

WORKING GROUP 5

**“Enhancing Local Government Revenue Raising Capacity:
A Way of Reaching More Accountable Local Government”**

Case Study

Kazakhstan

2003

Abstract

This paper deals with consideration of local government issues in the context of the Republic of Kazakhstan. Since its independence in 1991, Kazakhstan has made some progress in implementing complex political and socio-economic reforms to establish democratic state with socially oriented market economy. These reforms aim to create enabling conditions to develop the country's potential, to promote long-term economic growth and improve the quality of life of its citizens. An effective and accountable local government is an important condition for implementation of national development strategy given the territorial dimension and regional diversity of the country.

The introductory section describes the state governance system established in Kazakhstan after its independence in 1991 and gives some insights of country's development strategies 2030 and 2010. On the October 10, 1997, the Message of the President of the Republic of Kazakhstan "Kazakhstan -2030. prosperity, Security and Improvement of Welfare of the Citizens of Kazakhstan" was published, which defined a long term development strategy of Kazakhstan up to 2030. At the same time, strategic plans shall not become a rigid rule, but must become a flexible tool for the exercising of the state control over socio economic development of the country. Therefore, the strategic development plan of Kazakhstan up to 2010 was developed.

Furthermore, the section on Local Governance at Glance provides the brief to local governance system and dwells upon the problem of uneven regional and area development that pose new challenges of the young independent state. In the past few years, local governments have assumed increased responsibility for delivery of basic social services, although as of now, there is still insufficient involvement of local authorities in planning and implementing development efforts. These issues are connected directly with fiscal viability of the local governments and with their capacity to maintain local budgets.

The fiscal relationship between center and regions is described in the section on Local Government Finance. This section depicts the structure of revenue and expenditure side as well as local taxes. It describes fiscal relationship between center and the regions and describes the role of the banking sector and security markets.

The section on Political Economy of Local Budgeting Process covers the issues of policies adherent to revenue formation as well as legislative framework of local budgeting process. Special focus in this section is given to budgetary control and accountability. The section concludes with recommendations to be made to improve transparency of local budgetary process.

The sections on Reconsidering the Original Local Government Revenue Sources and Original Revenue Sources and Local Public Borrowing deal with legal framework, methodology of collecting taxes and tax administration as well as with revenues from non fiscal activities at local level.

The section on Local Capacity and Democratic Accountability and Conclusion provide overall policy recommendations to be made to improve and strengthen local governance system.

1. Introduction

With its territory of some 2.7 million square kilometers Kazakhstan is the second largest in the CIS, it borders Russia in the north and west, China in the east, Kyrgyzstan, Uzbekistan and Turkmenistan in the South. The population of Kazakhstan is 14.9 million, of which 56,4 per cent live in urban areas. The average population density is low, 6 per square kilometers (compare to a European average of 67 per sq.m). Kazakhstan is a unitary state with presidential form of ruling. Since its independence in 1991, Kazakhstan has made some progress in implementing complex political and socio-economic reforms to establish democratic state with socially oriented market economy. These reforms aim to create enabling conditions to develop the country's potential, to promote long-term economic growth and improve the quality of life of its citizens. Kazakhstan has entered new stage of development and became aware of its place and role in the contemporary world.

Centralized governance system of early period of independence of Kazakhstan was justified by strategic objectives of that period, which included establishment of the independent state and strengthening of sovereignty, securing territorial integrity. An effective and accountable local government is an important condition for implementation of national development strategy given the territorial dimension and regional diversity of the country. As it has been indicated in the strategic plan of development of the Republic of Kazakhstan up to 2010, it is necessary to develop the gradual country strategy of decentralization taking into account the world experience of decentralization and realities and traditions of Kazakhstan. To date, in Kazakhstan there are 14 oblasts/regions, 84 cities, 160 rayons/districts, 2036 okrugs, 200 settlements and 7684 rural populated areas. In this context, decentralization and empowerment of local governments is an important element of overall public administration process in Kazakhstan. For this purpose, the State Commission on Differentiation of Functions between public administration levels and improvement of inter-budgetary relations was established in 2001. The major task of this Commission is to define and differentiate functions of governance bodies. For local bodies to be efficient it is necessary to provide them with real authority in relation to their budgets, each level of administration should be assigned with its own source of revenues and should enjoy the right to independently determine allocation of expenditures.

