

International Studies Program

Working Paper #01-9
June 2001

Expenditure Management and Fiscal Restraint: Lessons from Kazakhstan 1997-2000

Kelly Edmiston



Georgia State
University

Andrew Young
School of Policy Studies



**Expenditure
Management and Fiscal
Restraint: Lessons from
Kazakhstan 1997-2000**

Working Paper 01-09

Kelly Edmiston
June 2001

International Studies Program
Andrew Young School of Policy Studies
Georgia State University
Atlanta, Georgia 30303
United States of America

Phone: (404) 651-1144
Fax: (404) 651-3996
Email: ispaysps@gsu.edu
Internet: <http://isp-aysps.gsu.edu>

Copyright 2001, the Andrew Young School of Policy Studies, Georgia State University. No part of the material protected by this copyright notice may be reproduced or utilized in any form or by any means without prior written permission from the copyright owner.

International Studies Program Andrew Young School of Policy Studies

The Andrew Young School of Policy Studies was established at Georgia State University with the objective of promoting excellence in the design, implementation, and evaluation of public policy. In addition to two academic departments (economics and public administration), the Andrew Young School houses seven leading research centers and policy programs, including the International Studies Program.

The mission of the International Studies Program is to provide academic and professional training, applied research, and technical assistance in support of sound public policy and sustainable economic growth in developing and transitional economies.

The International Studies Program at the Andrew Young School of Policy Studies is recognized worldwide for its efforts in support of economic and public policy reforms through technical assistance and training around the world. This reputation has been built serving a diverse client base, including the World Bank, the U.S. Agency for International Development (USAID), the United Nations Development Programme (UNDP), finance ministries, government organizations, legislative bodies and private sector institutions.

The success of the International Studies Program reflects the breadth and depth of the in-house technical expertise that the International Studies Program can draw upon. The Andrew Young School's faculty are leading experts in economics and public policy and have authored books, published in major academic and technical journals, and have extensive experience in designing and implementing technical assistance and training programs. Andrew Young School faculty have been active in policy reform in over 40 countries around the world. Our technical assistance strategy is not to merely provide technical prescriptions for policy reform, but to engage in a collaborative effort with the host government and donor agency to identify and analyze the issues at hand, arrive at policy solutions and implement reforms.

The International Studies Program specializes in four broad policy areas:

- **Fiscal policy**, including tax reforms, public expenditure reviews, tax administration reform
- **Fiscal decentralization**, including fiscal decentralization reforms, design of intergovernmental transfer systems, urban government finance
- **Budgeting and fiscal management**, including local government budgeting, performance-based budgeting, capital budgeting, multi-year budgeting
- **Economic analysis and revenue forecasting**, including micro-simulation, time series forecasting,

For more information about our technical assistance activities and training programs, please visit our website at <http://isp-aysps.gsu.edu> or contact us by email at ispaysps@gsu.edu.

EXPENDITURE MANAGEMENT AND FISCAL RESTRAINT
Lessons from Kazakhstan 1997 - 2000

Kelly D. Edmiston*
Department of Economics
Andrew Young School of Policy Studies
Georgia State University

19 June 2001

* The information contained in this report was collected while the author was in the Republic of Kazakhstan on a World Bank mission. The views expressed are those of the author and do not necessarily reflect the views of the World Bank. The author gratefully acknowledges useful comments and suggestions from Jorge Martinez-Vazquez and João do Carmo Oliveira.

EXPENDITURE MANAGEMENT AND FISCAL RESTRAINT

Lessons from Kazakhstan 1997 - 2000

ABSTRACT

The macroeconomic picture suggests that the only viable option for maintaining a given level of public services for transition countries facing revenue volatility or shortfalls is to optimize public spending so that expenditures may be reduced while minimizing disruptions to the provision of government services. This, in turn, means that efforts must be made to ensure that public services are adequately prioritized and delivered as efficiently as possible. This paper takes a broad look at expenditure policies in the Republic of Kazakhstan in light of these issues, seeking both an overall evaluation and a consideration of options for improvement. Included are discussions of privatization and the changing public role of government, the choice of budget priorities among competing programs, and opportunities for creating a budget atmosphere conducive to proper expenditure management in volatile fiscal environments. The paper proceeds from the perspective of Kazakhstan, but the hope is that the experiences there will offer valuable lessons for other economies in transition.

EXPENDITURE MANAGEMENT AND FISCAL RESTRAINT

Lessons from Kazakhstan 1997 - 2000

AUTHOR BIO

Kelly D. Edmiston (Ph.D., Tennessee, 1998) is an assistant professor of economics at the Andrew Young School of Policy Studies, Georgia State University, where he teaches public finance and urban-regional economics. His research interests fall predominantly in the areas of state and local government finance, regional economic development, and intergovernmental relations. In addition to his academic research, which includes publication in journals such as the *National Tax Journal*, *Public Finance Review*, and *State Tax Notes*, he serves as a consultant to the World Bank on issues of tax policy, expenditure management and budgeting, and fiscal decentralization.

EXPENDITURE MANAGEMENT AND FISCAL RESTRAINT

Lessons from Kazakhstan 1997 - 2000

1. Introduction

For countries facing revenue shortfalls, there are two options available for maintaining a given level of public services. One option is to maintain current expenditure levels through deficit financing or the accumulation of arrears. The other option is to optimize public spending so that expenditures may be reduced while minimizing disruptions to the provision of government services. The macroeconomic picture in most transition economies suggests that the second option is the only viable one, which means that efforts must be made to ensure that public services are delivered as efficiently as possible. This requires increased standards of prioritizing expenditures within sectors.

Effective prioritization of public expenditure requires a careful review of each spending program in light of a set of basic questions. The necessary first question is the appropriateness of public sector involvement. If there is no rationale for government intervention, then the activity under consideration should be left to the private sector, regardless of other considerations. The second question is one of benefits and costs. Are there clear objectives for the program in terms of benefits (outcomes), do the benefits of the program outweigh the (social) cost, and are there ways to achieve these benefits with less cost? Next is the question of capacity. If the government does not have the technical and administrative capacity to effectively implement and maintain the project or program, then it is not going to be successful, regardless of its potential. Finally there is the question of priorities. Given limited budget resources, the government is not going to be able to finance all of the projects and programs that meet the above criteria, which means

selecting a limited number of projects and programs from a large portfolio of attractive options. This is where the most difficult choices must be made.

This paper takes a broad look at expenditure policies in the Republic of Kazakhstan in light of these issues, seeking both an overall evaluation and a consideration of options for improvement. The paper continues in section 2 with a discussion of the changing role of government in Kazakhstan, highlighting the successes in transition and suggesting ways in which the public sector role can be further rationalized. The next two sections then focus on the more difficult question of choosing among competing programs, including intersectoral (section 3) and intrasectoral (section 4) priorities. Finally, section 5 examines opportunities for creating a budget atmosphere conducive to proper expenditure management in volatile fiscal environments. The paper proceeds from the perspective of Kazakhstan, but the hope is that the experiences there will offer valuable lessons for other economies in transition.

