EVALUATION OF USAID FISCAL REFORM PROGRAM: KAZAKHSTAN AND KYRGYZSTAN

Submitted to:

U.S. Agency for International Development

Under:

Evaluation IQC No. AEP-I-00-00-00023-00
Task Order No. 838

Team Members:

Thomas L. Bertone, DPA
Fuat M. Andic, Ph.D.
Svetlana Druzhinina

Submitted by:

Development Associates, Inc.
1730 N. Lynn Street
Arlington, VA 22209-2023
(703) 276-0677

August 29, 2003

TABLE OF CONTENTS

Page No.

1.0 Executive Summary 1

1.1 Current Status. Budget Reform Objectives Have Been More Fully Achieved In Kazakhstan Than In Kyrgyzstan 1
1.2 Impact. Usaid Assistance Has Been Important To Progress 3
1.3 Lessons Learned. Technical Assistance Should Be Based Upon A Comprehensive View Of Institutional Development And Respond To The Client's Capacity 3
1.4 Recommendations. Consider A Transition Program For Kazakhstan, With An Exit Date Of Within Two Years, And A Program For Kyrgyzstan That Focuses Indigenous Resources On Areas Of Opportunity 3

2.0 Introduction 4

2.1 Objective And Scope 4
2.2 Organization Of The Report 4
2.3 Methodology 5

3.0 Kazakhstan 6

3.1 Tax Policy 6

3.1.1 Current Status. This Component of Technical Assistance Has Achieved Its Objective 6
3.1.2 Impact. USAID's Assistance Has Been Appropriate and Effective and Has Had a Very Positive Effect on Policy Design 7
3.1.3 Lessons Learned. There Is a Close Relationship Between Strong Tax Policy and Political Will 7
3.1.4 Recommendations. Considering the Achievements, No Further Technical Assistance Should Be Undertaken 8

3.2 Tax Administration 8

3.2.1 Current Status. Objectives Are Essentially Achieved; All But One Benchmark Is Reached 8
3.2.2 Impact. Assistance Provided by USAID Has Been Effective 9
3.2.3 Lessons Learned. Tax Policy and Administration Are Closely Linked 10
3.2.4 Recommendations. Consider the Mission Essentially Completed 10

3.3 Budget Reform 10

3.3.1 Current Status. Budget Reform in Support of Fiscal Policy Management Is in the "Effectively Achieving Objectives" Stage of Development 10
3.3.2 Impact. USAID Impact Upon Budget Reform Has Been Substantial 11
3.3.3 Lessons Learned. Adapt the Technical Assistance Program to the Needs of the Country 12
3.3.4 Recommendation. Consider Technical Assistance to Create Within ME&BP an Organization for Promoting Continuing Financial Management Improvement 12

3.4 Intergovernmental Fiscal Relations 13

3.4.1 Current Status. Intergovernmental Fiscal Relations Is in the First Stage of Development; Little Has Been Accomplished 13
3.4.2 Impact. USAID Has Been the Exclusive Source of Technical Assistance, and Progress Has Been Made in Improving Understanding of the Area 13
3.4.3 Lessons Learned. In Selecting Areas in Which to Provide Technical Assistance, USAID Could Consider (but Not Be Controlled by) Timing and Whether Contemplated Changes Are Politically Acceptable 14
3.4.4 Recommendation. Indirectly Assist ME&BP to Get the Technical Assistance that It Needs to Progress in Intergovernmental Fiscal Relations 14

3.5 Fiscal Analysis 15

3.5.1 Current Status. The First Stage of Development Has Been Successfully Concluded, but Much Progress Is Needed before Sustainability Will Have Been Reached. 15
3.5.2 Impact. The Parliament Does Recognize that Information from the Executive May Be Tainted, and that Recognition Is Linked to USAID Assistance 16
3.5.3 Lessons Learned. Successful Technical Assistance Depends upon the Client Wanting and Accepting Responsibility for Change 17
3.5.4 Recommendation. Continue Technical Assistance to the Parliament at a Greatly Reduced Level 17

4.0 Kyrgyzstan 18

4.1 Tax Policy 18

4.1.1 Current Status. Tax Policy Benchmarks Are Not Fully in Place 18
4.1.2 Impact. USAID's Assistance Was Effective at the Start 19
4.1.3 Lessons Learned. Policy Requires Capacity Building and Consistency In Management 20

4.1.4 Recommendations. Redirect Technical Assistance 20

4.2 Tax Administration 21

4.2.1 Current Status. Only Basic Components Have Been Partially Completed 21
4.2.2 Impact. The Impact Has Been Limited 21
4.2.3 Lessons Learned. Design Technical Assistance that is Compatible with the Capacity Formation in the Country 22
4.2.4 Recommendations. Provided Redesigned Technical Assistance for Some Time to Come 22

4.3 Budget Reform 23

4.3.1 Current Status. Budget Reform in Support of Fiscal Policy Management Is Still in the First Stage of Development 23
4.3.2 Impact. To Date, USAID Impact Upon Budgeting in the Kyrgyz Republic Appears to Have Been Significant but Limited (Extensive but not Deep) 23
4.3.3 Lessons Learned. For Countries in the Early Stage of Development, Reform Should Be Limited, Focused, and Methodically Follow a Broad Institutional Development Agenda 24
4.3.4 Recommendation. For a Two-Year Program, Focus Technical Assistance So As to Complete Benchmarks Needed to Progress Through Development Stages 24

4.4 Intergovernmental Fiscal Reform 25

4.4.1 Current Status. Intergovernmental Fiscal Relations Is in the First Stage of Development, although Progress Has Been Made 25
4.4.2 Impact. USAID, through Its Democracy And Governance Program, Played a Major Role in Developing the Draft Law; the Fiscal Reform Program Developed a Training Program to Improve Local Government Financial Management 25
4.4.3 Lessons Learned. In Kyrgyzstan, the Distribution of Wealth Makes It Particularly Important that MINFIN Concerns about Local Financial Management Be Addressed 26
4.4.4 Recommendation. As Indigenous Resources Permit, Consider Technical Assistance Support to Decentralization and Intergovernmental Fiscal Relations 26

4.5 Fiscal Analysis 27

4.5.1 Current Status. The First Stage of Development Has Not Been Successfully Concluded, and No Benchmark Seems to Have Been Attained 27
4.5.2 Impact. Internal Capacity Is Undeveloped; and, Consequently, Authentic Impact Has Not Begun 28

4.5.3 Lessons Learned. In An Environment of Limited Resources, the Client Will Tend to Use Technical Assistance Resources Operationally..... 28
4.5.4 Recommendation. Base Continued Technical Assistance upon a Memorandum of Understanding Signed by Leadership of the New Parliament Which Requires that Leadership to Create an Appropriate Internal Staff 29

5.0 Conclusion 30

5.1 It Is Premature To Withdraw From Kazakhstan, But The Technical Assistance Program Can Be Re-Designed And Reduced 30
5.2 Technical Assistance To Kyrgyzstan Should Plan For The Full Requirements Of Institutional Development And Focus Indigenous Resources To Maximize Progress..... 32

Endnotes..... 33

APPENDICES

Appendix I Scope of Work I-1

Appendix II List of People Interviewed.....II-1

Appendix III Materials Reviewed III-1

Appendix IV Tax Policy IV-1

Appendix V Fifteen Questions V-1

EVALUATION OF USAID FISCAL REFORM PROGRAM: KAZAKHSTAN AND KYRGYZSTAN

1.0 EXECUTIVE SUMMARY

USAID has operated the Fiscal Reform Program in Kazakhstan and Kyrgyzstan since 1995. It has now contracted with Development Associates, Inc. and Nathan Associates, Inc. to evaluate the success of the Program. The evaluation occurred over the period July 14 to August 31, 2003. This is the Executive Summary of the Evaluation Report.

1.1 CURRENT STATUS. BUDGET REFORM OBJECTIVES HAVE BEEN MORE FULLY ACHIEVED IN KAZAKHSTAN THAN IN KYRGYZSTAN

The fiscal reform status varies between Kazakhstan and Kyrgyzstan.

1.1.1 In Kazakzstan, Objectives Have Been Achieved in Two of the Five Components, and USAID Assistance Could End in These Two Areas

Reform objectives have been achieved in Tax Policy, Tax Administration, and Basic Budget Reform. Important progress has been made in Program Budgeting, where the mechanics of program budget preparation have been absorbed and budgets in program formats are being produced. However, since reform objectives for program budgeting have not been achieved, Budget Reform objectives overall have not been achieved. Additionally, important progress has been made in Fiscal Analysis, where the Parliament expresses a need for objective information of professional quality separate from that provided by the Executive. In Intergovernmental Fiscal Relations, little reform has been accomplished to date.

Kazakhstan has the resources and apparently believes that it, as the result of its progress, has the understanding to continue fiscal reform even if USAID assistance terminates.

On the basis of Kazakhstan's achievement of objectives and on the apparent capacity of Kazakhstan to continue reform, USAID could consider ending fiscal reform technical assistance in Kazakhstan for Tax Policy and Tax Administration.

1.1.2 In Kyrgyzstan, Basic Objectives Have Not Been Achieved, but Opportunities for Progress Seem to Exist

Objectives have not been attained in any of the five fiscal reform components. However, opportunities for achievement exist.

- Budget Reform. By focusing technical assistance, opportunities seem to exist for accomplishment in Basic Budget Reform. Acceptance of a new Budget Code seems attainable after passage of the Law on the Economic and Financial Bases of Local Self-Government. Similarly, creation of capacity in the areas of Medium-Term Budget Framework and Analysis of Expenditure Plans and Budgets (in a program budget context) seems attainable.

- Intergovernmental Fiscal Relations/Property Tax. Cities may now implement a real property tax, and the head of the Ministry of Finance (MinFin) Valuation Unit is providing leadership for them to do so. Regulations to implement the tax will soon be issued. A train-the-trainers program to assist implementation has been planned. In short, the Government seems serious about progress. Moreover, local governments need Own-Source Revenue. Finally, the property tax will support decentralization, a USAID priority. This seems an area ripe for USAID technical assistance.

- Intergovernmental Fiscal Relations/Budget Reform Support to the Property Tax. Local governments do not manage their finances well. If the property tax is to be implemented, budget reform technical assistance is also called for. Local budget reform is an interest of MinFin. This recommendation focuses that interest so as to maximize effectiveness. Kyrgyzstan has experience with budget reform, which could increase the probability of achievement.

- Tax Policy. Technical assistance is still required here. This technical assistance should be redirected after assessing the existing capacity and redesigned in a way that is compatible with the needs of the country and the absorptive capacity of the staff of the Ministry of Finance. For specific recommendations, see Point 4.1.4.

- Tax Administration. Technical assistance should continue in this component. To be discouraged by not obtaining the expected impact and to cut off assistance would result in the loss of past achievement. Without continuing technical assistance there would be no way to sustain those past advancements that are worth building upon. For specific recommendations, see Point 4.2.4.

