

**Country Assistance Program
for
the Republic of Uzbekistan**

Government of Japan

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Country Assistance Program for the Republic of Uzbekistan

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1. Basic Understanding of Central Asia

Geopolitically, Central Asia is surrounded by big powers such as Russia and China and is vulnerable to the impact of unstable situations of surrounding areas including the Middle East, Afghanistan, and Pakistan. Especially since the 9.11 event, there have been major changes in the region's strategic environment such as the stationing of the U.S. military and the movements of Russia and China. The peace and stability of the Central Asia region are crucially important to the stability and prosperity of Japan, the entire Eurasian continent and the international community as well.

The stable supply of oil and natural gas from the Central Asian region will contribute to the stability of the international energy market. With expected rising energy demand from China and India, a consistent energy supply from the region is important in ensuring diversification of supply sources that meet the demand.

Since their independence, Central Asian countries have been pushing for democratization and transition to a market economy despite political and economic difficulties. Fourteen years after their independence, the diversification of their economies and politics is underway and economic disparities tend to expand depending on the availability of energy resources. Conventionally, reform processes especially in liberalization and opening of market were analyzed based on the dichotomy between radicalism with emphasis on the speed of reform and gradualism. In addition, a new dichotomy between liberal decentralization and authoritarian centralization has emerged. Currently, the discussion on Central Asian transition economies and directions of assistance towards the region are facing important turning points.

On the other hand, central Asian countries have a number of issues that are common to the region and difficult to resolve by individual national approaches: terrorism, drugs, transport, and the effective use of water and energy resources, trade, and environmental preservation. They have previously grappled with various programs targeting the promotion of intra-regional cooperation. However, factors such as the diverse political, economic and social circumstances surrounding the countries and the differences in each government's strategy have restricted the progress for regional cooperation. To achieve peace and stability in Central Asia and to ensure the region's prosperity through potentially feasible economic development, it is crucial to promote integration into the global economy in concert with the region's countries by resolving common issues, achieving regional economic integration, and creating a "common market" on an economically appealing scale.

Based on this understanding, Yoriko Kawaguchi, the then Minister for Foreign Affairs of Japan, visited Central Asia in August, 2004, launched the framework of the "Central Asia plus Japan" Dialogue, and announced the policy for Central Asia based on the two pillars of 1)enhancing bilateral relations and 2)promoting dialogue with the overall Central Asia Region.

In June 2006, Mr. Taro Aso, Minister for Foreign Affairs hosted the Second Foreign Ministers' Meeting within the framework of the "Central Asia plus Japan" Dialogue in Tokyo. The delegates discussed future cooperation, focusing on the promotion of intra-regional cooperation within the framework and adopted the action plan for the five pillars including intra-regional coopertaion , which is related to this "Country Assistance Program".

2. Developmental Situation in Uzbekistan

In the period of transition, Uzbekistan has been addressing various reforms to attain economic development and sustainable growth. In order to support the country's effort, it is necessary to consider the circumstances peculiar to Uzbekistan such as the geographic features, population, ethnic groups, religions and other elements.

(1) General Situation

(A) Geographic features

Uzbekistan lies within the Eurasian continent and borders all the Central Asian countries and Afghanistan. With a total area of 450,000 sq. km (1.2 times that of Japan), the three-fifths of the land is desert and steppes, with farming land accounting for about 10%. In the border areas in the east and south are high mountain ranges and sandwiched by these mountain ranges is the Fergana valley, where

population is concentrated. There is a well-developed canal network in the country using the water from these mountains, the Amu Darya River, the Syr Darya River, and their tributaries. Especially irrigation systems extends to almost the entire Fergana valley. With neighboring landlocked Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Afghanistan are themselves, Uzbekistan is a rare example of a “double-landlocked” country. In the west lies the Republic of Karakalpakstan, consisting mainly of deserts and low-lying lands along the coast of the Aral Sea and whose land area accounts for 37% of that of Uzbekistan. Furthermore Uzbekistan has enclaves in Kyrgyzstan.

(B) Population and ethnic groups

Uzbekistan’s population is 26.1 million (2005), making it the largest country in the Central Asia region and accounting for nearly half of the 57.0 million combined population of the five Central Asian countries. Although Uzbekistan is a multiethnic country, with its population composed of over 130 ethnic groups, nearly 80% are Uzbeks making it the most racially homogeneous country in the region, alongside Turkmenistan. The combined population of the three ethnic groups, including Russians (6%) and Tajiks (5%), accounts for 90% of Uzbekistan’s population. About 200,000 Koreans who were forced to move from the Far East by Stalin during World War II and their descendants live in Uzbekistan.

With the high Uzbek birth rate and the increasing outflow of Russians due to the state policy to make Uzbek its official language, the percentage of residents with Uzbek family lines in its population is set to rise further. Its characteristics as a nation-state are likely to become more pronounced than those of other regional countries.

Uzbekistan has a number of historic cities that thrived as Silk Road oasis towns with flourishing Islamic urban culture and inherits strong Islamic influences. These include Tashkent, the current capital, known as a town of stones in days gone by, Samarqand which prospered as a capital of Timor’s Empire, as well as Khiva and Bukhara. Nearly 80% of the populations follow Islam, of which the majority is Sunnis. The tradition of Islamic mysticism has also been passed down, mainly in the Fergana region. Its southern tip shares border with Afghanistan and many residents with Uzbek family lines are living in the north of Afghanistan, having some influence on Afghanistan as well as being subjected to diversified influence from it.

(2) Political Situation

Since the independence of Uzbekistan in August 1991, President Karimov has maintained a strong leadership for more than fourteen years.

Immediately after independence, President Karimov clearly indicated his intention to take a gradual reform line focused on political stability by laying out the following five principles: (a) completely “deideologizing” the economy, (b) importance of improvement in the legal infrastructure for economic reforms, (c) state-driven reforms, (d) the implementation of up-front measures for social security, and (e) gradual and continuous stabilizing reforms.

Thanks to the gradual reform line, Uzbekistan was the most successful country of the Central Asia in minimizing the economic downturn and maintaining internal stability until around 1996. However, since around 1997, Islamic organizations, mainly in the Fergana region with historically heavy Islamic influences, have tended to intensify their activities. Some say that Islamic organizations are a factor back-grounding the incident in Andizhan occurred in 2005 and other say that people’s discontent to difficulty of living is also a distant cause.

Although recently the Uzbek government has been striving to avoid political turmoil by strengthening a crackdown on Islamic forces and political extremists, the alleged human rights abuse during this crackdown has been drawing criticism from the international community. The government tightened its control over NGOs. Some international NGOs left the country. Uzbekistan has many issues to overcome as far as achieving democratization and increasing its political freedom are concerned. Under the presidential system, the government claims to uphold a parliamentary democracy. The Assembly’s role was very limited. The Assembly reform for strengthening the functions as one of the democratizing measures has progressed since the December 2004 Assembly election, shifting from the previous unicameral system to a bicameral system.

In the field of foreign relations, after the 9.11 event, the Uzbek government allowed a U.S. military presence and supported the U.S. position on the use of forces against Iraq in 2003, hence the relationship with U.S. became closer. After the incident in Andijan, however, the relation with the US. And European countries became estranged with the withdrawal of U.S. military force as an example. In contrast, the relations with such countries as Russia, taking favorable positions for Uzbekistan regarding the events have been developed considerably.

