

**Republic of Kazakhstan: Report on the Observance of Standards and Codes—
Fiscal Transparency Module**

This Report on the Observance of Standards and Codes on Fiscal Transparency for the **Republic of Kazakhstan** was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on **October 8, 2002**. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of the **Republic of Kazakhstan** or the Executive Board of the IMF.

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REPUBLIC OF KAZAKHSTAN

**Report on the Observance of Standards and Codes (ROSC)
Fiscal Transparency Module**

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October 8, 2002

EXECUTIVE SUMMARY

This report provides an assessment of fiscal transparency practices in Kazakhstan in relation to the requirements of the IMF *Code of Good Practices on Fiscal Transparency*. It is based on discussions with the authorities and other organizations, the authorities' response to the IMF fiscal transparency questionnaire, and other sources of information. The IMF *Manual on Fiscal Transparency* (<http://www.imf.org/external/np/fad/trans/manual/>) should be consulted for further explanation of the terms and concepts discussed in this report.

Kazakhstan has made rapid progress recently in improving its fiscal legislation, simplifying intergovernmental fiscal relations, establishing a new treasury system, and achieving basic accounts transparency. Fiscal reporting and dissemination of information has already achieved a sound level of practice, and can be built upon with relatively little further effort. Promising work has also begun in establishing a disciplined medium-term budget framework. Such a framework will be essential to enable policy proposals to be appraised in light of their long-term costs, which is of central importance in linking development programs to recurrent costs and in examining social security trends. Consolidating the advances made on the treasury system and enhancing medium-term budget management should be given a high priority.

Sustaining these achievements over the long term, however, will require broader institutional reform, including a strong emphasis on establishing auditing institutions that meet internationally accepted standards of practice. Complex transparency issues arise in managing assets accumulated in the various stabilization, development, and social protection agencies or funds that have been established or proposed. Streamlining and rationalizing NFRK and budget flows will greatly enhance policy transparency. The risks from nonperforming use of NFRK assets can have considerable long-term costs to the country. It is equally important that gains from elimination of extrabudgetary funds in the past are not reversed by proliferation of new extrabudgetary funds as the latter increase demand for more oversight against an already weak oversight system and full accounting is provided on offshore extrabudgetary accounts that were disclosed recently. The system of intergovernmental transfers needs to be made more transparent and rule-based. Regulations covering operation of private enterprises need to be streamlined both to improve transparency and to enhance the investment climate. To sustain these various improvements over the long-term, it is essential that Kazakhstan build up its oversight agencies, particularly at the level of a national supreme audit institution. There is also a need to strengthen internal control mechanisms, and the supervision and transparency of public procurement.

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ABBREVIATIONS, ACRONYMS, AND WEBSITES

| | |
|--------|---|
| CPP | Committee on Public Procurement |
| DMFAS | Debt Management and Financial Accounting System |
| FCC | Financial Control Committee |
| GFS 86 | IMF Government Finance Statistics, 1986 |
| MOF | Ministry of Finance |
| NBK | National Bank of Kazakhstan |
| NFRK | National Fund of the Republic of Kazakhstan |
| PIP | Public Investment Program |
| ROSC | Report on the Observance of Standards and Codes |
| SDB | State Development Bank |
| SNA | System of National Accounts |

Fiscal-related Websites:

Ministry of Economy and Trade: <http://www.mineconom.kz>

Ministry of Finance: <http://www.mf.minfin.kz>

Ministry of State Revenues: <http://www.mgd.kz>

National Bank of Kazakhstan: <http://www.nationalbank.kz>

I. INTRODUCTION¹

1. This draft report provides an assessment of fiscal transparency practices in Kazakhstan against the requirements of the IMF *Code of Good Practices on Fiscal Transparency*. The assessment has two parts. The first part is a description of practice, prepared by the IMF staff on the basis of discussions with the authorities and their responses to the fiscal transparency questionnaire, and drawing on other available information. The second part is an IMF staff commentary on fiscal transparency in Kazakhstan.

II. DESCRIPTION OF PRACTICE

A. Clarity of Roles and Responsibilities

2. **The definition of general government has improved, but does not yet fully reflect accepted international standards.** As a result of reforms introduced since 1996, Kazakhstan started defining government transactions consistently according to IMF government finance statistics (GFS 86) principles and GFS/SNA definition.² Before these reforms, some government investment activities were off-budget and outside general government. In addition, government spending units were allowed to raise revenues from quasi-commercial activities to supplement their expenditures financed from the budget. There were also foreign currency accounts held by spending units and customs, and special accounts for recording the loan disbursements from international organizations and expenditures financed from them, that were not integrated into the budget. Budget reforms carried out since 1998 have considerably increased treasury's coverage of foreign financed public investment projects and have eliminated many extrabudgetary funds (e.g., Employment Fund, Road Fund). However, the current definition of general government now excludes newly created extrabudgetary funds such as National Fund of the Republic

¹ Discussions on fiscal transparency were held in Astana/Almaty during April 11-24, 2002. The staff team comprised Messrs. Seade (head), Allan, and Davoodi (all FAD), with significant contributions from Mr. Ramamurthy (a member of the FAD panel of experts). It met with officials from the Ministry of Finance, the Ministry of Economy and Trade, the Ministry of State Revenues, the Accounting Committee, the Ministry of Labor and Social Protection, the Financial Control Committee, the Investment Policy Committee, the Committee on State Property and Privatization, the Committee on Public Procurement, the Agency for Civil Service Affairs, the Agency for Natural Monopolies and Regulation, the National Bank of Kazakhstan, the State Development Bank, the City of Astana, Karagandiskaya Oblast, and the Committee on Finance and Budget of the *Majilis* (congress). *Observations generally refer to the situation pertaining at the time of the mission. However, where the authorities have subsequently introduced measures to address aspects of transparency, reference to these have been added at relevant points. Since full evaluation of these measures has not been possible, a complete analysis will be undertaken in ROSC updates during Article IV consultations.*

² General government, as at April 2002, consists of the following entities: the *republican* (central) government, comprising 15 ministries, 23 central agencies and authorities (covering around 2600 spending units); 14 *oblasts* (provinces) plus the cities of Almaty and Astana that have oblast status; oblasts are divided into *rayons* (districts)—of which there are 158 rural rayons and 37 towns with rayon status—and there are approximately 8,400 local government spending units.

of Kazakhstan (NFRK) and had also excluded funds accumulated since 1996 in some offshore accounts (see paragraph 37) which, the authorities advise, have been transferred to the NFRK.³ Government agencies are generally distinguished from other elements of the public sector, but, as discussed further below, some public enterprises and public financial institutions are required to provide noncommercial services to the public without clear budgetary financing arrangements.

3. The legal basis for the privatization process is transparent and appears to be generally followed.⁴ The process of privatization of state assets is governed by the presidential decree, with force of law, *On Privatization* (no. 2721 of December 23, 1995) and subsequent government resolutions.⁵ The decree sets out clear principles of legality, openness, competitiveness, and equality that help provide assurance of transparency. The decree defines the types of state property that can be privatized. The value of state assets is appraised in accordance with laws governing such assessment activity. The government or its authorized agency determines the terms and types of privatization and those assets not subject to privatization. Privatization proceeds prior to January 1, 2002 were recorded in gross terms as government revenues and deposited in the relevant treasury account. From January 1, 2002, privatization receipts are recorded as financing the budget deficit. The expenses incurred by the government agency in charge of preparing the asset for privatization are recorded as part of the agency's budget.⁶ Proceeds accrue to the level of government that is stated in the relevant government resolutions or decrees as the owner of the asset.⁷

4. Regulation of private enterprise is complex and the need for simplification is recognized. The government has passed a number of laws aiming to establish an open and market-oriented environment,⁸ but business perceptions⁹ are that inspection of business is

³ In late 1990s, construction of city of Astana was carried out through a joint stock company, Astana Finance, and expenditures were not included in the budget. All expenditures on Astana have been included in the budget from the 2000 budget (and actual spending was recorded from January 1, 1999).

⁴ Only limited progress in large-scale privatization has been recorded recently.

⁵ Particularly, resolution No. 942 of June 2000 which provides regulations on the sale of assets available for sale. Separate regulations may be issued regarding specific state assets, such as privatization of health care facilities (for instance, resolution No. 1052 of July 2000).

⁶ Prior to March 1997, the State Property Committee and the Privatization Committee were in charge of management of government property and privatization, respectively. With the decline in privatization proceeds, these two committees have been merged into one agency.

⁷ See, for example, resolution No. 1271 of December 1998.

⁸ For instance, a new labor law came into effect in 2000 and judicial review has been undertaken of bankruptcy, leasing, and collateral laws

used excessively as a source of revenue from fines—and, potentially as rent-seeking activity. The authorities recognize that the prevailing regulatory framework requires further changes. To help to address business fears, the Agency for Regulation of Natural Monopolies has submitted to the government draft *Rules for the Performance by State Agencies of Audits of the Activities of Economic Entities*. These rules are aimed at strengthening the policy of forbearance of direct, unauthorized interference by the state in business activities.

5. Some quasi-fiscal activity continues in the public enterprise sector. Kazakhstan has generally made good progress in privatization of enterprises and reduction of quasi-fiscal subsidies in the energy sector, particularly relative to other CIS countries. Problems of privatization in the electricity sector, however, appear to be related to the difficulties of setting tariffs at an economic level.¹⁰ A more detailed review of these issues could enhance progress in developing the sector. As discussed in paragraph 15, establishment of an extrabudgetary fund for social insurance has the potential for additional quasi-fiscal activity; and quasi-fiscal activity in the financial sector is discussed in paragraph 7.

6. The central bank in practice enjoys substantial operational autonomy and does not carry out quasi-fiscal activities. The National Bank of Kazakhstan (NBK) is formally accountable in a number of detailed respects to the President of the Republic of Kazakhstan.¹¹ It operates independently, however, within the limits of the powers assigned to it by legislative acts. Interventions on the foreign exchange market are carried out independently by the NBK and within the framework of the overall monetary policy. The NBK coordinates its activities with the government and, in its activities, takes into account the economic and social policies of the government. It is the custodian of the NFRK with a transparent contract establishing the relationship between its responsibilities as the custodian and those of the Ministry of Finance (MOF) as the agent of the government. The chairman of the NBK is also a member of the Budget Commission that is in charge of drafting the annual republican budget (see footnote 17). The NBK services the single treasury account of the MOF. Relations between the NBK and the government are transparent. All restrictions established by the legislation of the Republic of Kazakhstan on civil service employment apply to employees of the National Bank of Kazakhstan, who are government employees. The NBK's income, net of expenditures, provisions created for bank assets, and resources earmarked for the formation of authorized capital, is transferred to the republican Budget in the next fiscal year.