- Intergovernmental Fiscal Relations/Transfer Formulae. Passage of the Law on the Economic and Financial Bases of Local Self-Government offers significant opportunity. Therefore, technical assistance should be offered to develop transfer formulae. Nevertheless, this area also holds fairly high risk, for there is no assurance that political agreement can be reached upon particular formulae. For this reason, this assistance is listed sixth, even though the Law on the Economic and Financial Bases of Local Self-Government has passed the Parliament.

- Fiscal Analysis. Kyrgyzstan has a new constitution and will soon have a new, unicameral parliament. USAID should regard this as a new beginning and offer technical assistance, if an agreement with the parliamentary leadership to create an appropriate internal staff can be reached.

These opportunities contain political risk. Therefore, they are prioritized based upon Expected Value judgment, i.e., they combine judgment about the worth of a change and the probability of getting it. They should be pursued to the extent that indigenous resources are available, e.g., if the government can recruit and retain suitable personnel.

1.2 IMPACT. USAID ASSISTANCE HAS BEEN IMPORTANT TO PROGRESS

Whatever the degree of success in the two countries and the five components, USAID has been a major contributor to that success. In some cases, the IMF and the World Bank have provided important leadership and even an agenda, but it has been USAID that has provided the technical know-how to help each country make progress against the agenda. In doing so, USAID has been virtually the lone provider of fiscal reform technical assistance. Since all five components of the Fiscal Reform Program are heavily technical, neither country could have made progress without outside assistance. USAID provided that assistance.

1.3 LESSONS LEARNED. TECHNICAL ASSISTANCE SHOULD BE BASED UPON A COMPREHENSIVE VIEW OF INSTITUTIONAL DEVELOPMENT AND RESPOND TO THE CLIENT'S CAPACITY

To be effective, organizations/institutions have minimum requirement in eight areas. (For a list of the areas, see Point 3.3.3. in the body of the report.) If any of these requirements is not met, the organization will not function effectively. Therefore, technical assistance planning should consider and provide in some manner for minimum requirements in all eight areas.

Kazakhstan, because it is relatively resource rich for a developing country, is relatively well endowed in several of the eight areas For example, its personnel resource pool is fairly well developed. Therefore, an abbreviated program could be undertaken in the past with a reasonable likelihood of success.

Kyrgyzstan is relatively resource poor, including in its personnel pool. Therefore, its technical assistance program should explicitly address all eight areas for any fiscal reform measure that is contemplated.

1.4 RECOMMENDATIONS. CONSIDER A TRANSITION PROGRAM FOR KAZAKHSTAN, WITH AN EXIT DATE OF WITHIN TWO YEARS, AND A PROGRAM FOR KYRGYZSTAN THAT FOCUSES INDIGENOUS RESOURCES ON AREAS OF OPPORTUNITY

The evaluation team believes that Kazakhstan officials need continuing technical assistance in several areas to sustain past achievements and to progress on and complete other benchmarks. Program budgeting is a case in point. We think that they will fail if left to their own planning and will not consider all eight requirements of institutional development and the numerous components of a fully developed fiscal capacity. If this is true, further attempts at progress may fail, and past achievements may be lost. Therefore, we recommend that USAID work with Ministry of Economy and Budget Planning (ME&BP) over the next two years to establish an internal organization to lead and support continuing fiscal reform. Additionally, technical assistance to the Parliament could be continued if the Parliamentary leadership agrees to create a professional staff under a multi-partisan commission.

In the past, USAID has reduced the size of its program in Kyrgyzstan to match the program more closely to Kyrgyzstan's capacity to absorb technical assistance. The evaluation team believes that even further reduction in scope and greater focus are required. To elucidate, the report identifies a comprehensive list of opportunities. This results from the fact that objectives have not been

attained and much remains to be accomplished if objectives are to be attained. The report also suggests that, since Kyrgyzstan is resource constrained, a technical assistance program should not be bigger than indigenous resources can support. Therefore, priorities are set on the opportunities in the individual components, where it is helpful to do so. In Point 1.1.2.above, priorities are offered across the components. The opportunities listed in Point 1.1.2 should have call on available indigenous resources in the order in which the opportunities are listed.

2.0 INTRODUCTION

USAID has operated the Fiscal Reform Program in Kazakhstan and Kyrgyzstan since 1995. It has now contracted with Development Associates, Inc. and Nathan Associates, Inc. to evaluate the success of the Program. The evaluation occurred over the period July 14 to August 31, 2003. This is the report on that evaluation.

2.1 OBJECTIVE AND SCOPE

The objective was to provide an independent evaluation of the state of fiscal reform in Kazakhstan and the Kyrgyz Republic so as to inform USAID for its current and future decision making.

The evaluation covered both countries and all components of the program. There are five components:

- Tax Policy
- Tax Administration
- Budget Reform
- Intergovernmental Fiscal Relations
- Fiscal Analysis

For each component, the report was to provide and does provide four types of information. It provides information on:

- The current state of fiscal reform
- The impact of USAID assistance
- Lesson learned
- Recommendations, as needed, to achieve greater program impact, particularly over the next two years

In addition, the report was to provide, and does provide, answers to fifteen specific questions posed by USAID in the scope of work.

2.2 ORGANIZATION OF THE REPORT

To facilitate matching the results of the evaluation and its report to the objective, the organization of the report follows precisely the organization of the objective. Consequently:

- The body of the report is divided into two major sections, Kazakhstan and Kyrgyzstan.
- Each major section is divided into sub-sections corresponding to the five components, Tax Policy, Tax Administration, Budget Reform, Intergovernmental Fiscal Analysis, and Fiscal Analysis.
- Each sub-section is divided into sub-sub-sections corresponding to the types of information, Status, Impact, Lessons Learned, and Recommendations.
- To the sections and sub-sections, an Executive Summary, Introduction, and Conclusion are added.
- The fifteen questions are answered in a separate appendix, Appendix V.
- Four other appendixes are also attached, the Statement of Work, A List of Persons Interviewed, a List of Documents Reviewed, and a series of tables presenting the status of each benchmark used in the USAID Performance Monitoring System for the Program.

2.3 METHODOLOGY

Data was gathered for the evaluation through interviews and document review. As indicated, a List of Persons Interviewed and a List of Documents Reviewed are included in the Appendixes.

The status of reform is based upon, but does not adopt, the USAID evaluation scheme. The USAID Performance Monitoring System for the Program includes development stages and benchmarks of progress within each stage. The evaluation determined reform status by relating gathered data to the benchmarks and concluding whether the benchmark had or had not been achieved. The USAID scheme assigns each benchmark a value of 0 to 3 for progress. We believe that our binary approach, complete or not complete, is more appropriate for an "end of Program" evaluation for it relates more closely to achievement of the objective in a linked process. Thus, it is more important in our opinion to accomplish 100 percent of the benchmarks through the Sustainable stage than, say, 75 percent of each objective through the "Effectively Achieving Objectives" stage. We have, however, included scores for each benchmark to allow comparison between the two approaches.

This leads to some variation between reporting in the tax area and in other areas of reform. The Performance Monitoring System for taxation uses economic data, tax revenues as a percent of GDP, in its evaluation and does not in the other areas. Therefore, economic data is used prominently in the tax area but not in others.

Similarly, economic data is used importantly to determine the impact of tax reform, assessing ultimate consequences for the economy of reform efforts. In non-tax areas, the focus is upon the impact USAID technical assistance has had upon accomplishment of the benchmarks, movement through the stages of development, and building governmental capacity. The logic of the "brick chart" approach is that there can be socio-economic impact only if all bricks have been completed and put in place, i.e., if the "Effectively Achieving Objectives" stage is complete. Since in the non-tax area only one program component (Kazakhstan Basic Budget Reform) approaches "Effectively Achieving Objectives," by implication there is little or no socio-economic impact. In this institutional development stage, therefore, evaluation of impact should focus on benchmark accomplishment in non-tax areas.

Lessons Learned are derived from questions placed to interviewees and from the evaluation team's analysis of the gathered data.

Recommendations are derived from questions placed to interviewees, the evaluation team's analysis of the gathered data, and from the professional knowledge and experience of the team.

3.0 KAZAKHSTAN

3.1 TAX POLICY

3.1.1 Current Status. This Component of Technical Assistance Has Achieved Its Objective

After the breakdown of the Soviet Union, Kazakhstan became an independent republic, and began to veer towards a market economy. This country, rich in oil and gas resources, has had a very rocky start like so many FSU republics. Inflation in the early nineties and subsequently the Russian economic crisis (1998) caused the economy to shrink until the beginning of 1999. However, since then the economy has shown a healthy growth at an annual 5-6% rate, thanks to the boom in the petroleum sector. Per capita income rose and unemployment declined to about 10% in 2002, but the income disparity among the families did not decline.[i] During the initial years of independence national policies were aimed at political reform and macro-economic stabilization in order to assure a peaceful transformation of the country from the command to the market economy.

One of the giant steps that were taken was to install a tax system that incorporated all the parameters required for a market economy. Not only did IMF encourage the Government for the comprehensive revamp of its tax system (a system that carried all the idiosyncrasies of the Soviet era), but also USAID directed a massive technical assistance (TA) to prepare a comprehensive tax code and design a tax administration that would operationalize its application. A consulting firm (Barents) was contracted to carry out the required assistance and advice. The result was the tax code (adopted in 1995 by a Presidential Decree) that included all the provisions required by a market economy and all the rules and regulations for its application. The code was the very first one in the FSU republics of Central Asia and became a model for the other countries in the region.

In essence, the code was resource allocation neutral with some provisions that took into consideration, for example, a sui generis nature of the petroleum sector and of agriculture.[ii] From its enactment until 2002 the code has been changed several times introducing amendments consisting of a series of specific exemptions etc. It was thoroughly revised and the new code came into effect as of January 1, 2003. One of the major changes in the new code is the special regime applicable to the SMEs.[iii] The measure undoubtedly reflects the option of ease in administration. But at the same time it reflects the policy of the Government to stimulate the growth of SMEs. Although it stands to reason that the growth of SMEs is not only a function of tax provisions, but also depends upon several factors, such as credit facilities, markets, availability of transportation and a host of other factors, the provision in the tax code definitely reflects the concern of the Government to provide special stimulus for SMEs.[iv] It may be noted that small businesses in Kazakhstan are on the rise and, during the last several years, their number has been increasing on the average by about 20% per year, totaling 747,220 establishments in 2002.

In short, the current status of the tax code and the overall policy it has shaped appear to be satisfactory and consistent with the overall macro-economic policy followed by the Government, and also to both IMF and the World Bank. However, the tax-to-GDP ratio is still below 15% and heavy reliance on VAT (%48 of tax revenue) continues. The low tax-to-GDP ratio is perhaps understandable because of the preponderance of the revenues derived from gas and petroleum exploration fees and exportations.

