ICR Review
Operations Evaluation Department

Report Number : ICRR11497

1. Project Data:		**Date Posted :** 07/22/2003		
PROJ ID:	P009122		**Appraisal**	**Actual**
Project Name :	Uzbekistan Cotton Sub-sector Improvement Project	**Project Costs (US$M)**	84.6	76.3
Country:	Uzbekistan	**Loan/Credit (US$M)**	73.8	70.5
Sector(s):	Board: RDV - General agriculture fishing and forestry sector (45%), Agricultural marketing and trade (34%), Central government administration (11%), Agricultural extension and research (6%), Irrigation and drainage (4%)	**Cofinancing (US$M)**		
L/C Number:	L3894; LP230			
		Board Approval (FY)		95
Partners involved :		**Closing Date**	12/31/2000	05/31/2002

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2. Project Objectives and Components

a. Objectives

"This project starts the process of modernizing the Uzbek cotton sub -sector by supporting selective critical interventions that would open it up to the world market and build the basis for improving its efficiency . It supports:
(i) The elimination of state orders, the liberalization of prices, and the privatization of the seed industry in the cotton sub-sector;
(ii) The development/introduction of technology to help avert negative impacts on the environment and productivity of past irrigation and pest control practices; and
(iii) The enhancement of the cotton sub-sector's foreign exchange earnings capacity". Staff Appraisal Report, p. 14.

b. Components

(i) **Cotton marketing**, centered on the introduction of cotton grading tecnology intended to boost export competitiveness (US$26.2 million, 41 percent of actual costs, as shown in Annex 2);
(ii) **Seed industry**, involving the creation of private companies to process and market seed (US$25.9 million, 40 percent of actual costs);
(iii) **Seed quality control**, entailing the introduction of public sector policies and institutions for quality control, certification, and continued development of improved cotton varieties (US$1.1 million, 2 percent of actual costs);
(iv) **Integrated pest management**, an applied research and development component involving propagation of insect rearing and dispersal technologies (US$1.4 million, 2 percent of actual costs);
(v) **Irrigation**, aimed to reduce water use in cotton production while improving land productivity and avoiding environmental damage (US$0.5 million, 1 percent of actual costs);
(vi) **Emergency drought assistance**, financing agricultural machinery, equipment and livestock vaccines : a component introduced in early 2001 in response to government's request for support in mitigating the effects of the 2000 drought (US$6.8 million, 11 percent of actual costs); and
(vii) **Project management**, including funding of the implementing unit (US$2.1 million, 3 percent of actual costs).

c. Comments on Project Cost, Financing and Dates

Annex 2 of the ICR (Project Costs and Financing) shows estimated project cost as US$66.1 million and actual cost as US$64.5 million; Section 5.4 of the ICR states that estimated cost was US$84.6 million and actual cost was US$76.3 million. This discrepancy is not explained. Also, Annex 2 fails to show the breakdown between Bank and government shares of project cost. Other sources show that government's contribution fell from US$ 10.8 million (Staff Appraisal Report, p. 26) to US$5.8 million (ICR, Section 5.4)

3. Achievement of Relevant Objectives:

(i) ***Partially achieved .*** Trade liberalization was not fully secured, mainly because state procurement prices were not aligned with world prices (and, moreover, failed to cover production costs), the state purchasing of cotton continued, and the export licensing system was not simplified . The government failed to grant independent status to the Seed Certification agency, further compromising the objective of private sector development . On the other hand, six private seed production companies were established, exceeding the SAR's target of 5; the economic rate of return for the six enterprises was 22 percent and the financial rate of return was 9 percent.

(ii) ***Partially achieved .*** The irrigation and integrated pest management (IPM) components supporting this objective were scaled back (from 10 percent of estimated to 3 percent of actual project costs). Neverthless, the area served by IPM increased from 3.8 million ha in 1996 to over 6 million ha in 2001, and a Law on Plant Protection was passed . The irrigation component (reduced to under US$0.5 million) succeeded in boosting cotton yields and reducing water consumption on demonstration plots, but this was only a small pilot exercise, and the ICR makes no comment about the prospects for scaling up .

(iii) ***Partially achieved .*** The project introduced stricter standards for grading cotton fiber, boosting the price commanded by the Uzbek product on internatonal exchanges, and generating an annual premium of US$ 8 million. Nevertheless, the low profitability of the cotton sector led to a decline in the area planted, and cotton yields fell during implementation, compromising the objective of achieving higher export earnings from this sector . The collapse of the world cotton price contributed substantially to the fall in profitability; but it was also substantially aggravated by the weak incentive regime, reform of which was in government's control and was a major objective of the project .