⁹ See *Kazakhstan: Costs of Unnecessary Bureaucratic Procedures and Delays*, Foreign Investment Advisory Service, IFC and World Bank, October 2001.

¹⁰ The authorities, however, stress the need for interim measures aimed at serious upgrading and adoption of new technologies, while agreeing with the long-term goal of removing quasi-fiscal subsidy.

¹¹ Law No. 2155, *On the National Bank of the Republic of Kazakhstan*, March 30, 1995 as amended and supplemented.

7. Some activities of a fiscal nature are carried out through public financial institutions. State ownership and government intervention in the financial sector, other than prudential regulation, are relatively small. However, the government has recently established a State Development Bank (SDB)¹², which, despite focusing on commercial projects, will provide various forms of implicit subsidy to commercial banks and client enterprises. The main role of the SDB is to finance strategically significant,¹³ commercially viable projects that commercial banks would not finance on their own. Projects are mainly to be financed in risk-sharing partnerships with commercial banks (approximately 25 percent bank partner and the remainder SDB). Because of the SDB's quasi-sovereign status, it can borrow money at better rates than the commercial banks, and also has lower overhead costs with no branch network to maintain. As a consequence, although full commercial rates are applied to the commercial bank component of the loan, the overall lending rate is below commercial bank rates. In effect, government support allows SDB funds and commercial bank funds to be applied to higher risk projects. The SDB can borrow from the budget, bring in government guarantees and mobilize funds at own risk for up to 6 times its statutory capital; within this limit, contingent liabilities are set at 2:1, and direct borrowing at 4:1. Measures are being taken, however, to apply stricter prudential requirements to lending and to declare all risks and results of the SDB operations.

8. Responsibilities and revenue powers of different levels of government are defined in law, but the design and implementation of intergovernmental transfers should be developed explicitly to reduce discretion and clarify policy on regional equity. The existing system of intergovernmental fiscal relations is governed by the budget system law (357-1), the *Law on State and State-Guaranteed Borrowing and Debt* (464-1), resolutions on transfers between the republican and local governments (No. 619 and No. 528), and various laws on responsibilities at the sectoral level.¹⁴ Revenue sharing formulas are clearly specified; as are spending responsibilities, which generally conform to the observed

¹² Set up by Presidential Decree 531 of December 2000. The law *On the State Development Bank* was enacted on April 25, 2001. The SDB is owned 75 percent by the central government and 25 percent by local government, with declared capital of 30 billion Tenge (paid up capital of 27.6 billion Tenge). The SDB Board consists of the President of the Bank, the Minister of Finance, the Minister of Economy and Trade, the Chairman of the Strategic Planning Agency, the Chairman of the Agency for Natural Monopolies and Regulation, and representatives from two akims.

¹³ The main focus for current loans has been on import substitution industries (currently 6 projects have been financed to a total value of around 9 billion Tenge, including manufacture of corn syrup, recycled paper for cardboard, and machinery for the oil sector). In addition to this role, the SDB also acts as the government's agent to coordinate implementation of selected projects on a fee basis.

¹⁴ There are other laws that determine the division of responsibilities between *akimat* (local government executive bodies) and *maslikhat* (local legislative council), *Law on Local State Government* (No. 148-II) and *Law on the Control of Execution of Republican and Local Budgets* (No.286-II)

international patterns.¹⁵ Revenue sharing responsibilities changed substantially in 2002 in order to provide local governments with stable source of revenues and reduce their dependence on a volatile tax base originating from the natural resource sector. In particular, corporate income taxes, royalties and VAT (except for the City of Astana) are now fully credited to the central government. Revenues from production sharing agreements continue to be shared between central and local governments. Generally, taxes that are mostly accrued to local governments (e.g., property tax) are those that also conform to the practice observed in other countries. However, transfers are ad-hoc and largely decided by the MOF. The size of these transfers is specified in the annual republican budget document; so are any changes in spending responsibilities. The size of transfers to local governments from the republican budget are governed by a number of competing principles. One objective is to promote minimum standards across various oblasts. Some transfers to local governments are conditional (for instance, contingent on a satisfactory tax collection standard being achieved). Some appear to be block transfers; others are capital transfers earmarked for investment projects of national importance (e.g., construction activities in the City of Astana)—the republican budget determines the time of such transfers. However, these features are not clear in the laws and resolutions. Some sectoral laws on the responsibilities of different levels (e.g., on health, 111-I of May 19, 1997) attempt to be more specific, but they also serve a number of different objectives, such as setting regulations and standards, or defining objectives of socio-economic developments pursued by different levels of government.¹⁶

9. Roles of the executive, legislative and judicial branches are clearly defined in the constitution, with an emphasis on strong presidential powers. The *Constitution of the Republic of Kazakhstan* (1995) clearly defines the roles of the president, the government, the parliament (senate and majilis), the constitutional council, and the judiciary. Under the constitution, the president exercises considerable power over the judiciary and the legislature. As discussed further below, mechanisms for parliamentary and judicial oversight of the executive branch of government are not fully developed.

10. Budget management is defined by a generally clear legal and administrative framework. Under sections 61(3) and 66(2) respectively of the constitution, the parliament has the right to issue laws governing the republican budget, and the government is required to present the republican budget, and is responsible for execution of the republican budget. Detailed budget management is governed by the law *On the Budget System* (No. 357-1 of April 1, 1999, as amended)—henceforth, the budget system law—and by presidential

¹⁵ For example, pensions, higher education, national debt service, and tertiary health are responsibilities of the republican budget, while basic education, local police, targeted social assistance, local roads are responsibilities of local governments; both levels are responsible for secondary education.

¹⁶ Recently, a Commission on Decentralizing State Functions has been set up to review the system of intergovernmental relations and suggest avenues for reforms.

decrees covering policy directions and administrative matters each year.¹⁷ The budget system law prescribes principles of management applying to all levels of government and, as discussed above (paragraph 8) defines revenue sharing arrangements and expenditure assignments between the republican and local budgets. It also prescribes a unified budget classification (broadly consistent with GFS 86) for all levels of government. The law is based on well accepted principles of comprehensiveness¹⁸ and transparency, and it clearly specifies the procedures for preparation, approval and review of the republican budget as well as for government borrowing.

11. Coordination of development and recurrent budget spending is being improved. Prior to 2001, investment policy in the Republic was implemented via the generation of a rolling three-year Public Investment Program (PIP), but it was not well coordinated with the budget process. In 2002, the PIP was integrated into the indicative plan for socioeconomic development of the Republic of Kazakhstan. In preparing the 2002 budget, steps were taken to establish a more comprehensive medium-term rolling program budget framework covering both capital and recurrent spending proposals over a three year time horizon (budget plus two years). Budget programs are to be maintained on a rolling three-year basis, and budgetary institutions now submit their estimates in the form of *passports*,¹⁹ which will be reviewed and updated annually through the budget process.

12. Many extrabudgetary activities have been merged with the budget, but others are being created and continued effort is needed to ensure a unified fiscal management system. From 1999, under the new budget system law, most existing extrabudgetary funds were incorporated into the budget. Some revenues for user charges levied by the ministries of Health, Education, Natural Resources and Environmental Protection, Interior, and Justice are maintained in off-budget accounts, but these are tracked separately and recorded in the government general ledger. However, some new extrabudgetary funds have been

¹⁷ Among other things Article 6(4) of the budget system law requires a republican Budget Commission to be set up. Up to the 2002 budget this had been done each year under presidential decree, but has now been established on a permanent basis. Local executive bodies are required to set up similar bodies. The republican commission is chaired by the Prime Minister and includes all deputy prime ministers (including the Minister of Finance), the deputy head of the presidential commission, the head of the executive office of the president, 4 deputies of parliament (2 from the senate and 2 from the Majilis), the Minister of Economy and Trade, the Minister for State Development, the Chairman of the State Planning Agency, the Chairman of the Agency Regulating Natural Monopolies, the Minister for Justice, and the Governor of the NBK.

¹⁸ Noting, however, that the budget system law was recently amended (see footnote 19 below) to exclude stabilization flows to the National Fund of the Republic of Kazakhstan (NFRK) from the definition of government revenue. Transfers to NFRK for the purpose of achieving the saving objective of the NFRK is included in the republican budget; see Box 1 for an explanation of this objective.

¹⁹ This term is used in Kazakhstan to describe the key documentation used to incorporate in the budget, monitor, and evaluate all budget programs, after appraisal in the indicative plan. Passports contain an assessment of the program/subprogram cost (over three years, rolled forward each year), its legal basis, sources of financing, objectives, expected results, timeframe, and administrative responsibility.

created, and it is important that the risks inherent in creating centers for fiscal activity outside the budget are recognized and monitored and that adequate measures are taken to maintain a unified, comprehensive fiscal management system. The special issues facing a resource rich nation were seen to require the creation of an extrabudgetary fund, the NFRK, which is discussed in detail below.

13. The NFRK is an extrabudgetary fund—and an extremely important one. Design of the NFRK and lack of a unified approach to fiscal management could lead to costly inefficiency, fiscal risk, and hamper the effectiveness of fiscal policy. Fiscal management for a natural-resource-rich state like Kazakhstan requires that particular attention be paid to questions of long-term fiscal sustainability. This in turn requires a unified, coherent, and fully transparent management of assets and liabilities, natural resource wealth and their impact on the rest of the economy. An external audit of the NFRK has been recently completed by an international accounting firm, although the full audited report has not yet been made public. Important advances have already been made following the still recent creation of the NFRK, in particular concerning transparency in management and control of the fund, its sterilization role as well as changes in its funding to reflect, starting in 2002, changes in revenue sharing formulae between central and local governments (oblasts). It would be important to maintain the reform momentum of such changes and be aware of problems associated with the design of the NFRK, in particular in relation to the following issues and areas (but see also paragraphs 54-56 in section III below).