The overall conclusion is that Kazakhstan has completed practically all the benchmarks. The basic components are in place; the system is operationally functional and sustainable. Practically all objectives have been effectively achieved, with the exception of the establishment of quantitative analysis capabilities in the Parliament.

3.1.2 Impact. USAID's Assistance Has Been Appropriate and Effective and Has Had a Very Positive Effect on Policy Design

Government activities, output and socio-economic data, structural reforms in the country (the tax code being one of many), good macro-economic management, and the preponderance of the petroleum sector began to show their impact especially as of 2000.[v] The annual average growth rate of GDP during the last few years was around 10%. However, while the economy is growing, the buoyancy (the ratio of the percentage change in tax revenue to percentage change in GDP without taking into consideration the statutory changes) of total tax revenues is not fully satisfactory. The average buoyancy during the period 1995-2000 was only around 1, and only after 2000 did it begin to increase, due to the better collection of income taxes, reducing the heavy reliance on heavy indirect taxes. And despite the fact that almost 30% of the population lives below the poverty line, this reduction in the reliance on indirect taxes is yet to inject the equity considerations into the tax system.[vi]

The impact of the code and tax policy, thanks to USAID's assistance, had a positive impact on the overall economic policy of Kazakhstan. It simply made the code consistent with the overall policy target of moving from the command to transition economy, and from the transition to market economy. The assistance provided has clearly showed the Kazakh authorities the essential elements of a good tax policy as incorporated into the code. The necessary provisions are already now in the code, such as the special status of SMEs as well as of the petroleum industry was also clarified. The code, as amended and now operational as of January 2003, clearly shows the policy parameters that are consistent with the overall economic policy, as the original code also reflected. In this context it may be added that in the parliamentary circles there are some thoughts to simplify the tax code even further by, for example, reducing the income tax rate or even making it a flat rate, further facilities for foreign direct investment, etc. These thoughts, whether or not will be implemented remain to be seen. They do indicate, however, that in the Legislative level (as in the Executive level) the parameters of tax policy are well understood. This is another indication of the impact of USAID's tax policy. In short, the impact has been essentially positive and consistent with the economy that is about to complete its transitional state.

3.1.3 Lessons Learned. There Is a Close Relationship Between Strong Tax Policy and Political Will

Several lessons can be extracted from the experience of Kazakhstan.

- There is a good relationship between tax policy (and tax code) and political will. The success of a good tax policy and its concordance with overall economic policy must be attributed at least partially to the political will. As conditions mature and the economy comes closer to the market economy, tax policy changes that correspond to such conditions must be incorporated into the tax code on a need basis, as the Kazakhstan case shows.

- The code is the essential guide for tax policy. Again, as the experience of Kazakhstan shows, its application as well as policy design requires quick capacity building in this area.

- The code should contain only general principles. Their interpretation, however, should be left to regulations and jurisprudence without continuous recourse to the parliament for the required changes.

3.1.4 Recommendations. Considering the Achievements, No Further Technical Assistance Should Be Undertaken

Kazakhstan has successfully put in place a tax code with a well-prepared cadre of staff (thanks to USAID assistance). It is recommended, therefore, that no further TA be undertaken on a long-term basis.

If and when some specific need arises, USAID may consider providing short-term well-focused TA, if the need for and the scope of such TA are well articulated by the Ministry of Finance.

The analytical capabilities in the Ministry of Finance are well developed and the staff well trained in projections, cost-benefit analyses of the proposed changes in the code. However, the Tax Analysis Unit in the Parliament and its national staff require further assistance and training. This shortcoming may be remedied with a well-designed TA that should not exceed one year. It is recommended, however, that the national staff of the Tax Analysis Unit in the Parliament be provided with assistance directed to training, so that their analytical capabilities are enhanced. This assistance should not exceed one year.

3.2 TAX ADMINISTRATION

3.2.1 Current Status. Objectives Are Essentially Achieved; All But One Benchmark Is Reached

It is axiomatic that any tax reform and its implementation via the tax code are as good and efficient as its administration. In other words, tax policy and tax administration are inextricably related. Hence, in order to implement the tax code and the ensuing tax policy efficiently the Ministry has to be organized on a functional basis. This objective was accomplished as one of the very first activities, and the output is the Ministry as it is today.

IMF, in its dealings and negotiations with the Government of Kazakhstan, had suggested that not only a new code was necessary, but a new tax administration system had to be put in place, reflecting one of its strong recommendations that the Ministry of Finance be organized on a functional basis. However, it was USAID who undertook the job and provided the required technical assistance for the reorganization of the Ministry. Through its contractor USAID proceeded with the necessary manuals and the training to reform the administration and that was

fully achieved in 1999. The USAID contractor subsequently concentrated its attention on the following aspects: (i) single taxpayer identification number; (ii) comprehensive tax returns; (iii) audit process; and (iv) appeals process.

Considering that the overall management process of the administration also requires the installation and functioning of an IT system that would track down a complete process of tax payments, a system (hardware and software) was installed with the assistance of the World Bank with 8,000 computers and the accompanying software. The required training was completed during the 1997-1998 period. Upon the completion of the IT system the contractor undertook several activities that produced several outputs.[vii]

This report concludes that, in terms of benchmarks, the system has all the basic components and is operational and functional. It is also expected that the results obtained from the technical assistance will be sustainable. All but one benchmark has been achieved. This exception is that compliance is not necessarily consistent with international standards. However, Kazakhstan should be able to improve further the tax administration with its own resources and emphasize further taxpayer education.

3.2.2 Impact. Assistance Provided by USAID Has Been Effective

The overall impact is that the Ministry of Finance became considerably more efficient, the tax collection has increased, and so did the number of taxpayers. Although it is difficult to disaggregate the impact of good tax administration from the expansion of economic activities and assign a numerical weight to each, it is undeniable that the substantial increase in the number of taxpayers can and must be attributed at least partly to the efficiency of the administration.[viii]
In the beginning the Government was very receptive to the idea of the single management of revenues and expenditures. However, during the last couple of years or so the Government took several measures that tarnished this unitary approach. For one, the budget (revenues and expenditures) was split. The Ministry of Finance remained essentially a tax collecting agency and Ministry of Economy and Budget Planning assumed the remaining responsibilities of the budget. Further, the collection of taxes on international trade, i.e., customs, was taken out of the Ministry of Finance and entrusted to an agency directly attached to the President's office. Although the consultants of the contractor vehemently opposed and prepared several memoranda objecting to this administrative decision and declaring that, among others, thereby cross checking of returns would be lost, the Government did not heed this warning.

Moreover, the SMEs were separated from the overall tax regime (the economics of this separation was discussed in Section 3.1.1). Purely from an administrative standpoint, this separation can be viewed as a measure of expediency. It is expected that the existing staff of the Ministry of Finance can now concentrate its efforts on the verification, audit, appeals, etc. of the returns of the taxpayers whose payments are not negligible.

Also, as suggested by IMF, the Ministry has established a Large Taxpayer Unit whose functioning is considered efficient. The USAID contractor contributed to the functioning of this Unit. Moreover, every year in June the Government publishes the list of the major taxpayers, including those who are classified as large taxpayers, an action that adds to transparency of the administration.[ix]

In general, it can be concluded, however, that the Ministry of Finance has enough well-trained cadre of officials who are able to carry out their mandate, thanks to the concentrated efforts of intensive training and availability of manuals. These are all provided by USAID's well-programmed technical assistance.

3.2.3 Lessons Learned. Tax Policy and Administration Are Closely Linked

Tax administration reform and the training of the administrators should start parallel to the codification of the tax system. It appears that this was achieved in Kazakhstan with good results.

On the other hand, splitting the administration of taxes in general from customs is fraught with serious problems, because it may render rather difficult the cross-checking of declarations and may be conducive to corruption that may be one of the reasons for the low tax-to-GDP ratio as discussed above.

The success of the training cannot only be attributable to the technical assistance provided, for the success of training depends at the start also on the minimum absorptive capacity and technical knowledge of the trainees.

3.2.4 Recommendations. Consider the Mission Essentially Completed

Taking into consideration that the Ministry of Finance now has a good nucleus of trained staff, and assuming that this staff can be retained at the Ministry,[x] which would avoid to a large extent the drainage from the public sector to the private one, it is recommended that USAID, considering that its mission is essentially completed, the objectives have been achieved, all the benchmarks have been reached, and the expected impact has been attained, should not contemplate further technical assistance.

Should particular specific areas occur in which the tax administration may be in need of short-term and well-focused assistance, and the Ministry of Finance were to articulate and justify such assistance, USAID should respond to such a petition through short-term consultancy services.

3.3 BUDGET REFORM

3.3.1 Current Status. Budget Reform in Support of Fiscal Policy Management Is in the "Effectively Achieving Objectives" Stage of Development

The USAID evaluation scheme has two benchmark tables, one for Budget and one for Program Budgeting. The one for Budget may be conceived as a scheme for evaluating progress toward building a budget capacity to manage fiscal policy. Management of fiscal policy requires a capacity to establish fiscal policy through a medium-term budget framework, to establish a budget within the guidance provided by that framework, and to execute the budget in accordance with the guidance so as to protect the deficit/surplus number embodied in the fiscal policy. Given this definition of budget capacity, Kazakhstan budget reform has succeeded. Seven of eight benchmarks through the Sustainability Stage have been achieved. (See Table 3 in Appendix IV.) Using the USAID methodology, this would give 78 percent achievement or a score of 2.33, Significant Progress. In fact, budget reform has progressed further and completed one benchmark in the "Effectively Achieving Objectives" Stage.

On the other hand, progress on Program Budgeting benchmarks has been less impressive. Only two of eight benchmarks through the Sustainability Stage have been completed, and reform has not yet entered the "Effectively Achieving Objectives" Stage. In fact, program budgeting reform is still in the first stage of development, "Basic Components," having focused upon the mechanics and procedures of program budget preparation. The substance of program budgeting, program analysis and performance analysis is only now beginning in earnest. The mechanics are important because they force the line ministries to begin to structure their planning in terms of missions, objectives, goals, outputs, etc…; but the major benefits of program budgeting appear when service delivery systems are changed based upon program and performance analysis. This has not yet happened in Kazakhstan. Using the USAID methodology, progress on program budgeting would be rated at 42 percent with a score of 1.27, Reform Initiated. (See Table 4, Appendix IV.)

3.3.2 Impact. USAID Impact Upon Budget Reform Has Been Substantial

USAID technical assistance has had a substantial impact upon budget reform in Kazakhstan. The impact, however, has varied with the type of reform.

For budget reform in support of fiscal management, USAID came upon the scene after progress was made under IMF and World Bank leadership. Establishment of the Single Treasury Account, for example, appears to have occurred without USAID assistance. However, in three benchmarks of budget reform, USAID has provided important assistance: drafting the Budget Code (in conjunction with the World Bank), building capacity to prepare a Medium-Term Budget Framework (in conjunction with the World Bank), and preparation of performance indictors as a basis for adequate analysis of expenditure plans and budgets. Very importantly, basic budget reform has had socio-economic impact: Kazakhstan now has a 2.5 billion dollar development fund and no longer relies upon IFI borrowing.