(3) Economic Situation

(A) General condition

Due to the confusion following the collapse of the Soviet economic system, the Uzbek economy had negative growth until 1995, although its slowdown in production and the effects of the confusion were relatively slight in comparison with other Central Asian countries. The economy reverted to positive economic growth in 1996 and kept growing ever since, achieving self-sufficiency in oil and natural gas supply and raising food self-sufficiency rates until around the Russian economic crisis. The major factors behind the post-independence stability of the economy can be attributable to the stability of the major industries such as cotton, and mining and manufacturing. This is the result of the government's intensive investment (budget input) in both sectors under the planned economy system. Conversely, however, it could be argued that the transition to market economy of the country has made little progress. On the other hand, some believe that the gradual reform line, launched by the government after early days of independence, functioned effectively in stabilizing the national economy and politics.

During the Soviet era, Uzbekistan was a production base of electronic equipment and parts for military use, playing an important role in supporting the industrial sector of the former Soviet Union by producing aircraft, steel plates, power generators, electric cables, mechanical shovels, cranes, and tractors. Due to the outdated production facilities and the loss of market, caused by the collapse of the Soviet-era division of labor, growth rates of the Uzbekistan's industrial sector, the key sector of the economy, have remained stagnant in comparison with others. (According to the EBRD survey, the average annual growth rates by sector during 1993-2003 were 1.1% for the industrial sector as compared to 3.0% and 4.1% for the agricultural and service sectors respectively.)

Uzbekistan had a history of focusing on cotton cultivation with large-scale irrigation facilities based on the division of labor under the Soviet regime. Even today, cotton accounts for 18% of the country's foreign currency revenue. The agricultural sector accounts for 26.8% of GDP and employs about 40% of the total workforce. Uzbekistan is ranked 6th as a cotton producer and second as a cotton exporter after the U.S in the world. The most important source of foreign currency revenue after cotton is mining and manufacturing industry, especially the mining and production of gold with annual production of 84-85 tons is the second-largest between the CIS countries after Russia. However, these primary commodities are vulnerable to the price fluctuations of the international market.

While the Uzbek government is calling for food and energy self-sufficiency, it emphasizes economic security and efforts to advance the economic structure and diversification under the import substituting policies. The country set a national goal of boosting cotton processing rate from the present 20% to 50% by 2005.

Although Uzbekistan is rich in natural resources such as oil, natural gas, coal, iron ores, and uranium, its export potential for oil and natural gas is relatively insignificant in global terms and it is hence unlikely that they would become an important source of foreign currency anytime soon. In 1999, the Uzbek government announced a policy to privatize the affiliated companies of "Uzbek Neftgaz" which was a state-owned company exclusively controlling the resource development of oil and natural gas, the government also adopts selling the stocks of its subsidiary companies and gives favorable measures for foreign companies wishing to make inroads into oil and gas exploration and drilling in Uzbekistan. However, generally, investment climate concerning strict control on foreign exchange and business activities, and low rate of selling stocks of state-owned enterprises (the government owns more than 51% of most large firms, strongly performing) has been constraint on attracting foreign capital to the resource development sector.

(B) Trade and Investment

Uzbekistan's total imports amounted to \$4.853 billion in 2004. The major exports were cotton, energy and gold with Russia, the U.K. and Iran as the key export destinations. Imports, meanwhile, amounted to \$3.816 billion in 2004, and major imported items included machinery and facility, chemical products and rubber goods, ferrous and non-ferrous metal. Its principal exporters were Russia, the U.S. and Korea. Its exports to Japan were \$86 million (gold, textile products, chemical products) and imports \$52 million (metal and copper products, precision apparatus, electric equipments).

At the end of 2001, the Uzbek government resumed talks with the IMF which had faltered. Under the IMF's staff-monitored program (SMP), the government has increased trade surpluses and foreign currency reserves through a belt-tightening policy, and moreover, achieved liberalization of foreign currency and the abolition of multiple exchange controls which are conditions for an IMF Article VIII country. Finally Uzbekistan became an IMF Article VIII country in October 2003. On the other hand, due to the government's firmer import control measures (restrictions on border trade, etc.) to improve the trade balance, Uzbekistan's trade is still inactive.

Setting the liberalization of trade system and WTO accession as one of the main issues, the government launched efforts toward trade liberalization. The Uzbek government applied for WTO accession during the GATT era in 1994, and the first WTO working party on Uzbekistan's trade system was held in 1995. In 1998 the government submitted a memorandum on the trade system and started bilateral consultation with the U.S., EU, New Zealand and Australia. Subsequently, in July 2002, the first working group meeting on the accession was held, followed by the third in October 2005. Although the government has accelerated its efforts toward the accession with the help of the U.S. Agency for International Development (USAID) by establishing a cross-ministerial meeting headed by the Cabinet of Ministers, the process remains at an early stage and needs some improvement of the legal systems which might require considerable time to join in WTO.

In terms of per capita direct investment, Uzbekistan remains far below the averages of the former republics of the Soviet Union and equivalent to Tajikistan where direct investment could not be expected due to the lingering effect of the civil war. Investment from Japanese companies has been mainly focused on textile-related, computer sales, and transport and tourism sectors. The activity of Japanese companies is far from being active.

Japanese business activity to date has been mainly in ODA-related areas and commercially-based transactions have been sluggish. The reasons can be cited as follows:

- The market is hardly attractive to Japanese companies including trading companies strong in large-scale transactions, because of the low purchasing power of local business and people.
- The quality level of domestic products does not meet the standards of overseas markets.
- Since Uzbekistan is a "double-landlocked" country and the transport routes are limited, the business climate has a disadvantage in terms of transport costs and time. Customs procedures in the transit countries are complicated and troublesome.
- Because of the complicated export and import procedures (quality and standards review, advanced registration system, sales certificate) and high risks for many uncertainties over the gap between the law and its application, foreign companies are inhibited psychologically. As many decrees issued by the Cabinet of Ministers and the Presidential Office are frequently changed, it is required considerable time and expense to comply with them.
- With respect to the major export items such as cotton, gold, silk, the government does not approve their exports during sluggish market periods and no transactions can be completed below the floor prices set by the government. This involves significant investment risks, often resulting in vicious cycles of excess inventories and stoppages in production during this period.

(C) Economic reforms

Since the last days of the Soviet Union, Uzbekistan has been positively grappling with legislation governing activity in private company. In 1990, ahead of Russia, the government introduced an ownership law allowing diverse ownership forms while state ownership remains, as well as prescribing legal equity in

order to expand the rights of the assets owner and the activity in private sectors as a key player of national economy. However, with respect to the privatization of state-owned enterprises, the government keeps retaining 25-50% of their voting shares and major state-owned enterprises performing strongly are not targeted for privatization. With this in mind, the privatization of its state-owned enterprises, in a real sense, is considerably limited, undermining the effectiveness of the ownership law and the improvement of other relevant laws. As the Uzbek government defines enterprises solely owned by the state as state-owned enterprises, one where 51% of the shares are owned by the state is not regarded as a state-owned enterprise. Consequently, since the non-state sector is not always the complete private sector, the privatization rate in the official statistics remains unreliable. In addition, the country's former ministries such as Ministry of Power Engineering and Electrification Ministry and the Ministry of Light Industry were privatized and became industry organizations. However, through these organizations the government intervenes domestic economy.

Since early 2003, the government has been strengthening their efforts in the field of the privatization, starting with the presidential decree on the "Measure on Radical Increase the Share and Significance of the Private sector in the Uzbek Economy" and other Presidential and the Cabinet of Ministers' decrees on such as liberalization of securities trading, the improvement of the securities market, the promotion of privatization, the invitation of foreign capital to invest privatized companies, the improvement of corporate governance, and the improvement of the corporate registration system. As a result of these measures, the government reports that revenues from the privatized enterprises increased 30% in 2003 over the previous year with 1,519 privately owned facilities and enterprises. A survey on actual situation must be conducted to ascertain whether market economy is being developed by "full privatization."