As a complementary activity, the UNDP country office in Kazakhstan assisted the Administration of the President in conducting the situational analysis of regional development and local governance with the goal to improve policy making process at local levels. By joint collaborative efforts of donor community in Kazakhstan as well as through regional UNDP programs several activities were conducted for mixed group of decision makers from the Presidency, Parliament and Government to familiarize with various aspects of decentralization such as fiscal, administrative and political decentralization. However, the structure of local authorities has not undergone yet any substantial changes, it has three descending hierarchical levels, regions (oblasts), districts (rayons) and towns (villages) with weak vertical and horizontal linkages that lead to duplication of functions of the authorities at local level.

Overall, the following primary objectives of decentralization have been defined in the strategic plan of the country up to 2010 such as:

- Divide spheres of activity, functions and responsibilities between different levels of authority;
- Create conditions for effective functioning of local state bodies;
- Introduce local self-governance as a basis of democratic state.

2. Local Government at a Glance

Financial crises in South East Asia and Russia in 1997-1998 has showed that economy of Kazakhstan has its potential to adequately react on external changes. Kazakhstan was able to overcome crises with minimum loses and was able to secure GDP in the first six months and to improve macro economic indicators. The real growth of GDP during the last five years was 26%. In 2001 the banks gave credits worth of 460 billion tenge (over \$3 billion). Refinancing rate of the National Bank was reduced from 340% in August 1994 down to 9% in 2001.

Description	1995	1996	1997	1998	1999	2000 forecast
Actual growth of GDP, % to previous year	-9,2	0,5	1,7	-1,9	1,7	3
Inflation:						
By the end of period, %	60,3	28,7	11,2	1,9	17,8	9,5
Average for year, %	176,2	39,3	17,4	7,1	8,3	13,6
Exchange rate of tenge to US Dollar.						
By the end of period	63,95	73,3	75,55	83,7	138,2	154,8
Average for year	60,95	67,3	75,44	78,3	119,53	146,5
Monetary aggregates in % to GDP	11,4	9,5	10,3	8,6	14,4	15,6
Refinancing range of National Bank, %	52,5	35	18,5	25	18	12
Revenues of state budget, in % to GDP	19,5	16,9	24,4	21,8	21,1	22,4
Including fiscal revenues in % to GDP	15,5	12,5	19,7	16,6	17,4	17,4
State budget deficit, in % to GDP	-1,4	-2,8	-3,8	-4,1	-3,5	-2,9
Expenditures for state debt and debt of local executive bodies, in % to GDP	0,6	0,2	0,6	0,8	1,0	2,2
Export turnover, million US dollars	5440	6291,7	6899,2	5870,6	5988,5	6300
Import turnover, million US Dollars.	5325,9	6626,7	7175,6	6671,5	5644,8	6070
Net export, mln dollars	114,1	-335,1	-276,5	-800,9	343,8	230
Investment growth to capital, % to previous year	-42,4	-40,3	12,6	13,1	15,0	15,0

Source: Agency of Statistics, National Bank, Ministry of Finance

According to the accounting data for 1999, the state budget revenues have made 19,8% to GDP, the costs and crediting have comprised 23,2% to GDP. The deficiency of the state budget has made 3,5% to GDP and has decreased by 0,7% in comparison with 1988. In 2000, by the accounting data (without the accounting period), the state budget revenues made 32,1% of GDP, the costs and crediting 23,0% of GDP with an insignificant proficiency of the state budget about 0,1% to GDP. The exchange rate of the national currency Tenge was maintained rather stable. In 2000 the decrease of the tenge exchange rate versus the USD has comprised 5.2%. A relative stability of the tenge exchange rate as well as significant growth of production have preconditioned twofold decrease of inflation during one year from 17.8% down to 9.8%.

The development of republican and local budgets is regulated by the following acts¹:

¹ Law of the Republic of Kazakhstan "On Budgetary System" on April 1, 1999 N 357-1, Law of the Republic of Kazakhstan "On Public and Publicly Guaranteed Borrowing and Debt" on August 2, 1999, N464-1, Law "On Taxes and Other Mandatory Payments in the Budget" on June 12, 2001, N 209, Decree of the President of the Republic of Kazakhstan on January 29, 2001, N543 "On Some Issues of National Fund of the Republic of Kazakhstan", Decree of the President of the Republic of Kazakhstan "On Budget Commission on Formation of the Draft of Republican Budget in Appropriate Fiscal Year", April 25, 2001, N589, Decree of the President of the Republic of Kazakhstan "On Creation of Special Economic Zone, Astana is a new city", June 29, 2001, N645.