In program budgeting, USAID has been the exclusive provider of technical assistance. Since Kazakhstan now develops its national budget upon programmatic basis and to do so required substantial technical assistance, and since only USAID provided such assistance, it may be concluded that the impact of USAID assistance on program budget reform has been substantial. However, national ministries are just beginning to re-structure programs and to expect socio-economic impact, i.e., improvements in program effectiveness, now would be premature. A recent performance audit conducted by the Accounts Committee concluded that expenditures for the Tuberculosis Program had been sufficient but that program results had not been comparable. See below.

USAID has also had a major impact on the work of the Accounts Committee. The Accounts Committee is responsible for setting standards for all government audits and for auditing central government agencies. USAID provided a consultant to the Committee for eleven months during 2002-2003, and that consultant produced four documents on how to conduct audits that were well received. Additionally, the consultant helped the Committee implement performance auditing that is now required by the 2002 law on auditing. The consultant provided training in performance auditing and then guided the conduct of two audits, one in health on the Tuberculosis Program and one in education on the quality of higher degrees. Both audits apparently had substantial impact upon the way that central government officials view the effectiveness of their programs and on how they think about their programs and effectiveness.

(Nevertheless, it is not recommended that technical assistance to performance auditing be continued. First, Accounts Committee staff report that they have already been trained sufficiently to fulfill any continuing need for training. Second, additional performance audits in the short-term would not be appropriate. Audits should be made against standards that the Executive is using. The Executive is not yet able to use performance standards; it is still in the process of trying to do so. Therefore, any performance audit will reveal a host of deficiencies in Executive programs, and everyone will know this before the audit is conducted. It is also highly likely that program designers in the Executive will not find such audits very useful in re-designing programs. Additional program audits should be delayed. It is undoubtedly true that the two audits were helpful in demonstrating to Executive officials that their programs need re-design, but only one or two audits for this purpose seem necessary.)

3.3.3 Lessons Learned. Adapt the Technical Assistance Program to the Needs of the Country

Major change in all the components requires an Institutional Development approach. Institutional Development as a discipline is well established and consists of eight components. These components are: mission and policy statements, organizational structures, staffing (numbers and types of people), budgets, facilities and supplies, systems and procedures, data, and, in the developing world, technical assistance. To succeed, executors of change must ensure that all of these eight elements are planned and provided. Because Kazakhstan is relatively developed, it entered budget reform with the ability to provide organizational structures, staffing, budgets, and facilities and supplies in support of budget reform. USAID could, therefore, focus upon providing systems and procedures, training to implement the systems and procedures, data, and technical assistance. In short, USAID could offer an abbreviated program for development and expect some level of success. For countries less well endowed than Kazakhstan, a full institutional development program, in which all eight components are addressed, would probably be necessary.

3.3.4 Recommendation. Consider Technical Assistance to Create Within ME&BP an Organization for Promoting Continuing Financial Management Improvement

As suggested in 3.3.1 above, if the objective of technical assistance is to create capacity to manage fiscal policy, the objective has been achieved, and technical assistance may end. If the objective is to "…promote sound budget policies and administration…" as defined by program budgeting, there is ample room for continued assistance. Since the current Strategic Objective is the latter, the objective has not been achieved (indeed the Sustainable stage is not complete), and it would be premature to terminate technical assistance in program budget reform.

However, we understand that the Mission is under budget pressure, may be able to fund only the highest priorities in the Central Asian Region, and is seeking assistance in setting priorities. In this vein, although it might be premature to terminate technical assistance in Kazakhstan, technical assistance need not be delivered in the same way. Kazakhstan has made considerable progress in fiscal reform, and USAID could use this progress to re-design its program.

A Deputy Minister in the Ministry for Economy and Budget Planning (ME&BP) has stated that ME&BP has been pursuing budget reform long enough that it understands the additional reform that is necessary, that it has the resources to continue reform, and that it can and will continue reform. He stated further that, if additional technical assistance is needed and USAID is not

available to provide it, other donors would. However, in the interview, the Minister did not exhibit a clear understanding of program and performance analysis. We believe that the Minister underestimates the difficulty of further reform, has an incomplete understanding of what full program budgeting entails, i.e., program and performance analysis, and lacks an appreciation of the need for comprehensive institutional development if major change is to be effective and sustainable.

Therefore, USAID could draw upon the experience gained by Kazakhstan to re-design and reduce its program there. At the same time, to protect past investment in budget reform, it is recommended that USAID negotiate with ME&BP to provide technical assistance aimed at creating within the ministry an organization designed to promote and lead continuing financial management improvement in both the central and local governments. Members of the new organization should have a comprehensive understanding of modern financial management and institutional development and the capacity to promote and lead change to establish this financial management in the governments of Kazakhstan. The new organization could then contract with USAID to provide consulting assistance e.g., in program analysis training, in institutional development for line ministry program analysis units, on a reimbursable basis. USAID would provide the institutional development technical assistance to set up the new unit.

3.4 INTERGOVERNMENTAL FISCAL RELATIONS

3.4.1 Current Status. Intergovernmental Fiscal Relations Is in the First Stage of Development; Little Has Been Accomplished

Kazakhstan has made little progress on Intergovernmental Fiscal Relations. Not one benchmark has been achieved; and, as a result, development is still in the first stage. Using the USAID methodology, this performance equates to 18 percent achievement or a score of 0.5, Reform Initiated. (See Table 5, Appendix IV.)

This lack of progress appears to be related to the process used. The accepted process consists of three steps taken in the following order: (1) assignment of expenditure responsibilities to the various levels of government; (2) assignment of revenue responsibilities to the various levels of government; and (3) establishment of formulae, usually concentrating upon the equalization of fiscal capacity among local governments, to transfer funds among governments in a predictable and transparent way. Kazakhstan began with the third step in 1999 but has not been able to agree upon formulae. In January 2003, a working group of the Government concluded that the accepted process should be used and that work should begin upon the assignment of expenditure responsibilities. As a result, the environment may now be more hospitable to progress than it has been.

3.4.2 Impact. USAID Has Been the Exclusive Source of Technical Assistance, and Progress Has Been Made in Improving Understanding of the Area

USAID support for Intergovernmental Fiscal Relations has not been substantial because of the high risk associated with the area. Nevertheless, USAID has been the sole provider of technical assistance. (USAID has now introduced Kazakhstan to the Moscow Center for Fiscal Policy, which may now also provide technical assistance.) Therefore, whatever progress the Government

has made in understanding and resolving the issues in the area can be said to stem from USAID assistance.

And progress has been made in improving understanding. The fact that the working group concluded that work focus should shift from developing formulae to reassignment of expenditure and revenue responsibilities is prima facie evidence of progress. Moreover, governmental staff exhibited understanding of the characteristics of transfer formulae.

On the other hand, expenditure and revenue responsibilities have not been reassigned, transfer formulae have not been agreed upon, and financial resources are not transferred to local levels on a transparent, predictable, and rational basis.

3.4.3 Lessons Learned. In Selecting Areas in Which to Provide Technical Assistance, USAID Could Consider (but Not Be Controlled by) Timing and Whether Contemplated Changes Are Politically Acceptable

USAID has invested technical assistance resources in this area, but little has been achieved. Why? Perhaps because intergovernmental fiscal affairs is an area in which it is inherently difficult to progress because progress usually involves political agreement and legislative action. The area almost certainly requires some political jurisdictions to be financial winners and some financial losers. The probability is high that the losers will oppose the proposed intergovernmental solution. Therefore, getting agreement can be difficult and the probability of progress can be low.

An important requirement in providing technical assistance is for the client to want the change contemplated and to perceive that technical assistance is a precondition for change. If the client is not ready for change, USAID could consider whether it is prepared to present assistance to promote a change in attitude (as in Parliamentary fiscal analysis). If the client is ready, direct technical assistance should suffice. Thus, if the client is not ready for change and USAID proceeds with technical assistance, USAID should expect a two-phase process (initially preparing the client and then providing direct assistance) and an extended assistance period.

In the case here, technical assistance began with the first phase. That phase seems to have been completed. Both executive branch staff and parliamentary elected officials expressed interest in receiving technical assistance. No one, however, indicated that political agreement on expenditure and revenue assignments or on transfer formulae would be easily obtained.

3.4.4 Recommendation. Indirectly Assist ME&BP to Get the Technical Assistance that It Needs to Progress in Intergovernmental Fiscal Relations

A priority of USAID is decentralization. Progress in intergovernmental fiscal relations would benefit decentralization. Kazakhstan may now be poised to make progress in the area because it is changing its focus from transfer formulae to reassignment of expenditures and some executive officials have expressed an intent to progress. Progress in this area would be easier if technical assistance were available to the Government. Therefore, it is in the interest of USAID for technical assistance to be available.

On the other hand, our interviews in the Parliament elicited interest in the area but no strong sentiment in favor of progress. Progress in the area is inherently difficult and the likelihood of progress low. USAID may, therefore, wish to be cautious.

As a consequence, it is recommended that USAID offer to help ME&BP acquire any needed technical assistance. Kazakhstan has the resources to pay for any technical assistance that it receives in the area, and it should do so. However, USAID could assist the ME&BP to acquire that assistance. Therefore, it is also recommended that USAID contract for the assistance under its existing IQC's and require reimbursement from ME&BP. If the unit recommended under Point 3.3.4 above is established, the technical assistance should be planned and managed by that unit.

3.5 FISCAL ANALYSIS

3.5.1 Current Status. The First Stage of Development Has Been Successfully Concluded, but Much Progress Is Needed before Sustainability Will Have Been Reached

There is no USAID benchmark table for Fiscal Analysis. Therefore, we have postulated a five-step progression, as follows: (1) establish a recognition within Parliament of its need for objective information of professional quality and, therefore, of its need for information separate from that provided by the Executive; (2) establish within Parliament a professionally competent staff that can provide that information; (3) establish a belief within Parliament that such a staff must be non-partisan and free from control by any political party; (4) establish within Parliament "ownership" for that non-partisan, professional staff; and (5) establish a fiscal analysis capacity within the Executive.

Using the above progression, our interviews and review of documents indicate that steps 1and 5 have been accomplished; steps 2, 3, and 4 have not. Since we believe that this activity focused primarily upon the Parliament and since steps 2, 3, and 4 have not been achieved, substantial progress must still be made before this area reaches "Sustainability." Specifically, we believe the following with regard to these five steps.