It is vital for the activity of private companies supporting a market economy that banks fulfill the function of financial mediator. However, the assets of Uzbek state banks remain extremely high as a percentage of total bank assets, accounting for 77.5% (3.5% for Kazakhstan), with the assets of the National Bank of Uzbekistan (NBU for Foreign Economic Activity) accounting for about 60%. The NBU alone handles 90% of country's foreign-currency trading while 80% of household savings are handled by the state-owned savings banks. Since the majority of corporate financing by the state banks is basically targeted at investment in state-owned enterprises and "private enterprises with state-owned shares", the country urgently needs to establish a financial system that helps private sector growth. Under the present circumstances, in which the state banks are saddled with huge amounts of bad loans while still financing state and government-affiliated enterprises, the sweeping reform of financial systems remains the major issues in Uzbekistan. Therefore, the Uzbekistan government has begun the concrete process of privatization of two major banks which are the NBU and Asaka Bank since 2005.

The Uzbek government introduced a multiple exchange policy in early 1997. -The government has prioritized the establishment of a domestic production system for specific products through import-substituting policies, extending preferential treatment to specific industries. The country implemented reform of the exchange system and achieved the status of an IMF Article VIII country in October 2003. Uzbekistan, however, is still strictly controlling money supply in order to maintain foreign currency reserves and stabilize exchange rates. There would be a potential for economic standstill due to a money supply shortage.

Right after Uzbekistan became an IMF Article VIII country in October 2003, the government released presidential decrees on the economic and administrative reforms (the "On Perfection of a System of Republican State Governing Bodies" and the "On Improvement of Management System of Economic Entities" were issued on December 9 and 22, 2003 respectively). As a result of these decrees, the government stipulated the implementation of radical administrative reforms involving the reduction of the state role in economic management, the elimination of unnecessary state intervention in the activities of an economic entity, the partial transfer of authority from state organizations to local governments (employment measures, social security and improvement in living standards), and personnel cuts in national economic administration institutions. With respect to the structural reforms of local administrative institutions, eight district administrations were said to have been abolished in the first quarters of 2003 and 2004, and more than 40,000 personnel, equivalent to 22% of the total administrative office employees, were slashed in early 2004.

As noted above, the Uzbek government has announced a variety of liberalization measures. However, many point out that the intervention by the government over the economy still remains. It is therefore necessary to conduct a detailed investigation and analysis of the actual situation concerning complicated laws, regulations and their operation.

3. Major Development Issues and Trends of Assistance for Uzbekistan

(1) Key Development Issues of Uzbekistan

(A) The promotion of governance reforms, market economy and institutional building

To ensure dynamic and sustainable economic growth of the Uzbek economy, it is indispensable to promote further development of market economy based on the principle of competition. Despite the fact that gradualism has played a significant role in mitigating the impact of the Collapse of the Soviet Union and contributing to the stability of public life, It is necessary to note that it tends to retain the existing structure of organizations and their interests, occasionally hampering the development of a market economy. Governance reforms represent an important issue that leads to an improvement in the investment environment and the creation of “democratic and fair society,” because the reforms involve restructuring of the framework of laws and regulations such as administrative and financial reforms, judicial reforms and the deregulation of economic activity toward the development of market economy.

Substantial efforts for liberalization, privatization and free competition are the important prerequisites for shifting to a market economy. Steady and step-by-step promotion of liberalization and privatization is one of the important issues of the country. Moreover, it is necessary to obtain knowledge and skills in financial, fiscal, industrial and trade sectors to change the paradigm in both the administration and citizens. On the administration side, promotion of expertise and knowledge on policy-making, implementation, finance and fiscal affairs, law and etc. are important issues. On the citizen’s side, nurturing human resources to lead industries under market economy in future is still an important issue.

There are various issues for achieving economic growth such as the promotion of basic industries and the nurture of small and medium-sized enterprises (SMEs) and export-oriented industries. Therefore, economic reforms including reforms of financial and judicial systems and so forth, to make them suited for market economy is also an important issue for the country. Trade development is indispensable for sustainable growth of the economy and the establishment of a trade system based on international rules is necessary. After becoming an IMF Article VIII country in October 2003, the Uzbek government has positioned the reform of the trade system and the promotion of preparation for the accession to the IMF as key issues and has been striving to upgrade the relevant domestic laws to target WTO accession, seeking technical support from the international community in this endeavor.

Furthermore, there are cases where pre-independence operating authorities are concurrently involved in policymaking and industry control as de facto “regulatory authorities”, even after becoming state-owned companies. Another key issue for the Uzbek government is to streamline the relationship of the state-owned enterprises and administrative functions that may impede the private sector development in administrative reforms.

(B) Poverty Issues

During the Soviet era, Uzbekistan was one of the poorest republics with 45% of its residents living under the poverty line. After the collapse of the Soviet Union, GDP declined by 24% till 1996 and poverty groups expanded. According to a 1994 survey, 44.5% of population worked for less than the minimum wage. Meanwhile, the government strengthened its social security instead of drastic economic reforms. Therefore, declines in real income remained relatively small in comparison with those of other CIS countries. According to statistics, despite the fact that the Uzbek economy regained a recovery trajectory (annual average GDP growth rate for 1998-2002 was 4.3%) since 1996, poverty group only decreased by 3%.

About 70% of population live in rural areas and mainly engages in agriculture. Since the independence, most developmental investment has been focused on cities, leaving a widening gap between urban and rural areas and increasing poverty groups in rural communities. In particular, it is said that levels of poverty is

relatively high in the Fergana valley with a high population density and Republic of Karakalpakstan near the Aral Sea.

In areas near the Aral Sea, salt damage is causing shrinkage of arable land and having adverse effects on the health of local residents. The disparity between urban and rural areas is not only just limited to the gap in income but also large gaps exist in the quality and access to education, safe water, and healthcare.

The following factors could be pointed out; population issues (families with many children), low income (especially public servants and farmers) and educational levels (the poverty rate of families where the household head got only primary education is twice as high as that of those with household head of secondary education). These factors cannot be fundamentally solved unless the increase in economic standard is achieved. Consequently, in a long run, the country is required to develop market economy and restructure economic infrastructure targeting poverty reduction with economic growth. In the short and medium term, it is necessary to restructure the social sector as a safety net for those in poverty.

Uzbekistan's levels of educational and medical services are relatively high compared with other developing countries with similar income levels. This owes to the Soviet-era systems where education and healthcare services were provided free of charge nationwide. However, it is one of the key issues for transition to market economy to restructure the social service systems including education and healthcare. Previously, even the poverty class was able to receive education and medical services, and facilities, equipments and materials were provided relatively well at schools and hospitals. After the independence, however, since the Uzbek government could no longer rely on subsidies from the Soviet government, it has been unable to maintain the social service system. The poverty class may be able to benefit from the educational and healthcare services as previously. Furthermore, there are some cases where the government cannot properly cope with the decaying facilities and equipment of schools and hospitals.

(C) Agriculture

Uzbekistan is ranked sixth as a cotton producer, fifth as a tomato paste producer, third as a cocoon producer, and tenth as a dried fruit producer in the world. The agricultural sector shares over a quarter of GDP and employs 40% of the total workforce. Agriculture is therefore the essential industry. Sustainable growth in this sector is one of the most important issues for social and economic stability, since it is related to welfare improvement of the poverty group in rural areas.

