting Private Sector and SME development**

70. *Increase the demand for labor through an improved environment for private sector and SME development.* Experience from high growth transition countries has shown this sector is the main generator of jobs and productivity growth for the economy.

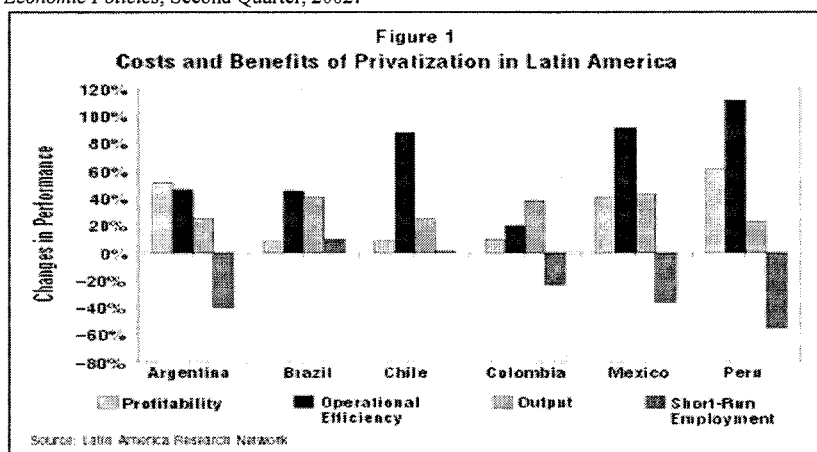
- *Promote macro-economic stability and proceed with fundamental structural reforms.* Key reforms include the liberalization of the foreign exchange and trade regime (in conjunction with tight fiscal and monetary policies to contain inflation), budget management and financial sector reforms, further reduction in state intervention in production, prices and marketing, and continued progress in privatization.
- *Improve the business and competitive environment for private firms and SMEs.* The main reforms include the imposition of hard budget constraints on state owned enterprises to create a level playing field, improving the legal and institutional framework for access to credit, tax and tax administration reform, and further reduction in licensing and regulatory requirements. Box 3 shows that privatization has been associated with large gains in productivity profitability, efficiency and output, albeit with some employment costs in the short term.

**Box 3: In Latin America, Privatization yielded many benefits, but had some short term costs...**

Privatization has done much for Latin America. Studies show that thanks to privatization, several Latin American countries have enjoyed greater investment, profitability, efficiency, and output. A series of studies analyzed costs and benefits of privatization in Argentina, Bolivia, Brazil, Chile, Colombia, Mexico and Peru. Figure 1 summarizes the empirical results of the impact of privatization on four major indicators: profitability, operational efficiency, output and employment. In all four countries profitability, operational efficiency and output were up while short-run employment suffered but the magnitude of the impact varied.

In terms of profitability, except for Colombia, Chile and to a lesser extent Brazil, public companies prior to privatization suffered huge losses that were financed by the state at the expense of a ballooning fiscal deficit. Given greater profitability, it is not surprising that operational efficiency was vastly improved and output was also dramatically up. The costs of privatization were felt through a fall in employment in affected firms. However, this refers only to short-run, direct, stable employment. More recent studies indicate that post-privatization employment is increasing, either through re-hiring of previously laid-off workers or new hires. Moreover, when new indirect jobs generated in privatized sectors are considered, the employment picture is much brighter.

Source: *Latin American Economic Policies*, Second Quarter, 2002.



## B. Increasing Agricultural Growth and Reducing Rural Poverty

71. Particular attention should also be paid to enhancing non-farm agricultural opportunities in rural areas, through the measures discussed above.

72. *Reduce distortions through pricing and procurement, production, and input policies.* Priority actions for improving agricultural productivity and incomes, which would have a significant impact on rural poverty, are: (a) complete the process of alignment of cotton and grain prices to world market prices through



foreign exchange rate liberalization- as discussed below, this will significantly benefit the rural poor; (b) reduce procurement quotas and eliminate mandatory sown crop areas, accompanied by encouraging private sector participation in product markets and agricultural processing; and (c) reduce input subsidies and encourage private sector provision of inputs. The recent experience of the Kyrgyz Republic shows that major agricultural reforms in the area of land policy, the incentive framework, credit, irrigation and agricultural services, leads to significant agricultural growth and reduction in rural poverty. The country realized a growth rate of 6% per year, which lead to a steady fall in rural poverty- at an average annual rate of 8% per annum. The experience in China also supports the importance of agricultural reforms in alleviating poverty (Box 4).

73. **Increase the equity of land reforms.** In the next stage of transformation of shirkats, consideration should be given to reducing the legal distinction in land size between private and dehqan farms, and permitting the expansion of household plots for shirkhat members (above the current 0.16 hectares). These changes should be accompanied by the creation of a legal and institutional framework for leasing and consolidation of land use rights, to facilitate the use of land where its marginal productivity is highest.

**Box 4: China: Reforms, productivity growth and rural living standards**

China's agricultural reforms, which began in 1979, resulted in remarkable growth in both agricultural productivity and incomes. In real terms, the gross value of agricultural output increased by more than 6% annually between 1978 and 1990 versus 2.1% over the period 1952-78. As a result, living standards in rural China escalated. From 1978 to 1990, per capita rural incomes increased from 134 to 330 yuan, or about a 10% annual increase in real terms. This was the fastest growth rate observed in the developing world over this period.