- Step 1. The Parliament recognizes that information from the Executive may be tainted, from inadequate technical competence or from political purpose. Access to another information source is necessary and that source could be a Parliamentary staff.
- Step 2. The skills of the USAID financed Fiscal Analysis Unit have not been transferred to the internal staff of the Parliament. The professional staff of the Parliament uses the Unit operationally to fulfill assignments and passes the work product of the Unit on to the legislators.
- Step 3. Parliament has not necessarily concluded that the source of information need be non-partisan. An alternative would be for each party to have its own competent staff, which it could control. (Political parties receive and issue information. Each wishes to issue information that will contribute to its political objectives. If a political party receives information from the executive, that political party can assume that the information will be issued so as to accomplish the objectives of the executive. If a political party receives information from a non-partisan organization that works publicly, the party will be constrained in re-issuing that information to suit its objectives by the

fact that the basic information is publicly available. The best solution for a political party is to receive information for a professional staff that it controls, so that it can control the issuance of the information and even the directions under which the information is prepared. It can be assumed that, given the choice, a political party will prefer a professional staff that it controls to a professional staff that it does not control. Similarly, a political party will tend support a non-partisan professional staff only if its need for partisan staff has been met and/or creating the needed staff is too expensive for the political party. As a note, partisan staffs can be professional and objective, providing information to politicians who use it in a partisan way. That is, political parties need not rely on non-partisan staffs to get objective information.)

- Step 4. The Parliament does not feel "ownership" for the USAID Fiscal Analysis Unit and has not committed itself to making its internal staff, for which it does feel ownership, over in the image of the USAID Unit. In an interview, a representative of the Senate expressed no inclination to improve the Senate internal staff if USAID technical assistance ends. That is, although the Parliament may recognize that information from the executive is tainted, it does not seem to have a firm conclusion as to how far it must go to create a satisfactory staff.
- Step 5. Fiscal analysis staffs of the Executive can produce a Medium-Term Budget Framework, expenditure and revenue projections, and other fiscal analyses of acceptable quality.

3.5.2 Impact. The Parliament Does Recognize that Information from the Executive May Be Tainted, and that Recognition Is Linked to USAID Assistance

The Parliament, including the head of the internal staff, does recognize that information from the Executive may be tainted and that an alternative source of information is needed. The Parliament does recognize that alternative, high quality information can be useful to it; and the USAID Unit appears to be responsible for developing this recognition. Therefore, the first phase of development, recognizing the need to change, has been completed. (Parliament recognizes the need to change and not be dependent upon the executive for information. It is not clear that the Parliament is agreement on what to change to.)

Additionally, the USAID unit has directly impacted fiscal operations. Using the unit's work, a 50 billion tenge positive balance was discovered for 2002, and revenue estimates for the 2003 budget were raised. However, to be an authentic impact for this component, the impact would have had to originate from the Parliament's internal staff. It did not. Technology transfer has not occurred satisfactorily.

In the Executive, fiscal analysis personnel were professionally educated before the arrival of USAID assistance. Therefore, they were prepared to absorb the training provided. They have done so. The USAID impact on the Executive has been important, particularly in modeling for revenue and expenditure projections.

Parliamentary staff were not adequately prepared, and they have not absorbed training. Moreover, although the head of the internal staff originally requested assistance from the US Ambassador in 1997, he stated in an interview that initial USAID assistance was not sufficiently attuned to conditions in Kazakhstan and that initial consultants turned over too frequently. Additionally, although the Memorandum of Understanding establishing the USAID Unit requires

the Parliament to provide five counterpart staff, only two have been consistently provided. Instead of using the Unit as a model from which to learn, the head has used the Unit on problems to provide answers using best international practices rather than requiring his staff to learn those best practices. For all these reasons, the impact in terms of technology transfer has been less than complete.

3.5.3 Lessons Learned. Successful Technical Assistance Depends upon the Client Wanting and Accepting Responsibility for Change

Neither the members of Parliament nor the head of the Parliamentary staff appear to have accepted responsibility for creating a fiscal analysis capability internal to the Parliament. The attitude seems to be that the Unit is to provide service that the internal staff and the Parliament may accept or reject. If the Parliament and the head of the staff do not accept responsibility for creating an internal fiscal analysis capability, such a capability will not be created. The USAID Unit cannot do it. Therefore, future agreements between USAID and a Parliament in other Central Asian Republics to provide phase two technical assistance per Point 3.4.3 above should be designed to make the Parliament or its agent responsible for creating the internal capacity that is needed, with USAID assisting the Parliament or its agent to do so. To do this, that Parliament should be clear about the characteristics of the capability that is wants to create, as does not seem to be the case in Kazakhstan. If the purpose of the agreement is to create recognition within Parliament of its need for objective information of professional quality, i.e., to provide phase one technical assistance, then a separate Unit, as used now in Kazakhstan, would be appropriate. (Relating Points 3.4.3. to 3.5.1., Step 1 of Point 3.5.1, would be included in Phase 1 of 3.4.3.; and Step 2 would be included in Phase 2. Steps 3 and 4 would be a pre-condition for Phase 2 technical assistance, as just discussed.)

3.5.4 Recommendation. Continue Technical Assistance to the Parliament at a Greatly Reduced Level

The first phase has been achieved: the Parliament recognizes its need for objective information of professional quality. USAID could consider providing technical assistance under phase two. In doing so, there are two issues: (1) creating a professional staff internal to the Parliament; and (2) ensuring that that staff is non-partisan and free from political control.

To do this, the Parliament needs to be clear that this is the type of staff that it wishes to create and that it will assume responsibility for doing so. Developing this clarity should be a pre-condition for continuing aid. It would seem that the Parliament has had sufficient experience with the USAID unit to make an explicit decision now about whether to create such a unit. For this, as a precursor to a new round of assistance (should there be one) USAID should engage the leadership of the Parliament in an explicit decision-making process. If the Parliamentary leadership should decide to create a unit such as described in (1) and (2) above, USAID could consider the following approach.

To accomplish (1), it is recommended that USAID require a plan for institutionalization of Parliamentary fiscal analysis capacity and establishment of a schedule for phasing-out USAID assistance. USAID should also require Parliamentary officials to spend from their institutional budgets to support meeting the phase-out schedule (so that the Parliament would be investing its own resources and expect to see a return on the investment). USAID assistance would consist

primarily of an expatriate advisor to the local head of the parliamentary professional staff. Existing USAID-funded local staff in the Fiscal Analysis Unit would be terminated (although they could be hired by the Parliament). The head of the internal staff would have responsibility and authority to use the resources at his disposal, i.e., his parliamentary budget and the expat., to institutionalize the capacity. This could include procuring additional contractual technical assistance from USAID. It should be clear to USAID, the Parliament, and the public that the institutionalization responsibility lies with the head of the parliamentary professional staff.

To accomplish (2), it is recommended that USAID require that the Parliamentary staff report to a multi-partisan commission, so that no political party could control the "non-partisan" staff. The parliamentary leadership might not agree to a multi-partisan commission, but this would be a test of its commitment to a non-partisan staff.

4.0 KYRGYZSTAN

4.1 TAX POLICY

4.1.1 Current Status. Tax Policy Benchmarks Are Not Fully in Place

A market-based tax system began to be implemented as of 1992 pursuant to the Constitution (Art. 25) which stated that "citizens of the Kyrgyz Republic shall be obliged to pay taxes and fees." The system is in a fledging state and is still not being fully implemented, yet at least in its spirit it shows the signs of a genuine desire towards a market system. However, a real market-oriented tax code came into being in July 1, 1996. Most, if not all, of its articles did not differ from that of the tax code of Kazakhstan.[xi] Drafting of the code was accomplished with funds provided by USAID, and its contractor Barents carried out the actual work.

Originally, the code was meant to be resource allocation neutral, but as will be seen below, numerous amendments tarnished seriously its intention. It was to be the prime instrument (with its corresponding administration) for raising revenues to finance the state expenditures. The code also incorporated all the rules and regulations for a proper tax administration.

However, from its enactment until now the code was constantly amended. In fact, some 700 modifications were introduced. Some new provisions were worked in for the purpose of assuring economic development and enhancing equity. The major changes in this vein were: accelerated depreciation enabling businesses to increase their profit and replacement of fixed assets; generous loss carry forward provisions; special treatment of geographically disadvantaged areas; reduction of the VAT rate; and special treatment to SMEs in July 1999 in simplifying the tax code by subjecting them to the patent and gross receipt tax. In fact, the Government, conscious of the very slow pace of economic development in the country, is desirous to stimulate SMEs.[xii]

While the above amendments clearly indicate the concern of the Government to encourage economic development and to create favorable conditions for investment, several other amendments were also introduced with the purpose of recognizing special benefits in terms of exemptions, favorable treatments etc. to certain economic subjects and entities. There are some 500 such provisions in the currently existing code. The end result is that the code has become very eclectic and riddled with contradictory provisions. Such frequent changes without having undertaken detailed cost-benefit analyses (for which the in-house capacity is inadequate) serve

only the benefits of specific taxpayer categories, are conducive to corruption,[xiii] and undermine the stability of the tax system. As a result the code reflects no consistent tax policy, impedes proper tax administration, and damages the integrity of the tax structure.[xiv]

It must be kept in mind that tax collection based on the code has shown a poor picture. Total tax proceeds (1996-2002 average) is slightly less than 13% of GDP, which is low by any standard. Income taxes are only 2.5% of GDP and the only major source of revenue is VAT (40% of total tax revenue) which was about 5% of GDP during the period under consideration.[xv] Granted, the revenue collection is not only a function of the tax code and tax policy, but also of a host of other socio-economic conditions. However, it stands to reason that a poor tax code, as it is, has certain negative impact on tax collection.[xvi]

The major activity of the USAID-provided technical assistance, i.e., preparation of the tax code, had been completed successfully and the output was at hand free of internal inconsistencies. However, as explained above, the changes that have been introduced eroded the effectiveness of the tax policy based on the code.

The report concludes that only the first benchmark, i.e., the basic components of the tax code, despite the frequent changes, is essentially at hand. But the system is yet to be operational and functional, and certainly the sustainability is questionable. The special provisions for SMEs and their sustainability are also question marks, since these provisions are very new and their application is yet to be tested. Whether the objectives are effectively achieved is open to questioning. The tax code does not discourage foreign investment, but a set of non-fiscal conditions in the country are likely to discourage DFI. Despite the fact that originally the tax code included provisions for horizontal and vertical equity, numerous exemptions are in fact working against the equity principle. It would be premature to say that objectives are effectively achieved.

4.1.2 Impact. USAID's Assistance Was Effective at the Start

The Kyrgyz Republic is one of the poorest countries in the world (per capita GDP was barely US$ 300 in 2002). More than 50% of the population lives below the poverty line. The country is sparsely populated and mountainous with very limited arable land (7% of the total). Very many agricultural and pastoral villages are barely connected with the rayons to which they belong. Natural resources are also limited. Gold and few other minerals and abundant hydropower are the only wealth.