2. The Changing Role of Government in Kazakhstan

Kazakhstan has made remarkable progress in its transition from a planned to a market economy relative to many other countries of the former Soviet Union, especially in the privatization of small enterprises and the reduction of the public sector's share of GDP. The share of small firms privatized increased from just over 27 percent in 1993 to 100 percent by 1997.¹ Another indicator of progress in this transition, the private sector's share of gross domestic product, also shows substantial improvement, moving from 10 percent in 1993 to approximately 60 percent in 1999, about the average for transition economies in Europe and Central Asia.² The process has slowed recently, however, as privatization revenues for the first half of 2000 were only 17 percent of projections. Total 2000 privatization revenues were approximately KZT 22

billion, or about 37 percent below 1999 levels.³

Where Kazakhstan has not fared as well is in the privatization of large enterprises. Less than half of large enterprises are in majority private hands,⁴ and entirely state-owned enterprises continue to contribute a substantial share of the country's GDP.⁵ Moreover, the government has retained large stakes in many of the enterprises that have been privatized. There is no convincing rationale for continued government involvement in these enterprises, and efforts should be made to disentangle the public sector role completely. Doing so would increase the efficiency of these firms by compelling financial discipline; that is, ridding these enterprises of the soft budget constraints induced by state support

While Kazakhstan continues to privatize large enterprises on a case-by-case basis, the process slowed considerably in 1998 and 1999 with deteriorating market conditions. As in Russia, Kazakhstan was waiting out the decline in an effort to maximize privatization revenues. While the rationale behind this delay is understandable, the blue-chip privatization program remains "effectively stalled," even as the economy has gained some steam in the new century.⁶ Privatization in 2000 did not fare much better (Table 1).

Governments in transition economies such as Kazakhstan must not only accelerate the reduction of their direct function in the production of private goods and services, but should also think carefully about their less direct roles. The government of Kazakhstan still maintains a significant, although decreasing role in production enterprises through its use of tax incentives, government loan guarantees, and the direct support of agriculture and small and medium sized business. Certainly the government has a reasonable interest in promoting the development of its infant market economy; however, these interests must be balanced with the competing interests of

more traditional government roles, such as social sector spending. Moreover, development efforts are likely to be much more cost-effective if they are refocused on creating a generally attractive environment for business rather than targeting or supporting specific sectors and enterprises.

As Kazakhstan continues to inventory its budget in an effort to locate activities that would be better left to the private sector, it may consider extending its privatization program to encompass private production of some public services. Public *provision* of goods and services does not necessarily imply public *production*. For example, some activities in the health and education sectors (*e.g.*, some clinics, hospitals, schools, and universities) may be more efficiently produced in the private sector, although the government may retain its role in seeing that the necessary services are provided and financed in an equitable manner.

While clearly there is room for continued reduction of the public sector's role in private sector activities in Kazakhstan, in reality most of what the government does is consistent with the proper role of government. The more difficult choices involve selecting a limited number of financeable projects and programs from a large portfolio of competing options. The first step is an assessment of the priorities implicit in the broad functional composition of expenditures. This process can be difficult in the sense that expenditures in broad categories often are equally defensible and important. In this regard, the distribution of expenditures should be a function of the specific needs and desires voiced by the people who consume the services. Nevertheless, there are some basic criteria that can be used to optimize the broad composition of expenditures, such as their relative contributions to growth and social equity. Moreover, if a change in expenditure composition brings about a reduction in cost rather than a change in output, then

inter-sectoral priorities are in part an issue of efficiency rather than value judgements.⁷ Perhaps more important is the prioritization of spending *within* sectors, specifically, the distribution between programs and sub-programs and the economic composition of expenditures.

3. Inter-sectoral Spending Priorities

Table 2 shows the execution of consolidated government expenditures in Kazakhstan by functional composition for 1997-1999 and projections for 2000.⁸ There are two salient, interconnected features of this data. First, total spending is, for the most part, a function of revenue collections. That is, at least for 1997-1999, efforts were focused on expenditures rather than deficit reduction. This focus changed to some degree for 2000, as planned spending was reduced by 1.7 percent of GDP from 1999 levels, while revenue collections were expected to drop by only 0.6 percent of GDP. Secondly, when expenditures are reduced, it is spending in the social sector that bears most of the burden. For example, total expenditures fell by 2.4 percent of GDP from 1997 to 1998, but social spending fell 3.1 percent. Likewise, the 1.7 percent (of GDP) reduction in total expenditure for 2000 encompasses a 2.8 percent (of GDP) decrease in social spending. Similarly, increases in social sector spending tend to comprise the bulk of overall expenditure increases, as was the case in 1999. Spending in other categories tends to be relatively stable, especially for general government administration, defense, and public order, all of which changed very little over the period.

As shown in Table 3, health expenditures and social security and welfare tend to see the greatest fluctuation in social spending from year to year, but tend to revert strongly back to previously established levels as revenues revive. Education expenditures, on the other hand, have shown a consistent pattern of reduction, as spending increases in good times tend to be smaller

than expenditure declines in bad times. Education spending has fallen from 4.4 percent of GDP in 1997 to a projected 3.4 percent of GDP in 2000.

The large variance in social expenditures in general suggests that this sector is left largely as a residual item for the budget: if there are sufficient funds, social spending will be financed, otherwise it will be cut. This implies, in turn, that social spending is not given a high priority on the margin. The relative stability of education spending, which is partly a function of nonsequestration provisions, suggests that education may be given somewhat greater priority than health and social security and welfare, but the consistency with which education spending is being reduced suggests that in fact education is receiving less emphasis by the government. There does not appear to be a significant difference in the priority placed on social sector expenditures across levels of government, as social security and welfare, which is financed primarily by the central government, follows a spending pattern similar to that of education and health, which are financed primarily at the local level.

Perhaps the best way to examine Kazakhstan's inter-sectoral spending priorities is to compare them with those of other countries. As seen in Table 4, Kazakhstan seems to have embarked on a reasonable distribution of public spending, at least across the broader functional classifications. As compared to other countries in their income cohort (middle income countries), Kazakhstan spends relatively less on mostly unproductive military expenditures and relatively more on the growth-enhancing education and health sectors. Spending on social security and housing and other government services is more or less in line with international norms.

Of course, the fact that Kazakhstan's spending patterns are attractive by international comparison does not mean that they cannot do better. As highlighted in Table 3, education

spending is projected to fall to 13.4 percent of total spending (including lending minus repayment) in 2000, or approximately 3.4 percent of GDP.⁹ At the same time, health is projected to fall to 2.2 percent of GDP, and its share of total spending will fall from 10.7 percent to 8.7 percent. While these amounts would keep Kazakhstan in line with other middle income countries in terms of spending on education and health, it may want to reconsider the rationale of cutting these items in favor of other functions.

On average education and health comprise 12.5 percent and 13.1 percent of total public spending, respectively, in high income countries. While Kazakhstan's 2000 budget projections bring its expenditure distribution close to these proportions, public sector spending in higher income countries tends to comprise a larger share of GDP (39.1 percent) than is sustainable in Kazakhstan, and health and education expenditures each account for approximately five percent of GDP in these countries. Given the importance of the education and health sectors and the relatively lower level of aggregate public sector spending that is possible, this suggests that Kazakhstan should allocate a greater *proportion of its total spending* to these sectors. Five percent of GDP probably is not a reasonable target given current fiscal conditions, but something along the lines of four percent of GDP for education and three percent of GDP for health (approximately 1999 levels of spending) probably is reasonable for the short to medium term. For 2000, this would mean a 15.6 percent allocation of state spending for education and an 11.7 percent allocation for health. If these shares were maintained with an economic turn around, health and education in Kazakhstan could be greatly enhanced.

Of course, as noted earlier, overall spending for 2000 is projected to have fallen by 1.7 percent of GDP from 1999 levels, which means spending reductions had to come from

somewhere. The pertinent question is then whether or not something other than education and health could be cut, or alternatively, if health and education expenditures could be reduced less by focusing cuts in other areas of the budget.