The four broad areas of reform were: (a) the collective system of communes was transferred to the household-responsibility system (HRS), (b) price incentives to farmers were improved, (c) mandatory production planning was abolished and the scope of mandatory state procurement reduced, and (d) rural township and village enterprises (TVEs) were condoned and free markets reopened.

Among economists, the general consensus is that the rapid growth of agricultural production in China after 1979 was due mainly to productivity growth arising from the set of reform policies (Fan; Lin 1992; McMillan, Whalley, and Zhu). Table above summarizes the findings of these studies on the impact on output and yields.

Studies on the Effects of Reforms on Agricultural Productivity in China				
Author	Dependent variable studied	Period	(%)	Method
Lin (1987)	Gross value of agricultural output	1980-83	62	Production function
McMillan, Whally, and Zhu (1992)	Gross value of agricultural output	1978-84	51.8	Denilson-Solow accounting
Fan (1991)	Gross value of agricultural output	1965-85	56	Production frontier
Carter and Zhong	Grain yield	1979-86	19.5	Grain yield function
Lin (1992)	Gross value of crops	1970-87	46.9	Production function
Huang and Rozelle	Rice	1975-90	35.6	Rice yield function

A more recent and detailed study on the effect of agricultural reform on agricultural productivity, for the case of grain production across five agro-climatic regions in China over the period of 1980-90 shows that production efficiency gains from economic reforms between 1980 and 1985, on average contributed 38% to the growth in grain production in China. The production efficiency gains were sustained until 1987 and then fell in 1988 and 1989 to 24% of contribution to the annual growth rate in grain production.

Source: "Reforms, the weather, and productivity growth in China's grain sector". Zhang, Bin.; Carter, Colin A. *American Journal of Agricultural Economics* v. 79 no4 (Nov. 1997) p. 1266-77

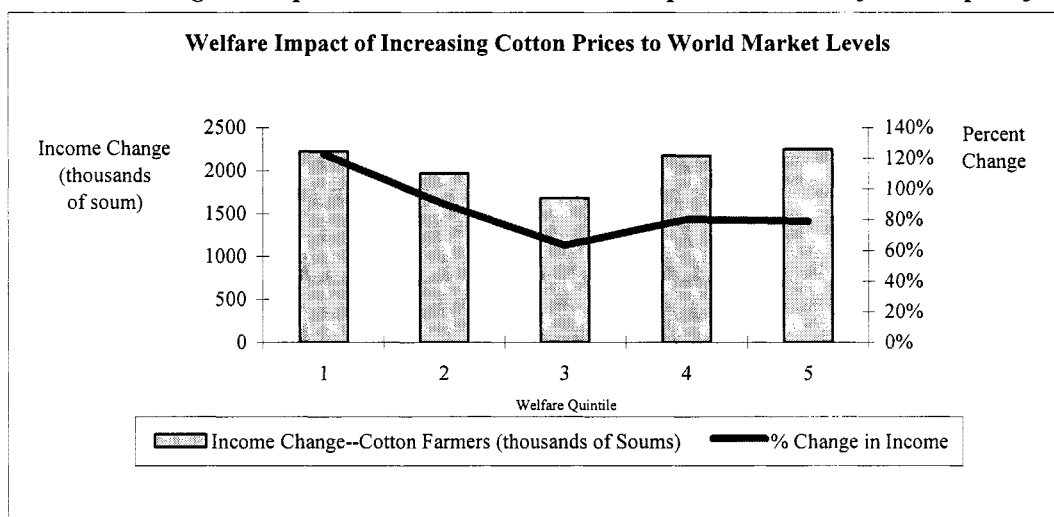
**C. The Distributional Impact of Reforms**

74. **Foreign exchange liberalization** will have a generally beneficial impact on rural incomes; however as with other actions such as privatization, reductions in price controls, or improvements in the effectiveness of the anti-monopoly committee, it could increase the cost of living through higher prices for some goods, including possibly essential commodities consumed by the poor. The evidence for Uzbekistan is that while

both urban and rural households will face higher (food) cost of living increases as a result of foreign exchange liberalization, the relative initial increase in cost of living will be higher for the urban population (roughly equally for all quintiles), and for the poorer quintiles in rural areas. Over time, however, individuals will adjust their consumption patterns and consume cheaper substitutes where possible.

75. *Aligning cotton and grain prices with world market prices* would immediately increase incomes for a large fraction of the rural population. While the increase in absolute terms is expected to be roughly equally distributed across all income quintiles, poorer farmers (who derive a larger share of their income from cotton and grain), will benefit more in relative terms. Figure 9 demonstrates this for cotton farmers. A similar result is found for grain farmers, although the magnitudes of the impact are smaller. In the short term, however, some groups, for example net consumers of wheat (in urban areas, but also in rural areas), may face higher prices.

**Figure 9: Increasing cotton prices to world market levels improves income of all and poor farmers**



76. *Enterprise Restructuring* that would result from the imposition of hard budget constraints, the removal of explicit and implicit subsidies to enterprises, or foreign exchange rate liberalization can be expected to be associated with employment losses, particularly in the short term. Many countries in Central and Eastern Europe experienced short term employment losses as a result of economic restructuring. However, countries that restructured more rapidly and moved quickly to reduce institutional barriers to job creation, such as Estonia, realized far greater gains than those who took a slower, more interventionist approach, e.g. Slovenia (see Box 5). Most countries protected the most affected workers by targeted social protection programs.