Like many republics of the former Soviet Union, the Kyrgyz Republic also suffered from a number of shocks. The early painful transition years and the 1998 economic crisis in Russia impacted its economy quite negatively. Its foreign trade was then, and is still now, dependent on exports to Russia. The Government undertook a number of reforms and initiatives during the last several years, but many of them are yet to bear fruit, and fiscal policy is no exception. The technical assistance provided for the design of the tax code was initially effective and positive, but this positive impact eroded rather quickly due to constant amendments. Some of these amendments were blocked, thanks to USAID's and the Ministry of Finance's scrutiny. Nonetheless, quite a number of them found their way and tarnished the consistency of the tax code. This is at least partly due to the staff's lack of quantitative analysis capability, low absorptive capacity of technical assistance, and its high turnover.

In short, USAID's assistance was effective at the start, but the effectiveness evaporated very quickly and the intended impact of the assistance to the design of the tax code and tax policy is no longer observable. Admittedly, in a country like the Kyrgyz Republic policies to terminate the transition period and to move to a market economy is rather difficult, given the socio-economic circumstances. It would be unduly optimistic to expect the same success observed in Kazakhstan. The Kyrgyz authorities seem not to have paid sufficient attention to the appropriate tax policy, partly due to the absence of qualified personnel, and succumbed to the influences of interest groups.

4.1.3 Lessons Learned. Policy Requires Capacity Building and Consistency In Management

The discussion above reveals several lessons.

- For one, a good tax policy requires capacity building and consistency in management, both of which are lacking in the Kyrgyz Republic.
- Secondly, frequent changes, especially to satisfy pressure groups, are detrimental to a consistent tax policy.
- And finally, good tax policy requires analytical capabilities both in the legislative and executive branch to assure the consistencies of the proposed changes with overall policy. In the Kyrgyz Republic the capabilities in both branches are lacking.

4.1.4 Recommendations. Redirect Technical Assistance

Given the state of affairs in the realm of tax policy, it is recommended that technical assistance is still required for some time to come. This technical assistance should be redirected after assessing the existing capacity and redesigned in a way that is compatible with the needs of the country and the absorptive capacity of the staff of the Ministry of Finance.

More specifically, it is recommended that the technical assistance should have the following form in the next two years:

- Provide technical assistance to review the code, eliminate inconsistencies, and assure simplification. Review the implementing regulations and assist the Ministry to make them consistent with the code. This should be completed in six months. Nothing can guarantee that what happened during the past will not repeat itself after revising the code, unless a political will is in place that will not give in to special interests.
- Redesign a thorough training program, taking into consideration the level of professional preparedness and the absorptive capacity of the staff.
- Start from elementary levels of statistical knowledge, gradually increase it to the quantitative techniques of revenue projections and methods of cost-benefit analysis of all forthcoming amendments, as well as to enhancing the capability of conducting studies to assess the equity (vertical and horizontal) implications.
- Review the feasibility of incorporating agricultural incomes into the tax net with the administrative staff of the Ministry, in order to incorporate the administrative parameters required for taxing the agricultural incomes.

This technical assistance to train and build capacity should be accomplished within two years.

4.2 TAX ADMINISTRATION

4.2.1 Current Status. Only Basic Components Have Been Partially Completed

The USAID, through its contractor, initiated the reform of the tax administration concomitantly with the codification of the tax system. Following the recommendation of IMF, the Ministry of Finance was organized on a functional basis and massive technical assistance was directed in the form of required manuals, training, and capacity building. To improve the tax collection further a Large Taxpayer Unit was also set up, and a tax identification numbering system put in place and lately tax and customs administrations were united under a single agency. Yet, tax administration remains essentially weak. In other words, the contractor, as prescribed, has carried out all activities, but not all outputs have been achieved, and the intended impact is yet to be observed. In other words, there are serious basic weaknesses in the tax administration; these stem from various factors. These can be summarized thus:

- There is a fair amount of turnover among the staff, i.e., there is a leakage in the capacity that is being built. Those who are trained move to the private sector where the remuneration is much more satisfactory. Hence, the capacity that is being built through technical assistance is constantly lost to the tax administration.
- There is a frequent rotation among the higher echelon of managers and decision makers. Therefore, the continuity of directive is frequently interrupted.
- Capacity among the staff who has been subjected to training is very low. Hence, the low absorptive capacity does not allow them to use their training efficiently and effectively with a larger perspective.
- Corruption in the administration is endemic and tax evasion is very widespread. The means to detect evaders are not in place.
- Basic tools, such as computers and software, are insufficient.[xvii]
- Although the IT system is essentially established, including central data base and its hook up with pilot offices, the full computerization it is far from being satisfactory. There is only preliminary verification. Audits and Arrears Departments are not carrying out their functions effectively.[xviii] There is an overhang of backlog of arrears that indicates inefficiency in collection.
- Hardly any crosschecking is carried out (although there is a single taxpayer unit identification number). This stems from the fact that the different IT systems designed make it impossible to share information among varying offices.
- It appears that very few cases are referred from the Audit Department to the Appeals Department. This suggests that all disputes are solved in the Audit Department through means other than legal. This also suggests some corruption in the administration.

In conclusion, only part of the first benchmark, i.e., the basic components of tax administration are in place. Functional organization is completed, computerization is yet to be completed, and the staff needs to be trained adequately. The system is neither operationally functional, nor is it sustainable. In short, the objectives are yet to be achieved effectively.

4.2.2 Impact. The Impact Has Been Limited

USAID directed considerable efforts to training, but due to the lack of absorptive capacity the impact was very limited. Also the absence of necessary tools (hardware and software), makes the

efficiency rather low. A good example for this is the incomplete use of tax identification number system that is set up in checking and cross checking the income tax declarations them with information from customs, VAT offices, etc. This indicates that basic tools are there, but they are not fully used.

It also appears that political will is lacking. Moreover, the constant change in the high level management and the fear to make decisions at the mid-level management (a Soviet legacy) are impediments for effective improvement in tax administration.

Many indications suggest that there is a certain amount of corruption that erodes whatever effectiveness exists in the administration.

In short, technical assistance is yet to show fully and satisfactorily the desired impact.

4.2.3 Lessons Learned. Design Technical Assistance that is Compatible with the Capacity Formation in the Country

Technical assistance should be designed in such a way that it is compatible with the existing capacity in the country. The technical assistance extended to the Kyrgyz Republic is similar to that of Kazakhstan. Yet, socio-economic conditions, capacity formation and the absorptive capacity in both countries are totally different. What is good for Kazakhstan is not necessarily good for the Kyrgyz Republic.

The effectiveness of the technical assistance is also a function of the continuity in upper management in order to reach the effective results that technical assistance is expected to yield.

4.2.4 Recommendations. Provided Redesigned Technical Assistance for Some Time to Come

The report recommends that technical assistance should continue in the Kyrgyz Republic for some time to come. To be discouraged by not obtaining the expected impact so far and to cut off the assistance would result in the loss of any results achieved up to date. Otherwise there would be no way to sustain even the preliminary advancements that are worth building upon. The Kyrgyz authorities perceive USAID as the only dependable assistance giver. IMF puts forward prescriptions to increase taxes and reduce expenditures without really assisting the authorities as to how to operationalize them. It is recommended, therefore:

- Engage the tax administration in contributing to the simplification of the tax code to enhance the feeling of ownership of technical assistance and understanding the administrative implications of the changes.
- Assist the staff of the Ministry of Finance to come to the technical level for weeding out from the tax code those provisions that are working against the principles of vertical and horizontal equity.
- Enhance the capacity of the staff for following the tax provisions for the development of SMEs and encouragement of FDIs. These provisions being fairly new, they require a proper monitoring for the next couple of years and, depending upon the results of the monitoring, certain requirements be added.
- Provide technical assistance to prepare the ground for the implementation of the property tax.

The above suggestions are over and above the need to enhance the overall capacity of the staff, which will require also the completion of the IT system, provision of all necessary software and other amenities.

4.3 BUDGET REFORM

4.3.1 Current Status. Budget Reform in Support of Fiscal Policy Management Is Still in the First Stage of Development

As with Kazakhstan, the USAID evaluation scheme has two benchmark tables, one for Budget and one for Program Budgeting. Again, the one for Budget may be conceived as a scheme for evaluating progress toward building a budget capacity to manage fiscal policy. Given this perspective, Kyrgyzstan budget reform is still in the first stage of development, "Basic Components." The very first benchmark in Basic Components (relating to passage of the Budget Code) has not been completed. The 1998 Budget Law might be considered satisfactory for purposes of the Central Government. However, both the Parliament and the Executive seem to consider it inadequate for purposes of intergovernmental fiscal relations and local government budgeting. Since Kyrgyzstan is a unity system, this evaluation considers that a budget law that does not meet the needs of all levels of government is deficient and, therefore, that the first component is incomplete. Moreover, only half of the benchmarks through the "Sustainable" Stage have been completed; and overall only five of twelve have been completed. Using the USAID methodology, this would give 61 percent achievement or a score of 1.88, Reform Initiated. (See Table 8, Appendix IV.) Budget capacity to manage fiscal policy has not been achieved, but progress has been made.

Similarly, budget reform in program budgeting is still in the first stage of development. None of the benchmarks in the first stage have been completed and only one of eight through the Sustainable Stage. Using the USAID methodology, progress on program budgeting would be rated at 33 percent with a score of 1.0, Reform Initiated. (See Table 9, Appendix IV.) Building budget capacity in program budgeting is just beginning. (As with Kazakhstan, program budgeting is defined here to include decision-making based upon program and performance analysis and is not limited to producing a budget in a program format.)

4.3.2 Impact. To Date, USAID Impact Upon Budgeting in the Kyrgyz Republic Appears to Have Been Significant but Limited (Extensive but not Deep)

In budget reform to support fiscal policy management, USAID appears to have assisted in only three of the first eight benchmarks, the Budget Code, the Medium-Term Budget Framework, and Adequate Analysis of Expenditure Plans and Budgets. However, none of these three have been completed. The three benchmarks that have been completed appear to have been completed before USAID technical assistance began, under IMF and World Bank leadership, i.e., the Single Treasury Account, Budget Group Has Authority, and Budget Group Staffed and Trained benchmarks. Moreover, the IMF and World Bank remain as important influences. Both, for example, heavily impacted the Medium-Term Budget Framework for 2004-2006, as did USAID. Similarly, satisfactory socio-economic impact has not been reached: Kyrgyzstan still requires IFI borrowing.

.

In reform for program budgeting, USAID impact has been exclusive (only USAID is providing technical assistance) and, therefore, important; but reform is still in the first stage, with only one of the first eight benchmarks completed. For example, the 2003 National Budget was prepared by ministries and submitted to the Parliament in both line item and program formats. Moreover, national ministries are just beginning to re-structure programs and to expect socio-economic impact, i.e., improvements in program effectiveness, now would be premature.

Nevertheless, Kyrgyzstan has moved to program budgeting. This is a significant accomplishment. Only USAID provide the technical assistance that would permit this to happen.