Local governments bore most of the burden of expenditure reductions in 2000, although they provide the bulk of education and health spending.¹⁰ Spending from local budgets fell by approximately 0.94 percent of GDP from 1999 levels, while Republican spending was due to decrease by only 0.42 percent of GDP. This does not tell the entire story, however, as budget withdrawals increased significantly and subventions were also slightly reduced. In total, the year 2000 saw (projected) an increased transfer from local governments to the center of approximately 0.42 percent of GDP. Net of this transfer, local government expenditures fell by nearly 1.3 percent of GDP in 2000 (projected), while Republican expenditures suffered only a 0.33 percent (GDP) decline.

The combination of increased debt service requirements and debt financing constraints left the Republican government with difficult choices to make in preparing the 2000 budget. Rather than using the opportunity to think carefully about spending priorities, it appears as though the central authorities shifted a substantial portion of the burden to local governments. Because health and education expenditures make up the majority of the local budgets (approximately 60 percent in 2000 projections), it is no surprise that these sectors would suffer substantial declines in the 2000 budget environment. If education and health are to receive the priority they deserve in Kazakhstan, it does not make much sense to force local governments to bear the burden of constrained financial resources. If shifting responsibilities in this way is to continue, it is likely that the education and health sectors will continue to see unstable spending patterns in the future.

4. Intra-sectoral Spending Priorities

Often the maintenance of a sustainable fiscal environment requires reducing public expenditure and cutting popular programs. The key to maximizing efficiency under these constraints is to allocate resources to those activities which provide the most benefits for a given pool of resources over the long-term. This means not only thinking carefully about how to distribute resources *across* sectors, but perhaps more importantly, how to shift resources *within* sectors. There are two important components of this intrasectoral expenditure prioritization: spending by program and spending by economic category.

4.1 Prioritizing Intrasectoral Spending by Program and Sub-Program

An important component of an effective approach to expenditure prioritization is an adequate focus on efficiency in service delivery at the program and sub-program level. In the health sector, for example, emphasis on preventive measures (such as immunization and pre-natal care) rather than curative treatment can help ensure a controllable health care budget in the future. Likewise, resources targeted to rural aid posts and clinics can prevent the exacerbation of easily treatable illnesses and injuries, and hence reduce the necessity for more extensive and expensive hospital treatment later. In the education sector, priorities can be similarly focused on medium and long-term benefits. For example, resources could be shifted from preschool and university education to primary and secondary education, which have been shown internationally to have greater returns. Finally, in the social protection sector, clear criteria and targeted programs can be established to ensure that limited funds go to those who are most needy. The new criteria established for low income families support is a good example of setting priorities in this fashion.

4.1.1 Issues in Prioritizing Health Programs: The Need for Prevention

Kazakhstan's health sector provides a good example of what is happening in intrasectoral public expenditure management. The current mentality in many places is that resources are only available to deal with emergency situations: to "put out fires" rather than to prevent fires from occurring. This myopic mentality is in some sense understandable, but there is a great potential for these fires to soon loom out of control. The only way to prevent uncontrollable health care costs in the future is to focus resources on prevention today. A case in point is the world-wide AIDS epidemic, which has only recently begun to surface in Kazakhstan.

The AIDS epidemic spreads quickly once it has taken hold. For example, there were approximately 100 documented cases of HIV infection in Ukraine 1995-96, but by 1999 there were approximately 50,000 documented cases of HIV infection and an estimated 50,000 in additional undocumented cases.¹¹ Today in Kazakhstan there are 900 documented cases of HIV infection and an estimated 9000 total cases. Thus, the potential exists for AIDS to capture a substantial share of the health budget in the future if action is not taken now. AIDS prevention costs between US\$0 and US\$120 per person, while effective treatment of AIDS patients costs between US\$8,000 and US\$25,000 per year. Thus, preventive measures targeted at high risk groups (such as Kazakhstan's estimated 250,000 IV drug users, who have a 95 percent infection rate when contact is made with an infected needle) would yield great benefits in the health budget over the medium and long-terms, not to mention the savings in human suffering.

The 2000 Republican budget projects an overall decrease of T 37.8 million (3.2 percent) in public health over 1999 levels, which highlights the need for rethinking health expenditure at the program level. At the same time, spending on specialized hospitals for the treatment and control of AIDS and tuberculosis will increase significantly (15 percent for AIDS and 63 percent for

tuberculosis).

4.1.2 Issues in Prioritizing Education: Maximizing the Social Return on Expenditure

As in other sectors, a key criteria in allocating education expenditures across programs is the maximization of the social return on public spending. There has been a great amount of research on the returns to education, and internationally, this research has shown that the return on spending for primary and secondary education tends to far outweigh the return from equal amounts of spending at other levels of education.¹² This suggests that expenditures on programs at the primary and secondary level should receive high priority. Kazakhstan seems to have recognized the relative importance of primary and secondary education, as its share of total education expenditure increased from 44.7 percent in 1994 to 62.3 percent in 1998.

Of course, this does not mean that the emphasis should be entirely on primary and secondary education -- there must be an appropriate balance. That is, the social rate of return will diminish with each tenge expended, and the objective should be to equalize this rate of return across all levels of education. Kazakhstan seems to have reached an appropriate balance between primary, secondary, and tertiary education, increasing its spending on primary and secondary education mostly at the expense of vocational schools and "other institutions," generally special schools such as those for sports and music. The benefits of education spending can be further enhanced by establishing priorities within programs. For example, as the private sector becomes an increasingly important source of employment relative to the public sector, spending at the tertiary level could be shifted away from training public officials toward programs that are more valuable for the private sector, such as engineering, computer science, and business administration.¹³

4.1.3 Issues in Prioritizing Social Security and Social Assistance Programs: A Focus on the Truly Needy

The key issue in intra-sectoral prioritization of social security and welfare in Kazakhstan is targeting, specifically, the continued provision of state special benefit programs that are not poverty-targeted. As part of the restructuring of benefit administration, special benefits for selected categories were streamlined, and a new cash allowance replaced the myriad types of discounts. While this restructuring is a welcomed development, there remains considerable room for improvement. Specifically, many of the special state benefits are targeted to beneficiaries who fall into narrowly defined categories that do not directly correspond to economic means. For example, special state benefits are provided to some veterans and their family members, mothers of families with many children, and recipients of special honors for extraordinary work or service. While the majority of the approximately one million beneficiaries are invalids, the extent of their disabilities vary from people who are totally or permanently incapacitated to those who are only temporarily disabled or have minor impairments.¹⁴ Some of the recipients of special state benefits might well be poor, but many of them may not be, suggesting that scope exists for better targeting of this benefit on the criterion of economic need, and for tighter screening process for claiming disability. Those beneficiaries who are truly in need of financial assistance could be covered by more general social assistance programs that are directly targeted to the poor.

While the government has expressed a recognition of the problem, a comparison of the 1999 and 2000 Republican budgets suggest that little effort is being made to better target social assistance programs (Table 5). Rather than eliminating or substantially reducing special state benefits in the 2000 budget, the government has actually chosen to increase them in nominal terms

by 15.4 percent over 1999 terms on an annualized basis.¹⁵ As budget resources become increasingly scarce, the government may want to reconsider its priorities in the area of social security and welfare and focus their efforts entirely on those who are truly in need of financial assistance.