- ***First, the funding rules of the NFRK need streamlining. These are unnecessarily complex as described in Box 1.*** This complexity has several and diverse implications, in particular leading to unpredictable (and contradictory) instrument-specific outcomes on spending vs. saving for the future which do not reflect any ex-ante policy choice. The resulting process is unpredictable and unclear to all participants, from NFRK administrators to republican and oblast budget authorities. Central to the current complexity is the fact that although the fund's saving and stabilization objectives are stated at the *economy-wide level, the transfers are set on a per-instrument basis.*
- ***Second, the objectives and the use of the NFRK should be consistent.*** The two objectives of the NFRK are saving, and stabilization of the budget. These are clear and are the unquestionably right objectives that such a fund should pursue. Nevertheless present rules provide for NFRK funds to be used in the form of “targeted transfers of the Fund to the republican and local budgets for purposes defined by the President of the Republic of Kazakhstan”.²⁰ To preserve a unified priority-setting process, it is **essential**

²⁰ Decree 543 Article 10(2).

that all expenditure from the NFRK be channeled through the annual republican budget and be subject to parliamentary approval. And,

- **Third, fiscal risks should be clearly and comprehensively assessed. The current NFRK funding mechanism gives rise to fiscal risks which need to be taken into account in assessing fiscal vulnerability during budget formulation and implementation, and in revising NFRK's funding mechanism.**²¹ In addition to the assumptions underlying the reference prices for oil and for nonferrous mining that *are* clearly stipulated in the annual budget document, some risks arise from the structure of contracts signed between the government and NFRK companies. Changes in key contract parameters—notably depreciation methods, production plans and size of investment—could give rise to substantial shortfalls in budgetary revenues, and consequently to sizable flows from NFRK to the budget

Box 1. NFRK: Rules of Operation²²

NFRK was created in 2000²³ to (1) reduce budget dependence on fluctuations in world prices of raw materials (*stabilization objective*) and (2) save resources for future generations (*saving objective*). Since its creation: changes in tax revenue sharing²⁴ have simplified the administration of the funding mechanism of the NFRK—until 2001 transfers to the fund came partly from the oblasts' share in the same tax base; stringent requirements for fiduciary management, investment operations, reporting, and auditing of NFRK operations have been put in place;²⁵ and an external audit of its 2001 operations has been completed, currently under government consideration for eventual publication. Nonetheless,

²¹ Fiscal vulnerability describes a situation where a government is exposed to the possibility of failure to meet its aggregate fiscal policy objectives. Fiscal risk, a component of fiscal vulnerability, is the risk arising from “unforeseen” changes in the underlying assumptions of fiscal policy, in general, and the budget, in particular.

²² Additional details are also found in *IMF country Report No. 02/63*, March 2002, available on the IMF web site. This is the first IMF staff report on Kazakhstan that has been placed in the public domain. Subsequent to the ROSC discussions the authorities introduced measures which they informed the mission are aimed at overcoming the issues described. In particular, Resolution 832 of July 25, 2002 *On approval of Rules for the Financial Procedures for Budget Execution and Maintenance of Reporting Forms (Periodic and Annual) for State Institutions* and amendments to the budget system law (passed on October 31, 2002) are aimed at determining compensatory transfers on the basis of total revenue rather than individual revenue sources and thus in principle appear to address the problems highlighted in the final paragraph of this box.

²³ See *On the National Fund of the Republic of Kazakhstan*, Decree of the President No. 402 of August 23 2000; and *Rules for the Establishment and Use of the National Fund of the Republic of Kazakhstan*, Decree of the President No. 543 of January 29, 2001. The budget system law and the NBK law were amended to incorporate the establishment of the NFRK; see law 182-II ZRK of May 3, 2001.

²⁴ Moving away from the former sharing of individual taxes towards an allocation of the entire tax instrument to the republican or regional authorities, the only exceptions being production sharing revenues, and VAT in the City of Astana, which remain shared. Taxes thus streamlined were the CIT; royalties, VAT (excluding Astana) and bonuses, which will now accrue fully to the republic. (Budget System Law, as amended December 6, 2000).

²⁵ See, respectively, Government's Resolution No. 655 of May 18, 2001, *On an Agreement on Fiduciary Management of the National Fund of the Republic of Kazakhstan*; NBK Executive Board Resolution No 237 of June 20, 2001, *On Confirming the Regulations Governing Investment Operations of the Republic of Kazakhstan*

(continued...)

The NFRK has a complex funding mechanism. Initially created from the sale of a 5 percent government share in Tengizchevroil and a related bonus, the NFRK's recurrent funding—paid throughout the year—comes from revenues paid by the raw materials sector;²⁶ it got additional funding starting in April 2002 from a secret offshore fund.²⁷ Reference prices for each commodity are first decided as part of the preparation of the indicative plan and the republican budget, and revenues at these prices are projected, which constitute the *annual budgeted baseline revenues* from the NFRK companies. Quarterly budgeted baseline revenues are then established²⁸ for each revenue instrument and for each of seven oblasts where the revenues due originate²⁹ and the transfers are then determined as per the NFRK's two objectives:

- *Saving*: ten percent of all baseline revenues is transferred to the fund, paid monthly; and
- *Stabilization*: revenues in excess of the baseline, for each revenue instrument/oblast combination, flow to the NFRK (each day during the quarter) once the quarterly baseline is exceeded; revenue *shortfalls* from the baseline are compensated by transfers from the NFRK to the republican and local budgets (within 20 days from the end of quarter I-III and before the end of the year for QIV).

Note that the latter transfers are assessed/effected for individual revenue instruments and for each of seven oblasts where the revenues due originate. It can thus happen that transfers in opposite directions occur concurrently, on different tax instruments or on the same one but in relation to different oblasts.

in spite of the fact that actual price is above the reference price. Such risks need to be more explicitly recognized in formulating policy on the budget and on NFRK flows.

14. Pension arrangements are well defined but transparency with respect to policy changes could be improved. The pension system in Kazakhstan has been substantially reformed with the establishment in January 1998 of a three pillar system, whereby most of the formal sector makes provision for retirement through mandatory and voluntary contributions to 16 pension funds, 15 of which are private. The obligations of the government have been significantly reduced; they include payments to disabled, to survivors, and a guarantee of a minimum pension to all retirees.³⁰ World Bank forecasts indicate that obligations for net payments from the government "solidarity" fund will be relatively manageable even under pessimistic assumptions. Changes in the parameters of pension policy, such as changes in benefits or retirement age, will of course have

National Fund (also known as resolution 787); Government's Resolution No. 631 of May 14, 2001, *Rules for the Crediting of Money to the National Fund of the Republic of Kazakhstan and its Use*; and Government's Resolution No. 1011 of July 26, 2001, *On Approval of Rules for Selecting an Independent Auditor to Perform the Annual External Audit of the Republic of Kazakhstan National Fund*.

²⁶ The sector, for the purpose of the NFRK, consists of 9 oil and 3 non-ferrous metals companies. The taxes affected include royalties, VAT, corporate income tax, and production sharing revenues and other bonuses.

²⁷ See paragraph 37.

²⁸ By government resolution during budget execution: in 2001 Resolution No. 627 issued on May 11 and in 2002 Resolution No. 400 issued on April 3.

²⁹ The revenue baseline at the oblast level serves mainly for accounting purposes, as most taxes accrue fully to the republican budget. But some inter-oblast reallocations do occur, as some taxes are subject to sharing.

³⁰ The minimum pension is revised each year and specified in the annual republican budget document.

significant implications for future budgets. At present, the annual budget system does not deal with costs beyond the immediate budget year. The passport system will improve this aspect by looking at medium-term costs.

15. Social insurance arrangements should clarify risks and long-term obligations. The government has correctly observed the need for social insurance in a modern market economy and is planning on the reform of the current system. It recently proposed introducing a compulsory social insurance scheme that would provide coverage against unemployment, disability, and loss of breadwinner. The scheme, contrary to current practice, will link unemployment benefits to employee's contribution, which is welcomed, and will operate through an extrabudgetary fund set up as a joint stock company and financed by a 3 percent tax paid by the employer. There will be a corresponding reduction in the social tax rate. The government has decided to postpone the creation of the fund until 2005 and in the interim would continue to provide health and social benefits through the budget. It is important that any future social insurance scheme be set up properly. To meet transparency standards, it should be included as part of the budget, and the risks associated with use of fund assets should be clearly disclosed. Finally, as with pension projections, the long-term costs of the scheme would need to be considered in the context of medium- and long-term budget planning.

16. The legislative bases for taxation policy and trade policy are being clarified, but leave considerable discretion to different organs of the government. A new tax code³¹ has included basic provisions of tax legislation, recoded all taxes to be paid to the budget, and significantly reduced a number of tax concessions permitted under the old tax code.³² Similarly a new customs code is being prepared which clarifies rights and duties of traders and reduces scope for interpretation—hence for rent-seeking. But an unusual amount of discretion arises through two main avenues. First, the rates, both of excise taxes and of import tariffs, are set periodically by presidential decree, and are not easily available in a standard form such as the annual budget or tax code. Second, while the tax code provides some provisions for tax concessions, a proposed draft Investment Law broadens them by granting tax concessions to companies that invest in certain sectors, the list of which is still being developed,³³ and may include negotiated concessions for not more than 5 years affecting corporate, land, property, and customs taxes, as well as transfers in-kind, such as free land or guarantees. The scope of, and procedures for, these concessions are set in the

³¹ The tax code came into effect on January 1, 2002, under the law *On Taxes and Other Obligatory Payments to the Budget* of June 12, 2001.

³² These included zero-VAT-rating for exports excluding scrap metals, VAT exemptions, and unifying VAT rates of 20 and 10 at 16 percent.

³³ These are aimed at promoting investment in priority sectors of the economy as approved by the President, and may include agriculture; processing industry; air-, water- and land-transport infrastructure; tourism; and social/sports sectors.

draft Investment Law³⁴ and administered by the Ministry of Foreign Affairs' Investment Policy Committee, which signs the contracts committing those concessions.

17. Public servants are subject to a code of behavior. The government is continuing to take steps to address issues of corrupt or unethical behavior by public servants—and the need for strong action in this area is recognized.³⁵ A presidential decree, *On Approval of the Rules for Workplace Ethics of Public Servants of the Republic of Kazakhstan* (No. 328), was issued in January 1999. These rules reinforce basic standards of behavior for officials, giving particular emphasis to the responsibilities of managers.³⁶ The law *On Combating Corruption* (No. 267-I, of July 2, 1998), among other things, requires (Article 9(4)) that all civil servants submit, from their tax return, a declaration of assets and bank accounts to their agency. A working group, comprising representatives from the Agency for Civil Service and the Ministry of Justice was set up to develop further legislative measures (as per the Prime Minister's Directive No. 8r of February 15, 2002). An Anti-Corruption Commission set up directly under the President³⁷ has been established to coordinate anti-corruption activities. The Agency for Civil Service Affairs is charged, as one of its central duties, with implementing anti-corruption measures. The head of the Agency serves as a member on the Anti-Corruption Commission and the Agency for Civil Service carries out on-site inspections, which have recently resulted in dismissal of a number of akims.

B. Public Availability of Information

18. The budget documents cover central government fiscal activities and provide indicative data on general government. The annual budget law covers the republican budget, including subventions from the republican budget to oblast budgets and reverse transfers of surplus revenues from designated resource-rich oblasts to the republican budget. Subventions to lower levels of government come from oblast budgets.