The budgetary system in Kazakhstan consists of the state, republican and local budgets. Local budgets are a consolidation of the oblast budgets and rayon budgets². However, the assignment of revenues between oblast budgets and rayon budgets is not defined by law. This allows oblast to assign its expenditures and revenues. Each year, a draft of the law “On Republican Budget” is prepared for the following fiscal year. It is then approved by Parliament and subsequently signed by the President of the Republic of Kazakhstan. The approved plan of the republican budget can be revised thought the year by the Republican Budget Commission. At local level, representative bodies known as Maslikhats approve the drafts of the local budgets. In accordance with the Law “On Budgetary System” the volume of revenues in the local budgets shared between republican and local budgets are approved by local representative bodies under the proposal of local executive bodies in the amount agreed with the Ministry of Finance of the Republic of Kazakhstan. During the course of the year, approved local budgets can be revised by Maslikhats at the suggestion of the budget commission at the appropriate level. Mid year revisions entail an increase in revenues for local budgets.

Administration of expenditures and approval of budget spending priorities is mostly conducted at a central level. The Republican Budget Commission resolves disagreements between republican and local budgets during their development and approves the main priorities for public spending. The central government establishes the norms and procedures for developing republican and local budgets. The Oblast Budget Commissions are key to developing budget at oblast level, with the rayon budget dependent directly on the Oblast Budget Commission. In 1999, a set of measures on reforming the Kazakhstan’s budgetary system including the development of inter-budget fiscal relations was developed. It included the introduction of a balancing mechanisms between the republican and local budgets by means of subventions and withdrawals. That was the beginning of new fiscal relations between the budgets at various levels.

During implementation of these measures, the following results have been achieved:

- legislative division of revenues and other mandatory payments to the state budget between central and local budgets, based on unified norms for all local budgets (instead of old system of balancing between central and local budgets individually by each region);
- development and performance of the state budget’s expenditures along with classification of three types such as: financing administrative expenditures of central and local government bodies, maintaining budget institutions, and assignments for public sector to provide public services;
- legislative determination of the main principles and phase of budget planning. The number of state organizations financed from the republican budget has been reduced as well as well the number of civil servants at central level has been reduced;
- all extra budgetary funds have been consolidated with the state budget and a unified body a national tax service has been established responsible for performance of revenues;
- further development of civil service reform that improved fiscal capacity of local bodies and improved accountability, transparency and efficiency of interaction between state and local entities;
- budgets at all levels are implemented through Treasury at the Ministry of Finance, which has improved monitoring of the use of public funds.

3. Local Government Finance: An Overview

Instability of the fiscal relations between central and local budgets makes the local budget development and performance dependent on decisions of central bodies. It also means that the process of state budget formation

² The Law “On the Budgetary System” defines the division of revenues and aggregated expenditures between the republican and local budgets.

becomes an annual process of negotiation between the Ministry of Finance and local bodies. The oblast and rayon budget commissions are formed by local authorities at the appropriate level. The general tasks of local budget commissions include; 1) determination of expenditure limits under the current budget programs and development programs; 2) consideration and approval of budget applications from the administrators of the budget programs; 3) resolution of difficulties with subordinate budgets. Thus, the present mechanism for determining subventions and withdrawals takes into consideration of total volume of expenditures financed by the local budgets own means and subventions, including current budget programs and programs for development budgets. However, it is important to measure interregional proportions related to the implementation of particular investment projects which are multi year projects that pass from one years' budget into subsequent years' budgets. Furthermore, each region's need for additional investment should depend on social and industrial infrastructure and on geographical conditions of the oblast. Analysis of interregional equality under the development budget should take the availability of fixed assets per capita this includes the physical infrastructure of the region such as schools, hospitals and other structures of social character. Estimation of real demand of the oblast can serve as the basis for building the development budget amounts.

The administrators of the local budget programs are state bodies financed from local budget, responsible for financial substantiation and realization of the local budget programs³ The primary objectives of the administrators of local budget programs are:

- 1) preparation of the report on implementation of budget programs for the previous year in accordance with description of the budget programs to local authorities;
- 2) elaboration of proposals for the list of expenditures priorities of the local budgets (oblast or rayon);
- 3) elaboration of proposals for the list of local budget programs which are not subjected to sequestering in the forecast year;
- 4) working out of budget applications within the expenditure limits for the current budget programs and development programs, list of investment projects to be financed from locale budgets, taking into account budget arrears and budget descriptions.

Expenditures of Local Budgets are divided into capital expenditures and operational expenditures. Capital expenditures provide innovative and investment activities and other expenditures associated with pension of production. Operational expenditures provide operational support to state administration bodies and local administration bodies as well as local self administration and other expenditures that are not included in capital expenditures in accordance with budget classification of the Republic of Kazakhstan.