4.2 Prioritizing Expenditure by Economic Category

Table 6 shows expenditure execution by economic composition for the consolidated state budget for 1997 through the first six months of 1999. The most obvious feature of this data is that expenditures by economic classification have been relatively stable over the last two and one-half years.¹⁶ The largest share of spending is in the form of transfers, mostly to households and nonprofit institutions, while wages and salaries receive the second greatest share, generally just under one quarter of total spending. Debt servicing has become increasingly important, moving from 2.1 percent of total spending in 1997 to 6.7 percent in the first six months of 1999. Much of the increase in debt servicing can be attributed to currency devaluation, although deficits of around four percent of GDP (including capital revenues) per year have certainly added significantly to the total debt figure.

4.2.1 International Comparisons

A comparison of expenditures by economic classification in Kazakhstan to those of other middle income countries suggests that Kazakhstan's public sector may be too focused on wages and salaries and that capital expenditure is receiving too low a priority. Combined wages, salaries and employer contributions accounted for 26.7 percent of total public spending in the first six months of 1999 (including net lending), which is substantially higher than the 12.2 percent average for similarly positioned countries. It seems that after making much progress in reducing

the wage bill's share of public sector spending through the early and mid-1990s, the government has either become complacent or has stopped short of a more appropriate target. There is no question that Kazakhstan has made a commendable effort to reduce the number of physicians per capita and teachers per pupil, as well as restructuring its civil service (especially when compared with other transition economies in the region), but more should be done to reduce the wage bill's share of total spending if public service provision is to be efficient and effective.

Perhaps the greatest problem here is priorities. In general wages and salaries are paid first, utilities are paid second, and the residual is left to purchase goods and services or to maintain facilities. In recent years when financial resources have been especially tight, this has meant that nearly the entire budget for some institutions has been devoted to employee compensation and utilities. For example, in the last two years wages and salaries have accounted for over 70 percent of local health care spending, compared to around 40 percent earlier in the decade. As a result, medical establishments have been pressed to provide the necessary medicines for their patients, and many have stopped providing food.

The establishment of wage and salary priorities in conjunction with deteriorating fiscal conditions has forced institutions to find alternative means for financing the purchase of goods and services. Many schools, for example, have been relying on parental groups to provide the necessary textbooks and materials. For some medical institutions, financial relief has come from the small number of patients that are able to pay for medical services (usually for better, private rooms, *etc.*). Part of these funds are used to purchase medicine for more indigent patients. The fact that hospitals and schools have been so resourceful in finding ways to minimize disruptions in service delivery in times of fiscal constraint suggests that great benefits could be achieved by

offering them more autonomy on the use of their funds. Given the decreasing resources that are going to the health and education sectors, this may be the best way to enhance the delivery of education and health in Kazakhstan.

There is a real need to reprioritize intra-sectoral expenditures so that the greatest benefits are achieved for each tenge expended. This is not done by paying salaries and utilities first and leaving the rest as residual items. Rather, if and when expenditures must be cut, the staff and facilities should go with them because they are no longer necessary. This will ensure that scarce resources are not wasted on redundant staff and facilities, but instead are used in a mix that offers the greatest return for a given pool of resources. Moreover, research indicates that expenditure reductions are more sustainable when employment is reduced than when compensation is cut.¹⁷

4.2.2 Capital Investment and Infrastructure Maintenance

Kazakhstan clearly has been under-investing in its infrastructure compared to other middle income countries. This is not too surprising given the disproportionately large share of public spending that goes to pay wages and salaries. In 1997 and 1998, capital expenditure accounted for 6.4 percent and 8.1 percent, respectively, of Kazakhstan's total public sector spending. The average for middle income countries, by comparison, is a substantially larger 18.1 percent. While the comparable figure in high income countries is 7.4 percent, these countries enjoy a substantial amount of investment by the private sector that is not possible in less developed middle income countries. The capital investment situation does not seem to be improving in Kazakhstan, rather, capital expenditure was down considerably to a mere 2.9 percent of total spending in the first six months of 1999. This would amount to approximately 0.8 percent of GDP on an annualized basis. If Kazakhstan is to continue in its development and prosper in the future, it must have the

requisite infrastructure, which means capital expenditure needs to increase significantly.

The problem of low infrastructure investment in Kazakhstan is exacerbated by the inadequate maintenance of existing infrastructure. As schools and hospitals have been necessarily closed, remaining facilities have been neglected to such a degree that they are barely usable in some cases. This is not an issue that is peculiar to Kazakhstan by any means, as most developing and transition economies suffer similar problems. In many of these countries, a major source of the problem is an emphasis on politically popular new investments rather than the maintenance of existing infrastructure. This typical assessment does not appear to be much of an issue in Kazakhstan, as capital investment overall is rather dismal compared to other middle income countries. Rather, the problem seems to be a combination of constrained financial resources and myopic priorities. Capital maintenance often is less politically appealing than other forms of current expenditure and thus tends to get a low priority during times of fiscal constraint. For example, as mentioned above, salaries and utilities generally get immediate priority, which leaves very little in the way of financing for infrastructure maintenance. If hospitals have stopped feeding patients and schools have been unable to provide textbooks, it is unlikely that any consideration has been given to the maintenance of buildings and equipment.

Eventually inadequate maintenance will render infrastructure such as school buildings and hospitals useless, which will necessitate investment in new facilities. Maintenance of existing facilities would be much less costly and would yield a substantially greater return. Greater priority for infrastructure maintenance is needed in virtually every developing and transition economy, but is especially critical in Kazakhstan during this era when so few resources are made available for new investment. The 2000 Republican budget reveals efforts to improve

maintenance in the transportation sector, as road maintenance is projected to increase by T 3.6 billion to T 5.3 billion, which is 229 percent greater than 1999 levels. More needs to be done in other sectors, however, especially in the more labor-intensive sectors like education and health which are especially constrained by established salary priorities in times of fiscal restraint.

There are several things that can be done to improve capital investment and maintenance. Most important is that a greater proportion of the budget should be allocated to investment and maintenance, which means a shifting of priorities away from wages and salaries. Secondly, each sector needs to clearly identify infrastructure needs and prioritize these needs within the confines of available resources. Thirdly, adequate recurrent expenditure for operations and maintenance should be appropriated when capital projects are approved. Because infrastructure projects are necessarily long-term investments, this will require much expanded use of multi-year budgeting. Finally, those responsible for planning, budget development, and oversight should ensure that the limited resources available for capital expenditure are utilized in truly public sector projects rather than for projects that should be privately financed.

5. Creating an Environment for Rational Expenditure Management

5.1 Off-Budget Spending

The government of Kazakhstan consolidated its extra-budgetary funds with the general budget beginning with the 1999 budget year, which was a substantial step in the right direction of presenting a transparent, fully integrated budget document. Nevertheless, there still exist some important off-budget items that should be carefully evaluated on a regular basis and perhaps integrated within the budget document itself. Specifically, soft loans and implicit subsidies in lending, tax expenditures, and government loan guarantees all represent costs to the government,

whether direct or contingent. As such, they should fall under the same scrutiny as direct expenditure outlays.

5.1.1 *The Tax Expenditure Budget*

Incentives designed to provide for favorable tax treatment of particular activities and groups commonly are referred to as “tax expenditures” to highlight the similarity between tax-based incentive or redistribution programs and direct expenditure programs.¹⁸ For example, tax exemptions, credits, or special allowances designed to stimulate business investment are conceptually the same as direct subsidies to business firms. Likewise, special tax treatment of narrowly defined groups of individuals (such as the disabled) also represent tax expenditures to the extent they could be provided for with direct subsidies.