The arable land accounts for about 10% of the total land area or 4.4 million ha. Because most of the regions have annual rainfall of less than 200 mm due to the continental climate, agriculture without irrigation is difficult. The total irrigated land is 4.2 million ha. 95% of Uzbekistan's agriculture is irrigated agriculture using water from the Sir Darya and AmuDarya rivers that flow into the fast-shrinking Aral Sea. The amount of the water used for the irrigation is now reaching the limit of available irrigation water supply decided by the related countries. Moreover, since the independence, the irrigation and drainage facilities have not been properly maintained, managed or rehabilitated by water users association due to lack of funds. The capacity of these facilities is getting lower and lower. This situation is further accelerating the advance of salt damage. In future, in addition to paying heed to excessive groundwater development, the important tasks are the proper management of facilities through measures such as creation and use of the most effective irrigation areas, renewal of aging irrigation facilities, etc., maintenance and management, planned utilization of water resources, and water saving cultivation techniques development. Although the maintenance and management of all irrigation waterways except trunk ones were transferred from government control to newly-established water users association, they are not functioning well due to financial difficulties and the lack of machinery and technology.

Since the Soviet era, Uzbekistan has concentrated on planting specialized for growing cotton, and cotton growing still takes priority for irrigation water use, fertilizers and agricultural machines. Furthermore, because farming loans by the agricultural financing institutions are limited to cotton and wheat growing, the diversification of crops has not made much progress.

Nearly all of the cotton and half of the wheat are designated as crops for national procurement, and their production planning and procurement are subject to rigorous government control. Consequently, as they are

traded at rates lower than international prices, some point out the system is hampering farmers' willingness to produce more.

In 1998, the Uzbek government formulated the "Agricultural Economy Strengthening Program 1998-2000," and the government started tackling agrarian reforms such as a long-term farmland leasing system aiming at increasing food production and gradual shift to market economy of farm organizations. As a result, *kolkhoz* and *sovkhoz* of the Soviet-era were dismantled, and reorganized into a large-scale farmers' cooperative known as *shirkat*. After that, part of *shirkat* were split and privatized, and a large number of smaller privately-owned farms (*fermer*) were born. The October 2003 presidential decree called for policies to split and dismantle inefficient *shirkat* and turn them into *fermer* by 2006, which is accelerating the country's efforts to privatize the agricultural sector.

On the other hand, workers at *shirkat* that failed to become *fermer* lost their jobs and became unemployed, or seasonally employed by *fermer*. They constitute the majority of the poor people in the farming communities. They mainly grow crops at family-owned farms (*dehkan*) with a plot of less than 0.35 ha allocated to each family or raising livestock for their personal consumption. They are allowed to sell excess produce at bazaars to earn cash. This functions as a sort of safety network alongside the agrarian reform. The *fermer*, created as a result of subdivision of *shirkat*, is required to expand support to promote farmers' self-management capacities such as legal consultation on its rights and obligations, education on farm management, the introduction and spread of new cultivation techniques, and the provision of market information about their shipping. In addition, it is necessary to pay attention that the national procurement system should not block the development of the *fermer*.

However, free access to production and procurement methods (seeds, fertilizer, energy, agricultural water, etc.) and adoption of market economy in agricultural production (the gradual abolishment of the national procurement system and the liberalization of the market) have made little progress and still remain limited. Although the *Fermer* Association, a nationwide body, provides support to farmers under government policies, some problems such as the availability of farming funds and agricultural machinery, the maintenance and management of irrigation facilities' end sections, and the improvement of degraded soils still remain as the major issues.

(D) Healthcare

Although Uzbekistan, in principle, maintains a free healthcare system, due to contraction of its national budget, the expenditure in the healthcare sector has been on the decline with annual per capita expenditure at \$8. Major issues for the healthcare sector are extremely low salary of personnel in healthcare services and the declining quality of services due to aging and outdated medical equipment and supplies.

In an attempt to upgrade the healthcare system, the government introduced a "National Healthcare Reform Program for 1998-2005" on November 10, 1998. Its goals are (a) the quality improvement of healthcare services and social security, (b) equitable access to healthcare services, (c) the introduction of market principles and mechanisms into healthcare services, (d) the efficiency of maternal and child care services, (e) the implementation of preventive medical care services, (f) the improvement of the medical financial system, (g) the strengthening of emergency medical care, and (h) the improvement of the referral system. The government has been carrying forward the integration of primary healthcare at rural clinics (SVP) and the establishment and improvement of SVPs with a view to improving primary healthcare in line with the above policies.

The characteristics of diseases in Uzbekistan are the coexistence of developed country-type circulatory system diseases and developing country-type infectious diseases. The death rate from heart diseases is high in terms of circulatory system diseases, while tuberculosis has been on the increase in infectious diseases and the increase of HIV/AIDS is also becoming a serious problem.

According to official statistics, the infant mortality rate in 2002 is said to have declined to 16.5 per 1,000 live births. This rate, however, is based on the Soviet-era statistical method and if calculated by the method adopted by the World Health Organization (WHO), it would exceed 60. International donor organizations, chiefly UNICEF, are considering offering support for programs to help to switch to international statistical methods such as other CIS countries adopted, and also to reduce infant mortality rates.

(E) Education

The education sector is the government's priority sector based on its perspective that nurturing human resources support the industrial arena after it shifts to a market economy. Consequently, expenditure on this sector accounts for 9% of GDP that is higher than those of the OECD countries. The literacy rate of the public exceeds 99% (2002) with the primary education attendance rate also standing at near 100% that is exceeding those of developing countries with similar income levels.

After the independence, the government brought the education law into effect in 1992, and formulated a new education law and national human resource development program in 1997. Under the education law in 1997, the 11-year compulsory education system (covering 7 to 17 year olds) to one covering 12 years (7 to 18 year olds), comprising 9 years of primary and secondary general education and 3 years of professional education were introduced.

Based on the National Human Resource Development Program formulated in 1997, the Uzbek government has been improving school facilities for secondary professional education including vocational schools to acquire professional techniques and *lycees* (equivalent to Japanese high schools) for increase in employment rates after compulsory education. The major issues in the education sector are the lack of techniques and information, experienced teachers and high-quality teaching materials. In addition, the following problems are pointed out; poor coordination between the educational and industrial worlds, mismatch between professional education and the labor market that makes trained persons difficult to utilize their professional skills.

As most of the expenditure for education has been allocated to secondary education that is centering on vocational high schools, the teaching environment of the primary education has considerably deteriorated. Therefore in July 2004, the Uzbek government has started improving the environment by rolling out a "School Education Development Program" (2004-2009). The government, based on the program, is planning a survey of the actual conditions of schools nationwide and implement to refurbish or rebuild school buildings and materials depending on their conditions. However, as it is difficult to fund these projects with the national budget alone, the government is seeking foreign aid.

With regard to Information-Communication Technology (ICT) education that is included in the school curriculum, most schools conduct their classes simply by teaching theory alone due to the lack of teaching materials. If computers are available, most of them are from the Soviet era and are out of order and unusable. Other major issues include the low quality of education with low motivation of teachers due to low salaries and the elimination of disparity correction in education between urban and rural communities.

Because primary education is conducted in Uzbek, Karakalpak, Russian, Kazak, Kyrgyz, Turkmen and Tajik languages, the multi-ethnic nature of the country compounds the difficulty for the government in creating textbooks and securing teachers for each language, despite a higher racial homogeneity than other CIS countries.