Expenditures financed from local budgets:

- State services of representative, executive and other entities that perform general functions of public administration;
- State services of entities that perform financial activities;
- State services of entities that are engaged in activities of military service campaign and organize work on extraordinary situations;
- State services of entities that perform law enforcement activities, exploitation of equipment and means to regulate road traffic in settlements;

³ Law on Budgetary System, on April 1, 1999, N357-1

- state services of entities that carry out state functions on education, healthcare, social welfare and social assistance for population, cultural development, sport and tourism and information network;
- state services on the development of agriculture, water resources, fishery and forestry and environmental protection;
- state services of entities that provide development of communal utilities and housing as well as roads financed from local budget;
- state services for development of transport and communications;
- other state services.

As for fiscal policy is concerned, the introduction of a precise distribution of all types of taxes and expenditures between central and local bodies and the gradual transition to stable sums of subventions and withdrawals was supposed to last for three to five years. Subventions and transfers from republican budget to local budgets in which the revenue capacity is less than the demand for expenditures; and withdrawals are transfers from local budgets to republican budget if there is an excess of revenue capacity over the need for expenditures. It is important that the volume of local budget expenditures during the transitional period should reach an average republican level of the local expenditures per capita. This would create equal conditions for all local budgets at the end of transitional period. As at the end of transitional period the performance of revenues and expenditures of local budgets would be more independent of the performance of the republican budget, as the sums of subventions and withdrawals would be fixed by the appropriate law with a long term perspective. It would strengthen the capacity of local budgets if additional revenues would become available. However, the proposal to fix subventions and withdrawal sums has been rejected during budget deliberations at the Parliament of Kazakhstan in 1999. One of the major reasons for rejection was inability of local authorities to use the allocated budget funds appropriately in accordance with the Law on Budgetary System due to absence of instructions and procedures and due to lack of training of staff involved in budgetary process in the regions, regional peculiarities and far away locations were not taken into account and it created additional difficulties to have clear picture for subventions and withdrawals. The Ministry of Economy and Budget Planning RK will be developing the draft Budget Code to be submitted for discussion at the Parliament RK in May 2003 whereby, clear instructions for local authorities will be elaborated.

In the long run, the following steps have been identified to achieve budget decentralization for the following five to seven years such as it has been stipulated in the strategy 2010:

- Creation an effective system of inter-budgetary relations by giving a maximum independence to the local budgets;
- Achievement an accurate legislative differentiation of spending authorities and respective accountability;
- Development and adoption of the Budget Code of the Republic of Kazakhstan that will allow ensure a single legal provision for development, approval and execution of budgets;
- Assignment of taxes and tax collection to definite levels of state budget;
- Creation of an effective system of transfers;
- Provision of regions with independence in defining priorities of social and economic development within the framework of the state development strategy and spending of budgetary funds in compliance with these priorities.

4. The Political Economy of Local Budgeting Process

The performance and control of both republican and local budgets is also regulated by the following laws⁴.

Control over execution of budgets is an important component of the budgetary system. It includes the process of monitoring, analysis, evaluation of quality of budget programs execution as well as budget efficiency and applied methodology in budgetary process. The following state entities are participants of budget control in Kazakhstan such as: President, Parliament, Accounting Control Committee, Committee of Financial Control at the Ministry of Finance, National Bank, Treasury and other central executive and representative bodies as well as at local levels Maslikhats and territorial and administrative units and executive bodies. Ministry of Finance, local executive bodies perform control over approval of expenditures of state institutions financed out of local budgets as well as they control the utilization of budgetary allocations. Revision commissions of representative bodies such as Maslikhats as well as Ministry of Finance and its territorial bodies perform control for development and execution of local budgets. The Ministry of Finance and local representative bodies determine the procedure and sequence for conducting revisions and checks of utilization of funds of republican and local budgets in accordance with legislation of Kazakhstan. Three types of control could be singled out such as:

Types of Financial Control

- **Preliminary Control** is carried during discussions of the draft law on budget and other budgetary and fiscal legislation;
- **Current control** is carried out when some issues of budget execution are discussed during working meetings, commissions and representative bodies;
- **Post fact control** is carried out during consideration and approval of reports on budget execution.