#### D. Ensuring Flexibility of the Labor Market

77. *Reform labor market policies and institutions to reduce labor costs and increase labor market flexibility* through a reduced role of the Common Tariff Scheme for wage setting and the reduction of non-wage labor costs (for example, payroll taxes, in the context of broader social protection reform). Implementing the recent legislation for the abolition of the tariff grid for wage setting in all enterprises except budgetary institutions as well as reducing non-wage labor costs will help ensure that reforms to improve the investment climate are accompanied by adequate supply response for employment, particularly in poorer, low productivity areas and for marginal workers. Examining and reducing barriers to labor mobility, including potentially, the use of the *propiska* to control entry into Tashkent, could facilitate geographical movement of labor in response to new opportunities.

78. **Ensure that the labor force has the skills that are demanded by the new private sector.** This will require reforms in the education system so that new labor market entrants have the skills that will help them meet the emerging and changing needs of a market economy (see education section below). Workers laid off as a result of restructuring can be re-trained through targeted training programs, provided with substantial involvement of private sector firms (see social protection section below). Targeted actions to encourage and increase their participation of women in higher levels of education could *reduce inactivity rates among women*.

**Box 5. Estonia and Slovenia: Policy choices and worker reallocations during transition**

The cases of Estonia and Slovenia offer important insights on reform options to encourage employment and earnings growth in the market economy. The two countries saw very different patterns of labor market adjustment in terms of labor market stocks and flows across different labor market states during transition. Estonia followed a liberal approach, with few barriers to labor market dislocations or new job creation, meager support of the unemployed, no effective wage floor, low taxation of labor, and privatization methods (primarily direct sales of assets to strategic investors) that strengthened corporate governance and thus encouraged labor shedding. In contrast, Slovenia adopted a much more cautious, interventionist approach, with significant barriers to job dislocation (including subsidies to prevent layoffs), generous support for unemployed workers, rigid wage setting mechanism, and mostly insider privatization that hindered reductions in employment.

Estonian reform generated large worker and job flows that have facilitated intense labor reallocation across sectors including high job destruction but also larger job creation rates including the creation of many productive jobs while simultaneously allowing the destruction of unproductive jobs. Direct job-to-job transitions strongly increased, more than doubling their pre-transition rate, and throughout the transition about half of the workers who lost jobs have been able to transfer to a new job without an intervening period of unemployment.

In comparison, a more “sclerotic” Slovenian labor market produced more segmentation and worse labor market outcomes especially for marginal groups (younger workers, ethnic minorities). Although the job destruction rates in Slovenia even at the height of restructuring remained below 60 percent of the maximum Estonian job destruction rate, the job creation rates in Slovenia were many times below the rates in Estonia, implying much higher net employment generation in Estonia.

Sources: M. Vodopivec. *Worker Reallocation During Estonia's Transition to Market: How Efficient and How Equitable? The World Bank, SP Discussion Paper, No. 0018, July, 2000.*

## 2. Improving Capabilities through Investments in Health and Education

79. To ensure that individuals, and especially the poor, are able to avail of the opportunities provided through growth, a poverty reduction strategy for Uzbekistan must focus on building their capabilities, particularly their health and education.

### A. Improving Quality and Access to Education

80. **Ensure that the education system provides relevant skills** that enhance the ability of individuals to find jobs and earn higher incomes. At all levels, attention should be paid to establishing a continuous process of evaluation of the skills provided through the system, through standardized national tests and participation in international assessments<sup>22</sup>, and making continuous adjustments and improvements. Specific measures include:

- *At the primary level*, continue efforts initiated under the National Program to improve quality of education, through ongoing reforms to ensure the provision of crucial inputs, modernization of curricula, and

<sup>22</sup> Students from Uzbekistan currently participate in international contests and Olympiads. These however, are for the best students. Participation in international tests such as PISA, TIMSS, etc. provide information on the performance of the majority of children in the system.

introduction of student centered teaching practices. Improve teacher incentives and link them with teaching loads and improved educational outcomes.

- *At the secondary level*, reevaluate the current plan to restructure secondary schools into professional colleges and academic lycea, to ensure that more general, academic skills, which are proving to be most in demand in market economies, are provided to the majority of students at this level.
- *At the tertiary level*, improve the understanding of falling university enrollments, and examine options for reversing this trend (e.g. encourage private sector provision, introduce subsidies on the basis of merit and means). Examine and undertake actions to increase enrollments of women in tekNIKUM and university.

81. ***Improve the targeting of public education resources*** to address disparities in attendance and quality between poor and non-poor and between regions. Introduce flexible financing mechanisms to enable directing of resources on the basis of need. Wherever possible, encourage local solutions by communities to increase attendance and quality.

- *Strengthen targeted efforts to increase attendance by the poor.* Continue and strengthen the existing programs of targeted provision of textbooks and educational materials for basic education, pilot other approaches (such as conditional transfers, scholarships- income and merit based, school lunches) that have had some success in other countries.
- *Adopt targeted approaches to early childhood education* to address the concerns of late enrollments and to improve performance in basic education among vulnerable groups, building on existing innovative approaches.

## **B. Protecting Health Status and Preventing Impoverishment**

82. ***Reduce the incidence of some infectious diseases and continue efforts to improve nutritional outcomes, especially among women and children.*** Many required interventions lie outside the health sector, and concerted efforts to work across the traditional boundaries of Government ministries will be required. Recommended actions are: (a) continue the program of restoration of primary health care services with particular emphasis on poorer rural regions; (b) place additional emphasis on improvements in water and sanitation services, particularly in rural areas and poorer regions; (c) continue efforts that have been initiated to strengthen programs for addressing TB and AIDS; (d) continue efforts on maternal and child health and monitoring; (e) encourage community based information and behavioral change programs; and (f) strengthen programs for fortification of foods (e.g. iron, iodine), etc.