(F) Internal and Regional Stability

Right after independence, Uzbekistan was affected by the conflicts in neighboring Afghanistan and Tajikistan and has adopted a variety of policies to prevent internal political insecurity and keep the conflicts from spreading to other Central Asian countries. As measures to prevent the infiltration of Islamic extremists, a major cause of political insecurity, and drug smuggling and contraband trade that are catalysts for crime in general, border management, formerly non-existent in the country, has become an urgent priority issue. For example, the government laid mines near the borders with Tajikistan and Kyrgyzstan as defense measures against intrusive and anti-government activities fuelled by international Islam terrorist groups prompted serious turmoil in Uzbekistan. At the same time, this defense measure was meant to prevent drug smuggling which had rocketed after the establishment of the Taliban regime. However, the consequent domestic and overseas landmine victims in neighboring countries have created a grave problem, leading to exchange of criticism among regional countries and adversely affecting the diplomatic relationship with them.

Although the mining has turned out to be effective in preventing the inward infiltration of Islamic extremists, drug smuggling, and contraband trade, on the other hand, it has been becoming a new impediment to regional stability and economic development. In view of this, landmine removal, and the prevention of drugs and smuggling are the overriding issues in Uzbekistan as well as its neighbors.

(G) Infrastructure renovation and Improvement

(a) Transport

Central Asia's transport infrastructure was built in the Soviet era as a part of a transport system centered at Moscow. Uzbekistan which became a "double-landlocked" country after independence has access problem to the international market. Therefore, the transport sector is important to hold the key to its economic development. With the geographical location, 3,000 km away from the Black Sea, 3,500 km from Moscow and 5,000 km from the main Chinese ports, Uzbekistan requires long-distance transport that is extremely costly. When transporting by land routes, it must traverse multiple countries compounding the vulnerability to the political situations in such transit countries. In addition, Uzbekistan's transport infrastructure is both inefficient and decrepit due to the lack of a properly maintained or upgraded road system or insufficient funding after the independence. Following the collapse of the division of labor in the Soviet-era, the country has seen a climb in exports to outside the former Soviet bloc as well as those inside the bloc. Consequently, Uzbekistan is faced with the need to build multiple, alternative international transport systems including a multimodal transport system starting with nearby ports, followed by land and railroad, an air transport and transmission pipelines networks for underground resources as well as to modernize and upgrade these infrastructure. For implementation of these projects, intra-regional cooperation with neighboring counties is a priority issue for Uzbekistan.

After the independence, in the wake of the loss of technicians and administration and management personnel in the sector, human resource development to fulfill the vacancy is an important issue in Uzbekistan. It is also important to nurture human resources of the new generation who are adaptable to market economy.

(b) Energy

The country is rich in natural resources such as natural gas, oil, coal and uranium. During the Soviet Era, the economy was integrated into the Soviet Union's demand-supply structure and, like other republics in the region, Uzbekistan did not have the authority over its own energy or opportunities to fully utilize rich resources. After the independence however, based on the own developmental policies, Uzbekistan has become capable of making its own decisions on the development and exploitation of resources. Consequently, phenomenal growth has been achieved in domestic oil production following its intensive oil development program targeting oil self-sufficiency.

Uzbekistan's electricity is generated by both thermal (87%) and hydraulic power (13%) with the majority of energy for thermal power generation coming from natural gas. There are 37 power plants in Uzbekistan and its power grid constitutes part of the power supply system across Central Asia, including Kyrgyzstan, southern Kazakhstan, Tajikistan, and Turkmenistan. As the control station for this system is in Uzbekistan, it plays a central management role. Uzbekistan has seasonal export/import agreements on power and the irrigation water supply with Kyrgyzstan and Kazakhstan, whereby Uzbekistan supplies natural gas to Kazakhstan and natural gas, heavy oil and power to Kyrgyzstan in winter, with Kyrgyzstan supplying power and irrigation water to Uzbekistan in summer. Despite Uzbekistan's considerable power supply capacity, the power plant facilities were built in the former Soviet era and have fallen into disrepair. Rehabilitation of these facilities is important task. In addition, constructing new power plants must be done to secure its continued growth in order to meet future demand increase.

With regard to charges on energy such as electricity, the country maintained an index-linked system until 2001. Henceforth, it's the country's credit that the rates have been adjusted periodically to bring them closer to the cost recovery basis. On the other hand, taking account for the impact of increasing energy charge on low-income class, both its consumer and supplier have to make efforts for cost reductions with promoting measures for energy conservation.

As noted in (a) above, there are important issues for improving skills and ability of administration, and management to recover from brain drain after the independence, and nurturing human resources for leading the next market economy.

(H) Environment

During the Soviet era, as Uzbekistan focused on the expansion of production according to quantitative goals involving large-scale industrialization and irrigation farming, serious environmental problems occurred. In the Aral Sea located in the arid regions northwest of Uzbekistan, during the Soviet era, based on the large-scale projects intended to remodel nature started in the 1950s, irrigation farming was encouraged using water from the AmuDarya and Syr Darya rivers that flow into the Aral Sea. These caused drastic declines in the water volume that pours into the Aral Sea, hence the shrinking of the Aral Sea and consequent environmental destruction. In comparison with the early 1960s, the water volume is now one-third of the original and its area is two-thirds with most of its fish having become extinct due to the increased salinity. In these areas, salinity flown by sandstorms from dried up sea bed became a threat to the health of local people. Salt damage is causing shrinkage and desertification of farmland. The effects of the shrinking Aral Sea destroyed the fishing-based local economy and society, forcing many local residents to flee from their ancestral acres as “environmental refugees.” The shrinking of the Aral Sea is considered to affect climate change on a global scale and is a widely acknowledged international environmental issue.

International organizations, such as the U.N. Environment Program (UNEP) and the World Bank have conducted analysis of its present state and held meetings of support countries urging the support of the international community. As the World Bank concluded in 1992 that it was impossible to restore the Aral Sea to its former state, the international community’s support programs are focused on the formulation of basic policy for water resource management, the collection of hydrologic and meteorological data and the creation of a related database, surveys of environmental destruction in the river basins, tree plantation on the exposed sea bed, supply of clean water to local residents, upgrading the managerial abilities of the related administrative authorities and organizations and so forth. Likewise, the Uzbek government instead plans to build water reservoirs by damming up the AmuDarya and Syr Darya rivers to reconstruct the fishing industry rather than targeting restoration of the Aral Sea.

In addition, Uzbekistan’s infrastructure facilities such as electricity, gas and water built in the Soviet era were often excessive creations not based on the economic rationale, giving heavy load on environment as they deteriorate over time due to lack of funds after the collapse of the Soviet Union. The contaminations such as air pollution in the large cities and industrial centers, the land pollution due to pesticide residues and heavy-metal pollution from mining activities, and water pollution remain a problem. There are also other problems. One is that the ability to collect environmental data is insufficient and the data is hardly reflected in the administration through lack of the proper sharing with the relevant authorities. Another is the system improvement of the entire environmental administration including the system of the collection and disposal of the solid wastes (households and industries).

Moreover, the country faces a problem with falling technical capabilities in the environment sector due to the technician brain drain.

(2) Points to be considered in Addressing Development Issues

(A) Medium/long-term comprehensive development programs, policies and I-WISP

Although Uzbekistan has never formulated a comprehensive national development program such as a 5-year plan, the government has prepared the Interim Welfare Improvement Strategy Paper (I-WISP) targeting poverty reduction by improving the living standard of the people through improved incomes and increased access to healthcare, education, the environment, and social security with the help of the World Bank, ADB, and UNDP. Based on the “Uzbekistan-style economic-social development model,” the social values of the public, and its commitment to the integration of international community, the I-WISP calls for the promotion of the reforms while protecting and developing its own special features. The I-WISP is built around four pillars of reform: (a) the achievement of sustainable economic growth, (b) the improvement of

nurturing human resources and social security, (c) the correction of regional disparities, and (d) the environmental improvement.