The necessity to review budgetary system and financial control followed by conducting functional analysis in Kazakhstan with the support of the World Bank and UNDP. Functional analysis⁵ allowed the state bodies to look at deficiencies in budgetary policies as well as to look at efficiency of state institutions and to make budgetary process more transparent. The functional analysis involved the program of Actions of the Republic of Kazakhstan government for 1998-2000, which was endorsed by the Decree of the Republic of Kazakhstan to reform the budget program. A budget commission was created at the Republican level by the order of the Prime Minister to summarize the findings of the public sector financial analysis, to reach decisions on limits for funding functional review of the national budget in 1999 and to plan actions to organize public finance. The commission outlined the results of work done with focus on specialization of a grouping of state functions, the distribution of functions between central and regional authorities, the transfer of functions of the review from one level of authority to another level of authority. Prior to commencing the 1999 budget elaboration the administration of the Ministry of Finance commissioned a group of ministry workers with implementing the following actions of budget programming:

- to work out precise criteria for evaluation of activities and methods of analysis

⁴ Law of the Republic of Kazakhstan “On Public Procurement” on May 16, 2002 N321 and Law of the Republic of Kazakhstan “On performance of republican and local budget control” on January 29, 2002 N286.

⁵ The functional analysis in Kazakhstan was conducted by the Ministry of Finance as a part of execution of the Decree of the Republic of Kazakhstan government, known as “On the Program of Further Reforms of the Public Service in the Republic of Kazakhstan and the Government’s Plan of Measures to Implement it”.

permitting to evaluate the fitness of the activities of public institutions or of better transmission to the private sector of all or some of their functions;

- To collect and validate information relating to the sorts of the activities of public bodies, list of organizations performing the state functions, the status and the sources of funding thereof;
- To evaluate the functions of establishments funded from the national budget in the conditions of a market economy; to distribute functions among different levels of power;
- To rationalize functions of executive bodies in order to define what functions and institutions would not be funded from the national budget, and how it would be done.

As the result of the conducted functional analysis the following recommendations were given that ensure budget transparency:

- Control of the use of the budgetary funds shall be increased for the purpose of evaluation of the budgetary funds efficiency;
- Monitoring of expenditures shall be carried out under a rigid and improved system;
- The work shall be continued on improvement of the legislative base for development of internal and external audit of the state sector;
- The role of Accounting Control Committee and its regional departments will be strengthened;
- Information on public finance issues at central and regional level will be published in mass media.

As it is mentioned in the strategic plan of development of Kazakhstan up to 2010, financial transparency must become guiding principle in development of preventive measures against corruption in public finance.

5. Reconsidering the Original Local Government Revenue Sources.

The adoption of the newly developed Tax Code in 2002 brought to redistribution of taxes between levels of budgetary system which is carried out in accordance with the Law on Budgetary System. The new tax Code was adopted, however, much room were left for its further improvement due to difficulties with its implementation at local levels.

Revenues of local budgets⁶

Taxes, fees and other obligatory payments:

- Income tax from legal entities;
- Excess for all types of spirit (50%), vodka (50%), liqueur (50%), wine (50%), konyak (50%),
- Income tax from individuals;
- Social tax paid by individuals engaged in entrepreneurship activities;
- Land tax;
- Unanimous land tax;
- Transport tax;
- Share of state in division of production on concluded contracts in the part related to revenues of local budgets;
- Fees for registration of individuals engaged in entrepreneurship activities;
- License fees for the right to be engaged in separate types of activities;
- Fees for state registration of juridical persons;
- Fees for sales from auction;

⁶ "On Taxes and Other Mandatory Payments to Budget," (Tax Code), 2002

- Fees for the right to sell goods at market;
- Fees for utilization of symbols of Almaty city in trade marks in accordance with the legislation;
- Fees for payment of paid roads of local importance;
- Fees for water;
- Fees for use of forestry.

Non fiscal revenues:

- Non fiscal revenues from individuals and financial institutions;
- Administrative fees;
- State fees;
- Penalties and sanctions;
- Other non fiscal revenues.

The division of property on republican and local (communal) has started in 1999. The government has approved the list of state shares in limited liability companies within republican property and those transferred to communal property. State shares of nationally owned companies as well as other important objects of economy are transferred to republican property. The social objects are transferred to communal property such as schools, kindergartens, hospitals, libraries, sport complex and theaters, all infrastructure including gas, energy and heating suppliers. At the local level, only oblast akyms and akyms of Astana and Almaty cities have communal property and can sell it or lease on the basis of auctions.

Revenues from operations with capital:

- Revenues from privatization of communal property objects;
- Revenues from sale of grain production, procured for self sustainability of regions;
- Revenues from sale of parcels and from right of permanent use

The new Tax Code has started to function since January 1, 2002 and all types of taxes and methodology to collect taxes have been determined⁷. The new Tax Code is focused on creation of favorable environment for an optimum combination of interests of the state and tax payers and grouping of regulatory norms under the framework of one legislative act⁸: Corporate income tax; Individual income tax; Value added tax; Excise tax; Taxes and special payments of users of natural resources; Social tax; Land tax; Transportation means tax; Property tax.