83. ***Improve the targeting of public health care resources to the poor.*** Actions include:

- *Increasing relative allocations to primary health care* through acceleration of the program of restructuring the hospital sector (but with greater consultation of local stakeholders), and introducing flexible financing mechanisms to permit resource allocations to poorer and more needy regions and sub-regions;
- *Review/replace existing specifications of exempt groups with alternative approaches to targeting* that are more closely related with poverty status. The existing package of exemptions (from care at all levels) could be delivered to the poor households thus identified, but it should be monitored carefully to ensure that there are no gaps in access to key services by the poor, particularly as privatization proceeds. Additional efforts are also needed to enforce these exemptions and protect the poor from informal charges (see below).

84. ***Protect the non-poor from falling into poverty as a result of costs of catastrophic or chronic care.*** New private insurance is envisioned, which could protect the non-poor from costs associated with catastrophic or chronic care. However, international experience has shown that these schemes need to be designed and regulated carefully. Alternatively, limited public subsidies, targeted in some way could be considered to protect the vulnerable groups from falling into poverty.

85. ***Foster development of private sector, but with greater protection to consumers.*** As the formal private sector develops, consider ways to foster its development while at the same time protecting consumers and monitoring quality: regulations and accreditation standards need to be further developed and monitoring mechanisms need to be strengthened. The emphasis should be on setting incentives and maintaining quality rather than imposing a burden on private providers.

### **3. Providing Effective Security through Social Protection Programs**

86. The Government has initiated reforms to strengthen the social protection system and improve its efficiency and effectiveness.

87. ***Provide effective old age protection through the pension system.*** Specific actions, which may lead to an effective security system that is financially viable and which has lower costs to formal employment include: (i) introduce parametric changes to the pension system (e.g. increase and equalize retirement ages and years of service requirements, and phase out pension privileges). If phased in systematically, these could help reduce fiscal pressures in the system, without compromising its ability to provide old age security, and (ii) continue on-going efforts to improve administrative efficiency.

88. ***Strengthen assistance to the unemployed*** through the following actions: (i) re-design the unemployment benefit program to restrict it to laid off workers, phasing out benefits to new labor market entrants or re-entrants. Consideration may be given to replacing the insurance program with a flat benefits program funded by general tax revenues. Such a program would be simpler to administer, and progressive. Additionally, by depending on general revenues it would help reduce payroll taxes. Adequacy and predictability of benefits should be ensured. (ii) conduct impact evaluations of existing active labor market policies, and phase out the less cost-effective ones (such as job creation programs which are micro credits provided through the banking system at beneficial terms). Although they are more expensive, limited use of self targeted public works programs could provide an effective safety net in some rural areas or poorer regions.

89. ***Further efforts could improve the targeting of social assistance benefits to the poorest.*** The Government plans to phase out social privileges from 2003<sup>23</sup>, which would free resources for better targeted programs. Further efforts should be made to reduce errors of inclusion and exclusion of all poverty benefits programs, while serious consideration should be given to consolidation of programs. Conditional cash transfers (for example to encourage school attendance or use of preventative health care services by the poor) could also be considered.

90. ***Reduce the social costs of reforms through an effective safety net.*** These reforms include restructuring and the associated employment loss, or the price liberalization reforms noted above.

- *To reduce social costs of layoffs*, labor re-deployment programs (which typically combine passive programs such as severance pay, with active programs) can help alleviate the social costs of restructuring in particular industries or as a general policy. Existing unemployment benefit, effective active labor market programs, and social assistance programs could also be used to protect these workers and their families against low incomes as a result of layoffs and redundancies.
- *To protect the poor from cost of living increases*, use means tested social assistance through mahallahs.
- *To allay the costs of utilities price increases for the poor*, consider various policy options. For example, life-line tariffs that provide subsidy to the poor, while recouping costs from higher income groups, could be

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<sup>23</sup> A resolution largely abolishing social privileges was passed in April 2003.

used where there is universal metering (electricity). For non-metered utilities (such as gas), the poor could be protected through the use of existing social assistance programs or notional burden programs (which compensate for a portion of utility services exceeding some proportion of family income), or one off transfers delivered through the mahallahs.

#### **4. Building inclusive institutions and facilitating empowerment**

91. Social and economic policies can go a long way to create opportunities, reduce poverty and bring about a more egalitarian society. But in order for these policies to work, institutions must work well and in the interests of all parts of the society, including the poor. There are three main areas for improvement.

92. *Increase the accountability of state institutions and reduce corruption.* The high incidence of informal payments or bribes to public officials constitutes a disproportionate burden for the poor, and is indicative of weak accountability of state institutions. Continued reduced burden of regulations, tax reduction and elimination of discretion in the tax regime, will all reduce the incentives for seeking or making informal payments. Improving clarity of regulations and policies is another important action. Improved civil service pay, and the introduction of performance based salary structures, strengthened oversight and monitoring, could further reduce incentives for informal payments to enhance low pay.

93. *Increase transparency, access to information and dissemination of policies and rights.* This is a key element of any strategy to enhance accountability of state institutions. Improving the quality of regulation and eliminating lower level regulations subject to greater discretion will improve transparency, as will efforts to increase dissemination of policies with the public. In addition, improving the legal framework for improved access to information, and for a free media will be important to enhance oversight by the public.

