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Kazakhstan
Public Expenditure Review

(In Three Volumes) Volume I: Summary Report

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CURRENCY AND EQUIVALENT UNITS

(As of December 31, 1999)

Currency Unit: Tenge (T)
Exchange Rate:
US$1.00 = 0.00724
Tl = US$138.20

Average Exchange Rate: Tenge per US$1		
1997	**1998**	**1999**
75.44	78.30	119.52

ACRONYMS AND ABBREVIATIONS

ADB	Asian Development Bank
AEP	Agency for Economic Planning
AIDS	Acquired Immune Deficiency Syndrome
ASPR	Agency for Strategic Planning and Reforms
BOP	Balance of Payment
CHIF	Compulsory Health Insurance Fund
CHP	Central Health Purchasing
CIS	Community of Independent States
CIT	Corporate Income Tax
CMIF	Compulsory Medical Insurance Fund
CPC	Caspian Petroleum Consortium
CPI	Consumer Price Index
DFID	Department for International Development (U.K.)
FSU	Former Soviet Union
GDP	Gross Domestic Product
GFS	Government Finance Statistics (IMF)

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HIV	Human Immunodeficiency Virus
IAAP	Internationally Accepted Accounting Practices
IBRD	International Bank for Reconstruction and Development
IEO	International Energy Organizaation (U.S. Dept of Energy)
IMF	International Monetary Fund
INTOSAI	International Organization of Supreme Audit Institutions
MOES	Ministry of Education and Science
MOF	Ministry of Finance
MSR	Ministry of State Revenue
MTEF	Medium-Term Expenditure Framework
NBK	National Bank of Kazakhstan
NFC	Normalized Fiscal Capacity
NSA	National Statistical Agency
OECD	Organization for Economic Co-operation and Development
OSHF	Oil Stabilization and Heritage Fund
PAYGO	Pay As You Go
PEMS	Policy and Expenditure Management System
PHC	Package Health Care
PIP	Public Investment Program
PIT	Personal Income Tax
PSRMAL	Public Sector Resource Management Adjustment Loan
REF	Regional Equalization Fund
SAF	State Accumulation Pension Fund
SAI	Supreme Audit Institution
SAP	Social Assistance Program
SCI	State Committee on Investment
SEZ	Special Economic Zones
TIMSS	Third International Mathematics Science Study
UNDP	United Nations Development Programme
UNFPA	United Nations Population Fund
UNICEF	United Nations Children's Fund
USAID	U.S. Agency for International Development
VAT	Value Added Tax
VTE	Vocational and Technical Education
WHO	World Health Organization
WTO	World Trade Organization

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ABSTRACT

This is Volume I of the Public Expenditure Review (PER) that has been prepared at the request of the Government of Kazakhstan. This PER builds upon the Bank's previous work on the country's transition experience to a market-oriented economy[1] and recent public sector reforms. This report aims at identifying key public expenditure issues and suggesting possible strategies and policy options. The PER is part of a capacity building effort to encourage the Government to independently carry out this exercise as a regular undertaking to effectively manage the country's public finances.

Kazakhstan is a reforming economy in the process of completing a first generation of structural reforms (by consolidating institutions and policies towards liberalization and financial stabilization), and is on the verge of preparing a second generation of structural reforms aimed at sustainable economic growth. The country has made significant progress on liberalizing and stabilizing the economy, and on implementing important institutional reforms to discipline public expenditures by: a) adopting international classification and standard reporting systems; b) adopting budget ceilings by function, program and program manager; c) incorporating extra-budgetary funds into the budget; d) formalizing intergovernmental relations; e) formalizing a Budget Commission to guide the budget process; d) starting an incipient Public Investment Program; and e) establishing a National Treasury.

Current outstanding public expenditure issues identified by the report as deserving particular attention from the Government include: a) persistent underlying fiscal imbalance; b) deficient domestic resource mobilization management; c) lack of reliable mechanisms for effective expenditure prioritization; d) inefficient budgetary execution, weak audit and lack of performance evaluation; e) deficient mechanisms of intergovernmental fiscal relations; f) inefficient public service delivery; and g) large disparities on per capita social expenditures (health, education, and social assistance) across regions.

The report points out strategy options and policy reform that can, through programmed deficit reduction, converge the system to fiscal sustainability by: a) rationalizing domestic resource mobilization, mainly oil/gas rents, which preserve domestic savings, capital accumulation and development of non-oil sectors; b) focusing governmental actions only on few areas (of market failure and/or for equity reasons), by prioritizing programs on the basis of output/outcomes, multiyear budgeting, and performance evaluation; c) strengthening intergovernmental relations, by extending the scope and improving central coordination of fiscal decentralization, increasing autonomy and accountability of local managers and authorities, and reforming the tax sharing and transfer mechanisms; and d) increasing efficiency of spending and improving access and quality of public service delivery, by focusing social assistance exclusively on the poor, restructuring service facilities (including selective rehabilitation of basic infrastructures and equipment, and phased implementation of public service reform), and creating conditions for private initiative participation.

[1] "*Kazakhstan: Transition of the State*", World Bank Country Study, 1997; "*Kazakhstan: Living Standards During the Transition*", World Bank Report no. 17520-KZ, 1998.

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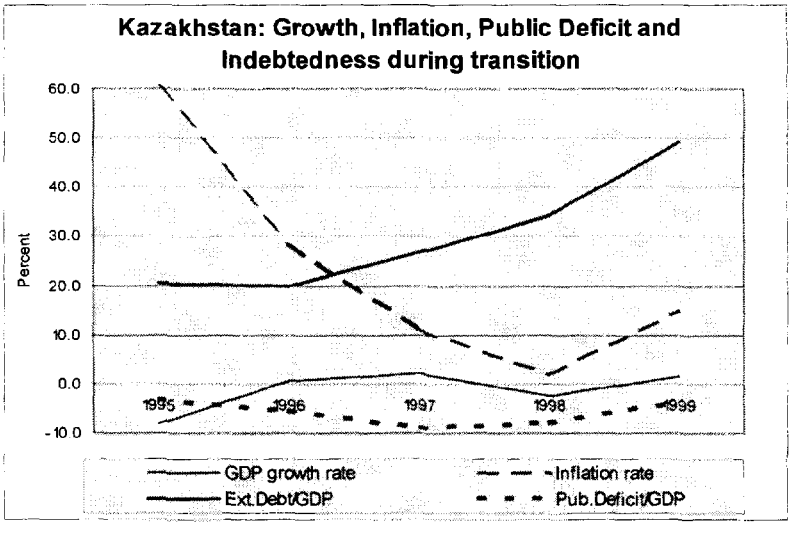
This report was written under the general guidance of Kiyoshi Kodera (Country Director), Pradeep Mitra (Sector Director), and Hafez Ghanem (Sector Manager). Valuable inputs and suggestions were received from Deborah Wetzel, Helga Muller, Amitabha Mukherjee, Anwar Shah, Friedrich Konigshofer, Maureen Lewis, Betty Hanan, John Langenbrunner, and Julia Devlin. The report was edited by Usha Rani Khanna and processed by Nancy Davies-Cole.

EXECUTIVE SUMMARY

Background and Issues

1. After the break up of the Soviet Union, Kazakhstan experienced a dramatic economic recession and hyperinflation until the mid-1990s.[2] The economic and structural reform policies implemented since then have been quite successful in combating inflation, but the underlying fiscal imbalances have not been resolved, domestic savings and investment remained low, and the economy stagnant.[3] By the end of the 1990s, external and public debt to GDP ratios increased rapidly to unsustainable levels, jeopardizing economic growth recovery (Chapter I, Volume II).[4]



2. Kazakhstan is one of the reforming countries among the economies in transition. Economic and trade liberalization have largely been accomplished. Public administration and financial sector reforms, and a new legal and regulatory framework are under way. With the privatization of most of the small and medium-sized enterprises, the government's scope in the economy decreased significantly by the late 1990s. Nevertheless, unemployment remains high,

[2] During the period, real GDP fell 50 percent, and inflation hit four digits in 1993 and 1994.

[3] Population fell at a –1.6 percent annual rate during the decade, to about 15 million in 1999. Estimated nominal per capita GDP was US$1,036 in 1995 and US$1,025 in 1999.

[4] Fiscal deficit has fluctuated between 4 and 9 percent of GDP. "Seignorage" has been insignificant as a deficit financing source. Half of the deficit has been financed by privatization proceeds, and the other half by foreign loans. Consequently, public and external debts have escalated from 12 and 21 percent in 1995 to 30 and 50 percent in 1999, respectively.

social indicators have mostly stagnated or deteriorated, and the public sector remains ineffective, inefficient and inequitable, with respect to revenue collection, spending and service delivery (Chapters II, III, IV, and V).[5] Incomplete structural reforms and inefficient domestic resource mobilization are major hurdles that the government might overcome in order to resolve the persistent underlying fiscal deficit and pave the way for economic recovery on a sustainable and equitable basis.

3. This report was prepared at the request of the Government of Kazakhstan, and is the result of a joint endeavor of the Bank and Government officials/staff. The report identifies and analyzes the outstanding issues in Kazakhstan public expenditure policies and processes, suggests options, and makes recommendations to address the current challenges. The first major issue identified in the report is the inadequacy of the domestic resource mobilization system. The present system neither promotes savings and private investments, nor sustains a reasonable and stable public expenditure program (Chapter I). A second major issue is the non-transparent process in prioritizing public expenditures, which jeopardizes governance (Chapter II). A third major issue is the deficient management of the public sector, which impairs efficiency and quality of public services (Chapter III). The fourth important area of discussion is the evolving system of intergovernmental fiscal relations, which is still only ambiguously leaning towards a more decentralized decision-making process (Chapter IV). Finally, although the government spends the bulk of its budget on social expenditures (social assistance, health, and education)[6], the quality of services continues to deteriorate, delivery is inefficient, and access unequal (Chapter V).