All fees and payments are listed in the tax Code Article 61 and 62 as well as state fee Article 63 and customs fees Article 64. Responsibility for tax collection is within the Tax Committee and its territorial entities at the Ministry of Finance. The tax bodies are subordinate to the highest tax body as a vertical line and do not refer to local executive bodies as it is stipulated in the Article 15 of the Tax Code. Redistribution of taxes between central and local budgets is made by Treasury in accordance with the norms adopted by regional representative bodies and by the National Parliament. Kazakhstan was one of the first states in CIS countries that achieved a duly and targeted financing of the budget programs through the Treasury system. The rates of value added tax were reduced down to 16% and social tax down to 21% in the year 2001 in order to decrease the tax load. The structure of local revenues is given in the table. One can observe that in the structure of local budgets the tax revenues increased from 64, 6 %

⁷ The Tax Code draft has been published in the mass media and has been widely discussed at all levels within 2001 and then has been approved by the Parliament.

⁸ In Section 11 of the Tax Code all major taxes are indicted as well as other obligatory payments to the budget, the following taxes have been defined in the Article 60 of the Tax Code

in 1998 up to 83, 5 % in 2001. There is a significant amount of social tax which has been introduced in 1999 and in 2001 its share constituted one third of local budgets revenues. Another important share is with income tax of individuals, which is characterized by stable growth.

Table 1. Structure of Local Budgets in Kazakhstan in % to overall amount (Source: Ministry of Finance)

Description	1998	1999	2000	2001
Revenues	100,0	100,0	100,0	100,0
Revenues total	73,3	85,2	86,1	87,6
Tax revenues	64,6	80,2	82,9	83,5
Income tax from legal entities	13,5	12,6	26,3	20,3
Income tax from individuals	16,4	16,0	16,0	17,8
Social tax	0,0	31,4	25,3	32,2
Property tax	14,7	10,9	8,3	8,6
VAT	7,6	3,8	3,8	2,4
Excise	7,8	1,8	1,3	1,1
Revenues for utilization of natural resources	0,9	0,2	0,3	0,2
Fees for entrepreneurial activities	2,9	1,8	1,3	1,0
Taxes for international trade and external transactions	0,2	0,1	0,1	0,0
Non fiscal revenues	8,7	5,0	3,2	3,4
Revenues from entrepreneurial activities and property	3,3	1,8	1,0	1,0
Administrative fees and payments, revenues	2,1	1,7	1,5	1,3
Revenues of penalties and sanctions	1,5	1,0	0,6	0,5
Revenues from operations with capital	0,1	0,0	0,0	0,7
Transfers	26,4	14,7	13,8	12,4

The share of income tax from legal entities has increased from 13, 5% in 1998 up to 26, 3% in 2000. However, in 2001 its share has been decreased up to 20, 3 due to establishment of the National Fund of the Republic of Kazakhstan. The revenues from this line item since 2002 are allocated to the republican budget.

The revenues from the VAT tax are from Astana city and they are allocated to the republican budget. Overall, in the structure of local budgets the expenditures for education, health and social welfare prevail and in almost 70% of local budget allocations have been geared towards these line items in 1999 and 60% of local budget allocations in 2000. The mechanism of budget subventions and withdrawals is used since 1999, in those regions where revenues increase expenditures, the surplus is delivered as subventions to the regions where revenues do not cover all budget needs. There is tendency whereby the size of withdrawals increase the size of subventions. As the result, in 2001- 84155 mln tenge were withdrawn and the number of subventions accumulated to 35504 mln tenge. This system of subventions and withdrawals would require further improvements as regions recipients and regions donors are not satisfied with this system.

Table 2. Subventions (+) and withdrawals (-) in 1999-2001 in million tenge

Regions	1999		2000		2001*(without taking into account accounting cycle)	
	+	-	+	-	+	-
Akmolinskaya	+3928		+4153		+4391	
Aktubinskaya		-1646		-1830		-3626
Almatinskaya	+5891		+6055		+8298	
Atyrauskaya		-6766		-13227		-28790
Eastern Kazakhstan	+275			-1279		-2460
Zhambylskaya	+2286	+3158			+4866	
Karagandinskaya		-3939		-5820		-9856
Kyzylordinskaya	+3169		+2403		+1262	
Kostanaiskaya		-363		-337	+841	
Mangistauskay		-4844		-4262		-10629
Pavlodarskaya		-3539		-1590		-2106
Northern Kazakhstan	+2791		+3192		+3732	
South Kazakhstan	+5959		+7902		+12115	
Almaty City		-16162		-21867		-25801
Astana City	+5103		+2200		+4646	
Total	24814	37259	27118	50251	35504	84155