”The achievement of sustainable economic growth” as noted in (a) above, aims to stimulate an efficient and fair economy by accelerating the transition of economic and social systems to market economy through macro economic policies, public expenditure management and structural reforms. “The improvement of nurturing human resources and social security” as (b) above, emphasizes the creation of a fair society by maximizing the social welfare for people through improved access to education and healthcare services, an improved labor market, improved access to employment measures and public services, upgraded child welfare, gender consideration, and a better standard of social security. “The correction of regional disparities” as (c) above, simultaneously involves an effective reduction in regional disparities and the provision of administrative services being respectively implemented by local governments through national programs as well as decentralization to create conditions that help solve the regional disparities in living standards and stimulate the potential of rural communities. Meanwhile, “The environment improvement mentioned” above (d), targets the protection of the environment and diversity and the creation of a people-friendly environment by drawing up economic and environment protection policies in an integrated manner.

It is necessary to have NGOs and citizens participate in preparation, implementation and monitoring of WISP, so that the low income groups could be benefited with the plan.

(B) Economic Statistics

When conducting analyses and surveys of development issues, a variety of information in the form of economic statistics such as information on the macro economy and data by sector is required. However, much information including its national budget remains undisclosed. Moreover, where some statistical information is provided in response to an inquiry, it is not allowed to publicly use them because those information is mostly classified as confidential. In addition, international financial institutions such as the IMF, question the reliability of the statistics released by the Uzbek government, hence it might not be always easy to correctly evaluate and analyze Uzbekistan’s economic situation.

(3) Trends of Japan’s Assistance to Uzbekistan

Japan has been providing assistance to Uzbekistan by utilizing every possible scheme of financial assistance (loan and grant aid) and technical cooperation focusing on those priority sectors such as transition to market economy, infrastructure improvement, and the restructuring of social sectors (education and healthcare).

Yen loan has focused on improvement of sectors such as transport infrastructure (airports and railroads), information and communications (network improvement), and energy (the rehabilitation of power plants). Since 1995 till 2004, exchanges of notes on eight projects have been implemented.

Grant aid to Uzbekistan has centered on medical equipment and supplies for the healthcare sector with assistance provided to “Grant Assistance for Underprivileged Farmers” (2KR) (formerly called “Grant Aid for Increased Food Production), every year during the period fiscal 1995-2004 except 2002 and 2004. Japan also provided Uzbekistan with “non-project grant aid” three times in fiscal 1994 and 1995 when dialogue with the IMF was cordial, and 2001 in the form of emergency assistance to Afghanistan’s neighboring countries. In addition, “Grant Assistance for Grassroots Human Security Projects” is given to 30-40 projects every year. These projects are mainly targeting at aging primary and secondary school buildings in rural communities and educational equipment and materials (desks, chairs, etc.) as well as for the national healthcare sector and support programs at women.

Regarding technical cooperation, Japan commenced full-fledged program of dispatching experts (business management sector) and acceptance of trainees from fiscal 1993 (Japan had accepted trainees before Uzbekistan’s independence as a part of the aid program for the Soviet Union). Then the total number are 318 experts and 881 trainees by fiscal 2004. The training course is focused on the specially-installed course for Central Asia conducted in Russian as well as many other training courses specifically targeted at Uzbek personnel.

During 1997-2000, as a part of cooperation for “human resource development to promote the shift to a market economy,” Japan offered the Academy of Nation and Social Building “key policy-centered support.” For two years from fiscal 1998, Japan dispatched long-term experts, “macro economy policy advisers”, to the Cabinet of Ministers to assist Uzbekistan in efforts to shift to a market economy. Dispatching foreign experts to the Cabinet of Ministers is very rare with only Japan and Germany having previously done so. Since December 2000, Japan started running a project, “Uzbekistan-Japan Center for Human Development” known as Japan Center, continuing to support the country’s efforts in human resource development to accelerate the shift to market economy.

Japan has also been sending Japan Overseas Cooperation Volunteers (JOCV) to Uzbekistan since 1999 and senior overseas volunteers (SV) since fiscal 2001. As of fiscal 2004 a total dispatched number are of 55 JOCV and 13 SV.

By fiscal 2004 Japan’s various aid programs to Uzbekistan amounted to 97.552 billion yen in Yen loans and 16.476 billion yen in grant aid (both based on exchanges of notes), and 7.466 billion yen in technical cooperation (based on actual JICA expenditure).

(4) Trends of Multi-bilateral Assistance to Uzbekistan

Since the 1991 independence of Uzbekistan, major multi-bilateral donors have been offering loan aid and grant aid to the country. In terms of the cumulative amount of monetary aid (ODA and Other Official Flows [OOF]) to Uzbekistan, it was amounted to \$2,342.4 million at the end of 2003, as international agencies have increased their funding since 2000. The total funding in 2003 was \$595.4 million (actual in 2002: \$379.3 million) with OOF accounting for over 60% of the total funding in contrast to 2002, while humanitarian support declined markedly to a third of the previous year’s total. Regarding the breakdown of the funding, international agencies accounted for 68.0% (\$404.87 million), bilateral donors 31.6% (\$188.15 million) and NGOs 0.4% (\$2.38 million). By aid category, OOF was 63.91% (\$380.52 million); ODA 30.13% (\$179.39 million) and humanitarian aid 5.96% (\$35.49 million). When individual donors’ funding results in 2003 were analyzed, the U.S. led on an ODA basis, accounting for 38.17% of total funding, followed by Switzerland, Japan, the EU, and Germany. In terms of the total funding amount including OOF, the ADB remains the largest, accounting for 50.38% of the total, followed by the U.S., the World Bank, Switzerland, Germany, Japan, and the EU (source: Development Cooperation Report in Uzbekistan [supported by UNDP]). Although there is no framework of the World Bank for the Consultative Group Meetings, WISP would draw donors’ attention as a chance of aid coordination.

There is common recognition among donors that intra-regional cooperation is indispensable for the economic development of Central Asia. The ADB, in particular, started the Central Asia Regional Economic Cooperation (CAREC) program in 1997, and has hosted annual ministerial meetings of Central Asia economic cooperation since 2002. The member countries are Uzbekistan, Kazakhstan, Kyrgyzstan, Tajikistan, the Uyghur Autonomous Region of China, Azerbaijan, and Mongolia. The CAREC involves the participation of international organizations such as the World Bank, EBRD, IMF, and UNDP with aid coordination focused on transport, the trade promotion, and energy sectors.

4. Directions of Japan’s Assistance to Uzbekistan

(1) Principles and Objectives of Assistance to Uzbekistan

For nearly 70 years, the Central Asia region was directed by the Soviet government with virtually no diplomatic and economic relationships with Japan. It is thus very important for Japan to make efforts to build diplomatic and economic relationships with these countries that surfaced as independent nations within the international community in the 1990s and to secure cooperative relationships with them. Having sloughed off the Socialist Regime, the country is moving toward market economy and standing for democracy and the regime based on the principle of separation of government and religion. In this respect, these countries share important value with Japan. It is an important task for Japan, which accomplished economic development with support from international community, to support efforts for nation-building, stability and development of these countries based on the shared common values.