94. *Undertake measures to enhance voice and participation and empower communities, especially the poor,* such as encouragement of civil society organizations, and representatives of consumers and businesses. Participation could be enhanced, and the relevance of policy improved by increasing public consultation, discussion and debates (for example on informal payments), directly with communities or with their representatives. The Government has, in recent years increased the role of communities in decision making, for example in delivering social assistance through the mahallah committees. The role of local mahallahs or other NGOs could also be enhanced to represent rural communities in mediation or in policy formulation. However, given the role that mahallahs themselves play in the delivery of social assistance benefits, additional measures to enhance their accountability may need to be introduced.

#### **5. Improving Monitoring of Living Standards**

95. Monitoring living standards will help policy makers review impact of macro economic developments and economic and social reforms on household welfare, and to revise such policies accordingly. The main process involves improving capacity for collection and analysis of household and administrative data, and strengthening the linkage between data analysis and policy formulation. It is equally important to fully disseminate individual record survey data (while withholding exact name and address of respondents to promote confidentiality and true reporting). The key survey instruments for poverty monitoring include:

- *The Family Budget Survey.* The recently improved Family Budget Survey has made it possible to provide the first national level assessment of poverty in Uzbekistan, and the recent adoption of the improved survey for regular collection of data is an important accomplishment for the poverty monitoring system in Uzbekistan. It has demonstrated the additional value of survey based information on income and non-income dimensions of poverty. The utilization of this data source for poverty analysis, however, has provided important feedback on how this survey might be improved. Key measures include, strengthening of the survey instrument to measure consumption based poverty (to more accurately capture non-food expenditures

among households), and expanding the present relatively limited information on non-income dimensions of poverty.

- *Labor Force Surveys.* Regular labor force surveys would provide regular updates, based on international standards, on the employment and unemployment developments in the country. As a first step, the Ministry of Labor and Social Protection introduced a quarterly labor market monitoring system in 2002.
- *The Population Census.* This is overdue in Uzbekistan with the last census having been conducted in 1989. An updated population census is essential for improving the reliability of the sampling frame for the household surveys
- *Poverty Mapping.* An updated census in combination with the Family Budget Survey could be used to potentially carry out cost-effective poverty maps like those that are currently being used in many other transition countries. Such poverty maps could be of great value in improving sub-regional targeting of programs.

## ANNEX: MATRIX OF POLICY PRIORITIES: BENEFITS AND COSTS

This matrix details the five strategic pillars for improving living standards in Uzbekistan: improving opportunities through economic growth, improving capabilities in health and education, providing effective security, building inclusive institutions and empowering communities, and strengthening poverty monitoring. It outlines the policy challenges involved in achieving each objective, and lists some of the significant benefits, as well as some of the possible short term costs associated with key policy reforms. As noted in the summary report, the implementation of policies in each area will generate large benefits, but some may also involve some short run costs for particular groups of the population. These costs can be allayed through well targeted social protection programs. International experience suggests that the benefits of the stated policies to promote growth far outweigh these short run fiscal and economic costs.

Role of Area	Policy Priorities	Short Term Costs (Possible mechanisms to reduce)	Benefits
<b>I. IMPROVING INCOME AND EMPLOYMENT OPPORTUNITIES THROUGH GROWTH: Increase growth, employment and incomes, with particular priority to rural areas</b>			
<b>A. Promote private sector and SME development.</b> Increase the demand for labor through an improved environment for private sector and sme development.	<ul style="list-style-type: none"> <li>• Macroeconomic and Structural Reforms                             <ul style="list-style-type: none"> <li>○ liberalization of foreign exchange and trade regime, macroeconomic stabilization</li> <li>○ Financial sector reform</li> <li>○ Continued progress in privatization, improved effectiveness of anti-monopoly committee, reduced role of PTAs</li> </ul> </li> <li>• Improve Business and Competitive Environment for SMEs                             <ul style="list-style-type: none"> <li>○ Level playing field by imposition of hard budget constraints on state owned enterprises</li> <li>○ Establishment of Credit information system, legal framework for micro-credit</li> <li>○ Tax and Tax Administration Reform</li> <li>○ Further reduction in licensing and regulatory requirements</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Loss of jobs in the short term (swift enactment of measures to increase sme employment generation, and increase relevance of skills, social protection through labor redeployment programs and strengthened unemployment protection)</li> <li>• Cost of living increases especially for urban residents and rural poor (targeted social assistance)</li> </ul>	<ul style="list-style-type: none"> <li>• Higher and sustained long term growth, with increase in productive income earning opportunities and therefore poverty reduction</li> <li>• Increased efficiency of resource use</li> <li>• Reduced informality and associated improved transparency and security for workers, improved governance, and lower inequality.</li> <li>• New private sector, especially SMEs are most effective safety net for job losses through restructuring</li> <li>• Increased fiscal revenues through growth, larger formal sector, and higher incomes</li> <li>• Improved living standards from long term price stability</li> </ul>
<b>B. Increase agricultural growth and reduce rural poverty</b>	<ul style="list-style-type: none"> <li>• Pay particular attention to above actions for rural areas</li> <li>• Align cotton and grain prices with world market prices and remove remaining distortions through foreign exchange regime.</li> </ul>	<ul style="list-style-type: none"> <li>• Loss of revenues (recover in short term through elimination of debt write-offs and input subsidies and in medium to long term through gradual introduction of</li> </ul>	<ul style="list-style-type: none"> <li>• Reduced dependence on agriculture and increased opportunities for labor released</li> <li>• Higher farm revenues and incomes for all cotton and grain farmers, relatively greater increases for poorer cotton and grain farmers.</li> </ul>
(i) Increase demand for labor from non-farm opportunities			
(ii) Reduce implicit taxation of cotton and grain through price and foreign exchange policies			