As it has been mentioned in the previous Sections, in spite of achievements made the following problems can be underlined:

- Incomplete decentralization of the budgetary system still remains a critical problem of the inter-budgetary relations;
- There is disproportion between the decentralization of the budget reserves and centralization of the budget authorities;
- Serious interregional disparities undermine advantages of decentralization of budget system;
- Own sources of revenues are not fixed at rayon and oblast levels;
- Over execution of the local budget revenues part through partial entry of the revenues to the Republican budget often generates free funds of the state budget;
- The local executive and representative bodies face problem of impossibility to increase the plan of revenues on these sources and reallocate the funds on additional expenditures. The spare funds can be timely involved in a turnover and directed to solution of serious social and economic problems at local level;
- Overestimation or under estimation of the forecast of data on different sources of revenues occur frequently and destabilizes the budget performance at different levels;
- The legislative procedures of defining long term budget withdrawals and subventions are insufficiently realized in practice;
- The expenditure part of local budgets is mainly focused on current expenses; there is an uncertainty as far as capital costs are concerned;

- The current mechanism of transfers does not contain any important criteria for evaluation of the status of the regions; it lacks transparency and needs to be constantly updated by the center;
- Insufficient transparency in the performance of state and local budgets results in poor control of the state expenditures;
- There is no monitoring system of budgetary funds spending efficiency wise.

As it has been emphasized, the proposals to consider the above mentioned problems will be presented in the new concept of budgetary process to be presented in May, 2003 by the Government.

6. Original Revenue Sources and Local Public Borrowing

The process of public borrowing as well as local borrowing is regulated in accordance with the following legislation⁹. State borrowing of local bodies shall be limited by the following parameters:

- By approved limits of borrowing in local budget and debt of local executive body;
- By volume of funds of local budget assigned towards clearing of debts of local executive bodies.
- Borrowing of local executive bodies is carried out in:
 - The form of loan agreements;
 - In the form of securities issuance by local executive bodies.

In order to determine the size and direction of borrowing, local executive bodies shall:

- Develop regional investment programs, that are subjected to priority implementation out of loan proceeds. The decision to attract loans is carried out within the limits of borrowing and debt of local executive bodies.
- Local investment bodies prepare necessary feasibility documentation and justification to be sent to local representative bodies for their consideration;

In order to finance regional investment programs by the Government of Kazakhstan, local executive bodies shall:

- Carry out the search of potential creditors;
- Conduct preliminary negotiations on schemes and conditions of loan provision;
- Prepare drafts of loan agreements to issue securities by local executive bodies in accordance with rules and procedures.
- Obtain financial expertise from the Ministry of Finance and for legal expertise to the Ministry of Justice. The drafts of procedures of issuance, circulation, repayment and service of securities is also send for consideration to national Commission of the Republic of Kazakhstan on Securities.

Furthermore, finalized agreements along with other attachments are sent to the Ministry of Finance where its compliance is checked with established conditions and the agreement is registered, local executive body shall receive afterwards. Local executive body shall organize and carry out registration, monitoring, management and repayment of debt as the result of borrowing. The local budgets could have deficit. Local representative and executive bodies are responsible to balance the budgets. Budget deficit is covered by borrowing. As it has been indicated in the above, the Ministry of Finance upon the request of akyms of the regions and Almaty and Astana cities can allocate budget credits from the republican budget. Overall, local executive bodies can have the right to borrow in accordance with the legislation from the following sources:

⁹ Law of Kazakhstan on August 2, 1999 “On State and Guaranteed Borrowing and Debt”, by provision of the Government on June 8, 2000 “On Set of Rules to Implement Government Borrowing and Borrowing of Local Executive Bodies of the Republic of Kazakhstan” and by other normative acts of the Republic of Kazakhstan.

- From legal entities and individuals to finance regional investment program in coordination with the Government;
- From republican budget from the special reserve within the reserve of the Government for the following financial year;
- From republican budget to finance investment programs approved in the law on republican budget for the following financial year.

Borrowing of local executive bodies is carried out in the form of loan agreements or by issuing of securities by local executive bodies. The government determines the procedure for issuance of securities and loan agreements fro local executive bodies¹⁰. The amount of reimbursement for debt of local executive body should not exceed 10% of local budget revenues for the following year. There is no specific law that regulates local borrowing, therefore, the Government issues various provisions and normative acts to regulate the issuance of securities. The below table shows the volume of local loans in relation to GDP.