19. Defense expenditures are reported in the budget. Defense transactions are fully recorded in the budget and incorporated in the treasury single account. They are presented in the budget in the same way as other ministries' expenditures.

³⁴ Submitted to Parliament on October 15, 2001 and currently under consideration. The objectives of this law are to provide trade/investment promotion and equal treatment of domestic and foreign investors, in addition to streamlining investment preferences in compliance with the new tax code.

³⁵ See World Bank: *Kazakhstan: Governance and Service Delivery: A Diagnostic Report*, June 2001, which highlights corruption within the civil service as a widely perceived problem and has been discussed by the authorities as a possible basis for regular surveys of corruption.

³⁶ Subsequent to the ROSC mission visit, the authorities advise that Decree 866 *On the incorporation of amendments and additions to Decree 328*, was signed on May 7, 2002, and further strengthens rules for work ethics of state employees, including akims at all levels and provides more detailed regulation for compliance procedures.

³⁷ Decree of the President, No. 839 of April 2, 2002, *On Fighting Against Corruption and on Civil Servants' Compliance with Business Ethics*.

20. The budget document discloses the main expenditure aggregates for the year preceding the budget year, but no detailed forward budget estimates. The annual budget documents consist of the annual budget law and an attached *Explanation of the Draft Law* for each year. Under Articles 14-16 of the budget system law, the budget for the year is required to be developed on the basis of forecast indicators for the next three years and consistent with the indicative plan of socioeconomic development for the relevant period. It is clearly determined by law that the budget is approved only for a single year. The *Explanation* includes a table of broad macroeconomic indicators (GDP, consumer price index, exchange rate, oil price etc.) covering two past years, the budget year and two forecast years. The budget estimates are shown in detail only for the budget year, with an aggregate table showing functional categories of expenditure comparing revised data for the previous year, the budget year, and the increase or decrease between years (see <http://www.mf.minfin.kz>). From 2002, passports are to be maintained for all budget programs, but the forward estimate details are not at present published (see discussion of budget process in paragraph 25 below).

21. Regular reports on debt and guaranteed debt of the central government are made available to the public. The monthly MOF *Statistical Bulletin* provides a table recording overall debt and guaranteed debt of the central government, but there are some problems in fully reconciling debt, financing, and monetary data.³⁸ The data cover both internal and external debt classified by domestic debt instrument and by external source of financing. Debt and external guaranteed debt are shown separately, but domestic guarantees are not identified. Data are also available on local government debt, but these data are not published because of jurisdictional issues on a small portion of debt following restructuring of oblasts in 1997-98.³⁹ The government has strengthened its system of controlling and monitoring issuance of guarantees and makes provision for contingent liabilities in the budget (13.5 billion Tenge in 2002). Data on called guarantees is also included as a specific item in the budget execution report. The law on the annual republican budget specifies limits on government debt at year-end, as well as the limit for granting of state guarantees.

³⁸ Debt records are maintained by the State Borrowing Department of the MOF in a database that is separate from the Treasury records (the UNCTAD Debt Management and Financial Accounting System—DMFAS). Records are reconciled between the two systems, but there are some difficulties and it is proposed to update the DMFAS version currently used to enable direct interface with the treasury system. In particular, foreign financed domestic expenditure is carried out through special accounts held in commercial banks and the current treatment causes problems in fully reconciling the fiscal and monetary accounts. When fully implemented, the treasury system will facilitate reliable debt reporting: actual disbursements and amortization payments will all flow through the general ledger when the transactions take place (cash basis). With the implementation of the debt subsystem in the new computerized treasury system, these transactions will automatically update the individual loan accounts.

³⁹ The authorities advise that, subsequent to the ROSC mission, they have taken steps to instruct akims of oblasts and cities to document all of their debt obligations. Implementation of this protocol could provide a basis for regular publication of comprehensive debt and guarantee data.

22. No estimates of tax expenditures or quasi-fiscal activities are currently presented with the budget, but relevant information on significant concessions is published and could be developed and included in budget documentation. The Investment Policy Committee publishes monthly information on the “budgetary efficiency” of the contracts it has signed under the investment law (see paragraph 16, above)—namely, the ratio of tax paid to tax foregone (through the concessions granted) in those programs, in aggregate. The underlying information on total taxes paid and tax revenues lost therein is also published sporadically, in articles and news releases—but could, together with data available in the Ministry of State Revenue, be used as the basis of a more comprehensive statement on tax expenditures. As indicated elsewhere in the report, some quasi-fiscal activities are carried out by state owned enterprises, but these are not systematically reported in the budget documents or otherwise.

23. Information on state financial assets is available but not systematically reported to the public. The government has indicated its intention to ensure centralized and full reporting of all state assets and to move toward a compilation of a state balance sheet.⁴⁰ However, at present limited information is published on a systematic basis. National companies⁴¹ submit their budgets each year to the MOF and file quarterly financial reports. In addition, a registry of state enterprises and institutions with state participation is maintained. As of January 2002, there were 226 joint stock companies with the participation of the state, and 478 republican state-owned enterprises.

24. There are formal commitments to publish basic fiscal data in law but advance release date calendars are not announced. The budget system law requires annual and monthly reporting by government; it does not stipulate publication, but, as discussed in paragraph 32 below, regular monthly and annual budget execution reports are published. The law *On Control of Execution of the Republican and Local Budgets* (No. 286-II ZRK) of January 29, 2002 (henceforth, the state audit/control law) requires publication of the report on execution of the republican budget with the findings of the Accounting Committee⁴² and approval by parliament. These publication practices have not been formalized in an advance release date calendar, but the reference date for monthly reports (before the fifteenth day of the month) is given in the *Statistics Bulletin* of the MOF.

⁴⁰ See *Report on the 2002-2004 Republic of Kazakhstan Government Program*, approved at a session of the Republic of Kazakhstan Government, February 19, 2002 (Section 3.3, “Management of State Assets”).

⁴¹ Thirteen companies are declared as national companies, or “companies of national importance”: *Closed Joint Stock Companies*: KazMunai Gas, Kazatomprom (nuclear power), Contractual Food Corporation, Information Technology, Air Kazakhstan, the State Funded Pension Fund; *Open Joint Stock Companies*: the Post Service, the Electricity Network Management Company, Kazakhtelecom; and *Republican State Enterprises*: Kazakhstan Temir Zholy, Khazaeronavigation, Aktau Trade Seaport, and Astana International Airport.

⁴² External audit agency, in some translations called “Comptroller’s Committee.”

C. Open Budget Preparation, Execution, and Reporting

25. The annual budget procedures are clearly described and focus on the functional and program allocation of spending consistent with agreed macroeconomic constraints. The budget cycle follows a regular timetable, which begins in February of the year preceding the budget and is directed by the Budget Commission, which coordinates the development of forecast indicators and sets priorities for the coming three years consistent with the indicative plan⁴³ (incorporating NFRK savings and stabilization objectives, as per Box 1). Once the main parameters are established, detailed budget preparation on a functional and program basis (see paragraph 29 below) is supervised by the MOF. Article 16 of the budget system law requires that the republican budget be submitted to parliament no later than September 15, and should be approved by parliament by December 15 of the year preceding the budget year. Local budgets are prepared on similar principles (Article 18), with oblast budget forecasts submitted to the MOF by August 1. Oblast (as well as Almaty and Astana cities) are required to submit their updated budgets to their maslikhats within 2 weeks after approval of the republican budget and rayons submit their budgets to their maslikhats a further two weeks after oblasts approve their budgets. Within a week after rayon maslikhats approve their budgets, oblasts are required to submit the approved oblast consolidated local budget to the MOF. After budget approval at any level, the law requires preparation of a financial plan (*rospis*) by all spending units, giving monthly expenditures by item of expenditure. The approved *rospis* is the instrument giving authority to spend. Actual practice appears to conform to the law, but it often takes until the end of January or early February before all local budget financial plans are approved. The budget system law provides for issuance of a financial plan for the first quarter should the annual budget fail to be approved at the commencement of the financial year.

26. The budget classification is consistent with GFS 86 standards. The budget system law (Article 6(1)) prescribes a uniform budget classification, covering functional, economic, and administrative dimensions, consistent with GFS 86, and applying to all levels of government and budgetary institutions. The republican budget is presented to the Parliament for approval of expenditures by aggregate classification functions, line ministries and agencies responsible for program administration and programs, with additional analytical information by sub-program. Sub-programs are further broken down by input items corresponding to economic categories.

27. The macroeconomic policy framework is generally well-defined and some use is made of sensitivity analysis, but the analysis could be made more widely available. The overall balance of the republican budget is the headline indicator of fiscal stance, while the general government balance is monitored during the year because of its inflationary and

⁴³ The rolling three year indicative plan is in turn developed within the framework of a *Strategic Plan for the Republic of Kazakhstan to 2010* (approved by Presidential decree No. 735 of December 4, 2001), which specifies the means of achieving priorities set out in the *Development Strategy of Kazakhstan to 2030*.

other macroeconomic considerations. The non-oil balance (overall balance, excluding all oil—and other resource—revenues) does not form a basis for policy formulation and is not reported.⁴⁴ Information on the general government balance as well as the republican budget is made public monthly through the MOF monthly *Statistics Bulletin* and press releases. Subnational governments are important, representing about half of general government spending. Aggregate fiscal policy does not take account of the fiscal impact of other elements of the public sector. There are significant stated-owned companies of national importance as well as joint-stock companies whose fiscal activities are captured only to the extent that they transfer dividends to the budget or the budget may on-lend to them; but quasi-fiscal activities (where they may offer social incentives financed from enterprise balance sheets) are not clearly identified. Regular disclosure of financial status of such companies will increase understanding of the size and significance of the public sector, and the effectiveness of both fiscal and quasi-fiscal operations. Forecasts for the republican budget are presented in the annual budget document, and assumptions for revenue projections are explained adequately, particularly for the 2002 budget document.⁴⁵ Forecast of outer years for spending are not explained in the republican budget document; and no statement is made on use of any fiscal rules, other than the NFRK rules, which have been discussed above. The republican budget document does not provide alternative scenarios for major budget aggregates in response to changes in the underlying macroeconomic assumptions (particularly for oil prices) although three scenarios (pessimistic, realistic and optimistic) are used by the Budget Commission when drafting the republican budget.

28. Estimates of new initiatives and ongoing costs of government policies are not yet clearly distinguished in the budget documents. In principle, the passport system (see footnote 19) allows identification of ongoing costs of approved government programs over the three year period of the rolling budget system. These data are used only at an individual program and subprogram level and are not presented in aggregate, nor are policy or parameter changes to passports in the subsequent years systematically recorded. As the system is further developed, such features may be added.