With the population of 26.1 million accounting for nearly half that of the entire region, Uzbekistan, in particular, is a major regional power. Tashkent, the country's capital and the fourth largest city in the former Soviet Union, is a core city in the region and plays a central role in many ways in the region. Additionally, Uzbekistan has a history as a thriving center of Islamic culture making it an important country and a historical and cultural pillar for Muslims in the region with the salient Islamic regression. Uzbekistan aspires to become a stabilizing force as a moderate Islamic country by excluding the radical Islamism that tolerates terrorism, while protecting the freedom of traditional Islamic belief. The menacing aspect of the expansion of radical Islamic groups to the international community as well as the region itself is self-explanatory from the experience of Afghanistan during the 1990s. It is, therefore, important for the entire Central Asia region as well as the global community to strive to prevent destabilization of Uzbekistan by radical Islamic groups, given its considerable clout in the surrounding area.

The people of Uzbekistan feel an affinity with Japanese as a fellow Asian nation and they have a high level of confidence and expectations in Japan as demonstrated by the signing of a strategic partnership declaration at the President visit to Japan in 2002. Collaborative relationships between Uzbekistan and Japan in the international arena have also run smoothly as shown by its official support for Japan's efforts to gain a permanent seat at the U.N. Security Council. The confidence and cooperative stance of Uzbekistan, as a regional power toward Japan are one of our important assets for Japan in the Central Asia.

(2) Major Considerations for Japan's Assistance

Japan has accomplished a certain results by using multiple schemes of assistance to support Uzbekistan's infrastructure improvement, human resource development and the restructuring of its social sector, all of which are necessary for Uzbekistan as it strives to implement nation-building as a democratic country oriented toward a market economy. On the other hand, as mentioned previously, the Uzbek government has opted for a line of gradual reform. The reform is sometimes alongside other newly-introduced restrictions. The economic reality is still characterized by the government retaining a centralized planned economy system that appears to hamper its shift to a market economy. Generally speaking, gradualism involves a strong tendency to make existing organizations retain their power and interest structure preserved with deep-rooted resource allocation by the government and paternalism seemingly in existence. Japan needs to appeal to the Uzbek government for the necessity of remarkable liberalization and privatization based on the understanding that either delayed or drastic reform would cause domestic and regional instability, considering socio-economic situations surrounding Uzbekistan. At the same time, Japan needs to provide assistance for promoting steady economic administration reform and democratization. Based on this perspective, Japan must focus on offering "assistance that reaches citizens" through promotion of local administration and building of civil society. Furthermore, concerning relations with the Uzbek government, Japan must focus on new regulations that may be introduced alongside reform measures and encourages the government to implement genuine reforms that will produce concrete results.

Japan launched the "Central Asia plus Japan" dialogue in August 2004, showing positive stance to tackle the promotion of intra-regional cooperation and confirming Japan's determination to pursue cooperation between Central Asia and Japan.

The countries in the region are exposed to favorable conditions for intra-regional cooperation compared with other regions as they share a 70-year-long Soviet-era history and can mutually communicate in Russian that is the region's common language. Although the region has many common problems such as industrial structures devoid of diversification due to the Soviet-era division of labor, aging infrastructure, and the difficulties in adjusting the conflicts of mutual interests in implementing concrete reforms and intra-regional cooperation policies despite their unitary direction of market economy or democratization, it could be said that the intra-regional cooperation, despite its importance, has made little progress in reality.

Each Central Asian country has a relatively small population and economy and, consequently, when considering the development of the economic relationship with Japan including trade promotion, it is vitally important to integrate the regional economies and market. Japan must be mindful of forming concrete projects that could contribute to the promotion of the future intra-regional cooperation, taking advantage of the start of the "Central Asia plus Japan" dialogue.

Japan's assistance should be directed toward empowerment of the poverty class through employment creation and improvement of the living standard of these people. It is also important to improve social, environment so that such ability could be displayed in the social economic and political fields.

(3) Priority Areas

Japan's assistance to Uzbekistan is based on the understanding that the steady implementation of reforms is the key to Uzbekistan's stability and development. Japan also considers it appropriate that the assistance should be focused on creating a basis for sustainable economic growth as well as mitigating the difficulties accompanied by economic structural reforms, so that the Uzbek government can press ahead with steady economic administration reforms and democratization. Japan will therefore offer as much support as possible for the Uzbek government's self-help endeavors focused on "Support for human resource development and institution building to facilitate a market economy and develop economy and industry" (support for transition towards a market economy and WTO accession), "support for the restructuring of the social sector" (agriculture and rural development, education, healthcare, environment), "Economic infrastructure renovation and Improvement" (transport and energy) and the "promotion of intra-regional cooperation." In view of significance of Japan's assistance to Uzbekistan, Japan will specifically offer its assistance targeting the following sectors:

(A) Support for human resource development and institution building to facilitate a market economy and develop economy and industry (Support for Transition towards a Market Economy and WTO accession)

(Financial and banking systems, Trade management, Judicial reform (civil law and commercial law), Trade promotion, Tourism, SMEs, Agricultural reform)

The introduction of liberalization or privatization is often accompanied by a variety of social pains, while gradualism, which means implementing slowly over a long period of time, has certain rationality. However, if it lasts overly long, an interest structure composed of vested interests tends to form hampering any further reform. Consequently, gradual reforms must be pushed setting a solid deadline and Japan's assistance must be also directed toward the area of formulating the reform policies.

As part of its economic structural reforms, Uzbekistan intends to tackle its financial and banking systems, foreign currency exchange system, trade control sector (development of domestic laws and human resource toward WTO accession) and the promotion of small and medium enterprises (funding by commercial banks including credit lines offered by international financial institutions and the exemption from the mandatory foreign currency exchange system). However, the reform programs have not led to sweeping reforms yet except for the slight easing of some governmental regulations. Therefore, building international economic relationships based on international rule will be effective in realizing reforms as well as developing its trade to rouse dynamic economic growth. Since WTO accession has such significance, Japan will assist the Uzbek government's efforts for the accession in various ways through indirect supports such as improvements of the financial and banking systems, reform of the civil commercial law, and economic reforms as well as the improvement of its economic and trade systems that comply with the WTO system.

When Japan supports for human resource development and institution-building targeting the promotion of economy and industry toward the shift to a market-oriented economy, it is important to nurture administrative officials responsible for reforms as well as private sector personnel equipped with new ideas who will become responsible for running business under the post-reform market economic system.

As part of support for Uzbekistan's private sector, Japan is going to support for the business course offered by Uzbekistan-Japan Center for Human Development known as the "Japan Center." Japan will also reiterate to emphasize that it is the revitalization of the private sector or SMEs that will particularly become the basis for economic development. Furthermore, in improving the business environment required to develop its private sector, Japan will provide tailor-made supports to Uzbekistan in the fields of legal and tax systems, human resource development, measures for promotion of SME's and SME's finance, counting the conditions such as market size through multifaced coordination among those fields.

With respect to agrarian reforms, productivity improvement can be attained by breaking away from its cotton-centered monoculture and producing crops in accordance with the market mechanism instead of keeping its cotton-centered monoculture. Therefore, the government needs to increase incentives for farmers' production through such measures as abolition of the government procurement system for cotton and introduction of market trading. As this will involve enhancing farmers' capabilities in order for privatized farms to engage in farm management strategically, Japan will provide assistances such as the network building of input material procurements, improvement of the agricultural product processing and distribution system, and extension of farming techniques. Moreover, as no agricultural water supply system has yet been established to privatized land, Japan needs to support reinforcement of the management capabilities of water users associations.

Uzbekistan has a considerable historic and cultural heritage including Buddhist temple ruins and is rich in tourist resources. As the development of its tourism industry has tremendous potential, Japan will also support for stimulating tourism in relation to the promotion of its SMEs and industry in mind.