Policy Strategy and Options

4. Kazakhstan has to start with a strategy of drastically reducing its fiscal deficit, while responding to significant pressures to improve the delivery of basic public services. International experience has shown that such a strategy can only be sustainable if economic growth is recovered early on in the process. Fortunately, Kazakhstan has a distinctive resource base characteristic (mainly oil/gas) which, if properly mobilized, can substantially help restore economic growth.

5. The main strategy suggested by the report is to take on the challenges on the following fronts:

(a) *accelerate structural reforms* (the ongoing ones and start as soon as possible the preparation of the new generation of reforms as proposed in this report), *while converging to fiscal sustainability*, i.e., stabilizing the public debt to GDP ratio at the present level;

(b) *reform the domestic resource mobilization system*, by restructuring tax and customs tariff policy and administration (including the approval and implementation of new Tax Code), and establishing an independent accountable mechanism to rationalize the use of oil/gas rents;

[5] Between 1993 and 1997, life expectance and basic education enrollment rate fell from 67 to 64 years and from 92 to 89 percent, respectively.

[6] Representing about half of the State Budget and three-fourth of the aggregate local budgets.

(c) *focus government actions on few areas of market failure and/or for equity reasons*, by prioritizing merit programs on the basis of output/outcomes, multiyear budgeting, and performance evaluation; and

(d) *reach a consensus on fiscal decentralization* (including tax and expenditure assignments, and transfer mechanisms), review the Budget System Law accordingly, and start the process of capacity building at the subnational level to increase both autonomy and accountability.

6. Ideally, these reforms could/should be tackled simultaneously. However, given, on the one hand, the amplitude and complexity of the policy agenda (as described below), and, on the other hand, the limited implementation capacity, the government may opt to phase in the reform agenda by prioritizing its most pressing components.

7. The specific findings, options and recommendations are summarized in the following sections, and detailed in the respective Chapters of the report. Policy sequencing is discussed at the end of this Executive Summary and outlined in the attached "Matrix of Main Issues and Recommendations".

Fiscal Sustainability and Structural Reforms

8. Progress in the proposed reform program that follows below is crucially dependent on how sustainable the ensuing fiscal stance is going to be. As referred above, since independence Kazakhstan has systematically incurred high fiscal deficits and the stock of debt has accumulated rapidly (particularly in the last three years), reaching unsustainable levels. Simulations developed in Chapter I suggest that to stabilize the public debt/GDP ratio at the current level, Kazakhstan should be generating a primary surplus of about 1.4 percent of GDP.[7] As the average actual primary surplus for the last three years (1997-99) was -5.6 percent, there would be an estimated required fiscal adjustment of 7 percent. As this is not a trivial adjustment effort, the recommendation is that it should be developed in the context of a medium-term macroeconomic framework, where consistent resource mobilization should go in tandem with implementation of the recommended structural reforms and an efficient and equitable allocation of public expenditures. Thus, even if the government can continue in the next two or three years to use temporary privatization receipts as a device to help finance the excess deficit as it did in the recent past,[8] about half of the required additional adjustment to reach fiscal sustainability still remains to be done in the interim. This effort will certainly demand more focused public expenditure prioritization criteria as described below (and in Chapter II and V) and improved domestic resource mobilization (Chapter I).

9. At the top of the policy agenda is the need to *increase emphasis on deficit reduction*, in lieu of the usual practice of merely letting total expenditure fluctuate with revenue collection and leaving a persistent underlying deficit to be financed (Chapter II). Authorities' commitment with a quick convergence to fiscal sustainability is *sine qua non* for the maintenance of price stability,

[7] Assuming an annual growth rate of 3 percent and an 8 percent interest rate on debt for the few years ahead. (Chapter I, Section B.)

[8] An average 3.5 percent of GDP in the last three years—Table I.1, Chapter I

and creating the conditions for the resumption of private investment and growth. Nevertheless, this commitment will only be credible, and the policy will be effective, if consistent concrete evidence show an *acceleration of structural reforms:* both the ongoing reforms and an effective preparation for the implementation of a second generation of required reforms to complete transition to a well-functioning market economy. The ongoing reforms associated with large scale privatization (especially the "blue chip" program), the financial sector, the regulatory framework, and public administration (especially the extension of public service reform to subnational government levels) are essential and urgent to restore competition and improve allocative and operational efficiency economy-wide. The next sections deal with the current fiscal issues and options for required reforms.

Mobilization of Domestic Resources

10. If a well-designed strategic mobilization of domestic resources (mainly the rents from non-renewable natural resources, including oil/gas) is put in place, Kazakhstan can aspire to secure stable financing for a reasonable public expenditure program, and at the same time support the basis for economic diversification and secure a permanent income stream for the benefit of future generations. Nevertheless, tax and customs policy and administration have not yet been effectively used for domestic resource mobilization, and have remained inefficient. In spite of the reforms of the mid-1990s, three main factors have impinged on the under-performance of the tax (and customs) system: (a) its use for several contradictory policy objectives, undermining the system's essential function of maximizing revenue collection; (b) excessive and widespread exemptions and privileges (tax incentives, tax holidays, accounting offsets), feeding moral hazard incentives; and (c) lack of transparency (including the de facto appropriation of gas and oil rents), coordination (particularly with customs), and accountability (including dual subordination of central tax inspectors), weakening tax administration and governance.

11. During the transition of the 1990s, parallel to the erosion of the tax system, the real sector of Kazakhstan's economy was undergoing substantial structural changes. Agriculture and manufacturing collapsed both in absolute and relative terms, while the extractive sectors (mainly oil/gas) took predominance, and the informal sectors of the economy (mainly services) expanded rapidly. The tax and customs systems did not adapt to these structural changes in the real economy. This fact has been of far-reaching consequences for resource mobilization, stability and economic growth in Kazakhstan. If these trends are left unchecked they may augur an undesirable pattern characterized by: (a) a lopsided economic structure (dominated by an *enclave* mineral export sector, appreciated exchange rate, low employment generation, and widespread informal activities); (b) increased external vulnerability (exposed to commodity price fluctuations, and "Dutch disease" effects); and (c) feeble public finances (government expenditure programs subject to unpredictable large revenue fluctuations).

12. In the long-term, with the prevailing deficiencies of the current tax and customs policy and administration and the weaknesses of non-renewable resource mobilization management, resources may be dissipated in consumption instead of reinvested in the non-oil sectors, and future generations' income may end up being reduced as a result of the depletion of natural resource reserves.

13. ***Recommendations.*** Rational domestic resource mobilization to strengthen public finance, and not discriminating against domestic savings, capital accumulation and development of non-oil sectors is the best strategic option the country should follow by:

(a) *restructuring the tax and customs policy and administration.* The tax policy should aim at diversifying and expanding tax bases (especially by providing the right incentives to incorporate informal activities into the regular economy), by promoting national savings, not penalizing capital accumulation and developing non-oil private sectors in general. A first important step could be to review and eliminate excessive tax exemptions, special treatments (particularly for the mineral sector), privileges, and fiscal incentives (including the ones to the industrial sector), and approving and implementing a new Tax Code. The tax and customs administrations should aim exclusively at maximizing government revenue collection as efficiently and equitably as possible (for a given tax policy).[9]

(b) *setting aside a substantial proportion of the oil/gas rents.* The depletion and the unpredictable components of non-renewable natural resources should be set aside (and saved abroad, while domestic technical, administrative, and absorption capacities are being built) and an accountable **"Oil Stabilization and Heritage Fund (OSHF)"** should be established and independently administered and audited. The purpose of the OSHF could be threefold: (i) to insulate the non-oil sectors (including public expenditure programs) from the vagaries of international price fluctuations; (ii) to neutralize the potential "Dutch disease" effects; and (iii) to protect a permanent income flow for the benefit of future generations. [10]

Role of the Government and Prioritization of Public Expenditures

14. The stated priorities both in Kazakhstan 2030's long-term perspectives and in the current Government Action Plan are broadly consistent with the role of government in an economy that is in transition to a market system. During the transition, government is expected to evolve from a heavy, ubiquitous and "all-encompassing" entity to a supportive, "mainly regulatory" authority, gradually refocusing its priorities towards supplying infrastructure, regulating economic activities, administering social justice, and protecting the poor and the environment. In a market economy the private sector takes the lead, and a rationale for government intervention can only be justified on the grounds of compelling market failure (i.e., public goods[11], externalities, and uncontested markets[12]) and social equity (e.g., access to basic goods and services).

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[9] Chapter I, Section B, "Mobilization of domestic resources", item b.

[10] Chapter I, Section B, "Mobilizing natural resources", item a.

[11] For instance, national defense, public order and security, clean air and water.

[12] Rationale for public intervention does not necessarily imply direct public provision and/or production (or delivery) of these goods and services, because they can be outsourced to the private sector. In fact, some health and education activities may be produced in the private sector, with the government overseeing that the services are being financed and delivered in an efficient and equitable manner. In the case of negative (such as pollution) and positive (such as immunization) externalities, government intervention may be more effective through taxation or subsidization to ensure that private providers internalize social costs and benefits and meet demand adequately. Also, government intervention through regulation can discipline uncontested markets for utilities (and to some degree, telecommunications), and avoiding decreasing costs that drive out competitive forces. (Chapter II).