29. Objectives of major programs are broadly described, but progress on measurement and reporting against objectives is limited. As indicated above, a program budgeting system is being introduced. Starting with the 2002 budget, all budgetary institutions are required to maintain program profiles in the form of passports. The MOF issues budget ceilings to all budgetary institutions, which in future will set limits for spending for the three-year period, and requests submission of passport estimates for all programs and subprograms within these ceilings. These procedures are described in more

⁴⁴ The non-oil balance provides a useful benchmark for assessing fiscal sustainability and vulnerability in oil/resource rich economies. For further discussion with reference specifically to Kazakhstan, see *Selected Issues and Statistical Appendix SM/02/11*, of January 8, 2002: background information to the 2001 Article IV consultation discussions with the Republic of Kazakhstan, available on the IMF external website.

⁴⁵ The 2002 central government budget included an increased degree of transparency about tax receipts from the raw material sector and the oil price assumption used for generating oil revenue projections.

detail in Government Resolution 1169 of September 10, 2001, but are subject to further development. The budget system law in 2001 was changed (Articles 6(2) and 6(3)) to give emphasis to classification of expenditures by programs and clear definition of objectives. An administrator (usually a line ministry) is identified for each program, and the intention is that objectives and output and outcome targets would be identified for each program. Little progress has been made as yet in developing output and outcome indicators.

30. Public procurement is controlled by law, but there are administrative constraints and transparency could be improved. Public procurement in Kazakhstan is decentralized and subject to oversight and regulation by the Committee on Public Procurement of the Ministry of Finance (CPP). At present, state procurement is regulated by the law *On Public Procurement* (No. 163 of July 16, 1997, as amended), but a new law is currently under consideration by parliament. The new law will increase the scope of the CPP to cover state-owned enterprises as well as budgetary institutions and establish the procedures of procurement in law rather than, as formerly, by regulation. Including the chairman and two deputies, the CPP has a total of 33 staff, which is seen as inadequate to cover the increased volume of procurement (9500 tenders were held in 2001, with many irregularities observed). Reviews of procurement activity⁴⁶ indicate weaknesses in administrative staff training and experience and uneven performance among government agencies. Complex customs clearance procedures, with scope for discretionary activity by officials, are cited as one reason for delays and inefficiencies.⁴⁷ Currently, some information on state purchases of goods and services subject to bidding (open and closed) and classified by supplier (foreign or domestic) and level of government is available on the MOF monthly *Statistical Bulletin*.

31. Civil service employment administration and payment structures require rationalization and strengthening to become less discretionary and more transparent. Basic wage and salary levels for civil servants are relatively low relative to the private sector, but supplemented by a number of ad hoc allowances and bonuses using resources saved from other recurrent spending items provided in the budget (including unspent budget provision for wages and salaries), providing there are no arrears.⁴⁸ The system provides considerable scope for discretion and gives incentives for overestimation of certain costs to give scope for bonuses. Work is proceeding to restructure the civil service pay and job structure, with assistance from the EU TACIS and UNDP. A computerized

⁴⁶ See World Bank *Republic of Kazakhstan: Country Procurement Assessment Report*, June 2000.

⁴⁷ External reports (e.g., *US Foreign Trade Barriers*) have noted problems for business because tender offers are not publicized, and because there is no standardized format for publicized tender offers. The current law also contains provisions giving preferential treatment to domestic producers and small businesses during the procurement process.

⁴⁸ These measures are allowed under Presidential Decree No 575 of March 25, 2001, *On a Unified Pay System*, and a Government Resolution (No. 1127 of August 29, 2001) prescribing the rules for granting bonuses and premiums.

personnel management system is also expected to be introduced by 2003. At present, staff positions are reported by ministries and agencies to the Agency of Civil Service Affairs and reports on staff positions by ministry and agency for republican and local government are prepared and published quarterly and annually by the National Statistical Agency. It is not possible under the present system to match staff on payroll accurately against wage and salary payments.

32. The accounting system produces satisfactory in-year and end-year reports on central and general government budget outturn, but coverage and reconciliation need to be improved. With the establishment of the government treasury system, which covers all transactions⁴⁹ of the republican and local budgets, an effective and timely system of reporting on government transactions has been established. Monthly reports of budget execution for the republican and state budgets (*MOF Statistical Bulletin*) are classified according to the budget functional and economic classifications and published within one month after month-end. The report includes a table giving the status of state budget arrears.⁵⁰ However, coverage of the treasury system, is not yet fully comprehensive with regard to investment income from operations of the NFRK (the latter from the point of view of consolidated general government reporting), and aggregate reconciliation needs to be improved with regard to foreign-financed investment projects and inclusion of NBK holdings of government securities (see the *Data ROSC for Kazakhstan, 2002* for further discussion of these items).⁵¹ Some limited offsetting of local government debt with private sector had occurred through regional clearing houses which undermines proper recording of receipts and expenditure in the treasury system and transparency in government operations, but this practice has been recently banned under a new resolution (No.820). Progress is being made to establish a centralized computerized financial management information system covering the entire country and all levels of government. The new system has been fully tested at Astana City and Akmola region and will be rolled out to all regions by the end of 2002. The computerization will further improve timeliness of reporting and reconciliation of treasury and NBK records.⁵²

33. Internal control procedures are compliance-oriented and require strengthening and modernization. The authorities have placed some emphasis recently on strengthening the internal and external control mechanisms of government. From January 2000, the

⁴⁹ The treasury single account records all transactions of the republican budget; local government transactions, however, are controlled and recorded by regional treasuries against regional correspondent accounts held in the NBK.

⁵⁰ In accordance with MOF Order No. 92 of March 6 2000, *On Rules for the Compilation and Submission of Reports on Arrears of Government Institutions Supported by the Republican and Local Budgets*.

⁵¹ The authorities advise that Resolution 832 (see footnote 22) addresses these issues.

⁵² The new system links the rayons and oblasts to the central treasury, enabling real time, on-line updating of the central general ledger with an interface to the Inter-Bank Settlement Center for the republican budget and each of the local governments.

internal control system for the republican budget and external controls over local government budget expenditures (but not revenue) have been reorganized under the Financial Control Committee (FCC). External audit/control is conducted by the Accounting Committee (see paragraphs 41-43 below). Basic elements of both external and internal controls are specified in the state audit/control law. Among other things, the law defines three basic types of control activity (Article 4), compliance, financial, and effectiveness (which correspond broadly to the generally accepted definitions of audit activity); and defines the powers of the constitutionally mandated Accounting Committee, and the state bodies for internal control of republican and local budget execution, covering the FCC and similar bodies at local level. The law mandates that reports from the FCC should be passed to the Accounting Committee—a practice not regularly observed in the past. The authorities recognize, however, that past experience and current practice are primarily oriented to compliance control and there are major needs to strengthen internal control practices using modern methods and to upgrade skills and train personnel.

34. Tax administration is given limited protection from political interference. The authorities indicated that the Ministry of State Revenue was established as a separate agency to provide some assurance of independence, but there are no specific guarantees in law other than the general provisions under the law *On Civil Service* protecting civil servants from following instructions contrary to law or sound administrative practice.

35. The legislature does not undertake a mid-year review. As indicated above, regular monthly reports are made available to the public, but no formal mid-year review of the budget is presented to parliament. The government carries out internal reviews of budget execution on a quarterly basis and is obliged under the budget system law to present a revised budget to parliament if budget expenditures are to be reduced by more than 10 percent.

36. The audited final accounts are finalized within six months of year-end and are available to the public around nine months after year-end. Under the budget system law, the government is required to submit the annual report on the execution of the republican budget to the Accounting Committee by May 15 of the year following the budget year. The state audit/control law (Article 8(3-3)) requires that the audited accounts be submitted by the Accounting Committee to parliament no later than June 1 and that these be published (see, paragraph 41 below). These elements of the law appear to be observed in practice.

37. The origin, use and details of the recently disclosed offshore accounts of the government need to be clarified fully. The Prime Minister informed Parliament in early April 2002 of the creation in 1996 of these accounts, which were credited over time with US\$1 billion from the sale of certain government interests in the oil sector, and of their disposal in various important ways in the years following. The rationale given for the creation of these accounts has been explained as being essentially for sterilization purposes prior to the creation of the NFRK, but as yet a full accounting of fund uses has not been made public.

D. Assurances of Integrity

38. Republican budget data appear to be a relatively reliable forecast of implementation, but local government data reflect shifting priorities during the year. Reported actual revenue for the republican budget coincided with the budget in 2001, while local government revenues overperformed relative to the budget by some 2 percent. On the spending side, actual republican and local spending were almost 5 percent below the budget. The budget data for local government reflect frequent budget adjustments during the year and at year-end, whereas the republican budget was revised only twice in 2001. Expenditures and revenues for both levels of government reflect upward revision in GDP since the original budget passed in December 2000, and introduction of the switch to VAT on the destination principle.

39. Statements of accounting policy are included in monthly budget reports. The monthly Statistical Bulletin of the MOF contains a brief statement (in the *Methodological Commentary* section) describing the analytical framework and accounting basis for the fiscal data. Data are reported substantially on a cash basis.⁵³ Grants in kind are not included (but are required to be recorded in monetary form in the republican budget—Article 24 (1-1) of the budget system law).

40. The processes of accounts reconciliation and fiscal reporting are generally effective, but treasury coverage needs to be improved. Treasury ledger accounts are reconciled daily with NBK bank balances and transaction records and the authorities have indicated that there are few discrepancies—mainly due to timing differences—and the monthly reports are fully reconciled.⁵⁴ No statement to this effect is included in the *Methodological Commentary* of the *Statistical Bulletin*. As noted in paragraph 32, however, some improvements are needed in coverage and aggregate reconciliation of monetary and fiscal data.

41. External audit is not fully independent of the executive branch, but reports directly to parliament and the public. The role of external audit of the republican

⁵³ However, aspects of modified cash-basis reporting are applied by allowing a complementary period (to March 15 of the following year) to allow investment expenditure and intergovernmental transfers committed in the previous year to be charged against that year's budget. The facility has been available for some time, but has only been applied to a significant extent with the 2001 budget. This practice appears more related to the need to smooth development expenditures between budget years than to commitment basis budgeting and accounting.