Kazakhstan, like many other countries, employs a great deal of special tax provisions for reasons of economic development or social equity.¹⁹ While the use of tax expenditures rather than direct outlays is not problematic *per se*, in that both operate to achieve government objectives at some cost to society, there are some unique issues of budgetary control that arise in the case of tax expenditures. First, because tax expenditures are less visible than direct expenditures, they tend not to undergo a regular review, such as that which would occur during annual budget development. Secondly, a large number of tax expenditures are established in permanent legislation (such as the tax code), which means they tend to follow revenue trends. That is, like entitlement programs in the social sphere, tax expenditures tend to be open-ended, which means costs are likely to increase with changes in exogenous conditions, such as growth in GDP.²⁰ Thus, tax expenditures may increase substantially with no budgetary action whatsoever.

Tax expenditures absorb the same budget resources that direct expenditures do, only they

do so on the revenue side of the budget. Thus, in setting priorities, tax expenditures should come under the same scrutiny as other, more direct expenditure items. That is, the cost of tax expenditures should be carefully tabulated and should be evaluated on a regular basis. Because no one currently is tracking the cost of tax expenditures in Kazakhstan, a proper accounting is the necessary first step.

There are three principal approaches to calculating the cost of tax expenditures:²¹ (1) the revenue forgone method, (2) the revenue gain method, and (3) the outlay equivalent method. The revenue forgone is an *ex post* measure that compares revenues that were collected with the particular tax provision to revenues that would have been collected if the provision did not exist. Virtually all countries that provide tax expenditure reports utilize this method, primarily because it is the most simple measure to calculate. The objective of revenue gain method is to calculate the expected increase in revenues, were the concession to be abolished. The revenue gain method is more complicated in the sense that behavioral responses must be incorporated *ex ante*. Finally, the outlay equivalent method, which currently is used only in the United States, measures the cost that would be incurred if the same benefit were provided as a direct expenditure outlay. As with the revenue forgone method, the outlay equivalent method proceeds under the assumption that behavior is not changed.

Once the costs of tax expenditures have been calculated, they can be formatted in a tax expenditure report which can serve as the basis for periodic evaluation. A good option for ensuring proper rationalization of tax expenditures would be to annex the tax expenditure report to the budget document itself. By evaluating the tax expenditure report during the course of budget preparation, there would be a greater assurance that tax expenditures are reviewed in light

of the overall spending priorities of the government and that the implicit trade-offs between direct and indirect outlays are properly recognized.

Canada provides perhaps the best example of the benefits that arise from integrating tax expenditure reports with the budget.²² Under its Policy and Expenditure Management System (PEMS), spending ceilings are assigned to various “policy envelopes.” If tax expenditures increase, the cost is allocated to the relevant policy envelopes, which reduces the financial resources available for direct expenditures. In an effort to prevent uncontrolled increases in direct spending, reductions in tax expenditures are credited to the relevant policy envelopes only in cases where they are “functionally equivalent” to direct outlays; otherwise they are apportioned to general revenues. The design of the PEMS thus compels policy makers and budget planners to thoroughly consider the trade-offs between tax expenditures and more direct outlays and ensures adequate prioritization of all aspects of government fiscal activity.

5.1.2 Lending and Loan Guarantees

Net lending has declined from approximately 1.8 percent of GDP in 1997 to a projected 1.2 percent of GDP for 1999 and 2000, which suggests that the government is relying less on lending as a source of financing projects. Most of the lending for 2000 is allocated to liabilities on state guarantees (46.6 percent) and infrastructure projects (46.5 percent). Some of the remainder will support agricultural enterprises and small and medium sized businesses, but as a general rule, the government appears to be shying away from lending support to the private sector, a commendable direction to be taking. What is questionable is the use of lending to finance government obligations on defaulted loans. Because the loans have been defaulted to the original creditor, it is extremely unlikely that these new loans will be repaid, which means the government

is making a soft loan for which it does not intend to collect. Effectively the government is issuing a grant to finance the project for which the guarantee was tendered, but these soft loans are not subject to the same scrutiny as an equivalent direct expenditure would be. This facilitates a break-up of budget discipline that can thwart efforts to prioritize public sector spending.

Government lending clearly is not a completely off-budget activity in Kazakhstan, as the government has made commendable efforts to report lending activities in the budget document itself. What is not clear from the budget is the extent to which lending entails subsidies or loans that are unlikely to be repaid and the costs involved in administering loans. If the government is subsidizing the interest on loans by charging interest rates lower than it pays on its own debt, then the costs of these subsidies should be clearly articulated in the budget. The preferred approach would be to include interest subsidies and administrative costs as separate line items in the budget, which would provide policy makers and budget analysts with a complete and transparent picture of the costs involved in their lending activities. Similarly, if the government intends to finance projects with a grant (by issuing a soft loan), then the financing should be listed in the budget as a grant, not as a loan.

In addition to directly issuing credits, the government of Kazakhstan also tenders a substantial amount of loan guarantees. The temptation is to view loan guarantees as costless because no money is expended up-front. In reality, however, the government does bear a very real expense. Because there is always some probability that each loan guaranteed will default, the expected cost is always positive. Rather than viewing loan guarantees as costless, the government would be better protected by treating the expected cost of each loan guarantee as a direct outlay up-front and budgeting for that expense accordingly through contributions to a risk fund. If

repayment is at all unlikely, the government should consider financing the item with a direct expenditure, such as a grant. By budgeting for contingent liabilities in this way, the government is not only protected from default risk, but decision makers are forced to consider the rationale of each loan guaranteed within the context of established spending priorities.

The Government of Kazakhstan has made some efforts recently to maintain a risk fund for these contingent liabilities, budgeting approximately T 13.2 billion in 1999 and approximately T 16.6 billion in 2000. While this effort is commendable, the amounts budgeted do not appear to be sufficient to finance the likely obligations of defaulted guarantees.

Protection from default risks is not the only issue with loan guarantees, but also the priorities implicit in the projects for which the guarantees are tendered. When guaranteed loans are defaulted, lenders can demand that the government make good on its commitment, and often do, which means the government's priorities are set for them. Because it is known *a priori* that some of the loans will be defaulted, by issuing a guarantee, the government is making a commitment to pay for part of the project being financed by the guaranteed loan. It may not seem reasonable to government officials to offer a grant to finance the construction of the Intercontinental Hotel in Astana or the construction of a plant for the production of spirits in Uralsk City, but because the government of Kazakhstan guaranteed significant loans for those purposes, and there is some probability of the loans being defaulted, the government effectively financed part of those activities.²³ In this sense, the expenditures financed with loan guarantees certainly should fall under the scrutiny given to direct loans, or for that matter, even direct expenditures. More importantly, because loan guarantees are solicited, it is actually the recipients that are setting the priorities, not the government.

Given the great potential for default risk and the sizeable expenditure obligations that can result, and the fact that loan guarantees often entail priorities that are established by the recipient rather than the government, there is a great need for effective control of loan guarantees. Of course, control can only be effective before guarantees are tendered. This means that loan guarantees should be carefully scrutinized before they are tendered. This will require the maintenance of explicit limits for loan guarantees and clear criteria for issuing guarantees that reflects the priorities established by the government. Kazakhstan has made positive progress in this direction recently by establishing a ceiling for guarantees and proposing restrictions of their use to infrastructure projects, but these limitations need to be legislated and the definition of an infrastructure project needs to be clearly delineated. As recently as May, 1999 the government issued loan guarantees for the purchase of Boeing aircraft in the amount of T 36 million. Appending an account of government loan guarantees to the budget would provide a basis from which better decisions can be made about the overall level of outstanding guarantees and the distribution of these guarantees across programs.