15. During the 1990s, progress in rationalizing the role of the government in Kazakhstan was reflected in the reduction of the public sector's share in GDP from 80 percent to about 45 percent. However, while most targeted small firms have been privatized, *large scale privatization is still lagging behind* and being conducted on a case-by-case basis. Also, *the government has retained large stakes in many of the "privatized" enterprises,* without a convincing rationale. Because the public sector remains so deeply entangled in typical private business activities, Kazakhstan is still highly vulnerable to soft budget constraints induced by the state's support to failing enterprises. Moreover, *the government still maintains significant indirect influence* in production enterprises through tax incentives, government loan guarantees, and direct support to agriculture and small and medium-sized businesses, thereby distorting economy-wide resource allocation. (Chapter II)

16. *On the direct provision* of public services, government's *stated* priorities (to a certain extent reflected in recent budgets) have been, on the one hand, to reduce expenditures on "social sectors" (understood as the old system of privileges, generalized unemployment benefits, and direct maintenance of tertiary and specialized schools and hospitals) and administrative areas (including military and defense), and, on the other hand, to increase allocation for basic infrastructure and social protection (including social assistance to the poor). While spending priorities are eminently a political decision, the technical analysis of budgetary allocation suggests that *expenditure composition in Kazakhstan has fallen short of effective selection criteria* that prioritize programs that can contribute the most for growth and/or social equity. This implies that priority decisions could better envisage the public expenditure process and what these expenditures are really buying (i.e., the *output/outcome,* reflected in the quantity and quality of public services), rather than focus exclusively on government spending itself, which is only an input in the process. (Chapters II, III and V)

17. *The economic composition* of expenditure in Kazakhstan has been relatively stable, but compared to middle-income countries, *spending on the wage bill is still high (a share of about one-fourth), and spending on capital investment and maintenance has been too little (a share of about 8 percent).* As public sector wages are actually low, the problem with the wage bill's share in total spending is related to over-employment, especially at the subnational government level (Chapter I, Annex I.1, and Chapter II). Low spending on capital investment and maintenance is the result of the lack of properly-designed priorities, and will have adverse budgetary consequences in the years ahead. While "net lending" (which includes bailouts of failing private and state enterprises) is still quite large, investment in infrastructure, rehabilitation and maintenance of existing basic facilities have been neglected to such a degree that they are barely usable in some cases. Interest on debt, as a share of the budget has expanded fast, suggesting that Kazakhstan has been increasing current spending at the cost of future spending. This means that, while present fiscal imbalances remain high, the spending share of interest on debt tends to continue to increase and the options for allocation in critical public services tend to narrow in the coming years. The broad trend of spending on "other goods and services" and "subsidies and transfers" though, seems to indicate a gradual move in the right direction: cost-recovery, private financing and delivery of public services, and reduced emphasis on subsidies in favor of more direct targeted transfers. (Chapter V).

18. *The functional composition* of expenditures shows that Kazakhstan, by comparison to middle-income countries, has spent: (a) relatively less on security (military and police

expenditures); (b) relatively more on (the growth-enhancing) education and health sectors; and (c) in line with international practices on social security and housing and other government services. Stability of the general administration and security spending shares implies that adjustments have basically been made on social sectors, although the latter has shown no definite trend. Larger fluctuations in the share of social expenditures suggest that the social sectors are basically treated as a residual item, meaning that high priority at the margin is not given to social spending in the aggregate. Government spending on "economic services" as a share of total public expenditures has been low (between 1-1.6 percent in the last three years), which is a welcome result for the reduction in subsidization of industry and utilities, although non-transparent support to agriculture (subsidization of farmers, and state grain reserve programs) still persists.

19. *The off-budget mechanisms* utilized to finance the construction of the new capital Astana raise some fundamental questions with respect to the country's expenditure prioritization. Apart from the potential inefficiencies resulting from the Special Economic Zone, the allocation of a substantial volume of public resources to Astana city construction (through the Joint Stock Company-Astana Finance) without an explicit and simultaneous submission to public scrutiny in the same budget document, undermines the integrity of the State Budget, prevents the clear establishment of adequate priorities, and is likely to yield a distorted allocation of resource.

20. *Intra-sectoral priorities* in Kazakhstan have been negatively affected by the persistent practice of prioritizing payments according to expenditure categories during budget execution: first wages and salaries, second utilities, and third goods and services or facility maintenance. This practice tends to distort the input mix of capital and recurrent expenditure aimed at reaching maximum technical efficiency in the use of budgeted resources and at improving the quality of service delivery. The current practice goes against sound established technical criteria for prioritizing expenditure by program.

21. ***Recommendations.*** Streamlining the role of government and prioritizing public expenditures are the main pillars on which the Kazakhstan economy will be consolidated as a viable market system. Strategically, to boost economic agents' reliance on market rules and ensure credibility in fiscal policies, the government should focus on fewer selected areas and fundamentally: (i) accelerate the large enterprise privatization program and; (ii) establish clear public expenditure priorities within the available resource envelope.

22. The main objective of the privatization program is to increase efficiency economy-wide. While its fiscal impact might be regarded important in the short-term in the face of the present financial constraints, this should, however, be considered ancillary from a medium/long-term perspective. Therefore, the government should turn the pace of the privatization program around and accelerate the implementation of the "blue chip" privatization program (which include banks, Kaztelecom, power companies, extractive sectors), and also disentangle the state completely from the "privatized" entities (including discouraging local government from participating in commercial/agricultural/manufacturing/banking activities).

23. To improve intersectoral allocation of public resources, the government may consider reviewing the current priorities for fiscal incentives to manufacturing, commerce, and

agricultural (including grain purchase programs and support to small and medium-sized businesses) when distorting market prices. Also, specific implicit and explicit incentive/subsidy/financing for any extra-budgetary program (such as for the construction of Astana city) should be reviewed and either explicitly brought into the state budget or eliminated outright. Moreover, the public service reform (which should include education and health sectors) now under implementation offers a rare opportunity for the government to increase efficiency in the public sector, by identifying and eliminating in each sector excess public employment, defining functions, introducing career plan and decompressing salaries by adopting a merit-based compensation system.

24. Best practices recommend that priorities should be determined by *programs* instead of spending categories. When a program is no longer justified, it should be discontinued altogether with the associated recurrent expenditures (e.g., wages, utilities outlays and maintenance of facilities). Also, a better allocation of resources to selected investment in *basic infrastructure* (and their corresponding rehabilitation and recurrent spending) would be necessary to improve the overall prioritization of public expenditures. Moreover, while the government should continue to *give priority to the social sectors* (education, health, and social assistance), it should make an effort to better rationalize intrasectoral expenditures by *focusing on merit programs*, and be prepared to provide supplemental funds when necessary to stabilize expenditures in those social sectors over time (especially for the "social safety net" program).

25. Kazakhstan can realize significant efficiency gains by reviewing intrasectoral priorities with a programmatic focus. For instance, the government should start refocusing intrasectoral priorities on: primary instead of tertiary and vocational education; prevention and primary healthcare instead of disease treatment; poverty-targeted social assistance instead of the broad Special State Benefit; basic agricultural infrastructure (e.g., rural roads, collective irrigation, as well as research, development, information and rural extension services) instead of market boards, grain purchasing, support prices and subsidized credit; limited technical assistance, informational and legal support and provision of a proper institutional and competitive environment for the development of small and medium-sized businesses instead of distorting discretionary fiscal incentives. (See below for specific recommendations on the social sectors).

Public Expenditure Management

26. The government of Kazakhstan is aware of the importance of developing and maintaining procedures and institutions of the budget process which are conducive to effecting policy priorities. Nevertheless, progress in this area has been uneven. The *structure, formulation and approval of the budget* are areas where progress has occurred, and the 1999 Budget System Law represents a major achievement. Authorities should as well be commended for other recent important realizations in these areas, including: (a) adoption of international classification and standard reporting systems; (b) adoption of budget ceilings by function, program and program manager; (c) incorporation of extra-budgetary funds into the budget; (d) formalization of intergovernmental relations; and (e) formalization of a Budget Commission to guide the budget process. Also, since 1998, a determined effort to design and implement a three-year rolling cycle Public Investment Program (PIP) has been evolving, and, starting with the 2000 budget

formulation exercise, an incipient Medium Term Expenditure Framework (MTEF) seems to be a highly promising development.

27. On *budget execution*, however, the process is still lagging behind. Although modern Treasury functions were designed and started implementation four years ago, they have not yet been fully set up. In the meantime, as an adequate commitment-based control mechanism is not in place, arrears have been accumulating. In practice, the budget execution institutions (both central and local) are considerably limited in their resource allocation capacities, focusing only on inputs control, and are not fully accountable. The fact that the payroll system (representing 70 percent of current expenditures) is not yet computerized also represents a drawback for efficient budget execution.

28. While *reporting* is an area of solid improvement, *monitoring and evaluation* remain the weakest link in the Kazakhstan budgetary process, with feeble internal audit and non-existent ex-post and independent audit and evaluation systems. Although internal audit institutions have been created, procedures are not independent, since auditors perform other activities as well which in turn need to be audited. The audit system lacks manuals for standard procedures and policies, and audit activities have focused mostly on compliance with laws and regulations, little on financial and accounting practices, and almost nothing on value-for-money auditing.

29. Probably due to a lack of tradition with external audit in the budget system of the FSU, there is still no solid external audit and verification of budget execution in Kazakhstan. The existing Accounting Committee is not independent from the executive branch of government, and its staffing, funding, and accountability is still directly under the President, instead of the Parliament as best practices recommend. Both at the central and local levels, "auditing commissions" lack adequate staff and training. Although with increased fiscal decentralization it is now more important than ever to ensure efficient use of funds and achievement of desired standards of public services, performance evaluation and monitoring functions practically do not exist in Kazakhstan yet.