⁵⁴ The general ledger (interim as well as the new system) is double entry, with bank accounts tracked automatically against receipts and payments. This design ensures accuracy and completeness of all transactions accounted for and provides the basis of daily reconciliation of balances with the cash balance movements reported by the NBK in regard to the treasury single account. The NBK provides daily cash balance reports and monthly reports in regard to the treasury single account.

budget⁵⁵ is carried out by the Accounting Committee. Under the constitution (Article 44(7)), the President appoints the chairperson and two members of the committee for a period of five years. The constitution (Article 57(1)) requires each chamber of parliament to appoint three members, also for a period of five years. The state audit/control law requires that the Accounting Committee be directly subordinate and answerable to the President (Article 8(1)) and to submit quarterly information on its work to the President (Article 8(3-1)). A strong feature of the law, as indicated above, is that a report on the execution of the republican budget must be submitted to the parliament within six months and shall be released to the mass media following parliamentary approval.

42. Strengthening of audit capacity is required. As noted, the state audit/control law has substantially broadened the mandate and scope of both internal and external audit/control activities. The current mode of operation of the Accounting Committee, however, continues to emphasize past inspection/compliance activities and it does not have enough trained support staff to carry out its new functions.⁵⁶ At present, there are only 31 professional staff working to support the nine Accounting Committee members.

43. The legislature follows up on external audit reports to a limited extent. The parliamentary joint Standing Committee on Economics, Finance, and the Budget⁵⁷ reviews the Accounting Committee report on the execution of the budget, together with the report on budget execution prepared by the MOF. Upon receipt of the report, deputies are assigned to analyze specific sectoral chapters, other specialist committees of parliament also comment on relevant chapters and experts may be retained to assist in analysis and preparation of draft resolutions on the report. The analysis, however, is limited by the narrow scope of the report's recommendations and deputies have indicated the need to improve the quality of the Accounting Committee's report as a basis for parliamentary action. After the Standing Committee has approved the report and made recommendations, the Accounting Committee report and the Standing Committee resolution are discussed by both houses and approved by parliament. The process of parliamentary review takes approximately three months and the report is released to the mass media around September/October.

⁵⁵ Similar principles (and constraints) apply to auditing/control activities at local government level. The law *On Local State Government in the Republic of Kazakhstan* (No. 148-II, of January 23, 2001, as amended) provides for the establishment of an audit commission by all local level maslikhats (Article 16), and these carry out the internal control function at that level. They are required to prepare an audit report for the maslikhat and akimat not less than annually. The republican FCC carries out the external audit/control function for local governments.

⁵⁶ Control aspects are the most prominent feature of current practices: budgetary institutions/MOF are required to submit monthly implementation reports, indicating a supervisory rather than a systemic audit function. The law does not specify qualification requirements for Accounting Committee members or support staff.

⁵⁷ Article 60 of the constitution allows the formation of permanent committees in each house (limited to seven) and joint committees.

44. There is limited formal external scrutiny of macroeconomic models and assumptions. Other than regular consultations with the IMF and other international financial institutions, no mechanisms to encourage external scrutiny of macroeconomic models or assumptions have been put in place.

45. The national statistics office is given legislative assurance of independence. The National Statistical Agency and other agencies involved in preparation and compilation of national statistics are given the authority to collect necessary data and to apply statistical methodology in conformity with international standards under the law *On State Statistics* (No. 98-1 ZRK of May 7, 1997, as amended).

III. IMF STAFF COMMENTARY

46. Kazakhstan has made rapid progress recently in improving its fiscal legislation, simplifying intergovernmental fiscal relations, establishing a new treasury system, and achieving basic accounts transparency, but needs to consolidate progress and ensure that fiscal risks from extrabudgetary and public sector operations are addressed and that institutions of governance are strengthened. Basic fiscal reporting and dissemination of information has already achieved a sound level of practice, and can be built upon with relatively little further effort. Consolidating this work should be given a high priority. Sustaining these achievements over the long term, however, will require broader institutional reform. Promising work has begun in establishing a disciplined medium-term budget framework. Such a framework will be essential to enable policy proposals to be appraised in light of their long-term costs, which is of central importance in linking development programs to their recurrent costs and in examining social security trends. More complex transparency issues arise in management assets accumulated in the various stabilization, development, and social protection agencies or funds that have been established or proposed. Streamlining and rationalizing NFRK and budget flows will greatly enhance policy transparency. Another issue is that the risks from nonperforming use of NFRK assets can have considerable long-term costs to the country, and these should be taken into account as systematically as possible in formulating and monitoring fiscal policy. Allied to these issues, it is essential that Kazakhstan build up its oversight agencies, particularly at the level of a national supreme audit institution, but also at the level of effective internal control mechanisms and supervision and transparency of public procurement. Adding new extrabudgetary funds will place heavy demand on an already weak system of oversight and could significantly undermine transparency.

47. Impressive achievements have been recorded by Kazakhstan in recent years in reforming the budget system. Key features include:

- A revised budget system law that covers all of general government other than the NFRK;

- A treasury system that covers all levels of government—although not yet with full coverage (see following paragraph), with a treasury single account at republican government level and the capacity to produce timely, reliable, and analytical fiscal reports;
- By and large, information produced by the treasury system and government fiscal reports is available to the public in a timely way through the mass media and government websites; and
- Progressive improvements are being made to clarify intergovernmental relations, including advances to establish a stable system of revenue sharing.

48. The NFRK has applied basic principles of accountability. The NFRK provides an explicit accountable framework to address Kazakhstan’s long-term fiscal policy objectives, although complexity and fiscal risks of the present arrangements need to be addressed (see paragraphs 53-55 below)

49. A high immediate priority should be given to consolidating treasury reporting, in particular to ensure comprehensive coverage of general government. The achievements summarized above provide a solid basis for a fiscal reporting system that is comparable to the level of practice of leading emerging market economies and OECD countries. Some specific suggested actions drawn from the staff assessment are as follows:

- Improve reconciliation of foreign-financed project expenditure and establish a formal reconciliation process with the NBK to ensure consistent coverage of accounts by the treasury and the monetary survey;⁵⁸
- Incorporate a payroll module in the treasury system as soon as practicable—as noted in section II above, progress in this area will depend on reform of the government pay and employment structure and creation of a centralized pay and employment data base;
- Include explicit data on local budget execution in fiscal reports (rather than simply state budget and republican budget) showing clearly the status of the revised budget data (that is, designating the month of revision);
- Publish additional data distinguishing domestic guaranteed debt in the monthly and annual debt reports;

⁵⁸ Operationally, this will require close coordination between the State Treasury and Budget Departments of the MOF, and NBK. A clear reconciliation table comparing the fiscal deficit and financing data from the fiscal accounts with credit to government derived from the monetary survey and explaining discrepancies should be established as a routine part of reporting. Subsequent to the mission, the authorities advised that an MOF/NBK working group had been established to address these issues.

- Report total state debt—including local debt, with a footnote indicating that portion under jurisdictional dispute;
- For complete reporting on general government, steps should be taken to ensure that the treasury records and reports (1) revenues gross of flows into NFRK and investment income earned on NFRK assets as government revenues; (2) fees paid to NBK for its fiduciary management of the NFRK; and also takes into account (3) exchange rate valuation effects in recording of budget balance and in the reconciliation between treasury and NBK accounts.

50. **Accounting for the disclosed offshore accounts.** A more complete explanation of the rationale for these accounts and a full accounting for their use should be given, preferably subject to independent appraisal.

51. **Further improvements in a number of other aspects of fiscal transparency can be made in the short to medium term with relatively little additional resource costs.** In particular, the full report of the recent external audit of the NFRK should be published; and accountability and transparency in the use of budget resources can be rapidly improved by adopting the following measures:

- The budget document for 2003 should provide a more complete picture of fiscal trends by including more detailed, program-level information on the two years prior to the budget year, and projections for the succeeding two years, as currently provided for the main budgetary aggregates (including non-oil deficit and flows to NFRK) and for the functional classification of spending (see also the following paragraph);
- Budget annexes should be introduced to cover the following aspects:

Budget policy background

- ◆ alternative budget scenarios and assumptions (as presented to the Budget Commission);
- ◆ presentation of any intended changes in tax rates and discussion of their revenue implications; and
- ◆ discussion of revenue performance of oil and non-oil sectors (including flows to the NFRK) in the two years prior to the budget, the budget year and projections for the succeeding two years;

Tax expenditures

- ◆ a table showing estimated costs of existing tax concessions in terms of revenue foregone (drawing from data provided by the Investment Policy Committee as well as the Ministry of State Revenue).

Fiscal risks

- ◆ assessment of fiscal risks arising from contingent liabilities and changes in main macroeconomic assumptions underlying the submitted budget;

- ◆ assessment of risks arising from quasi-fiscal activities—and, where possible quantification of the costs of such activities; and
- ◆ adequacy of expenditure control—assessed by examining achievement of previous years' programs in the execution of the republican and local budgets relative to budget and planned objectives.

At least some elements of these annexes could be initiated in 2003 and progressively improved as the budget system is further developed and analytical capacity grows. Some aspects of these longer-term improvements are discussed further below.

52. Accountability for fiscal policy formulation and implementation can be progressively enhanced by developing the Kazakhstan passport budgeting system. The elements of a medium-term budget framework are being established through the MOF's passport system (see paragraph 11 above). Carefully developed, passports can help integrate the investment and recurrent budgets and lead to a more disciplined system for the introduction of new policies and increased reliability of budget data. Given the overall objectives of establishing a stable and sustainable program of development, a number of steps should be taken to build on the system that has just been initiated with the 2002 budget. Measures to further strengthen the process of preparing and presenting the budget could include the following:

- Require separate submissions of passports for continuing costs of currently approved programs ("existing policy" expenditure) and passports with proposals to expand current or introduce new programs ("new policy" expenditure);
- Apply a clear resource constraint to consider and set priorities for all new policy passport submissions—approved new policies would be added to existing policy expenditure in the final budget presentation;
- Publish forward estimates of existing policy expenditure for all programs and subprograms;
- Include a statement of program objectives and brief analysis of achievements (as far as possible in terms of clearly defined outputs and outcomes for each program); and
- In the second year of establishing the revised system, provide a summary budget table each year accounting for aggregate changes in the year's budget estimates compared with the previous forward estimate for that budget year, showing the extent of change due to cost changes and that due to new policies.

These developments would provide a basis for a transparent presentation and review of policies and a more disciplined system for introducing new policies. The system would also provide a basis for, and be supported by, a systematic analysis of fiscal risks and long-term sustainability of fiscal policy, as discussed further below.

53. Intergovernmental transfers need to be made more transparent and reporting, audit and control strengthened at local government level. The present system of intergovernmental transfers is subject to considerable ad hoc decision-making each year. Principles for capital transfers and stable formula-based current transfers need to be established and made public.