In this priority area as a whole, as setting long-term programs for poverty reduction and social stability as upper goals through economic growth, Japan's assistance will focus on programs that lead to economic liberalization and deregulation such as economic structural reforms necessary for economic development, the review of its legal system, and the development of new systems with emphasizing capacity building.

(B) Support for restructuring the social sector (Agriculture and rural development, Education, Healthcare, Environment)

Both productivity and income are low in Uzbekistan's rural areas where the country's poverty class is concentrated in. Japan will support the promotion of rural development and local industry to improve the medium-term living environment of the poverty class in the light of the human security perspective by focusing on the development of rural areas and the increase of farmers' income, in close coordination with support for agrarian reforms as noted in section (A) "Support for human resource development and institution building to facilitate a market economy and develop economy and industry." The development of impoverished regions, in particular, is also necessary for Uzbekistan's political stability.

With respect to education in Uzbekistan, the quality of education has deteriorated due to the decay of public educational facilities, the brain drain of excellent human resources, wealth gap, and regional gaps. Japan will render support that helps enhance the educational environment and the quality of education including that of teachers as well as educational environmental improvement.

Uzbekistan's healthcare has problems with its falling quality of medical services due to aging and lack of facilities including equipment and its inefficient system. Japan will offer technical and system improvement support aimed at enhancing the quality of healthcare, including possible preventive care programs.

As environmental issues have a direct impact on the health and safety of the people of neighboring Central Asian countries as well as those of Uzbekistan, Japan needs to deal with them as a cross-cutting issue related to other priority areas. It is important to improve energy efficiency through infrastructure renovation and improvement and reduce environmental burdens. Therefore, in close coordination with the "economic infrastructure renovation and improvement" as noted in the section (C) below, Japan will provide supports such as its capacity-building to upgrade technicians' expertise in environmental preservation technologies including water quality monitoring and waste treatment, and the promotion of environmental data exchanges with its neighboring countries.

(C) Economic infrastructure renovation and improvement (Transport and Energy)

Although the country's infrastructure built in the Soviet era has basic functions, its potential functions have considerably declined due to aging and the deterioration of maintenance technology because of the brain drain of engineers. Japan will provide Uzbekistan with financial cooperation to renovate its aging infrastructure which is a bottleneck in economic growth and to streamline its infrastructure toward economic growth, while considering effective coordination with our technical cooperation schemes for management and operational aspects.

(D) Promotion of intra-regional cooperation

With a mid and long-term perspective, Japan has called for the “Central Asia plus Japan” Dialogue. In the action plan adopted in the Second Foreign Ministers' Meeting of the "Central Asia plus Japan" Dialogue in June 2006, Japan and Central Asian countries including Uzbekistan identified "Measures against terrorism and narcotics", "Clearance of anti-personnel mines", "Poverty alleviation", "Health and medical care", "Environment", "Disaster prevention and reduction", "Energy/water", "Trade and investment", "Transport" as the specified areas of intra-regional cooperation which is one of the main pillars of the action plan. Japan will continue to support intra-regional cooperation with a view to complementing Central Asian countries' own efforts and facilitating their cooperation. In this regard, Japan will strive proactively with programs to enhance intra-regional cooperation of the Central Asian countries with taking into account any factors that would promote intra-regional cooperation while implementing bilateral support programs for the aforementioned priority areas when it is applicable.

Among many frameworks of intra-regional cooperation, Uzbekistan places its hopes on the Japan's dialogue and actively participates in it. As the country has half of the populations in Central Asia region and plays a key role in the region, international organizations indicate the necessity of the country's active engagement of intra-regional cooperation. Therefore, Japan must further pursue its “Central Asia plus Japan” dialogue.

5. Points to be considered in Implementing Assistance

(1) Policy Dialogue

Policy dialogue is highly important in removing the international community's distrust of the Uzbek government's programs for market economy and democratization and promoting the country's efforts to positively address its reform. Although the country has investment and development plans for each industry or sector, it has no documentation of its comprehensive national development plan. The policy dialogue is an important occasion for survey and confirmation of development needs.

In addition, as Japan has coordinated in grant aid and technical cooperation for the projects mainly in healthcare and education sectors, it is necessary to maximize the effect of assistance to its economic infrastructure sector in coordination with Yen loan and technical cooperation schemes. Therefore, Japan must deepen its discussions on effective coordination among the different aid schemes through policy dialogue in order to take advantage of Japan's experience, technology, and knowledge.

Concerning Japan's assistance to Uzbekistan, the Ministry of Foreign Economic Relation, Investment and Trade has been responsible for the formulation, selection, implementation and management of aid programs coordinating with related ministries, agencies and institution. The ministry has been smoothly handling administrative assignments as an office of economic cooperation and as a partner in policy dialogue or in concluding international agreements.

(2) Environmental and Social Considerations

Before formulating and implementing Japan's aid projects such as the development of economic infrastructures which have a possibility to affect both aspects of the environment and society in Uzbekistan, it is necessary to pay adequate attention to these aspects at early stage of the designing in accordance with the “Guidelines for Environmental and Social Considerations” established by Japan International Cooperation Agency (JICA) and Japan Bank for International Cooperation (JBIC).

(3) Coordination with Multi-bilateral Donors

International organizations such as the World Bank, ADB, EBRD, UNDP and bilateral donors are offering a variety of assistance to Uzbekistan including intra-regional cooperation. Japan has to collaborate with multi-bilateral donors to avoid the duplications of assistance programs. The collaboration is also required to grasp Uzbekistan's economic situation and the moves of other donors to adopt and implement Japan's ODA projects and to maximize the effectiveness of each donor's aid programs.

In the process of WISP growing from I-WISP to Full-WISP, Japan must participate in the process as a member of the stakeholders bringing the areas of development issues into shape and determining the order of priority areas.

(4) Safety of Aid Personnel

In 1999, a series of bombing incidents in downtown Tashkent reportedly aimed at the President and clashes with armed groups in the Tashkent suburbs occurred. A kidnapping case involving four JICA consultants by members of the Islamic Movement of Uzbekistan (IMU) occurred in the south of Kyrgyzstan. In 2000, anti-government armed groups infiltrated Tashkent and Surkhandarya regions and clashed with government forces. However, as the Taliban weakened in the course of mopping-up operations after the September 11 terrorist attacks in the U.S., the threat of the IMU has diminished.

In late March 2004, there was a suicide bombing at a bazaar in downtown Tashkent and also gun battles near the presidential palace involving armed groups and security forces as well as bombing incidents in local cities such as Bukhara. In addition, in late July of the same year, there was a suicide bombing in front of the Prosecutors' Office and the both U.S. and Israeli Embassies, although foreigners have been unharmed.

On May 13, 2005, a civil riot occurred in Andijan city located in Ferghana valley. Some view that there exists high discontent with the socio-economic situations-among population at the background. The current situation in Andijan seems calm, but it is unpredictable whether similar incidents may occur in the country.

Up to now, no incidents targeting Japan or Japanese people have occurred and no aid-related personnel from Japan have suffered. However, Japan strives to take adequate measures for safety of aid personnel, have the Uzbek government pay continuous attention to the security and share information on the security situation among them.

(5) Upgrade of Monitoring and Evaluation

It is important to monitor and evaluate whether aid programs are delivering the expected results both during and after these implementation. The evaluation is extremely helpful in discussing the direction of future assistance. Therefore, Japan needs to upgrade monitoring and evaluation methods in coordination with the aid office of Uzbek government.

In addition, the local ODA task force should verify the country assistance program by making reference to both its project formulation and implementation situations in each priority area. The results will constitute an important input for the next country assistance.