4.3.3 Lessons Learned. For Countries in the Early Stage of Development, Reform Should Be Limited, Focused, and Methodically Follow a Broad Institutional Development Agenda

Kyrgyzstan is in the early development stage. It is not rich in natural resources and does not have a thriving economy. As a result, its governments are not richly endowed. They are short of management skills, technical staff, financial resources, facilities and equipment, and access to state-of-the-art technology. If reform is to occur, it is highly likely that capacity in each one of these areas must be developed. To do so requires a comprehensive strategy as to how each these components, the components of institutional development, is to be obtained and retained. A long-term program is required, and the program should be tailored to the capacity of the country to progress.

More specifically, it appears that the USAID budget reform (and fiscal reform) program in Kyrgyzstan has pursued too ambitious an agenda. It has attempted to accomplish too much too fast. As a result, no stage of development in basic budget reform or reform for program budgeting has been completed, although important progress has been made in basic budget reform. The usual type of problem, for example, is that people identified for training do not appear for training because urgent work has to be finished. Or, a capable staff person trained in one area is re-assigned because a capable person is needed in an area that has become a priority. Kyrgyzstan is short of good people. To resolve the problem, limited, focused, long-term institutional development is necessary.

To distinguish between Kazakhstan and Kyrgyzstan, Kazakhstan had substantial trained technical manpower, computers, facilities, and financial resources. Therefore, an institutional development program could focus on developing mission statements and policies, appropriate organizational structures, management talent, and systems and procedures. Kyrgyzstan is resource deficient in all areas. Therefore, its needs are broad and "massive." However, because its resources are limited, a program to improve should be, in the short-term, narrow and focused and extend over a long period (to develop resources). The resources that are available should be used to build critical masses and functioning institutions that are effective. The problem is to decide where to focus in the short-term, given the broad array of needs.

4.3.4 Recommendation. For a Two-Year Program, Focus Technical Assistance So As to Complete Benchmarks Needed to Progress Through Development Stages

Point 4.3.3 above is most relevant when technical assistance to a country is beginning. USAID has been in Kyrgyzstan for a number of years and is now addressing its program for the next two years. In this context, it is recommended that USAID:

- Focus technical assistance so as to complete benchmarks, and development stages, in an orderly fashion;
- Consider the complete set of institutional development requirements for each benchmark and have an approach for acquiring and retaining each requirement for each benchmark to be addressed; and
- Give priority to completing basic budget reform through the Sustainability Stage, i.e., the Medium-Term Budget Framework, Adequate Analysis, and, to the extent possible, the Budget Code. Analysis should emphasize performance indicators and unit costing within the context of program budgeting and budget execution accountability for costing. This focus indicates that technical assistance in the short-term should be concentrated in the central budget office to develop a complete institution capable of preparing a Medium-Term Budget Framework and budgets that have good unit cost data and allocate money to agencies that keep their spending within unit costs, within the context of a program format. Technical assistance to the line ministries would be extended only when all the institutional development needs of the central budget office were met and would use the same strategy. Ministry budget offices would be developed institutionally and on a priority basis, i.e., not all at once.

4.4 INTERGOVENMENTAL FISCAL RELATIONS

4.4.1 Current Status. Intergovernmental Fiscal Relations Is in the First Stage of Development, although Progress Has Been Made

Kyrgyzstan has made progress on Intergovernmental Fiscal Relations. Although only one benchmark has been achieved through the Sustainable Stage, action has been initiated in nine of the eleven total benchmarks. Nevertheless, completion of only one benchmark means that development is still in the first stage, Basic Components. Overall, using the USAID methodology, this performance equates to 48 percent achievement or a score of 1.45, Reform Initiated. (See Table 10, Appendix IV.)

The draft Law on the Economic and Financial Bases of Local Self-Government obtained Parliamentary passage in July 2003. If the President accepts the draft in substantially its existing form, the first benchmark under Basic Components will be completed. The Law will make clear revenue assignments to all governments. Nevertheless, the third benchmark under Basic Components will still not be complete, and Intergovernmental Fiscal Relations will remain in the first stage of development.

Even after passage of the law, one of the three major pillars of Intergovernmental Fiscal Relations, intergovernmental transfer formulae will not be established, and substantial work will remain on this and supporting benchmarks.

4.4.2 Impact. USAID, through Its Democracy and Governance Program, Played a Major Role in Developing the Draft Law; the Fiscal Reform Program Developed a Training Program to Improve Local Government Financial Management

Initial work in Intergovernmental Fiscal Relations was led by the World Bank in the 1995 to 1997 period. During this period, work was undertaken on assignment of expenditures and

revenues and on transfer formulae. However, under the Budget Law of 1998, oblasts and rayon had considerable authority to determine how much revenue was decentralized to cities, villages, and settlements. They chose to decentralize far less than needed at local levels. USAID, through Barents and the Urban Institute, played a major role in crafting the draft Budget Code to give more revenue to local levels. However, because of a change in the Constitution, work on the Budget Code has stalled and emphasis has shifted to the draft Law on the Economic and Financial Bases of Local Self-Government. The Urban Institute played a major role in design of this draft. Although, Barents began work on transfer formulae in October 2002, it did not participate extensively in preparing the new draft law. Instead, it reflected the concern of its client, the Ministry of Finance, over the capacity of cities, villages, and settlements to manage additional monies well. Thus, USAID has had a major impact on recent progress in Intergovernmental Fiscal Relations but more through its Democracy and Governance Program than through Fiscal Reform. However, in 2001 USAID technical assistance consultants worked with MinFin to design a training program for local governments in budget reform, and this program will support implementation of the Law on the Economic and Financial Bases of Local Self-Government. Thus, major impact of Fiscal Reform technical assistance in intergovernmental fiscal relations lies in the future. So, also does socio-economic impact. It remains in the future for cities, villages, and settlements to receive the increases in revenue that will allow them to provide better local services.

4.4.3 Lessons Learned. In Kyrgyzstan, the Distribution of Wealth Makes It Particularly Important that MINFIN Concerns about Local Financial Management Be Addressed

In this area, several principles are important. First, local governments should raise most of their revenue by taxing themselves. Only by taxing themselves can local citizens decide how important local public services are to themselves and how much they are willing to pay. Second, grants to local governments, unless they are matching grants, will tend to be used inefficiently. Given "free" money, local officials will spend it all, even if this means some of it will be wasted.

In Kyrgyzstan, the issue is complicated because wealth is concentrated in Bishkek. Intergovernmental transfers mean that the citizens of Bishkek will be taxed, their taxes will be sent to the central government, and then the money will be transferred to local governments throughout the Republic, i.e., it will be the citizens of Bishkek who will finance the transfers This raises issues of political viability and justice. Specifically, will the citizens of Bishkek be willing to finance transfers if they do not believe that local governments manage their finances well? MinFin has a responsibility to the citizens of Bishkek to ensure that the transfers are spent efficiently and that the citizens of Bishkek know it.

4.4.4 Recommendation. As Indigenous Resources Permit, Consider Technical Assistance Support to Decentralization and Intergovernmental Fiscal Relations

Kyrgyzstan has a long history, dating from 1995, in attempting to improve intergovernmental fiscal relations. With adoption of the Law on the Economic and Financial Bases of Local Self-Government, it will make a major improvement. It is recommended that USAID support continuation of this improvement. The assistance outlined below presents a comprehensive list of the technical assistance opportunities but ranks them in order of priority. Kyrgyzstan is resource limited. A lower priority should not be undertaken if indigenous resources are insufficient to

allow effective execution of a higher priority. (It is expected that phased planning will allow a program through at least Priority 3.)

Priority 1. Provide assistance to implement the local property tax. It is important that the cities demonstrate that they are willing to tax themselves. Barents has prepared a training program (train the trainers); but an institutional development approach is needed. Cities are most likely to have the resources to make decentralization work in the short-term. This assistance should identify the organization units required to operate a property tax effectively, define their characteristics, and provide assistance to ensure that these units are put in place. A plan for each unit will be required. This assistance would cover the central as well as the local level. Assistance to the cities may need to be phased, based upon resource availability. (It is better to have a property tax operating well in a few cities than poorly in many.)

Priority 2. Provide budget reform assistance to local budget offices in support of the local property tax. The assistance should be limited to those local governments that implement the property tax and should be phased to support the property tax. Local governments seem enthusiastic about program budgeting, so this reform should continue. It should be married with development of performance indicators, training in costing and cost analysis, and training in holding spending agencies accountable for unit costs during budget execution. The assistance should follow a broad institutional development approach, calling upon local governments to use a portion of property tax revenue for improved financial management.

Priority 3. Provide technical assistance for transfers. This area holds fairly high risk, for there is no assurance that political agreement can be reached upon particular formulae. Therefore, this assistance is listed third, even though the Law on the Economic and Financial Bases of Local Self-Government has passed the Parliament. This should have three components.

- Provide assistance to develop grant formulae. Emphasis should be upon equalization formulae and matching grant mechanisms.
- Provide assistance to require that local governments devote a portion of grant money to their improved financial management.
- Provide assistance to establish in MinFin a mechanism to review local government finances and ensure efficient local government financial management.

Priority 4. Provide technical assistance for general local budget reform. An institutional development approach should be adopted, one that first creates effective central budget offices and then effective budget operations in the line agencies. USAID could link this aid to progress made in developing transfer formulae. The program should focus on groups of governments that have a reasonable chance of developing the critical mass of resources to be effective. Groups should be aided sequentially. No recommendation is made here as to whether oblasts, rayons, or lower levels of government ought to be first in the queue.

4.5 FISCAL ANALYSIS

4.5.1 Current Status. The First Stage of Development Has Not Been Successfully Concluded, and No Benchmark Seems to Have Been Attained

There is no USAID benchmark table for Fiscal Analysis. Therefore, we have postulated a five-step progression, as follows: (1) establish a recognition within Parliament of its need for objective information of professional quality and, therefore, of its need for information separate from that provided by the Executive; (2) establish within Parliament a professionally competent staff that can provide that information; (3) establish a recognition within Parliament that such a staff must be non-partisan and free from control by any political party; (4) establish within Parliament "ownership" for that staff; and (5) establish a fiscal analysis capacity within the Executive.

Based upon our interviews and review of documents, we believe the following with regard to these five steps.