54. Key challenges for fiscal transparency in Kazakhstan are to deepen the analysis of fiscal risk and sustainability and establish more effective institutions for fiscal governance. In the staff's view, an immediate and sustained emphasis should be given to improving fiscal transparency in the following areas:

- a) recognition of risks associated with some structural aspects of the NFRK;
- b) recognition of risks associated with quasi-fiscal operations and extrabudgetary funds;
- c) further enhancing the clarity, coherence, coverage and authority of tax legislation;
- d) clarifying and firmly establishing the authority of key external and internal control mechanisms; and
- e) developing transparent and stable intergovernmental relations as well as strengthening transparency of local government operations.

55. The government should take immediate steps to simplify the existing complex NFRK funding rules and move toward a transparent policy basis. Measures need to be taken to reduce flows into and out of the NFRK that arise from the present complex rules.⁵⁹ Such measures could include the following:

- Starting with the 2003 budget, centralize at the republican level the remaining taxes from oil revenues (production sharing revenues, and VAT for the City of Astana) that are currently shared between the republican and local budgets—the republican budget, in turn, could either increase revenue shares to the local governments from other, non-centralized taxes (e.g., excises, customs), increase net transfers to local governments, or devise some combination of these; and
- In tandem with these changes, transfers between the treasury and the NFRK should be based on *aggregate* revenues received by the treasury (i.e., at the end each month against the baseline), without regard to the type of tax, the region, or the originating NFRK company, based on the existing NFRK decrees, but amended appropriately.⁶⁰

⁵⁹ As indicated in footnote 22, the authorities advise that steps have been taken which would address these issues.

⁶⁰ Some welcomed regulations are currently under consideration that would eliminate just the regional component of the transfer.

- More fundamentally, a much simpler and transparent Norwegian-type funding rule based on the non-oil deficit should be considered for the medium term.⁶¹ Such a rule would be based on setting the non-oil deficit (rather than the transfers, as in the current system) as the key policy variable; revenues from NFRK companies would finance this deficit and the surplus would go to the Fund. Targets can be set so that transfers on balance are similar to present intentions. The changes proposed would greatly simplify the funding mechanism of the NFRK. They would leave more margin for policy makers to face spending needs or revenue shortfalls without the potential for either incurring unnecessary borrowing at the same time as tax revenue flows to NFRK or borrowing at higher costs than the rate of return earned on NFRK assets.

56. All uses of NFRK funds should be fully integrated into the budget process. The annual republican budget document submitted to the parliament and for the President's approval should provide a consolidated fiscal account incorporating NFRK. Such a consolidated account should, in turn, be reflected in the annual audited report by the Accounting Committee, and in the report on the execution of the republican budget prepared by the MOF. The budget document should provide a consolidated fiscal account that reports revenues and spending, as discussed above, and as financing items, flows into NFRK arising from the stabilization and saving functions of the NFRK. The consolidated fiscal account allows the government during its deliberation process to assess management of its asset and liability within a unifying framework that recognizes risk and return associated with alternative ways of financing budget deficit or using its surplus. A consolidated fiscal account will also allow for a critical review of the stabilization and saving functions of the NFRK.⁶²

57. All fiscal costs and risks associated with extrabudgetary and quasi-fiscal operations should be recognized as explicitly as possible. As recommended in paragraph 50 above, a budget annex should be developed to describe as fully as possible the fiscal costs and risks of activities carried out by other elements of the public sector. It will take time to develop a comprehensive analysis of all such activities, but it is important to initiate the processes of systematic investigation and reporting immediately. Potential risks associated with the operations of the SDB, and some public enterprise operations have been described in the preceding section of the report. Notwithstanding the fact that the laws in most cases provide solid prudential safeguards, it is vital that any quasi-fiscal costs be estimated and actual performance of the assets of these funds be carefully monitored and the information made public. A unit of the Budget Department of the MOF should be

⁶¹ See e.g. *Stabilization and Savings Funds for Nonrenewable Resources: experience and fiscal policy implications*, by J. Davis, R. Ossowski, J. Daniel and S. Barnett, IMF Occasional Paper No. 205, 2001.

⁶² The authorities have indicated that, subsequent to the ROSC mission, a number of changes to the structure of government were introduced by Decree of the President No. 931 of August 28, 2002, *On Measures for Further Improvement of the System of State Management of the Republic of Kazakhstan*, with a view to improving overall fiscal management

assigned to develop appropriate analyses and report results annually in the suggested budget annex.

58. Continuing efforts should be made to reduce discretionary activity under tax law. Commendable efforts have been made to streamline the tax code and are underway for the customs code. In this latter respect, it has been the practice to change tariff rates periodically by decree rather than through regular and comprehensive revisions promulgated through the budget or the tax code. In the staff's view, it would be more appropriate that tariff rates be set clearly in law, moving where possible to ad valorem rates to respond to changing prices. The main thrust of the new tax code and with it the investment law of reducing tax concessions is welcome. Nonetheless, in so doing, greater scope for discretion has been introduced, through the contracts with individual firms for which concessions are now to be granted under the draft Investment Law. This aspect is not a step forward in terms of transparency and governance. It is important to ensure that the programs agreed upon by the Investment Policy Committee are subject to appropriate mechanisms of internal and external control. Allied to the proposed tax expenditure annex (paragraph 50), the capacity to review overall direction of tax policy and use of incentives should be strengthened in the MOF and the Ministry of State Revenues.

59. Strengthening external audit and internal control and audit mechanisms will be key to long-term improvement of governance, and are critical to achieving international recognition of fiscal transparency improvements in Kazakhstan. The authorities recognize that the current focus on inspection and compliance oriented activities is inadequate. While the law on state audit/control gives appropriate emphasis to modern auditing methodology, there is a lack of capacity and authority of both external and internal audit functions to implement this law fully. In the staff's view, priority should be given to establishing the authority and mandate of the Accounting Committee, consistent with its constitutional status and in line with international standards for Supreme Audit Institutions. Effective and independent external audit will provide a driving force for more effective internal control systems and provide convincing evidence to the parliament, public, and international community of the standards of fiscal management that are being achieved in Kazakhstan. Consistent with this strategy, internal control mechanisms should be appropriately streamlined and strengthened.

60. Finally, strengthening the capacity of the Committee on Public Procurement is another vital element of internal control that needs sustained support. Computerization of this function will play an increasingly important role in enhancing transparency and providing a more effective basis for control. Given the expanded mandate of the Committee on State Procurement and the increasing volume of tenders, a heavy emphasis on training and building capacity in this area is warranted. The authorities plan to place increasing emphasis on computerization of procurement procedures, with the aim of making all stages of the process publicly accessible through the internet. Considerable progress can be made in this area and is necessary in the pursuit of greater overall fiscal transparency in Kazakhstan.

Assessment by the Republic of Kazakhstan of Issues on Which the Republic of Kazakhstan and the IMF Have Differing Opinions

Prepared by the Ministry of Finance
of the Republic of Kazakhstan

March 7, 2003

Paragraph 2:

The text of the letter contains some inconsistencies with the current legislation. This paragraph states that some public enterprises and public financial institutions are required to provide noncommercial services to the public without clear budgetary financing arrangements. According to the Civil Code of the Republic of Kazakhstan, however, all public institutions are financed entirely out of state budget funds, unless otherwise established by legislative acts. The annual law on the state budget establishes a list of public institutions that have the right to provide services for a fee and to use the proceeds for their own needs following the procedure determined by the Republic of Kazakhstan government. According to the Republic of Kazakhstan Law *On Public Enterprises*, a public enterprise fulfills state orders, but at the same time it may be supported by income it earns from its own operations. State orders are paid out of state budget funds, while products (work, services) not covered by a state order are sold by the enterprise independently.

In this connection, public enterprises fulfill not only state orders which are paid for out of the state budget, but may also earn additional income from other sources by performing work and services.

Paragraph 3:

In the first sentence the words “is transparent and appears to be generally followed” should be replaced with the words “is characterized by transparency.”

The second and third sentences should read as follows: “The privatization procedure is governed by the presidential Decree, with force of law, *On Privatization* of December 23, 1995 (referred to hereinafter as the Decree), and other regulatory legal acts of the Republic of Kazakhstan. The Decree sets out clear principles of legality, openness, competitiveness, equality, and legal succession that provide transparency in the privatization process.”

The fifth sentence should read as follows: “The value of objects of privatization is appraised in accordance with the legislation of the Republic of Kazakhstan.”

The sixth sentence should read as follows: “The list of state assets not subject to privatization is set forth in Decree No. 422 of the President of the Republic of Kazakhstan of July 28, 2000.”

Paragraph 7:

It must be pointed out that Kazakhstan Development Bank ZAO [Closed Joint-Stock Company] is a bank that operates independently in accordance with the Republic of Kazakhstan Law *On the Kazakhstan Development Bank*, the Lending Memorandum approved by the Republic of Kazakhstan government, and its own credit policy.

The government and local executive government authorities are shareholders in the Bank, but they do not provide any subsidies (the statutory capital has been paid up in full and totals T 30 billion).

The statement that “the Bank will provide various forms of **implicit subsidy** to commercial banks” is not correct, since the Development Bank is prohibited from lending to financial institutions, including commercial banks.

Paragraphs 8 and 55:

In accordance with the Republic of Kazakhstan Law *On the Republican Budget for 2003*, 100 percent of the Republic of Kazakhstan’s share under production sharing agreements is transferred to the republican budget.

In addition, the size of interbudgetary transfers is established by the annual law on the republican budget, while transfers allocated from the republican budget to lower-level budgets are earmarked for certain purposes, or to cover expenditures (grants). At the same time, “transfers ... contingent on a satisfactory tax collection standard being achieved,” as stated in this paragraph are not provided for under the budget system of the Republic of Kazakhstan.

Paragraph 13:

With the aim of restricting the outflow of resources from the NFRK to the budget, an addendum has been made to the Republic of Kazakhstan Law *On the Budget System*, according to which the amount of compensation for republican budget losses from the NFRK cannot exceed the total amount of the shortfall in execution of republican budget revenues.

fourth paragraph in Box 1:

In accordance with Republic of Kazakhstan Government Resolution No. 832 *On Approval of the Rules on Financial Procedures for Budget Execution and Preparation of Reporting Forms (Periodic and Annual) for Public Institutions Supported by the State Budget*, of July 25, 2002, (referred to hereinafter as the Rules), there has been a change in the procedure for the determination and transfer of excess revenues to the National Fund, broken

down by revenue codes for the republican budget as a whole and for local budgets individually. Work is being done on amendments to the legislation of the Republic of Kazakhstan on the National Fund with regard to use of the Fund to provide compensation for losses of the republican and local budgets by a decision of the Fund's Management Board, since its members are representatives of the executive and legislative branches of government. On the basis of the above, the last paragraph should be omitted.