4. Significant Outcomes/Impacts:

The most significant outcome was the transition from classing of cotton by lot to classing by bale, which was substantially responsible for the 1998-2002 increase of the Uzbek Middling index relative to the Cotlook A index, reaping a premium of about US$55 per ton of cotton fiber .

5. Significant Shortcomings (including non-compliance with safeguard policies):

Even without the devastating effect of the abrupt decline in the world market price for cotton fiber, project outcome would still have been stymied by the failure to reform the incentive regime . Initially, the cotton sector was heavily taxed through mandatory conversion of the cotton fiber export revenue into local currency at highly overvalued administratively-determined exchange rates . Although this distortion has largely been removed since 2000, farming incentives remain weak owing to the administrative regulation of farm production decisions, input supply, pricing and procurement. Government failed to comply with the project agreements that were critical for improving incentives (see Table 4 of the ICR), and its share of project financing fell by about one -half, indicating weak ownership of the project's development objectives . Comments on the ICR (section 9) by the Ministry of Agriculture indicate that this agency gave only lukewarm support to the reform agenda, and the failure to carry out reforms indicates that this investment had little policy leverage . Government also commented that the irrigation and integrated pest management components were awkward "add ons" that slowed project implementation .

6. Ratings :	ICR	OED Review	Reason for Disagreement /Comments
Outcome :	Satisfactory	Moderately Satisfactory	The project's overriding development objective was to increase the efficiency of the cotton sector . This was partially thwarted by the failure to improve the incentive regime .
Institutional Dev .:	Modest	Modest	Cotton grading reform was positive; but, more generally, private sector development received little stimulus .
Sustainability :	Likely	Unlikely	The lack of progress with policy reform and the uncertain outlook for world cotton prices call into question the resilience of benefits flowing from the creation of the six seed producing enterprises, and the cotton sector generally .
Bank Performance :	Satisfactory	Unsatisfactory	The Bank should not have pushed this investment before the government had demonstrated its commitment to policy reform; it should have waited for the outcome of the policy-oriented Rehabilitation Project (approved FY95, closed FY96). The unsatisfactory outcome rating of the Rehabilitation Project was evidence of the government's

			lack of commitment. Supervision was sound but costly (US$145,000 per year, almost three times the norm); and there were problems with the resident mission's handling of procurment, including fraud allegations resulting in dismissal of a Bank national staff member.
Borrower Perf .:	Satisfactory	Unsatisfactory	By itself, the government's failure to respect key project agreements (see Table 4 of the ICR) is grounds for an unsatisfactory rating.
Quality of ICR :		Unsatisfactory	

NOTE: ICR rating values flagged with ' * ' don't comply with OP/BP 13.55, but are listed for completeness.

7. Lessons of Broad Applicability:

The main lesson is that the Bank should not make substantial investments in countries that have not embraced the reforms critical for transition to a market economy; at best, small pilot projects are justified . Sector-oriented investments do not have leverage needed to achieve the broader liberalization and privatization reforms that are required. The ICR does not derive these particular lessons; but it points to others that are equally pertinent to transition economies. "An improvement in international price received for Uzbek cotton did not translate into better farm gate prices nor did it lead to sector liberalization . Critical aspects of agricultural policy such as introduction of competition into the ginning industry, farm credit and input supply were not defined . Potential drivers of sector liberalization such as farm restructuring and land reform were omitted from sector liberalization scenarios ". In other words, the Bank needs to give closer thought to the sequencing of policy -based loans and investment loans, and the sequencing of steps in the reform process .

8. Assessment Recommended? ● Yes ○ No

Why? OED should conduct a misson in five years time to re -estimate the economic rate of return to this investment and to derive lessons about the sequencing of policy reform in transition economies . Furthermore, Uzbekistan is a relatively new client which has been only lightly evaluated so far .

9. Comments on Quality of ICR:

The ICR fails to give sufficient weight to the policy reform dimension, even though this is an explicit development objective of the project. The lessons it draws (see Section 7 above) hint at this larger dimension, and these considerations should have led to a discussion of the project's relevance, which would logically fit in the Quality at Entry section. The government's failure to honor project agreements bearing on policy reform (Table 4) belongs in the section on Achievement of Objectives, but it is relegated to the section on Major Factors Affecting Implementation. The economic and financial analysis is detailed; but there is no sensitivity analysis to indicate how the net benefit stream would respond to different price scenarios; and the resilience of benefits to the adverse effects of the incentive regime (declining output) is not discussed. On project costs, there is a major discrepancy between Annex 2 and Section 5.4 of the ICR (spelled out in Section 2c of this form). Section 3.1 of the ICR does not give a complete account of the project's original objectives as conveyed in Staff Appraisal Report (objective (ii) is omitted).