5.2 Imposing Hard Budget Constraints: Arrears and Offsets

One salient feature of government finance in Kazakhstan in recent years is the continued, and at times accelerated, accumulation of budgetary arrears. Total arrears of the state increased over 70 percent from January, 1998 to June 30, 1999, and increased almost 33 percent in the first half of 1999 alone (Table 7). By far the bulk of this increase has come from the Republican government, due mostly to the accumulation of large arrears in pensions and social benefits in the first half of 1999, which amounted to almost 18 billion tenge.

Kazakhstani authorities have been moving in the right direction in reducing this problem.

Recent changes have been proposed to the Administrative Code that would hold public managers more accountable for irresponsible spending decisions such as deviations from programmed expenditures. This has the potential to substantially reduce the accumulation of future arrears if it is consistently enforced. Given the acceleration of arrears in the last year, these changes need to be implemented immediately in order to avoid compounding an already serious problem.

The remaining question is what to do about the current stock of arrears.²⁴ The government clearly is committed to paying its obligations, which not only is the most equitable option, but will work to enhance the credit-worthiness of the government in the eyes of its suppliers and the trust of its constituents.²⁵ Plans are to pay T 10 billion in arrears at the Republican level and T 5 billion at the local levels in 1999. Nevertheless, as shown in Table P12, the stock of arrears increased substantially in the first six months of 1999. The commitment to pay arrears must be accompanied by a commitment to stop accumulating additional liabilities if progress is to be made. Payment of arrears has been de-emphasized in the 2000 budget, as only T 6 billion has been allocated for that purpose. While cash payment of arrears probably is the best solution, there are alternatives available that would allow Kazakhstan to immediately honor its commitment on arrears while living within its financial constraints. One option is to retire the entire stock of arrears immediately by borrowing and earmarking the borrowed funds to pay off arrears. While this would increase the explicit debt of the government, its overall debt picture (explicit and implicit debt) would not change. Of course, interest would have to be paid on the new debt, but this would represent a transfer of costs to the government from those who are owed the arrears. While this may not be feasible, the government would establish greater credibility if it were to at least schedule payment of arrears so as to reduce uncertainty about its

honoring its commitments. This would be especially effective if the government were to securitize the arrears, which means providing those who are owed payment with marketable claims with set (probably phased out) maturity dates.²⁶

What should not be done is a continuation of tax offsets against arrears. First, some claimants may not have taxes to offset, which means arrears would be paid on an arbitrary basis. Secondly, and more importantly, offsets in general (against not only arrears but against expenditures generally) facilitate the breaking of budgetary discipline, provide opportunities for hidden subsidization, and reduces the transparency of the budget more generally. Current plans are to eliminate the use of offsets beyond 2001.

5.3 Budgeting for the Medium Term

If Kazakhstan is to be more focused on priorities in public expenditure, perhaps the greatest need is for a multi-year planning and budgeting process. The use of a multi-year budget would allow them to better balance the prioritization of expenditures, would provide an early warning signal for budgetary imbalances, and would help increase the allocative efficiency of expenditures. For instance, capital investment projects may be found to be unsustainable when recurrent costs to cover the necessary operation and maintenance in future years are considered, or budget entitlements and obligations may be found to grow out of control in a few years should they continue to follow current trends. The government has already made significant progress in this direction by developing the major macroeconomic and budget indicators for 2000-2002. This framework could now be expanded into a complete Medium-Term Expenditure Framework (MTEF) in the near future, a framework which would establish spending priorities over a 3-5 year time horizon, much in the way that currently is done in the Public Investment Program (PIP).

The lack of a multi-year budgeting framework provides for a much greater connection between policy objectives and budget planning. First, as highlighted above, sufficient recurrent expenditures for operations and maintenance needs to be appropriated with capital investment if infrastructure development is to proceed in a cost-effective manner. The MTEF, by incorporating spending plans over a multiyear time horizon, provides a mechanism for these appropriations. Secondly, as also noted previously in the report, expenditures on social sectors such as health and education are much more effective if they follow a stable and predictable path. Education is necessarily a cumulative process, and the benefits of health efforts tend to deteriorate rapidly in the absence of continued support. The MTEF would help ensure that these dynamics are adequately considered in the annual budget. Thirdly, the presence of a MTEF allows for more strategic, longer term planning, which would help the government establish reasonable and thoughtful spending priorities. Finally, if developed and implemented appropriately, the MTEF allows for a well-connected cycle of planning, budgeting, and control (Box 1).

Multiyear budgets should not be seen as commitments of future funds, and certainly should not be viewed as spending floors. The future fiscal environment is uncertain, and the macroeconomic envelope is likely to dictate the extent to which planned spending can be realized. This is the real danger with multiyear budgets, as they tended to hinder efforts to constrain public expenditures in many industrialized countries during the budget crises of the 1970s.²⁷ This is a danger that can be avoided, however, if the role of the multiyear budget as a planning tool rather than a list of expenditure commitments is clearly expressed up-front.

5.4 Planning for Contingencies

The necessity of several budget revisions recently in Kazakhstan, along with its volatile

fiscal environment, suggest that the government should better prepare itself for the possibility of fiscal contingencies in the coming budget year. Even if the fiscal situation were to turn around, Kazakhstan's reliance on revenues from the commodity sectors, and the lack of predictability that involves, means that the possibility for future crisis would be continually present. That is, there is likely to always be a potential for fiscal crisis in Kazakhstan, and consequently, the necessity for substantial mid-year budget reductions.

One option for making fiscal adjustments is to impose across-the-board or *ad hoc* cuts in expenditure. This sort of adjustment often is attractive to policy makers because it is straightforward and provides an aura of fairness. In reality, however, across-the-board or *ad hoc* cuts indicate a lack of priorities and do not work to minimize the damage to social welfare that may arise from government fiscal restraint. First, some programs and projects have less slack than others, which means the cost in terms of diminished service delivery is likely to be much greater than for programs with more flexible budgets.²⁸ Secondly, unprioritized cuts do not take the dynamics of individual programs into consideration. For example, education and health programs must be financed in a stable fashion over time if they are to provide maximum benefits. Finally, the imposition of across-the-board cuts or *ad hoc* reductions, does not allow for adequate planning because of the large degree of uncertainty involved. The existence of formal mid-year budget revisions in Kazakhstan suggests that expenditure cuts are not made in such a manner, but in fact they sometimes are. As stated in the *Law on the Budget System*, formal (legislated) budget revisions are not necessitated unless spending must be reduced in amounts greater than ten percent of the existing budget in force. Because the various departments do not plan for specific spending reductions before hand, this often leads to last-minute budget adjustments which rarely

are carefully thought out.

Currently provisions are made for nonsequestration in the budget, which establishes a limited means of prioritizing expenditures and provides some framework for making cuts, but there is a great need for more detailed contingency planning. This means developing an *ex ante* plan for spending cuts. The first step would be for each department to establish a transparent and comprehensive set of spending priorities based on long-term policy goals. A set of these programs would then be targeted for elimination or postponement should resources fall short of projections, and individual spending activities within this set would be prioritized as well. In addition to allowing for a more rational approach to spending cuts, this planning process would provide for an increased focus on prioritization during the budget development phase and would add a layer of transparency to the budget revision process. Moreover, the process of reducing public expenditure would be much less arduous and more politically palatable.