Table 3. Volume of local loans in relation to GDP in Kazakhstan

Description	1999	2000	2001
Volume of local loans, mln US dollars	7,824	4,555	38,666
GDP in million US dollars	16854,4	18264,7	21873,5
Share of loans to GDP in %	0,0005	0,0003	0,0018
Exchange rate	119,64	142,14	150,2

The major holders of securities of local executive bodies are banks and pension funds. Regions that issue the securities are able to obtain for the first time the credit rating from leading international companies such as Fitch and Monday's Investors Services in 2000-2001. In spite of progress made by local executive bodies in issuance of securities, some problems can be mentioned that undermine the service of local loans such as:

- Lack of systematic and reliable budget planning and forecast at local level due to subsequent changes of the state policy related to import and export and taxation and etc;
- Frequent changes of fiscal legislation related to tax collection and distribution between republican and local budgets;

Overall, the local budget revenues are remain unstable and the Government intends to impose more restrictions for local authorities in the part of loan procedures by local administrators.

7. Enhancing Local Capacity and Democratic Accountability

As it has been mentioned previously, the structure of local authorities has not undergone yet any substantial changes, it has three descending hierarchical levels, notable, regions (oblasts), districts (rayons) and towns (villages) with weak vertical and horizontal linkages that lead to duplication of functions of the authorities at local level. Gradual transition to a system of horizontal accountability of akims by making them elected is foreseen for 2000-2007. Pilot election of rural district akim was held in Almaty oblast and is expected to be replicated at rayon, city and oblast level in all regions by 2007. But before entrusting local administrations with expanded responsibilities and resources much work need to

¹⁰ In the Law "On state and Guaranteed State Borrowing and Debt" it is stipulated that the limit of local borrowing should not exceed 1-% of local budget revenues for the following year and limit of the debt of local executive body should not exceed 25% of local budget revenues.

be done to ensure that proposed intergovernmental rules will balance national level interests of stable economy with minimum level of social safety for all and local interests in specific public services. Regional disparities and abuse of delegated power is also another a problem. By joint collaborative efforts of UN system and donor organizations in Kazakhstan as well as through regional UNDP programs several sub regional activities were conducted for mixed group of decision makers from the Presidency, Parliament and Government to familiarize with various aspects of decentralization such as fiscal, administrative and political decentralization. UNDP contributed to programming of the study tour of group of agency heads and akims to US in 1999. UNICEF in Kazakhstan has undertaken a recent initiative “Quality of Life for All Approach” in collaboration with the Government of Kazakhstan. The purpose of this approach is to provide quantitative framework that will serve as a basis for local government in situation analysis, planning, implementation, monitoring and evaluation. This initiative envisages to enhance national capacity in monitoring sub national development, strengthen administrative leadership in social development concerns, and develop greater responsibility, authority and accountability of local government in monitoring and improving the quality of life of all their constituents.

The above mentioned activities conducted within the framework of international organizations led to a number of lessons learned such as:

- Plans for decentralization should be strategic rather than predefined. There should be a clear implementation design with defined roles for the various management levels and linkages between them.
- Broad participation is needed for the decentralization process to be successful. Not all government functions should be decentralized. While decentralization is primarily a political process, it will not be successful unless adequate provision is made to finance the developed or decentralized responsibilities.
- More capacity and technical expertise needs to be provided in the areas of local revenue generation and financial assistance from the center.

It has been stipulated in the strategic plan of development 2010 to undertake the following step by step by step measures such as:

- Divide spheres of activity, functions and responsibilities between different levels of authority;
- Create conditions for effective functioning of local state bodies;
- Introduce local self-governance as a basis of democratic state.

8. Summary and Conclusion

Having studied the issues related to fiscal capacities of the local governments, the budget system at local level in Kazakhstan can be characterized by:

- Established and developed fiscal and budgetary legislation at republican and local levels;
- Established standards of reporting system;
- Established inter governmental commission on distinction of functions between center and regions;
- Planned programs of state investments at republican and local levels.

However, the following problems can be singled out such as:

- Budget misbalance (budget deficit and surplus);
- Non effective use of budget expenditures at local level;
- Differences in social expenditures per capita level between regions of the country

The following issues should be taken into account and thoroughly investigated while talking about financial viability and capacity of local governments such as:

- strengthening of capacity of local bodies at all levels of power with clear differentiation of responsibilities in the part related to revenues;
- removal of duplication of functions of state administrations at local level;
- establishment of conditions for participation of citizens in decision making process;
- making the process of budget deliberations at local level transparent and open to public;
- introduction of practice of public hearings on budget deliberations at local level;
- improvement of fiscal system at local level to make it adaptable to reality;
- establishment of transparent and accountable budget system at local level;
- strengthening of further capacity of executive and representative bodies as well as civil society institutions at local level.

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