<p>(iii) Increase farm productivity through greater flexibility to farmers in selecting crop structure, and reducing state purchases</p>	<ul style="list-style-type: none"> <li>• Gradual reduction of procurement quotas and the policy of mandatory sown crop areas for cotton and grain</li> <li>• Privatization in product markets (e.g. cotton ginneries)</li> </ul>	<p>water tariffs and increased land taxes)</p> <ul style="list-style-type: none"> <li>• Increases in grain prices (targeted social assistance through mahallahs)</li> </ul>	<ul style="list-style-type: none"> <li>• Increased productivity, profitability and farm incomes from improved price incentives, and higher growth</li> </ul>
<p>(iv) Reduce input subsidies and encourage private sector provision of inputs</p>	<ul style="list-style-type: none"> <li>• Eliminate debt write-offs, and input subsidies, and improve environment for private sector provision of inputs</li> <li>• Pay particular attention to increasing options for credit use, and</li> <li>• Gradual introduction of charges for water use, and creation of legal basis for piloting self-governing water users associations</li> </ul>	<ul style="list-style-type: none"> <li>• Possible reduction in grain output by large farms (due to substitution towards cotton)</li> </ul>	<ul style="list-style-type: none"> <li>• Improved agricultural productivity and incomes and higher growth</li> <li>• Possible increase in cotton production from large farm sector</li> </ul>
<p>(v) Increase equity of land reforms</p>	<ul style="list-style-type: none"> <li>• Permit expansion of household plots for shirkat members above current 0.16 ha, and rescind the minimum size for private farms</li> <li>• Create legal and institutional framework for leasing and consolidation of land use rights</li> </ul>	<ul style="list-style-type: none"> <li>• Loss of employment from restructuring (increase non-farm opportunities, employment programs)</li> <li>• Increase in input costs (but higher revenues)</li> </ul>	<ul style="list-style-type: none"> <li>• Improved availability and choice of inputs and credit</li> <li>• More efficient input and water use</li> <li>• Eventual reduction in vulnerability from irregular availability of water</li> </ul>
<p><b>C. Reduce labor costs and increase labor market flexibility</b></p>	<ul style="list-style-type: none"> <li>• Limit influence of Common Tariff Scheme, and reduce non-wage labor costs (e.g. PTT, payroll taxes-but in context of social protection reform)</li> <li>• Examine and reduce regional barriers to mobility</li> </ul>	<ul style="list-style-type: none"> <li>• If taken to an extreme, could result in excessive fragmentation of land (but at present dehqan sector accounts for only 12% of total sown area)</li> </ul>	<ul style="list-style-type: none"> <li>• Increased land assets and improved incomes for poorer farmers</li> <li>• Greater productivity from reduced inequality in long run.</li> <li>• Possible increase in grain output from dehqan sector</li> <li>• Will permit land to be used where most productive</li> </ul>
<p><b>D. Increase women's labor force participation</b></p>	<ul style="list-style-type: none"> <li>• Targeted actions to increase enrollment of women in education, especially higher levels</li> <li>• Reduced disincentives for early retirement in pension system, increased child care, equality in labor market</li> </ul>	<ul style="list-style-type: none"> <li>• Increased inequality from decentralized wages</li> <li>• Reduced revenues (but use more effectively)</li> <li>• Cost of programs</li> </ul>	<ul style="list-style-type: none"> <li>• Improved employment opportunities, especially for unskilled workers and reduced regional inequalities in labor market outcomes</li> <li>• Reduced informality and associated benefits (see above)</li> <li>• Will permit quicker absorption of released labor into new employment opportunities, and more equitable impact of growth</li> </ul>
			<ul style="list-style-type: none"> <li>• Increased use of important labor resources, improved living standards, higher growth</li> </ul>