30. Moreover, the prioritization of expenditure in Kazakhstan tends to be less effective because: (a) government fiscal activities are not yet all consolidated in the State Budget (which omits, for example, "tax expenditures" from fiscal incentives, the financing of Astana construction, and contingent liabilities from state guarantees); (b) indicators used in the budget formulation are not realistic and/or accurate (e.g., under/over-projections of revenue); (c) soft budget constraints still exist in the form of lending (soft loans), arrears and tax offsets; and (d) a systematic contingency plan to preserve priorities in case of fiscal crisis is still lacking.[13]

31. ***Recommendations.*** Strengthening public expenditure management is central to effecting policy priorities and to achieving efficient delivery of public services. Although Kazakhstan has started reforming its budgetary process and institutions, the strategic direction in this area should now be the *acceleration and expansion of the reforms* to complete a basic set up of budgeting instruments, role of agents, rules of the game, and incentive mechanisms.

[13] On the latter, there is only an incipient exercise carried out in the context of the 1999 IMF program.

32. On the budgetary process' *structure, formulation and approval,* the government may decide on a new strategic approach and start with the immediate implementation of some institutional arrangements, as indicated in the next paragraph. The *new strategic orientation for the budgetary process*, which may take time to be fully implemented, would be achieved by:

(a) focusing the budget structure and process on: (i) sectoral *programs*, quantity of *output*, and *quality* of service delivery; and (ii) measurable *outcomes* to be achieved. (Input control and facility maintenance become ancillary implementation mechanisms);

(b) integrating the PIP into a *Medium-Term Expenditure Framework* (MTEF), which formally considers recurrent expenditures of investment projects;

(c) integrating, and periodically evaluating, all the off-budget government fiscal activities into the state budget in a transparent manner by: (i) including an "annex" to the budget document which reports the computed *"tax expenditures"* fully; (ii) considering an explicit line item in the budget for an adequate "risk fund" provision which should reflect the expected costs to be appropriated on account of *contingent liabilities* (including those associated to "state loan guarantees"); and (iii) including a line item in the budget for the "subsidies and administrative costs of government loans" implicit in the *soft loans* operations;[14]

(d) forecasting more *accurate budget indicators*, by entrusting more than one agency to produce them and by improving fiscal data availability, quality and dissemination; and

(e) formulating, on a systematic basis, detailed *contingency plan* based on ex-ante line ministries' priority listing, as an instrument to guide expenditure cuts in case of necessity during the execution phase.

33. Towards this strategic orientation, the government may consider to start with the immediate implementation of the following institutional arrangements:

(a) *defining specific institutional responsibilities* in the budgetary formulation process and strengthening consultation mechanisms among agencies (Budget Commission, Ministry of Finance, ASPR, Ministry of Economy-AEP, and the PIP Commission);

(b) *reforming the Budget Commission* by: (i) providing a permanent status to it and empowering it with exercising oversight over policy outcomes, reconsidering future priorities, and continuing decision-making beyond the current budget; (ii) changing its membership from annual appointment based on individual capacities to automatic nomination based on functional capacity of the members; (iii) improving sectoral representation;

(c) *enhancing the involvement of the line ministries* in budget preparation by requiring the filing of sectoral strategies and the establishment of the linkages between expenditure programs and measurable outputs.

[14] For example of methodologies and best practices, see Box III.1 to Box III.4, Chapter III.

(d) *amending the Budget System Law* by: (i) clarifying conditions under which "emergency state budget" could be adopted; (ii) conditioning parliamentary innovations and amendments to the budget proposal (or new fiscal legislation), which increase or create expenditures, to an accompanying proposal to decrease other expenditures or increase revenues by the same amount; and (iii) advancing the calendar for approval of the Republican budget to no later than November 15.[15]

34. Specifically to the *budget execution phase,* the government should consider accelerating the pace of reform for the modernization of the Treasury and regularizing arrears, by: (a) changing the Administrative Code to hold public sector managers directly and fully responsible for any expenditure commitment in excess of their budget appropriations; (b) computerizing the government payroll; (c) returning to the practice of monthly or quarterly releases for budget execution; (d) discontinuing the practice of having the Budget Department set the financing limits for the Treasury; (e) sticking to a viable program to retire the current stock of arrears and avoid accumulating new ones; (f) discontinuing any "tax offset" scheme as a mechanism for retiring arrears. These measures should help the government to avoid the continuing bail out of enterprises and subnational governments in financial difficulties and prevent moral hazard incentives.

35. Moreover, the government should consider putting in place an effective *budget monitoring and evaluation system* by: (a) strengthening the central unit at the Treasury Committee in charge of internal audit (making it responsible for standards, recruitment and promotion, training, and annual reporting); (b) accelerating the approval of the draft law on external audit, which should stipulate the independence of the Accounting Committee; and (c) creating institutions to check on the performance of programs, evaluating whether or not budgetary outcomes correspond to intended policy objectives.

Intergovernmental Fiscal Relations

36. Intergovernmental relations inherited from the previous regime were characterized by soft-budget constraints, as they lacked formal rules of expenditure and revenue assignments. The transfers of resources and settlements of financial obligations between government levels were essentially made on an ad hoc case-by-case basis. In the wake of the education and health systems reforms of the 1990s, these relations experienced some changes, but it was only in the last two years that they started being formally transformed, as a result of the reforms on the social protection system, and the adoption of the Law on Local State Government, Law on Government Guaranteed Borrowing and Debt, and the Budget System Law. Nevertheless, Kazakhstan still has a long way to go with regard to the scope of fiscal decentralization and the right incentive structure for expenditure efficiency and quality service delivery. The reforms have stopped at the oblast level, leaving the relationship between oblasts and the third-tier governments (rayons and cities) unaddressed, and has not yet reached implementation units, such as schools and hospitals.

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[15] So that local akims and maslikhats could have adequate time to deliberate on the local budgets. (Chapter III, Section A, "Budget Formulation and Approval", item b.)

37. Especially at subnational levels, the system still lacks clear assignment of responsibilities and delegation of authority, autonomy to perform functions, and accountability for results. While proposals exist to provide for elected Akims, so far only the old hierarchical reporting system is in place, and the local chief executives (at oblast, rayon, and city levels) are usually not subject to any horizontal mechanisms of accountability to the local population. The intergovernmental fiscal relations also lack coordination and leadership from the center to guarantee sustainability for the decentralization process.

38. Presently, *expenditure assignment* among the republican and local government budgets are broadly consistent with established principles, and the social sectors dominate the local budget spending.[16] Education continues to be mostly a local budget responsibility (accounting for 80 percent of the total public education expenditures), and healthcare financing was recently pushed down to the local budgets (now accounting for 84 percent of the total health expenditures) after the elimination of the off-budget Compulsory Healthcare Insurance Fund in 1998 (Chapter V, Section A).[17] This push may pose a problem, since basic healthcare could be considered a national program but citizens may not have equal access to services because of the great disparities across regions in their ability to raise resources. Also, the 1998 social protection reform shifted the "categorical" State Special Benefit to the Republican budget, while unemployment benefit and other social assistance programs were entirely pushed downwards to local governments. The latter may also be a questionable move because of the inverse correlation across oblasts between the incidence of these social assistance needs and the ability to raise resources.

39. The economic structure of the local budget is, on the one hand, too concentrated on current expenditures (basically on "wages" and "utilities", and little on "supplies" and "operation and maintenance"), while capital expenditures have been extremely low because: (a) a remaining confusion regarding the responsibility for capital expenditures; (b) negative incentives for local governments (owing to the paternalistic approach of central government); and (c) lack of a developed financial market. On the other hand, increased local spending on "economic sectors" confirms the perception that oblasts' and rayons' akims are still inclined to continue their undue support to and intervention in commercial/production activities.

40. After the consolidation of the 1999 off-budget social protection funds into the State budget, termination of several Special Economic Zones-SEZ (except for Astana), re-assignment of VAT (100 percent) and excise (50 percent) back to the republican budget, and adoption of the 1999 Budget System Law, the *revenue sharing system changed* in three fundamental ways: (a) sharing rates became uniform for every oblast, facilitating predictability, but increasing collection disparities across oblasts; (b) the new "Social Tax" (a payroll employers' contribution) became by far the most important local revenue source (35 percent, excluding transfers), followed by PIT (20 percent) and CIT (10 percent), while local taxes (property taxes including: buildings, land and vehicles) remained at about 14 percent; and, as a consequence, (c) the vertical fiscal imbalance (as perceived by the Republican government) reverted in favor of local

[16] Education 40 percent, health 16 percent, and social security and welfare 21 percent of the 1997-98 average local budget expenditures. (Chapter V, Section A).

[17] Local budget expenditures represented 44 and 43 of the consolidated State Budget in 1999 and 2000, respectively. (Chapter II, Table II.7).

budgets, which the center saw as a justification to introduce net "withdrawals" (transfer from the local budgets to the center).

41. The *Social Tax and the PIT are inadequately apportioned*: their collection basis has been the place of work rather than the place of residence, thereby detaching tax payments from the public service benefits received. Moreover, the redistribution function of a progressive PIT should be better carried out at the national rather than at the local level. Also *CIT is not an ideal tax for directly funding local governments*, because it is easily exportable, its revenue yield is highly volatile, its incidence is likely to be outside the jurisdiction where it is collected, and it tends to exacerbate horizontal disparities because its base is unevenly distributed.

42. Two critical issues have not yet been addressed by revenue sharing and assignment reforms in Kazakhstan: *local decision autonomy and governance*. The lack of local autonomy on revenue policies (with the exception of land tax) deprives communities of the incentive to make choices at the margin. The lack of tax autonomy eliminates the possibility of maximizing efficiency from fiscal decentralization, and detracts from accountability and vertical balance. Governance and tax collection capacity (central vis-à-vis local) may have been affected by the dual subordination of tax inspectors, and a *de facto* allegiance of these officials to the regional authorities as opposed to their central bosses.