6. Conclusions

The volatile macroeconomic picture in many transition countries suggests that the only viable option for maintaining a given level of public services is to optimize public spending so that expenditures may be reduced while minimizing disruptions to the provision of government services. This, in turn, means that efforts must be made to ensure that public services are adequately prioritized and delivered as efficiently as possible. Using the Republic of Kazakhstan as a case study, this paper suggests that a successful effort to this end will include an analysis of the appropriate role of government, including the privatization of agriculture and industry and the rationalization of public subsidies and lending; a determined and thoughtful choice of budget priorities among competing programs; and the creation of a budget atmosphere that is conducive

to proper expenditure management. Of course, prioritizing expenditures during the budget process does little good if there is inadequate control over spending on the execution end. Proper audit and evaluation systems are an equally crucial component in creating an environment for the proper rationalization of public expenditure.

TABLES

TABLE 1
Privatization of State-Owned Enterprises (number of units privatized)

	1994	1995	1996	1997	1998	1999	2000
Small-scale privatization	2,748	2,477	3,393	5,590	2,539	2,153	1,581
Mass privatization	N/A	147	497	1,122	514	161	129
Privatization in agriculture	918	513	138	18	9	4	11
Case-by-case privatization	N/A	5	28	47	11	0	3
Total	4,147	3,142	4,056	6,777	3,073	2,318	1,724

SOURCE: European Expertise Service, *Kazakhstan Economic Trends*, Quarterly Issue, October-December, 2000, February, 2001.

TABLE 2
Consolidated Expenditures by Functional Group and Net Lending
As a Share of GDP (%)

	1997 Executed	1998 Executed	1999 Executed	2000 Projected
Revenues	20.8	17.6	20.9	24.9
Expenditures	26.3	24.3	23.5	22.3
Government Administration	1.8	1.8	1.5	1.2
Defense and Public Order	2.8	2.9	2.6	2.4
Social Sector	16.2	13.1	14.9	13.4
Economic Services	1.6	1.0	1.2	1.7
Debt Servicing	0.6	0.8	1.0	1.6
Other	3.4	4.7	2.3	2.0
Lending - Repayment	1.8	1.4	0.9	0.8
Total Expenditures and Lending - Repayment	28.1	25.7	24.4	23.1
SURPLUS (DEFICIT)	(7.3)	(8.1)	(3.5)	1.8

SOURCE: 1997-98, Kazakhstan Ministry of Finance and World Bank staff calculations; 1999-2000, IMF (2001).

NOTES: Revenues exclude capital transactions, which are treated as a financing item; 1997 and 1998 include extra-budgetary funds; GDP (bil Tng): 1997 = 1672, 1998 = 1748, 1999 = 1893; 2000 projections based on budget execution, Jan - Jun, 2000 (IMF); Components may not sum to totals due to rounding

TABLE 3
Consolidated Social Sector Expenditures, 1997-2000
As a Share of GDP (%)

	1997 Executed [% of total]	1998 Executed (% change) [% of total]	1999 Executed (% change) [% of total]	2000 Projected (% change) [% of total]	Local Share (%) 1999
TOTAL SOCIAL SPENDING	16.2 - [53.8]	13.1 (-19.1) [47.5]	14.9 (13.7) [60.9]	13.4 (-10.1) [57.7]	44.8
o/w Education	4.4 - [15.6]	3.9 (-11.4) [15.3]	4.1 (5.1) [16.9]	3.6 (-12.2) [15.6]	78.9
o/w Health	2.8 - [9.8]	2.1 (-25.0) [8.0]	2.4 (14.3) [9.6]	1.9 (-20.1) [8.0]	83.5
o/w Social Security and Welfare	8.0 - [28.4]	6.2 (-22.5) [24.2]	8.4 (35.5) [34.4]	7.9 (-6.0) [34.1]	13.8

SOURCE: 1997-98, Kazakhstan Ministry of Finance and World Bank staff calculations; 1999-2000, IMF (2001).

NOTES: 1997 and 1998 include extra-budgetary funds
GDP (bil Tng): 1997 = 1,672; 1998 = 1,748; 1999 = 1,893
2000 projections based on budget execution, Jan - Jun, 2000 (IMF)
Components may not sum to totals due to rounding

TABLE 4
General (Consolidated) Government Expenditures by Function
International Comparisons

	Kazakhstan		Middle Income Countries		High Income Countries	
	1997-1998 (weighted average)		1983-1990 (two-year weighted averages)			
	% GDP	% Total	% GDP	% Total	% GDP	% Total
Expenditure	25.3	100.0	23.9	100.0	39.1	100.0
Defense	1.1	4.3	1.5	6.5	4.7	12.0
Education	4.1	16.4	2.4	10.1	4.9	12.5
Health	2.4	9.5	1.7	7.0	5.1	13.1
Social Security and Housing	7.4	29.2	7.0	29.3	11.3	28.8
Other	10.3	40.6	11.3	47.1	13.1	33.6
Number of Countries	N/A		7		8	

NOTES: Expenditure does not include lending minus repayment; Middle Income countries include Argentina, Chile, Hungary, Panama, Romania, Swaziland, and Zimbabwe; High income countries include Australia, Canada, Denmark, Germany, Israel, Luxembourg, the United Kingdom, and the United States

SOURCES: International Data, Ke-young Chu *et al.*, "Unproductive Public Expenditures: A Pragmatic Approach to Policy Analysis," *Pamphlet Series No. 48*, International Monetary Fund, Washington, DC, 1995. Kazakhstan Data, Ministry of Finance; World Bank staff estimates.

TABLE 5
 Projected Spending on Social Security and Social Assistance by Program
 Republican Budget, 1999-2000 (KZT)

	1999 Projected	1999 Annualized*	2000 Projected	% Change 1999-2000 Annualized
Social Security	139,883,498	142,887,008	137,749,946	(3.6)
Pensions	102,271,404	102,271,404	100,489,617	(1.7)
Social Benefits	27,186,045	27,186,045	21,887,077	(19.5)
Special State Benefits	9,010,531	12,014,041	13,862,475	15.4
o/w miners and other workers retired from hard labor conditions	-	-	300,000	
Other	1,415,518	1,415,518	1,510,777	6.7
Social Assistance	494,500	494,500	16,924	(96.6)
Social Security and Social Assistance Service	869,833	869,833	1,639,031	88.4
TOTAL	141,247,831	144,251,341	139,405,901	(3.4)

SOURCE: Kazakhstan Ministry of Finance, 2000 Budget.

NOTES: * Special State Benefits were funded by the Local Budgets until April, 1999
 These data are projections based on early 1999 budget execution and the initial 2000 budget document; data on actual budget execution were not available at this level of detail

TABLE 6
Expenditure Execution by Economic Classification
Consolidated Budget, 1997-1999

	1997	1998	1999	1996	
				Middle Income Countries	High Income Countries
Current Expenditure	87.2	86.5	92.6	81.1	92.6
Goods and Services	40.0	38.6	49.9	35.1	46.0
Wages and Salaries	21.2	20.6	22.4	12.2	22.7
Employers Contributions	4.8	4.7	4.3		
Other Goods and Services	14.0	13.3	23.2	17.0	21.8
Interest Payments	2.0	3.1	6.4	4.3	11.2
Subsidies and Transfers	45.2	44.8	36.3	41.7	35.4
o/w subsidies	4.7	3.1	0.9		
o/w extra-budgetary funds	27.2	16.8	-		
Capital Expenditure	6.4	8.1	2.9	18.1	7.4
Total Expenditure	93.6	94.6	95.5	99.2	100.0
Lending - Repayment	6.4	5.4	4.5	0.8	0.0
TOTAL	100.0	100.0	100.0	100.0	100.0