<p><b>E. Ensure availability of relevant skills</b></p>	<p>opportunities.</p> <ul style="list-style-type: none"> <li>• Education system reform (see below)</li> <li>• Limited re-training for those already in workforce, with substantial involvement of firms (demand based)</li> </ul>	<ul style="list-style-type: none"> <li>• Costs of programs</li> </ul>	<p>higher growth</p> <ul style="list-style-type: none"> <li>• Improved health nutrition, education outcomes for children</li> <li>• Quicker employment response to reforms</li> <li>• Higher productivity and growth</li> </ul>
<p><b>2. IMPROVING CAPABILITIES THROUGH INVESTMENTS IN HEALTH AND EDUCATION: Build human capital assets, protect the poor and prevent impoverishment</b></p>			
<p><b>A. Improve capabilities in education</b></p> <p>(i) Improve quality of education and ensuring provision of relevant skills through education system</p>	<ul style="list-style-type: none"> <li>• Continue reforms to improve education quality in basic education with particular emphasis on rural areas and poorer regions</li> <li>• Greater attention at all levels to continuous evaluation and improvements, improved incentives linked to outcomes, involvement of stakeholders in quality improvements (e.g. curriculum reform)</li> <li>• Urgent re-evaluation of skills being provided in secondary education system and reorientation towards more general, broader, transferable skills to adapt to changing needs; and reduced reliance on early specialization or vocational skills</li> <li>• Analyze reasons for continued sharp declines in enrollments (especially in higher education), and examine options for maintaining very recent reversals of the negative trend (e.g. encouraging private sector provision to address supply constraints)</li> <li>• Increasing allocations to poorer and more needy regions and sub-regions (introduce flexible financing mechanisms)</li> <li>• Building on targeted efforts to increase attendance by the poor (e.g. provision of textbooks and materials to needy families by mahallahs) and consideration of other approaches (e.g. conditional transfers, scholarships)</li> <li>• Encouraging solutions to increasing attendance and quality by local communities</li> <li>• Particular actions to increase early childhood education especially in poorer regions and rural areas (building on existing innovative approaches for community provision)</li> </ul>	<ul style="list-style-type: none"> <li>• Costs of programs</li> </ul>	<ul style="list-style-type: none"> <li>• Improved foundations at base of education pyramid</li> <li>• Increased relevance and ownership of reforms</li> <li>• Improved labor market outcomes for new entrants, higher productivity and growth</li> <li>• Lower recurrent costs associated with more general education programs</li> <li>• Higher productivity and growth and improved employment response to reforms to encourage private sector</li> <li>• Improved ability of poor and poorer regions to benefit from growth and lower long run income inequality</li> <li>• Reduced burden of private expenditures for poorer households</li> <li>• Reduced incidence of late participation and improved educational outcomes in early years of primary, especially for poor</li> </ul>
<p>(ii) Reverse disinvestments in higher levels of education and maintain very recent positive trend</p> <p>(iii) Protect educational investments by the poor through greater targeting of public education expenditures</p>	<ul style="list-style-type: none"> <li>• Analyze reasons for continued sharp declines in enrollments (especially in higher education), and examine options for maintaining very recent reversals of the negative trend (e.g. encouraging private sector provision to address supply constraints)</li> <li>• Increasing allocations to poorer and more needy regions and sub-regions (introduce flexible financing mechanisms)</li> <li>• Building on targeted efforts to increase attendance by the poor (e.g. provision of textbooks and materials to needy families by mahallahs) and consideration of other approaches (e.g. conditional transfers, scholarships)</li> <li>• Encouraging solutions to increasing attendance and quality by local communities</li> <li>• Particular actions to increase early childhood education especially in poorer regions and rural areas (building on existing innovative approaches for community provision)</li> </ul>	<ul style="list-style-type: none"> <li>• Reduced relative allocations to higher levels (scholarships to cover private costs based on merit and means)</li> </ul>	<ul style="list-style-type: none"> <li>• Improved ability of poor and poorer regions to benefit from growth and lower long run income inequality</li> <li>• Reduced burden of private expenditures for poorer households</li> <li>• Reduced incidence of late participation and improved educational outcomes in early years of primary, especially for poor</li> </ul>

<p><b>B. Improve capabilities in health</b></p> <p>(i) Reduce incidence of some infectious diseases and continue efforts to improve nutritional outcomes</p> <p>(ii) Protect health investments by the poor through improved targeting of public health expenditures and prevent impoverishment</p>	<ul style="list-style-type: none"> <li>Focus on prevention, continue the program of restoring and improving quality of primary health care facilities, especially in rural areas and poorer regions</li> <li>Place additional emphasis on improvements in water and sanitation services, particularly in rural areas</li> <li>Continue efforts to strengthen programs for addressing TB and AIDS</li> <li>Continue efforts on maternal and child health and monitoring, develop strategy for improved infant feeding practices, encourage community based information and behavioral change programs</li> <li>Strengthen programs for fortification of foods</li> <li>Increase relative allocations of to primary health care through accelerated hospital restructuring</li> <li>Greater relative allocations to poorer and more needy regions through more flexible financing mechanisms</li> <li>Review and replace existing specifications of exempt groups with alternative approaches to targeting (pilot alternative approaches)</li> <li>Monitor and enforce package of exemptions that covers services at all levels</li> <li>Careful design and regulation of private health insurance, or consider provision of limited targeted subsidies to protect the vulnerable from costs of catastrophic or chronic illness</li> </ul>	<ul style="list-style-type: none"> <li>Cost of programs</li> <li>Reduced relative financing of secondary and tertiary facilities (strengthen protection of poorest, increase stakeholder consultation)</li> </ul>	<ul style="list-style-type: none"> <li>Improved health and productivity, especially for the poor.</li> <li>Reduced burden of health care expenditures for poor</li> <li>Reduced vulnerability from illness</li> <li>Improved efficiency of resource use</li> </ul>
<p><b>3. INCREASING SECURITY THROUGH EFFECTIVE SOCIAL PROTECTION Improve effectiveness of safety nets and reduce costs</b></p>			
<p>(i) Reduce costs to employment of security through pension system</p> <p>(ii) Improve protection for unemployed</p>	<ul style="list-style-type: none"> <li>Undertake parametric changes to pension system: increase and equalize retirement ages and years of service requirements, phase out privileges</li> <li>Continue reforms to strengthen pension administration</li> <li>Redesign unemployment insurance program to restrict it to laid off workers and phase out benefits to new labor market entrants or re-entrants. Consider replacing with flat benefits program funded by general tax revenues; ensure adequacy and predictability of benefits.</li> </ul>	<ul style="list-style-type: none"> <li>Costs of programs</li> <li>Flat benefits program is not very attractive to better off unemployed workers</li> </ul>	<ul style="list-style-type: none"> <li>Reduced fiscal pressure and possibility for payroll tax reduction, and associated reductions in informality and increases in demand for labor</li> <li>Improved incentives to stay in employment</li> <li>Improved incentives to contribute to pension system through reduction in re-distributive elements</li> <li>Improved protection for unemployed</li> <li>Greater efficiency of labor market outcomes as more willing to go in for frictional unemployment (search)</li> </ul>