43. The present system of *intergovernmental transfers*, although operating under a new revenue sharing setting (which reverted the previous vertical fiscal imbalance) has, in practice, basically replicated the old "gap-fill" mechanism by "regulating" *withdrawals* and *subventions* on a rather arbitrary basis by balancing the individual oblasts' budgets. The current transfer system has not satisfactorily resolved the problems of horizontal and vertical imbalances in Kazakhstan, and has been perceived by local authorities as a non-transparent and confused micro-management tool arbitrarily operated by the republican government. The initial intention was to adopt a "fraternal" funding approach for the equalization transfer. But, as the formula-based methodology proposed by government Resolution 529/99 was not approved by Parliament, and has not been followed in practice, the perverse efficiency incentives remain and the country still lacks a truly equalizing transfer mechanism. Even the government proposed formula missed critical factors of regional differences (including the absence of a fiscal capacity indicator).

44. Local government *indebtedness* has been low in Kazakhstan and borrowings are mostly from the Ministry of Finance. Some of these borrowings still have the character of soft loans, being interest-free and/or repayment forgiven. The latter establishes a bad precedent for moral hazard behavior. Although the current formal regulation on local indebtedness is adequate, local governments still have to overcome difficulties to access long-term financing due to a lack of creditworthiness and underdeveloped financial markets.

45. ***Recommendations.*** Furthering the fiscal decentralization process may allow Kazakhstan to effectively benefit from better resource allocation, by increasing efficiency and equity of public expenditures. The government may ponder options of: (a) extending and strengthening the *scope and coordination* of the decentralization process; (b) defining and better *specifying funded mandates, increasing the autonomy* for managers to perform, and making local

authorities accountable for results; and (c) adjusting tax *sharing arrangements and transfer mechanisms* (equalization and conditional grants) accordingly.

46. Kazakhstan can benefit from extending fiscal decentralization reforms to rayons, cities, and towns, as well as to implementation units, such as schools and hospitals. Local authorities are in a position to make better choices, since they are expected to possess better information about local preferences. However, this requires three basic conditions that should be considered by the government prior to their implementation: (a) local authorities (Maslikhats representatives as well as Akims) be fully *accountable to the local population*; (b) an adequate level of *local administrative capacity* to effectively implement policies; and (c) a *central official body to lead and coordinate intergovernmental relations*, promoting communication and facilitating conflict resolution between the central agencies/line ministries and local governments (including dissemination of information, management experiences and best practices), especially in the areas of finance, education, health and social assistance.

47. Responsible decentralization means that funding should follow the assignment of responsibilities rather than just pushing down to lower level of governments new responsibilities without providing the necessary administrative capacity, autonomy to perform and without attributing sound mechanisms of monitoring and accountability. To *prevent the proliferation of unfunded mandates*, the following is required: (a) restraints by parliament and the central government; (b) watch-dog committees that permanently review draft legislation; (c) coordinated dialog between levels of governments; and (d) clearer assignment of responsibilities. Also, the republican government has the option to develop *pari-passu* mechanisms to stabilize local revenue, to make budgeting and accounting transparent, and to allow for an appropriate degree of *local autonomy* (both on marginal adjustments on revenue and input mix). On the one hand, improvement in revenue autonomy at the margin can be achieved by: (i) delegating to local administrations decision autonomy at the margin on local tax rates and the possibility of piggybacking to national existing taxes; (ii) boosting property taxes (with the implementation of a well-designed cadastre) ; (iii) making use of surcharges and surtaxes as appropriate; and (iv) shifting, in the medium term (after creating the necessary administrative capacity) the administration of local taxes to local administrations (such as property and land taxes).

48. On the other hand, besides the specific responsibilities defined in the Budget System Law, the central government may consider: (i) discouraging local governments' involvement in commercial/production activities; (ii) ceasing the practice of soft loans to subnational governments by charging competitive interest rates and enforcing the payment of principal, by requiring collateral on the MINFIN loans; (iii) shifting proper capital expenditures responsibilities to local governments—clarify this assignment in the Budget System Law—and considering a policy of matching contributions by local budgets for local investments; and (iv) phasing out, in the long term, central government loans to subnational governments as the domestic financial sector reforms bear fruit and the financial system develops. (Chapter IV, Section B).

49. Moreover, a more adequate *tax sharing arrangement* will require that: (a) the Social Tax should be shared by place of residence, rather than by place of work; (b) the CIT should be reassigned totally to the Republican budget; and (c) the PIT should be split in two components:

(i) a progressive rate assigned to the Republican budget; (ii) an autonomous proportional piggyback rate assigned to the local budget—on the occasion of the reform these changes could be tax-burden neutral. (Chapter IV, Section C).

50. To improve the *intergovernmental transfer system* in Kazakhstan, three options are envisaged: Option (I), by mending the mechanism of the current "fraternal" system, by improving (with the inclusion of fiscal capacity indicator, among others) and systematically implementing an effective distribution formula; or, better, Option (II), by reforming the tax sharing system (as indicated in the previous paragraph plus the elimination of the SEZ-Astana) and creating a vertically financed ***Regional Equalization Fund (REF)*** based on stable rules both for funding (say, as fixed proportions of CIT and PIT collected by the center) and for distribution (as a function of fiscal capacities normalized by "needs" indicators); or, the most desirable, Option (III), by combining Option (II) with a centrally-financed *"conditional grants" mechanism* to guarantee efficient and equitable implementation of the "social safety net" (basic education, basic healthcare, and social assistance to the poor).[18]

51. Finally, it should be taken into account that *fiscal decentralization is also a political process*, which in general demands painstaking consensus building, requiring time, legitimacy and adequate level of authority to conduct it. Therefore, the government may consider establishing an **"Intergovernmental Relations Reform Committee"**, with the participation of local representatives, to *deliberate, at the highest possible level*, on the decentralization process.

Social Sectors

52. The following reasons justify the focus of the intrasectoral analysis of the report on the social sectors (healthcare, education and social assistance): (a) the economic crisis that hit the country since independence brought a dramatic deterioration in the living standards of the population, as reflected in the main aggregate social indicators; (b) the social sectors have represented the bulk of Kazakhstan government expenditures (about half of the overall state budget and three-fourths of oblasts' budgets in the last three-years); and (c) these sectors are of critical importance if government policy is to contribute to long-term growth in the country.

53. Healthcare and education have been relatively higher priorities than "social security and welfare" (including pensions, state special benefits, unemployment benefits, and social assistance), the latter being essentially a residual adjustment item in the public expenditure allocation process in Kazakhstan. Since independence, basic education has been basically a responsibility of local governments, absorbing above 40 percent of their budgets, and social assistance increased its importance in the local budget (from 13 to 29 percent) after the social protection system reform. In 1999, about four-fifths of education and health expenditures were financed by local budgets. Nevertheless, despite the decentralization move of the 1998 social protection system reform, about 86 percent of total "social security and welfare" expenditures were still financed by the republican budget, on account of pensions and State Special Benefit. (Chapter V, Section A).

[18] Chapter IV, Section D, "The Transfer Mechanisms", item c.

54. In Kazakhstan, unfunded mandates and inefficient intrasectoral allocation of resources in the social areas are aggravated by considerable vertical and horizontal fiscal imbalances. Per capita expenditure disparities across regions are high, and may have increased as a result of the social protection system reform cum new revenue sharing arrangement, because of the inverse correlation between fiscal and administrative capacities of the oblasts to raise resources with the distribution of their social needs.

55. ***Recommendation.*** Improving efficiency of public spending and quality of service delivery is the main objective of public sector reforms. A general strategic policy direction recommended by this report towards the social sectors is to *compensate regional inequities by redesigning the tax sharing arrangement and the transfer mechanism with the subnational governments* (as proposed in the previous section, and Chapters IV and V). Specific recommendations for each sector are delineated in the following next three subsections.

Social Assistance

56. Inequities are particularly accentuated on the distribution of social assistance, and may have aggravated after devolution of responsibilities to local governments, because of the low fiscal capacity of the poorest oblasts. Moreover, contrary to the initial official intentions, in practice great inefficiency persists in the allocation of social assistance resources, because "categorical", rather than "poverty", continues as the relevant criterion for the identification of eligible households.

57. ***Recommendations.*** In order to achieve better outcomes and revert the current trends of poverty indicators in Kazakhstan, the government may consider focussing social assistance exclusively to the poor and:

(a) adopting a combination of legal measures to enforce, and incentives (centrally-funded conditional grants) to induce a minimum level of social assistance allocation[19] to fill at least half of the poverty gap (or about 25 percent of the poverty threshold consumption expenditure in 1998)[20] (in accordance with the proposal to reform the intergovernmental transfer system, Option III, Chapter IV)[21];

(b) targeting the benefits through: (i) cash allowance for those who are unable to work (e.g., poor single elderly without support, poor mother with many children); (ii) well-designed self-targeted, low-wage public workfare program for those who are able to work;

(c) discontinuing the following inefficient social assistance programs: (i) the "State Special Assistance" program (categorical); (ii) the "Subsidized Works Programs"; and

(d) monitoring "poverty" and "targeting" more closely, by: (i) introducing a module on "Social Assistance" in the forthcoming National Statistical Agency (NSA) new household

[19] As part of the national "social safety net", distributed according to regional need differentials, and revised periodically.
[20] I.e., about the same level of spending on social assistance to GDP experienced in 1998.
[21] Chapter IV, "The Transfer Mechanism", item c.

survey; and (ii) conducting and evaluating—by a specialized independent body—a sample survey of Social Assistance recipients.