SOURCES: Kazakhstan data, Ministry of Finance; International data, Ke-young Chu *et al.*, *Unproductive Public Expenditures: A Pragmatic Approach to Policy Analysis*, Pamphlet Series No. 48, International Monetary Fund, Washington, DC, 1995; World Bank staff estimates

NOTES: 1997 and 1998 include extrabudgetary funds; "Wages and Salaries" and "Other Goods and Services" do not add up to total Goods and Service in the international comparisons because some countries do not separate wages and salaries from other goods and services; "Subsidies and Transfers" include unclassified expenditures from extra-budgetary funds (1997 = 27.2%; 1998 = 16.8%)

TABLE 7
Arrears of the State Government, 01.01.98 - 01.07.99
(mil Tng)

	January 1 1998	January 1 1999	July 1 1999	% Change 1/98 - 7/99	% Change 1/99 - 7/99
Local Budgets	28,917	31,672	33,731	16.6	6.5
o/w salaries	3,447	1,829	2,382	(30.9)	30.2
Republican Budget	8,088	12,748	29,292	262.2	129.8
o/w pensions	-	-	10,519		
o/w social benefits	-	-	7,412		
Former Extra-Budgetary Funds	7,136	11,543	11,543	61.8	-
Social Insurance Fund	4,606	6,534	6,534	41.9	-
Employment Fund	1,953	3,209	3,209	64.3	-
Road Fund	578	1,800	1,800	211.4	-
Other*		664	664		-
State Total	44,141	56,627	75,231	70.4	32.9

SOURCE: Ministry of Finance

NOTES: * Sanatorium and Rehabilitation due to Ministry of Internal Affairs

BOX 1

Linking Strategic Planning, Budgeting, and Evaluation in a Medium Term Expenditure Framework

The development of a medium term expenditure framework in Kazakhstan is a necessary step in integrating strategic planning with the budget process and expenditure evaluation. The links could be established in the following steps:

- (1) Forecast realistic macroeconomic scenarios for the medium term and project consistent and sustainable envelope for public sector resources within that framework (Kazakhstan has made significant progress in this area by including broad macroeconomic and budget indicators with the 2000 budget)
- (2) Delineate outcomes-based objectives for each policy arena and establish clearly-defined expenditure priorities with which these objectives can be achieved
- (3) Incorporate these priorities in a medium term spending plan, being sure to account for the necessary operations and maintenance costs to sustain capital investments
- (4) Plan the annual budget within the framework of the medium term plan
- (5) Implement the budget, ensuring that any mid-year revisions are consistent with established priorities
- (6) Account for expenditure by closely monitoring government activities
- (7) Evaluate the success or failure of programs in reaching their objectives
- (8) Reconsider expenditure priorities in light of evaluations and restart the planning and budgeting process with (1)

SOURCES: World Bank, *Public Expenditure Management Handbook*, 1998; Allen Schick, Ed., *Perspectives on Budgeting*, American Society for Public Administration, 2nd ed., 1987; World Bank, *Ethiopia Public Expenditure Review*, November, 1997.

NOTES

1. European Bank for Reconstruction and Development [EBRD], *Transition Report 2000: Employment Skills and Transition*, EBRD, London, Nov. 2000. The European Expertise Service, which publishes the quarterly *Kazakhstan Economic Trends*, suggests that as of January 1, 2001, only 80.8 percent of small firms were privatized, with 13.4 percent remaining under State control, 3.2 percent under mixed ownership, and 2.6 percent under foreign ownership.
2. EBRD, 2000.
3. European Expertise Service [EES], *Kazakhstan Economic Trends*, Quarterly Issue, October - December, 2000, EES, Brussels, Feb. 2001.
4. EES, 2001.
5. See EBRD, 2000. The EBRD estimates that fully state-owned enterprises contributed approximately 35 percent of GDP in 1998.
6. EBRD, 2000, 174. The EBRD notes that one potential cause of this stall is the reluctance to adhere to strict disclosure requirements.
7. Ke-young Chu, Sanjeev Gupta, Benedict Clements, Daniel Hewitt, Sergio Lugaresi, Jerald Schiff, Ludger Schuknecht, and Gerd Schwartz, *Unproductive Public Expenditures: A Pragmatic Approach to Policy Analysis*, Pamphlet Series No. 48, International Monetary Fund, Washington, DC, 1995.
8. The government significantly changed the way expenditures are reported in 1997, which makes for tenuous comparisons with earlier periods at best. For this reason, the analysis is focused on the period 1997 and onwards. Given the enormous changes in Kazakhstan since its inception as an independent country in 1991, the more recent data is really the only relevant data.
9. Lending minus repayment is excluded in Table 4 to make the figures comparable to the international data that is available. Otherwise, all figures are expressed as a share of total expenditure + lending - repayment to make them consistent with other data in the report.
10. These figures reflect the author's estimates based on 1999-2000 Kazakhstan Ministry of Finance and World Bank staff budget projections.
11. Personal communication, UNAIDS Project, Almaty, Kazakhstan.
12. George Psacharopoulos, "Returns to Investment in Education: A Global Update," *World Development*, 22 (9), Sept. 1994, pp. 1325-43.
13. Ke-young Chu and Richard Hemming, Eds., *Public Expenditure Handbook: A Guide to Policy Issues in Developing Countries*, International Monetary Fund, Washington, DC, Sept. 1991.
14. Invalids may fall into one of three categories of disability, and the benefit varies across categories.
15. Special State Benefits were funded by the Local Budgets during the first three months of 1999

16. There appears to be a shift of resources from subsidies and transfers to purchases of goods and services in 1999; however, the expenditures from extra-budgetary funds for 1997 and 1998 were allocated entirely to subsidies and transfers in this table because a breakdown by economic composition was not available. Most likely a portion of this expenditures was for the purchase of goods and services.
17. Vito Tanzi, "Fiscal Issues in Adjustment Programs," *Ricerche Economiche*, 44(2-3), 1990, pp. 173-194.
18. Specifically, tax expenditures represent forgone revenue arising because of deviations from the normal tax structure. Thus, tax credits for children would be considered a tax expenditure, while graduated personal income tax rates would not.
19. In Kazakhstan, many tax expenditures serve both economic development and social equity goals, such as special allowances for employers of the disabled.
20. Allen Schick, "Controlling Nonconventional Expenditure: Tax Expenditures and Loans," *Public Budgeting and Finance*, 6(1), 1996, pp. 3-19.
21. For a review of tax expenditure calculations and reporting across several countries, see Organisation for Economic Co-operation and Development [OECD], *Tax Expenditures: Recent Experiences*, Paris, 1996.
22. Schick, 1986, p. 12.
23. These guarantees were in amounts of T 14.2 million for construction of the Intercontinental Hotel in Astana (31.10.97) and T 79.0 million for the construction of the distillery in Uralsk (19.11.96).
24. For a comprehensive discussion of options available for retiring arrears, see Alberto M. Ramos, "Government Expenditure Arrears: Securitization and Other Solutions," IMF Working Paper WP/98/80, Washington, DC, International Monetary Fund, May 1998. Much of the discussion in this section is attributable to this source.
25. The repudiation of arrears would be equivalent to a lump sum tax on those who are owed, which is not only inequitable from a horizontal perspective, but given the amount of pension and wage arrears, may also violate vertical equity goals Kazakhstan may have.
26. Ramos, 1998, discusses this procedure in detail, as well as the benefits and costs involved.
27. Schick, 1986.
28. See "Managing Fiscal Stress," in A. Premchand, *Public Expenditure Management*, International Monetary Fund, Washington, DC, 1993, pp. 53-80.