<p>(iii) Improved employment services through active policies</p>	<ul style="list-style-type: none"> <li>Conduct impact evaluations, and reduce reliance on expensive job creation programs. Strengthen job search and counseling assistance, and consider limited use of the more successful public works programs in rural areas or depressed regions.</li> </ul>	<ul style="list-style-type: none"> <li>Costs of evaluation, design of new programs</li> </ul>	<ul style="list-style-type: none"> <li>More progressive targeting as a result of flat benefits</li> <li>Reduced administrative costs and complexity</li> <li>Improved opportunities for employment</li> <li>Improved cost-effectiveness of employment programs</li> <li>Improved opportunities in poorer and rural regions</li> </ul>
<p>(iv) Improve targeting of social assistance programs and social subsidies</p>	<ul style="list-style-type: none"> <li>Phase out social privileges (largely accomplished through recent Presidential Decree)</li> <li>Further efforts to reduce errors of inclusion and inclusion, including simplification of and assistance in application, improved publicity, further examination of means test, closer checking and ex post monitoring of awards</li> <li>Examine and improve mechanisms to allocate funds to needier regions and sub-regions</li> <li>Re-examine low income benefits program and consider consolidation of social assistance programs</li> </ul>	<ul style="list-style-type: none"> <li>Unpopular among current recipients (subsume the subsidy in the form of improved pay)</li> </ul>	<ul style="list-style-type: none"> <li>Improved targeting efficiency and greater protection to larger fraction of poor</li> </ul>
<p>(v) Protect poor and vulnerable from short term negative impacts of economic reform</p>	<ul style="list-style-type: none"> <li>Design labor re-deployment programs to reduce employment losses from restructuring</li> <li>Introduce mechanisms to protect poor from increases in utility tariffs e.g. consider life-line tariffs for metered services, or use existing mahalla scheme for social transfers)</li> <li>Means tested social assistance through Mahallahs to compensate for short term protection from price increases</li> </ul>	<ul style="list-style-type: none"> <li>Costs of new subsidies and programs</li> </ul>	<ul style="list-style-type: none"> <li>Preventing deterioration in living standards and risk of impoverishment for many</li> <li>Labor redeployment programs can substantially increase labor market efficiency during restructuring</li> <li>More efficient targeting of currently across the board utility subsidies</li> </ul>
<p><b>4. BUILDING INCLUSIVE INSTITUTIONS AND FACILITATING EMPOWERMENT Ensuring that state and social institutions work for the poor</b></p>		<ul style="list-style-type: none"> <li>Could be unpopular among affected public officials (but improve formal pay)</li> </ul>	<ul style="list-style-type: none"> <li>Improved equity (corruption hurts poor the most)</li> </ul>
<p>(i) Increase accountability of state institutions and reduce corruption</p>	<ul style="list-style-type: none"> <li>Improve clarity and reduce discretion in regulations</li> <li>Improve civil service pay and introduce performance based salary structures</li> <li>Strengthen oversight and monitoring (including penalties, complaint hotlines)</li> </ul>	<ul style="list-style-type: none"> <li>Systematic and wider dissemination of policies, regulations to the public</li> </ul>	<ul style="list-style-type: none"> <li>Greater benefit from regulation to poor</li> </ul>
<p>(ii) Increase transparency and access to information</p>			

<p>(iii) Increase voice and participation, and empower communities</p>	<p>regulations to the public</p> <ul style="list-style-type: none"> <li>• Improve legal framework for improved access to information and data</li> <li>• Increase freedom of media</li> <li>• Encourage development of civil society organizations, NGOs, representatives of consumers and businesses</li> <li>• Increase public consultation, discussion, debates (e.g. on poverty, informal payments, etc.)</li> <li>• Consider enhanced role of mahallahs or other NGOs to represent communities in mediation or policy formulation</li> </ul>		<ul style="list-style-type: none"> <li>• Greater predictability in policy environment and greater participation</li> <li>• Increased accountability of state institutions</li> <li>• Much greater relevance and predictability of policies</li> <li>• Empowerment of communities</li> <li>• Greater responsiveness of state institutions to needs of communities</li> </ul>
<p><b>5. IMPROVE POVERTY MONITORING</b></p> <p>Improve quality of data for better monitoring of poverty and design of policies</p>	<ul style="list-style-type: none"> <li>• Improve Household Budget Survey (for consumption poverty and non-income dimensions)</li> <li>• Undertake regular labor force surveys</li> <li>• Consider developing poverty maps to improve sub-regional targeting</li> <li>• Build capacity in data analysis within and outside government</li> <li>• Widely disseminate analysis and results as well as raw data</li> </ul>	<ul style="list-style-type: none"> <li>• Costs of new surveys</li> </ul>	<ul style="list-style-type: none"> <li>• Regular feedback on living standards and policies</li> <li>• Improved effectiveness of social and economic policies</li> <li>• Useful feedback on and improved quality of data</li> </ul>