Healthcare

58. As a consequence of the extreme scarcity of public resources during the transition, healthcare financing and provision have diversified towards local government and the private sector. Since independence, disparity in per capita expenditures across regions has accentuated, the health status of the population has deteriorated, and the poor have been affected disproportionately. In spite of government initiatives to reform the healthcare system (including some restructuring/privatization/closure of facilities since the mid-1990s), the operational inefficiencies inherited from the Soviet system have been aggravated, because no relevant public service reform has actually been carried out, repair and replacement of equipment have been almost nonexistent, and infrastructures have been deteriorating.

59. Low execution rates of budgeted healthcare expenditures have reflected inadequate priority choices, and have led to payment delays and accumulation of arrears in the sector. Owing to a lack of clear priority policy, ex-post allocation has ended up emphasizing:
(i) curative, rather than preventive healthcare; and (ii) hospitals and specialized clinics expensive inpatient care, rather than family doctors and outpatient care.

60. Healthcare expenditure efficiency and service quality in Kazakhstan have deteriorated as a consequence of: (a) excess capacity and employment, lack of adequate autonomy for managers to perform, and limited accountability of local authorities for the outcomes; (b) private practice in public facilities, facilitating corruption and spending scarce public funds to subsidize privately provided services; (c) payment to service providers on the basis of actual running costs of respective health facilities, instead of based on the lowest per capita cost of primary healthcare packages; (d) monopoly position of some local hospitals, which prevent the State Order tendering mechanism to fully operate in practice as intended; and (e) inadequate decentralization of financing and provision of healthcare services in certain cases beyond the oblast level (down to rayon/and cities), which may duplicate functions, preventing resource pooling and economy of scale. (Chapter V, Section C).

61. ***Recommendations.*** Any reform strategy for healthcare in Kazakhstan should necessarily include a phased implementation of the *employment and wage reform* in the sector, and a selective *rehabilitation of infrastructures and equipment*, while carrying on *privatization/conversion/consolidation/closure* of facilities to optimize capacity, increase competition, and improve efficiency and the quality of service delivery.

62. While full implementation of this strategy may take time, its design and preparation should start soon, by observing the following resource management principles applied to the Kazakhstan healthcare sector: (a) *prioritizing programs* on preventive care, treatment of infectious diseases, and primary healthcare packages; (b) providing managers of state health facilities with enough *autonomy to perform* (particularly on determining the input mix) and make them *accountable for the results* (output and service quality); (c) specifying *clear responsibilities for local authorities* on their sectoral resource allocation decision spheres, and making them *fully*

accountable for the policy outcomes; (d) *adopting a multi-sector approach*, by promoting adequate provisions for safe water supply and basic sanitation improvements; and (e) encouraging *private sector participation*, by assuring the proper legal and regulatory framework that create an enabling business environment for the development of private initiative in the sector, including health insurance markets.

63. Specific policy actions recommended for the healthcare sector include:

(i) *improving the central-government-led healthcare policy coordination* [22] with the Oblasts' Health Departments and health facilities' managers, as a mechanism to identify and anticipate problems, and as an instrument for conflict resolution and dissemination of best practices on healthcare management among regions;

(ii) *redesigning equalization transfer mechanism*, taking into account each region's specific needs and fiscal capacity, in order to create the conditions for access to equal level of health services, and reduce disparities in per capita spending across oblasts;[23]

(iii) *optimizing the level of decentralization and rationalizing the use of resources in healthcare service delivery* according to regions, in order to preserve competition among providers, permit economy of scale, and avoid duplication of functions, aiming at maximizing the potential benefits of decentralization, for example by: (a) merging city and oblast health departments in oblast capital cities to optimize resource use; and (b) installing metering devices in all health facilities to reduce energy costs (as proposed in the Bank-financed Health Project);

(iv) *separating private practice from public facilities*, by privatizing the facilities and/or contracting out services;

(v) *reviewing government regulation that interferes with facilities' management* (including Decree # 1314/98), by providing managers with freedom to optimize resource mix and making them accountable for results;

(vi) awarding *State Order to providers competitively*, allocating resources on a per capita basis for a minimum standard cost of primary healthcare package;

(vii) *exempting the poor from user fees* in order to promote guaranteed access to basic healthcare services;

(viii) *monitoring service delivery* according to output, service quality, and outcomes, as well as *monitoring and evaluating outcomes of ongoing sector reforms* (as proposed in the Bank-financed Health Project).

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[22] Central Agency for Healthcare, Committee of Health, and the Ministry of Finance.

[23] As proposed in Chapter IV, Section D, "The Transfer Mechanism", item c.

Education

64. At independence, Kazakhstan inherited a well-developed network of education facilities and good education indicators, including relatively high enrollment rates and a nearly universal adult literacy rate (97.5 percent at early 1990s). With the financial crisis during the transition period, Kazakhstan has struggled to retain the past educational achievements, while reforming the education system on the basis of the principles of an independent state and a market economy.

65. Reflecting the impact of economic recession, resource allocations to the education sector fell substantially, and the intrasectoral composition of spending has experienced major structural transformations, including: (a) public spending on education physical capital investment declined dramatically, and became insignificant; (b) although recurrent public expenditure as a share of GDP has been maintained since the mid-1990s, it has declined in real prices; (c) the share of the wage bill has increased and remained high (although the wage rates are low); (d) outlays on basic education materials and supplies remained low; (e) expenditures on operations and maintenance of facilities have declined significantly;[24] and (f) spending on staff training became insignificant (Chapter V, Section D). Also, a large number of schools (especially preschools) have been closed, direct parental expenditures on education (e.g., formal and informal fees, in-kind contributions) have increased substantially, and the number of private institutions have expanded.

66. Because of the country's economic situation, there remain deficiencies of funding to local governments to fully execute their mandates in the education sector. However, given the mandates, these deficiencies can only be satisfactorily resolved with the recovery of economic growth. Apart from this aspect, the country's present major challenges related to education public expenditures include: (a) *considerable inefficiencies* in the use of resources (e.g. too low student/teacher ratio, small average class size, low actual teaching load, excessive non-teaching staff, extensive use of outdated infrastructures and equipment); (c) *increasing regional inequities* in the access to education, with an exclusion of the rural poor; (d) *deterioration of the quality of education services* at all levels; and (e) an *inappropriate education output mix* for an emerging market economy.

67. ***Recommendations.*** Given the importance of education for both poverty reduction and economic development, and in the face of the public resource constraints in Kazakhstan, the sector reform strategy should focus on increasing efficiency in the use of resources, improving the quality of education services and reducing the identified inequities in access, particularly in basic education. (Chapter V, Section D).

68. Specifically, the government of Kazakhstan may consider actively using public spending policies as an incentive instrument in the education sector for:

[24] Except for utility expenditures, whose share increased considerably, crowding out essential teaching material and equipment.

(a) *Increasing efficiency and ensuring financing sustainability* by promoting rationalization of the existing education facilities (through merging and elimination of idle/inoperative/redundant programs and facilities) including: (i) reducing the number of teaching and non-teaching staff; (ii) eliminating the existing excess physical capacity (especially vocational and technical education institutions); (iii) reviewing the sector's social welfare programs (stipends and food); and (iv) improving space and heating utilization; (Chapter V)

(b) *Improving the quality of education* (mainly financed by savings from the wages bill, utilities, and social welfare program) by prioritizing: (i) provision of basic education materials and supplies; (ii) provision of teacher training; (iii) introduction of a new system of student assessment and monitoring (shifting focus from input to output/outcomes); and (iv) upgraded management capacity;

(c) *Improving equity in education* by focusing on the special educational needs and conditions of the poor and on the regional disparities in access to education services and: (i) providing free of charge basic education materials; (ii) providing education and training subsidies particularly in rural areas; and (iii) weighting any capitation formula of resource transfer according to the poverty level of the local community;[25]

(d) *Improving budgeting and transparency in the resource allocation* process on the basis of: (i) a Medium Term Expenditure Framework (MTEF) for an effective multiyear prioritization plan; (ii) number of students rather than conventional notional or physical norms; (iii) more flexible and decentralized finance policies; and (iv) a system of accountability to the local population; (see above, and Chapter II)

(e) *Reducing excessive reliance on state* funding, through diversifying the sources of sector's revenues by: (i) accelerating implementation of the newly-adopted higher education tuition policy accompanied by a student loan program; (ii) formalizing the current informal cost-recovery mechanisms, with transparent user fee collection process; and (iii) creating an enabling environment for furthering development of private initiatives in the sector, by reviewing and refining the regulatory framework, including quality assurance procedures (e.g., accreditation), tax treatment of private schools and universities, and admission procedures and policies.

Policy Sequencing

69. Public deficit reduction is at the top of Kazakhstan's economic stabilization policy agenda. However, fiscal sustainability will only be attained if the deficit reduction policy is consistent with: (a) a reasonable expenditure framework and a realistic scenario of resource mobilization (mainly from oil/gas rents) over the medium term, as discussed with the simulations developed in Chapter I; and (b) the structural reforms at the Republican and local level of administrations, aiming at increasing efficiency and accountability of public spending.

70. Therefore, from an aggregate viewpoint, the strategies for deficit reduction, resource mobilization, expenditure prioritization, and intergovernmental relation reforms are complementary policies, and, ideally, they should be conducted simultaneously as a package. However, given the extent and complexity of this reform agenda on the one hand, and the limited implementation capacity on the other, the government may have to select some of the most pressing components in each of these reform fronts and tackle them in turn. This poses a

[25] Chapter IV, Section D, "The Transfer Mechanisms."

problem of policy sequencing, which requires an examination of the order of precedence and interdependence among the various components of the proposed reforms.