In footnote 25 the words "No. 631 of May 14, 2001, *Rules for the Crediting of Money to the National Fund of the Republic of Kazakhstan and its Use*" should be replaced with the words "No. 832 of July 25, 2002, *On Approval of the Rules on Financial Procedures for Budget Execution and Preparation of Reporting Forms (Periodic and Annual) for Public Institutions Supported by the State Budget.*"

Paragraphs 16 and 58:

Regarding rates for excise taxes and import customs duties:

1. Republic of Kazakhstan Code No. 209-II *On Taxes and Other Obligatory Payments to the Budget*, of June 12, 2001, (referred to hereinafter as the Tax Code) clearly defines the rates, procedure, and methodology for the calculation of taxes and other obligatory payments to the budget.

In accordance with Article 258 of the Tax Code, excise tax rates are set by the Republic of Kazakhstan government and are established as a percentage of the value of the goods (ad valorem) and/or as an absolute amount per unit of measure in physical terms (fixed). In accordance with Article 110 of Republic of Kazakhstan Law No. 2368 *On Customs in the Republic of Kazakhstan*, of July 20, 1995, the customs duty rates for imported and exported goods are established by the Republic of Kazakhstan government and enter into force 30 days after their official publication.

The setting of excise tax rates is one of the main instruments used in state regulation of the excisable goods market to create conditions for increasing the effectiveness and competitiveness of domestic commodity producers through indirect regulation of price formation and providing for stability of the domestic market and the country's economic security. Import duty rates are set on the basis of indicators of the effectiveness of foreign trade, conditions in the global market, and in accordance with international agreements ratified by the Republic of Kazakhstan.

The relevant information is readily available; in accordance with Republic of Kazakhstan Law No. 213-1 *On Regulatory Legal Acts*, of March 24, 1998, regulatory legal acts of central executive and other central government authorities are published in the periodical press. The official publication of regulatory legal acts of central executive and other central government authorities is mandatory and is performed only in periodical publications that are distributed throughout the entire territory of the Republic of Kazakhstan.

2. Footnote 32 [sic] should read as follows: “law of June 12, 2001 on the entry into force of the Republic of Kazakhstan Code *On Taxes and Other Obligatory Payments to the Budget*.”

On granting concessions:

The Republic of Kazakhstan Law *On Investment* was passed on January 8, 2003. This law defines the general procedure and conditions for granting investment tax preferences established by Republic of Kazakhstan Code No. 209-II *On Taxes and Other Obligatory Payments to the Budget*, of June 12, 2001, (the Tax Code) under the section “Investment Tax Preferences.”

The establishment of investment tax preferences arose from the need to stimulate investment in the creation of new production facilities and the expansion and renovation of existing facilities, using contemporary technologies in priority areas of activity, a list of which is established by the President of the Republic of Kazakhstan.

In order to achieve transparency and establish an effective mechanism for monitoring the procedure and validity of the conclusion of contracts by the authorized agency granting investment tax preferences, regulatory legal acts governing these issues are now being drafted.

According to the Tax Code of the Republic of Kazakhstan, it is prohibited to grant tax concessions of an individual nature. The time period that preferences are in effect is determined on a case-by-case basis depending on the size and recoupment period of the investments, but the duration of the preferences may not exceed five years. According to the Tax Code, investment tax preferences are granted to investors only when they make direct investments in the fixed assets (fixed capital) of a Kazakhstani legal entity for the purpose of carrying out an investment project, and also provided that the investor presents the relevant documents confirming that the investor has the financial, technical, and organizational abilities to meet the relevant obligations and to comply with the liability requirements for implementation of the project. Investment tax preferences allow for a significant increase in the flow of private capital into the Republic of Kazakhstan’s economy, and they will serve as the basis for the creation of a favorable investment climate.

Paragraph 21:

The IMF’s suggestions regarding the publication of data on external and internal publicly guaranteed debt of the Republic of Kazakhstan in the *Statistical Bulletin* of the Republic of Kazakhstan Ministry of Finance have already been carried out by the Ministry of Finance.

As for the publication of data on local government debt as part of total government debt in the *Statistical Bulletin* of the Republic of Kazakhstan Ministry of Finance, at present

the publication of information about local government debt does not appear to be possible in connection with the fact that work has not been completed on the formation of a data base on local government debt obligations, due to the failure by local governments to confirm debts on private credits attracted against Republic of Kazakhstan government guarantees and debts from previous years on credits attracted against oblast government guarantees; the refusal to meet obligations previously assumed; and the unresolved status of debt obligations of reorganized, eliminated, and amalgamated administrative-territorial units.

With the aim of resolving this problem, Protocol No. 30 of the meeting of the Republican Budget Commission on August 14, 2002 instructed the governments of the oblasts and the cities of Astana and Almaty to document all of their debt obligations following the established procedure and to sign the relevant certification documents with the Republic of Kazakhstan Ministry of Finance. The publication of information about local government debt will be possible only after local governments have carried out the aforementioned protocol decision of the Republican Budget Commission.

Paragraph 23:

In the first sentence the words “but not systematically reported” should be omitted.

The third sentence should be omitted.

The fourth sentence should read as follows: “Each year national companies prepare their development plans for a three-year period on a sliding basis (referred to hereinafter as Development Plans). A Development Plan is prepared within the framework of the existing indicative planning system, which calls for the inclusion of key target areas and a projection of basic development indicators of national companies in the Indicative Plan for the Socioeconomic Development of the Republic of Kazakhstan. With a view to ensuring transparency, national companies and their subsidiaries (dependent companies) file quarterly financial reports.”

Paragraph 24:

In accordance with item 5 of Article 29 of the Republic of Kazakhstan Law *On the Budget System*, the Republic of Kazakhstan government and local government authorities publish quarterly reports on execution of the relevant budgets in the mass media. In addition, pursuant to said provision, reports on the execution of the republican and local budgets are published monthly in the *Statistical Bulletin* of the Republic of Kazakhstan Ministry of Finance.

Paragraph 25:

The eighth through tenth sentences should read as follows: “The rules call for budget program administrators and the public institutions under their jurisdiction to compile the relevant plans for the financing of a budget program (subprogram) based on payments and obligations, which represent a monthly schedule of the assumption of obligations and the performance of payments to meet them, with a breakdown by economic classification. Plans for the financing of budget programs (subprograms) based on obligations are used to issue permits to assume obligations related to the implementation of measures provided for in budget program passports.”

Paragraph 29:

In accordance with Republic of Kazakhstan Government Resolution No. 592 of May 29, 2002, Republic of Kazakhstan Government Resolution No. 1169 of September 10, 2001 is no longer in force and a new version of the Rules for the Preparation of Draft Republican and Local Budgets has been approved, the purpose of which is to identify the stages and time periods for the preparation and review of draft republican and local budgets for the coming financial year. The Rules establish a link between the processes of preparing the draft republican and local budgets, and specifically, they identify a procedure for coordinating the forecast indicators of budgets at various levels, the submission of budget requests, and so on. They also establish the process for the performance of procedures by budget program administrators and administrators of the relevant financial authority, as the working body of the budget commission, in the preparation of the draft budget for the relevant financial year.

Paragraph 31:

This paragraph states that it is not possible under the present system to match staff on payroll accurately against wage and salary payments. It should be noted that the Republic of Kazakhstan Statistics Agency does have this sort of information and regularly publishes the data in statistical bulletins.

Paragraph 32:

The fifth sentence should read as follows: “The *Rules on Financial Procedures for Budget Execution and Preparation of Reporting Forms (Periodic and Annual) for Public Institutions Supported by the State Budget*, approved by Republic of Kazakhstan Government Resolution No. 832 of July 25, 2002, specify that the Republic of Kazakhstan Ministry of Finance maintains a record of government debt, including government external loans, and transactions involving investment projects being implemented at the expense of government external loans. In accordance with the Rules, the Treasury Committee maintains these

records strictly on the basis of statements from accounts opened at second-tier banks of the Republic of Kazakhstan, and accounts opened at banks outside the country.”

Paragraph 37:

It is not clear which “recently disclosed offshore accounts of the government” are being referred to here.

Second paragraph of paragraph 49:

At present the National Bank of the Republic of Kazakhstan, in conjunction with the Ministry of Finance, is creating a working group for the formulation of accounting policy and accounting practices for the NFRK and cooperation on other issues in the fiscal sphere.

Paragraph 55:

The second sentence in the first paragraph should be omitted, since measures have already been taken to reduce flows into and out of the National Fund under Republic of Kazakhstan Government Resolution No. 832 *On Approval of the Rules on Financial Procedures for Budget Execution and Preparation of Reporting Forms (Periodic and Annual) for Public Institutions Supported by the State Budget*, of July 25, 2002.

The VAT collected in the city of Astana has nothing to do with flows into and out of the NFRK, since there are no companies in this region whose business results in obligations to transfer funds to the NFRK.

Starting with the 2003 budget, all revenues earned under production sharing agreements are distributed only at the republican budget level. Therefore, the recommended centralization has already been implemented.

The recommendation calling for an increase in the local budget revenue share from customs duties cannot be implemented due to the fact that customs duties are transferred in full to republican budget revenues. For these reasons we believe that in the final report the first recommendation in this paragraph should read as follows:

“The republican budget could either increase revenue shares to the local governments from other, non-centralized taxes, increase net transfers to local governments, or devise some combination of these.”

Starting in 2003, in accordance with the Republic of Kazakhstan Law *On the Republican Budget for 2003*, the Republic of Kazakhstan’s share under production sharing

arrangements is credited in full to the republican budget. Local budget losses are covered by interbudgetary transfers. As for the VAT collected in the city of Astana, the Budget Code that is being prepared calls for its transfer in full to the republican budget.

Paragraph 56:

In accordance with Article 29 of the Republic of Kazakhstan Law *On the Budget System*, the Republic of Kazakhstan government submits to the Republic of Kazakhstan Parliament an annual report on the execution of the republican budget for the financial year, including information on activities involving the formation and use of the National Fund of the Republic of Kazakhstan.

At the same time, in accordance with Decree No. 931 of the President of the Republic of Kazakhstan *On Measures Aimed at Further Improvement of the System of Government of the Republic of Kazakhstan*, of August 28, 2002, a number of ministries and departments have been reorganized: for example, the Ministry of Finance and Ministry of State Revenues were merged, the Ministry of Economy and Budget Planning was created, and the Republic of Kazakhstan Public Procurement Agency has independent status. In addition, a number of regulatory legal acts that were not taken into account in the Report have recently entered into force.