71. Actually, for most of the proposed reforms there is no rigid linear timetable to follow, and implementation can proceed with minimum preconditions. There are, however, some outstanding cases where precedence or simultaneity in policy implementation should be observed. In fact, "shifting administration of local tax" to local government (as proposed in Chapter IV) tends to be effective only if started after the proposed "monitoring and accountability mechanisms" are well in place and the "local capacity building" in tax administration has reached an advanced stage of implementation in at least the most important regions (Chapters III and IV). Also, the success of "large scale privatization," "extended public employment and wage reform" (now reaching local administrations), and "transfer of financing responsibility of proper capital expenditures to local governments" would be greatly facilitated in an environment of flexible and dynamic markets, which would be created by accelerating the ongoing implementation of the "labor law", the "financial system reform", and the "regulatory system reform".

72. The most outstanding case requiring simultaneous implementation of components lies in the intergovermental relations reform. In order to preserve macroeconomic stability and vertical fiscal balance, the proposed reform for a "centrally-funded intergovernmental transfer mechanism" (Options II and III) and the proposed reform of the "tax sharing system" (reassignment of PIT and CIT) should go in tandem. (Chapter IV).

73. In any case, as policy implementation may take time, the government may consider starting preparation of practically all agreed reforms soon, since an advanced stage of implementation of some policies may be conditioning the initiation or successful completion of others. Fortunately, in Kazakhstan, most of the first-generation structural reforms either have already been implemented by the government during the transition—liberalization of prices, exchange rates, interest rates, trade regime; small and medium-scale privatization—or the implementation process is under way—the legal and regulatory framework; liberalization of the labor market and the financial sector; large-scale privatization; public employment and wage reforms; tax policy and tax administration reform; fiscal system (see Chapter I, Annex I.1). As mentioned above, it is crucially important that the completion of the structural reforms underway be accelerated, in order to put in place the necessary market incentives and consolidate a business enabling environment. This would facilitate a successful implementation of the awaiting second generation of public sector reforms as proposed in this report. The attached "Matrix of Main Issues and Options/Recommendations" summarizes the strategic direction of policies and suggests the timing for specific reform actions.

Kazakhstan: Matrix of Main Issues and Options/Recommendation

Issues	Issues/Findings	Options/Recommendations		Timing (*)
		Strategic Direction of Reforms	Policy Actions	
I - Fiscal Sustainability and Structural Reforms	1. Persistent underlying **fiscal imbalances.** 2. Areas of **governance problem,** including lack of transparency, coordination, and accountability.	**Quick convergence to fiscal sustainability.**	a. Emphasize **fiscal deficit reduction to stabilize the public debt to GDP ratio at the present level.** b. **Complete implementation of ongoing structural reforms**, including: large scale privatization, public employment and wage reform, financial sector reform, and the legal and regulatory framework. c. **Design and start implementing a second generation of structural reforms** geared to: . rationalizing domestic resource mobilization . focusing government actions on outcomes of merit programs, multiyear budgeting, and performance evaluation . strengthening intergovernmental relations . improving access to and quality of public services.	Medium-Term (starting immediately) Medium-Term (ongoing) Short-Term
II - Mobilization of Domestic Resources	1. **Weak management** of domestic resource mobilization, and lack of a strategy to deal with rents from non-renewable natural resources, including oil/gas. 2. **Recent economic trends indicating risk** of: (i) a lopsided economic structure; (ii) external vulnerability; and (iii) feeble public finance	**Rational domestic resource mobilization to strengthen public finance, without discriminating against domestic savings, capital accumulation and development of non-oil sectors**	a. **Restructure tax (and customs tariff) policy and administration**, by reviewing and eliminating excessive tax exemptions, special treatments (particularly for the mineral sector), privileges, and fiscal incentives (including to the industrial sector). Approval and implementation of new Tax Code. b. Establish an independent and accountable ***"Oil Stabilization and Heritage Fund (OSHF)"*** abroad funded by the transitory/depletion component of the oil/gas rents, aiming at: stabilizing revenues, dealing with "Dutch disease", and securing a permanent stream of income for the benefit of future generations.	Short-Term Short-Term

(*) Immediate = to be implemented in the next three months
Short-Term = to be implemented during the next budget cycle
Medium-Term = to be implemented during the next two budget cycles

Issues	Issues/Findings	Options/Recommendations		Timing (*)
		Strategic Direction of Reforms	Policy Actions	
III - Role of Government and Prioritization of Public Expenditures	**1.** More than half of **large enterprises are state enterprises,** the government has maintained **large stakes in some "privatized" enterprises**, and **supports specific industries** through special tax incentives, loan guarantees, and direct subsidies. **2. Economic structure of the Budget needs improvement:** (i) public sector wage-bill share is still large; (ii) debt servicing is increasing too fast; (iii) capital investment and maintenance are too little. **3. Functional allocation has fallen short of effective selection criteria**: (i) social sectors' shares has been unstable; (ii) some "economic sectors" are hardly justifiable; (iii) Astana city construction criteria are not explicit. **4. Intra-sectoral allocation has been ill-affected by current practices** of: (i) prioritizing (during budget execution) by spending category instead of by programs; (ii) supporting potentially inefficient programs to economic sectors (agriculture and industry).	**Focus government intervention on few areas where there is market failure and for social equity reasons, and clearly prioritize expenditures by program within the overall budget constraint at budget formulation phase.**	**a. Accelerate large enterprises privatization and disentangle government completely from the "privatized" enterprises**, aiming primarily at increasing efficiency economy-wide, and secondarily to help financing the deficit during the interim fiscal adjustment. **b. Prioritize *programs* in the formulation phase instead of spending categories during the budget execution**: (i) improve allocation to selected basic infrastructures (investment and maintenance); (ii) stabilize resources to social sectors, and focusing on merit programs, including "social safety net". c. Review intrasectoral priorities including: (i) **fiscal incentives and extra-budgetary programs** (including Astana construction); (ii) **public service reform** by extending it to local governments, accelerating employment rationalization, and improving the current compensation system; (iii) **refocus support to agriculture** towards basic infra-structure (rural roads, collective irrigation), research, development and information, rural extension services, food security programs, and away from marketing boards, grain purchasing, minimum support price and subsidized credit programs; (iv) **limit support to "economic sectors"** (small and medium-sized business) to technical assistance and creating the requisite legal and institutional environment for entrepreneurial activity.	Medium-Term Immediate Short-Term

Issues	Issues/Findings	Options/Recommendations		Timing (*)
		Strategic Direction of Reforms	**Policy Actions**	
IV - Public Expendi-ture Manage-ment	**1. Uneven development and maintenance** of procedures and institutions. **2. Reforms in the budget formulation phase**, but the process still lacks: (i) coordination and definition of functions; (ii) a transparency, unification, and medium-term perspective; (iii) realistic projections of budget indicators; (iv) provision for contingent liability, and (v) contingent plan to preserve priorities. **3.** Incomplete reforms at the **budget execution phase** (Treasury). The system only controls input at the payment phase, and payroll is not yet computerized. Accumulation of arrears, soft loans, tax offsets, and lack of accountability. **4.** Reporting is a solid area, but **monitoring and evaluation are either weak** (internal audit) or non-existent (ex-post external audit, and performance evaluation).	**Complete a basic set up of budgeting instruments, role of agents, rules of the game, and incentive mechanisms, in order to effecting policy priorities and achieving efficient and equitable delivery of public services. Move towards a new strategic approach based on program output/ outcomes, multiyear budgeting, and performance evaluation.**	**a. Consider driving the budgetary *formulation* process** towards: (a) **prioritizing sectoral programs**, on the basis of quantity of output, and quality of service delivery, and measurable outcomes to be achieved; (b) **integrating the PIP into a Medium-Term Expenditure Framework (MTEF)**; (c) integrating, and periodically evaluating, **all the off-budget government fiscal activities into the state budget** (including "tax expenditures"; "risk fund" provision for contingent liabilities; and costs of implicit "soft loans" operations); (d) improving **forecasts of budget indicators**, fiscal data availability, quality and dissemination; (e) formulating, on a systematic basis, **detailed contingency plan** to guide expenditure cuts and preserve priorities. **b.** Consider the following **improvements in the *institutional set up*:** (i) **defining specific institutional responsibilities** in the budgetary formulation process; (b) **reforming the Budget Commission**; (c) **enhancing the involvement of the line ministries**; (d) **amending the Budget System Law** on advancing the calendar for approval of the Republican budget, and on the conditions for: "emergency state budget"; and amendments to the budget proposals. **c. Accelerate the Treasury reform** for an effective budget execution by: (i) implement **computerization of public sector payroll**; (ii) changing the Administrative Code to **make the public sector managers accountable**; (iii) discontinue setting **financing limits for the Treasury**; (v) retire the stock of **arrears**, avoid accumulation of new ones, and discontinue the practice of "**tax offsets**" scheme; (vi) controlling expenditures at commitment phase. **d. Boost the monitoring and evaluation systems** by: (i) strengthening the **central audit** unit; (ii) regulating an **independent external audit**; (iii) accelerating the approval of the draft Law on audit (including independence of Accounting Committee); and (iv) creating institutions for **program performance evaluation.**	Medium-Term (starting immediately) Immediate Medium-Term (i) Short-Term (ii) immediate (iii to vi) Medium-Term

Issues	Issues/Findings	Options/Recommendations		Timing (*)
		Strategic Direction of Reforms	**Policy Actions**	
V - Inter-governmental Fiscal Relations	**1.** Recent reform of IGFR: (a) fell short of addressing: (i) the **third tier of government** (rayons and cities) and implementation units, (ii) **unfunded mandate, autonomy to perform, and accountability** of local managers and chief executives, (iii) **central coordination** of the decentralization process, and (iv) the confusion on capital expenditure assignment; and (b) unduly pushed down to local budgets **responsibility for national "social safety net"** (basic healthcare and social assistance). **2.** Local budget **spending is concentrated on current expenditures** (mainly wages and salaries), and little is allocated to investment, rehabilitation and maintenance. Long-term investment borrowing limited by lack of creditworthiness and underdeveloped financial markets. Local governments still inclined towards commercial business activities.	**Furthering fiscal decentralization for increased efficiency and equity in public expenditures by: (a) extending the scope and coordination of the decentralization process; (b) specifying funded mandates, increasing managers' autonomy to perform, and making local authorities accountable for results; (c) adjusting tax sharing arrangement and transfer mechanisms accordingly.**	**a.** Consider creating: (i) an "**Intergovernmental Relations Reform Committee**", to deliberate, at the highest possible level, on the decentralization process; and (ii) a technical **central government body** to coordinate intergovernmental relations, promote communication, facilitate conflict resolution, disseminate information, management experiences and best practices. **b.** Consider: (i) **reassigning CIT** entirely to the republican budget; (ii) **splitting PIT** into two components--a progressive tax rate (assigned to republican budget) and a proportional piggyback rate (assigned to local budget); and (iii) **sharing the social tax by place of residence.** **c.** Consider the following options to reform the intergovernmental transfer system: ***Option (I),*** by mending the current "fraternal" system by implementing an improved version of Resolution 529/99; or, better, ***Option (II),*** by reforming the tax sharing system as proposed above and creating a vertically financed **Regional Equalization Fund (REF)** on the basis of stable rules both for funding and distribution; or, the most desirable, ***Option (III),*** by combining Option (II) with "conditional grants" (for social safety net) also centrally financed.	Immediate Short-Term (i and ii) Medium-Term (iii) Short-Term

Issues	Issues/Findings	Options/Recommendations		Timing (*)
		Strategic Direction of Reforms	Policy Actions	
	3. Marginal **tax autonomy still lacking**, and tax administration and **governance likely to be affected** by the dual subordination of tax inspectors. **4. The tax sharing system remains deficient**: (i) inadequate apportioning of "Social Tax", PIT, and CIT; (ii) progressive PIT inappropriately assigned to local budgets, because of its redistributive function; (iii) CIT is not an adequate local budget financing source, because it is exportable, volatile, incidence outside jurisdiction, exacerbate horizontal disparities. **5.** New tax sharing: (i) **aggravated the horizontal fiscal imbalances**, because fiscal capacity disparities across region and its inverse correlation with expenditure needs; (ii) **reverted vertical fiscal imbalance** (as perceived by central government), justifying the introduction of net "withdrawals". **6.** The present **transfer mechanism is inadequate**: (i) de facto **replicates the old "gap-fill"** system; (ii) its original formula **lacked critical factors** of regional disparities, has not been approved by Parliament, has not been followed in practice; (iii) it is being perceived as **non-transparent and arbitrarily micromanaged** by the center.		**d.** Consider: (i) boosting the **property taxes** and making use of **surcharges and surtaxes** as appropriate for local budget financing; (ii) delegating to local administrations **decision autonomy at the margin on tax rates** and the possibility of piggybacking to national existing taxes; and (iii) **shifting the administration of local taxes to local governments** (such as property and land taxes), after creating the necessary administrative capacity. **e.** Develop mechanisms to **turn local budgeting and accounting transparent.** Discontinue the practice of "soft loans" to subnational governments, and discourage local governments' involvement in commercial/ production activities **f. Clarify in the Budget System Law and in the Local Government Law** as appropriate: (i) decisions on the scope of the decentralization; (ii) the specification of funded mandates, the degree of local managers' autonomy to perform, and the latitude of local authorities' accountability for policy results; (iii) the assignment of proper capital expenditures to local governments and the rules for their inclusion in the PIP.	Short-Term (ii) Medium-Term (i and iii) Short-Term Medium-Term

Issues	Issues/Findings	Options/Recommendations		Timing (*)
		Strategic Direction of Reforms	**Policy Actions**	
VI – Social Sectors	1. **Great disparity on per capita social expenditure across region**, may reflect the inverse correlation between fiscal capacity and social needs. Recent fiscal and social protection system reforms may aggravate disparities.	**Increase efficiency of spending and quality of service delivery, while compensating for regional inequities.**	**a.** Compensate regional inequalities by **reassigning responsibilities, redesigning the tax sharing system and the transfer mechanisms** with the subnational governments (as proposed in Chapter IV).	Medium-Term
VI - Social Sectors: Social Assistance	**1. Social assistance has been treated residually** and **interregional disparities in spending** may remain a major issue after the social protection system reform. 2. In practice, **"categorical" rather than "poverty" continues as relevant household eligibility criterion.**	**Focus "social assistance" exclusively on the poor.**	**a.** Adopt legal measures and incentives ("conditional grants") to **ensure minimum level of social assistance allocation** to fill at least half of the poverty gap. **b.** Consider ceasing **inefficient programs**: (i) "State Special Benefit" program; and (ii) "Subsidized Works Programs". **c.** Target **benefits only to the poor**: (i) cash allowance for those unable to work; (ii) self-targeted, low-wage public workfare programs for those who are able to work. **d.** Monitor **poverty and targeting** closely by: (i) collecting information through NSA new household survey; (ii) evaluating a sample survey of social assistance recipients.	Immediate Short-Term Short-Term Immediate

Issues	Issues/Findings	Options/Recommendations		Timing (*)
		Strategic Direction of Reforms	Policy Actions	
VI - Social Sectors: Healthcare	**1.** The **health status of the population has deteriorated**, and regional disparities in per capita expenditure has accentuated. Operational inefficiencies have been aggravated by overcapacity, lack of public service reform, repair, and adequate replacement of equipment. Managers' autonomy to perform has been insufficient, and authorities' accountability to local population is limited. **2. Lack of prioritization policy has resulted in inadequate budget execution, reflecting**: (i) frequent payment delays and arrears accumulation; (ii) emphasis on curative, rather than preventive healthcare; and (iii) emphasis on hospitals and specialized clinics expensive inpatient care, rather than family doctors and outpatient care.	**Focus on facilities' restructuring (privatization, conversion, consolidation, closure) to increase competition, efficiency and quality of service delivery. Reforms must include: (i) a phased implementation of the employment and wage policy reform, and (ii) a selective rehabilitation of basic infrastructures and equipment.**	**a.** Adopt the following guiding policy principles for the sector: (i) **prioritizing preventive care**, treatment of infectious diseases, and primary healthcare; (ii) **providing managers enough autonomy** to determine input mix and make them accountable for the results (output and service quality); (iii) **specifying local authorities responsibilities** on their decision spheres, and make them fully accountable for the outcomes (policy objectives); (iv) **adopting a multi-sector approach**, by promoting adequate provisions for safe water supply and basic sanitation improvements; and (v) assuring the legal and regulatory framework that create an enabling business environment for the **development of private initiative** in the sector, including health insurance markets. **b.** Specifically consider: (i) improving central-government-led healthcare **policy coordination** with Oblasts' Health Departments and facilities' managers; (ii) redesigning equalization transfer mechanism, taking into account each **region's specific needs and fiscal capacity** (as proposed in Chapter IV); (iii) optimizing sector decentralization and rationalizing resource use, by **merging city and oblast health departments** in oblast capital cities, and by installing metering devices in all health facilities; (iv) **separating private practice** from public facilities; (v) **reviewing government regulation** that interferes with facilities' management (including Decree # 1314/98); (vi) awarding State Order to providers competitively, **allocating resources on a per capita basis** for a minimum standard; (vii) **exempting the poor** from user fees; (viii) **monitoring and evaluating outcomes** of ongoing sector reforms (as proposed in the Bank-financed Health Project).	Immediate (i) Short-Term (ii, iii) Medium-Term (iv, v) Short-Term (i, iv-viii) Medium-Term (ii, iii)

Issues	Issues/Findings	Options/Recommendations		Timing (*)
		Strategic Direction of Reforms	**Policy Actions**	
VI - Social Sectors: Education	**1.** Inadequate structure of public education budget: (i) **high wage-bill share** (although low wages); (ii) **O&M share have declined** dramatically; (iii) **allocation for training** education staff has been insignificant. **2. Major challenges** include: (i) *inadequate funding* ; (ii) *considerable inefficiencies* in use of resources; (iii) *increasing regional inequalities*; (iv) *deterioration of the quality of education services* at all levels; (v) *inappropriate education output mix* for an emerging market economy.	**Focus on increasing efficiency in the use of public resources, improving the quality of education services, reducing the identified inequities in access, expanding for alternative source of funding, while adapting education output mix to an emerging market economy.**	**a. Consider increasing efficiency and ensure financing sustainability** by: (i) reducing teaching and non-teaching staff; (ii) eliminating the existing excess physical capacity; (iii) reviewing sector's social welfare programs; (iv) improving space and heating utilization. **b. Consider improving the quality of education** by prioritizing: (i) provision of basic education materials and supplies; (ii) provision of teacher training; (iii) introduction of a new system of student assessment and monitoring (shifting focus from input to output/outcomes); (iv) upgraded management capacity. **c. Improve equity** by focusing on the special needs and conditions of the poor and on the regional disparities in access to education services by: (i) providing free basic education materials; (ii) providing education and training subsidies particularly in rural areas; (iii) weighting capitation formula of resource allocation by poverty level of the community. **d. Improve budgeting and allocation by**: (i) a Medium Term Expenditure Framework (MTEF); (ii) number of students rather than notional norms; (iii) flexible and decentralized finance policies; and (iv) a system of accountability to the local population. **e. Reduce excessive reliance on state funding** by: (i) implementing the new higher education policy accompanied by student loan program; (ii) formalizing cost-recovery mechanisms; and (iii) fostering an environment for development of private initiatives in the sector, by reviewing regulatory framework, quality assurance procedures (accreditation), tax treatment, and admission procedures.	Medium-Term Medium-Term Short-Term Medium-Term(i, iii, and iv) Short-Term (ii) Short-Term

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