- Step 1. The Parliament does not seem to recognize the need for objective information of professional quality if they have to pay for it. The Parliament seems to be taking no steps to improve its own staff in numbers or in quality. It is not requiring quality analysis from its own staff. It is, however, eager to use the free assistance provided by USAID.
- Step 2. The skills of the USAID financed Fiscal Analysis Unit (FAU) have not been transferred to the internal staff of the Parliament. The Parliamentary staff is not professionally qualified, and no one has been specifically assigned to work with the USAID Unit. The internal staff of the Parliament uses the Unit operationally to fulfill assignments professionally, not as a training experience, and passes the work product of the Unit on to the legislators. Assignments could be executed jointly, but they are not.
- Step 3. Parliament has not necessarily concluded that the source of information need be non-partisan. An alternative would be for each party to have its staff that it could control. The existing Parliamentary staff is not immune from political control.
- Step 4. The Parliament does not feel "ownership" for the USAID Fiscal Analysis Unit and has not committed itself to making its internal staff over in the image of the USAID Unit.) Presumably, the Unit is an image of what a proper fiscal analysis staff should be.
- Step 5. Only a few members of the Executive have absorbed USAID fiscal analysis training. The Kyrgyz Republic Executive Branch staff remains heavily dependent upon the IMF, the World Bank, and USAID to produce the Medium-Term Budget Framework, expenditure and revenue projections, and other fiscal analyses of acceptable quality.

4.5.2 Impact. Internal Capacity Is Undeveloped; and, Consequently, Authentic Impact Has Not Begun

There is sparse evidence that significant progress has been made in developing a fiscal analysis capacity in either the Executive Branch or the Parliament. However, it appears that the Parliament is beginning to recognize the need for (free) training of the internal staff: the upper house staff requested training from the FAU, but the request was reject because of resource constraints. To the extent that such advances occur, those advances stem from USAID assistance, for only USAID is providing technical assistance in fiscal analysis.

There is evidence that the Parliament uses FAU outputs to improve both its original work and the work that it receives from the government. Parliamentary representatives reported that USAID-funded technical assistance improved the draft property tax law that it received from the Executive, its own draft on the Road Tax and Emergency Tax, and customs codes, to name several. However, for such improvements to be considered authentic impacts for this component, the improvements would have had to originate from the Parliament's internal staff; and they did not. Technology transfer has not occurred satisfactorily. (One might argue that the program budget is a better document than the traditional line item budget, but it would be difficult to tell how much such improvements result from better Parliamentary review and how much from direct USAID technical assistance to the Executive.) Similarly, authentic socio-economic impact has not yet begun.

4.5.3 Lessons Learned. In An Environment of Limited Resources, the Client Will Tend to Use Technical Assistance Resources Operationally

As stated in Point 3.5.3., successful technical assistance depends upon the client wanting and accepting responsibility for change. The Kyrgyzstan experience suggests that, in addition, unless the client has sufficient resources at his disposal, he will find it difficult to release those resources for absorption of technical assistance. He will be so burdened by accomplishing his daily work that he will, to the contrary, use the technical assistance resources in an operational capacity, to relieve his workload. Therefore, in designing technical assistance, USAID should consider whether a potential client has the minimum level of resources needed to absorb technical assistance.

On the other hand, Kyrgyzstan was a phase one situation. That is, USAID undertook to demonstrate to the Parliament the value of fiscal analysis with the expectation that the Parliament would develop a desire to develop its own fiscal analysis capacity. Therefore, the logic of the situation implied that, in the short-run, technical assistance would not be absorbed. That would remain for phase two. However, it appears that, up to now, the Parliament has not recognized the value of having an internal fiscal analysis unit, if it has to fund the unit.

4.5.4 Recommendation. Base Continued Technical Assistance upon a Memorandum of Understanding Signed by Leadership of the New Parliament Which Requires that Leadership to Create an Appropriate Internal Staff

The above evaluation could be read to suggest that USAID technical assistance to the Parliament should be terminated. However, Kyrgyzstan has a new constitution and will soon have a new, unicameral parliament. USAID could regard this as a new beginning. If so, it is recommended that an agreement be concluded with the political leadership of the new parliament. That agreement would require the leadership to create an appropriate internal staff in return for continuing technical assistance, as follows.

- The director of the staff would report to a multi-party commission that would supervise the new unit.
- The director and all members of the staff would have professional credentials.
- USAID would make available to the director an expatriate advisor to assist the director in creating a non-partisan, professionally qualified fiscal analysis staff.

- The director, with assistance from the advisor, would prepare an institutional development plan, and could request USAID to assist in execution of that plan (to include the provision of training).
- The plan would include explicit milestones to guide progress.
- The plan would provide a clear date for withdrawal of the advisor and termination of USAID assistance.
- Periodically, the director would report to a joint meeting of the multi-party commission and USAID on progress in execution of the plan.

Under this approach, personnel currently employed by FAU would be terminated and made available to the Parliament for employment. To attract these personnel, USAID could recommend to the Parliament that new job titles and pay grades commensurate with the training of the ex-FAU personnel be established. In addition, USAID would recommend that:

- Training be offered to the existing internal staff in return for a guaranteed period of service;
- At least two employees be assigned to each position and that the two be assigned on a staggered basis to ensure coverage in case of a vacancy; and
- Job titles, qualifications, and pay grades consistently reflect the requirements of the Parliament for trained staff and be consistent, i.e., if the Parliament needs highly qualified staff, the qualifications and pay should reflect this.

5.0 CONCLUSION

Review of the USAID Fiscal Reform Program over the 1995 to 2003 period leads to two primary conclusions.

5.1 IT IS PREMATURE TO WITHDRAW FROM KAZAKHSTAN, BUT THE TECHNICAL ASSISTANCE PROGRAM CAN BE RE-DESIGNED AND REDUCED

The Fiscal Reform Program has been operating in Kazakhstan long enough to reach conclusions about its success and the likelihood of future success. These conclusions suggest that:

- The program has been successful in Tax Policy and Tax Administration. In these areas, USAID can declare success and withdraw.
- The program has not been very successful in Intergovernmental Fiscal Relations and Fiscal Analysis to the Parliament. These are high-risk areas without a high probability of success. USAID could shift most of the burden for progress in these areas to the national government and operate in supporting role.
- Results in Budget Reform are mixed, as is its prognosis. At the national level, reform has not had sufficient time to succeed fully but has a good prognosis; extension of program budgeting to the local level is a massive undertaking. Here USAID could work jointly with Kazakhstan to prepare for continuing reform under national government control and funding.

Kazakhstan has the resources to continue the reform process, if USAID should withdraw. It is not clear that Kazakhstan has the sophistication to do so. If USAID withdraws abruptly, it runs the risk of losing past successes and putting at risk several prospective future advances. Therefore, it seems preferable to invest in a two-year transition period in which Kazakhstan would be prepared for the termination of technical assistance. Specifically, with USAID assistance, a unit would be created in the Ministry of Economy and Budget Planning that would be responsible for ensuring continued fiscal reform. That unit could provide contractual technical assistance for the Ministry of Finance. (This unit is described more fully in Point 3.3.4.) Such contractual assistance could include technical assistance for Intergovernmental Fiscal Affairs, if the Ministry of Finance should decide to spend money on such assistance. USAID could also provide sharply reduced assistance to the Parliament, if parliamentary leadership should make a clear decision to create a professional, non-partisan staff.

This approach would constitute a re-designed and reduced USAID technical assistance program in Kazakhstan.

5.2 TECHNICAL ASSISTANCE TO KYRGYZSTAN SHOULD PLAN FOR THE FULL REQUIREMENTS OF INSTITUTIONAL DEVELOPMENT AND FOCUS INDIGENOUS RESOURCES TO MAXIMIZE PROGRESS

Kazakhstan is resource rich, as developing countries go. As a result, technical assistance can be undertaken there in an abbreviated form with a reasonable probability of success. This is not true in Kyrgyzstan. Kyrgyzstan is resource poor. Therefore, in planning any technical assistance effort in Kyrgyzstan, USAID should consider all eight areas of institutional development and have a strategy for ensuring that the requirements in all eight areas will be satisfied. USAID may not need to provide all requirements in all eight areas, but it should have a plan as to how the requirements will be provided.

Such an approach implies that the size of the USAID program will be constrained by the availability of indigenous resources. It also implies that USAID should focus it efforts so that available indigenous resources are directed to those building blocks that, when combined, give authentic progress. This has been done in the recommendations above.

- Budget Reform. Under the recommendation, the USAID program would focus on the New Budget Code, the Medium-Term Budget Framework and Analysis of Expenditure Plans and Budgets. This will complete capacity to manage fiscal policy.
- Intergovernmental Fiscal Relations. Under the recommendation, the USAID program would focus on implementing the property tax in cities (benchmark: Process Provides Local Government with Resources…), budget reform in support of the property tax (benchmark: Local Authorities Trained in Basic Budgeting), and developing transfer formulae (benchmark: Transfers and Subventions Transparent). This would complete the Basic Components and make very important progress on the Operationally Functional Stages of development.
- Taxation. The recommendations for taxation focus on six of twenty-two benchmarks: Tax Code, No Internal Consistencies in the Code, Code Consistent with Need for Economic Development of SMEs, Code Does Not Discourage Foreign Investment, Fair Horizontal and Vertical Equity, and Staff Adequately Trained.

- Fiscal Analysis. Under the recommendation, Steps 1, 3, and 4 would be accomplished through USAID negotiation and agreement with parliamentary leadership. Step 2 would be accomplished through the technical assistance. This would complete the reform.

These recommendations would reduce the breadth of the USAID program in the sense that fewer building blocks within a component would be worked on. However, all components could be worked on, and the depth of work within individual building blocks would presumably expand. Therefore, the dollar value of the USAID program might increase or decrease, depending upon the ability of the Program to mobilize (and focus) indigenous resources, the size of the Mission budget, and the level of risk that the Mission could accept.

ENDNOTES

[i] See UNDP, *Millennium Development Goals in Kazakhstan*, Almaty 2002. According to this report the Gini coefficient was 0.32 in 1996, but rose to 0.35 in 2001.

[ii] See, for example, Articles 4 and 5 of the original code; also Article 378 provided special provisions for peasant farmers, industrial land, and industrial lands located outside of population centers.

[iii] The code, as of April 2003, created three SME categories based on turnover and employment criteria. These are the patent tax (on single ownerships with gross receipts not exceeding Tenge 1.5 million) that levies gross receipts at 3%; the coupon tax (coupons are to be purchased very 90 days) whose rate varies according to type of activity and geographical location; and the tax on SMEs whose turnover is Tenge 4.5 million or less with employment of less than 15 workers (these pay 3% tax on gross receipts in lieu of income tax, VAT, excise, etc.; if the business is not an individual firm and its turnover is Tenge 9 million or less with employment of 25 or less, then the rate varies between 4% and 9%.)

[iv] In May 2001 the President issued the following decree: "*Improvement of the policy of state support insuring dynamic development of the small entrepreneurship [is] based on provisions of strategy Kazakhstan 2030."* Decree # 597. Subsequently, the Government issued a resolution (# 969) that reads as follows: "*Handover of property complexes, technologies and equipment of reorganized and segmented enterprises to small business entities with a view to creating favorable conditions for small business infrastructure."*

[v] One of the indicators is that a special fund set up from petroleum revenues to be used for the needs of future generations has already reached the level of US$ 2.5 billion.

[vi] The ratio of taxes to GDP in 2001 were as follows: Total tax revenue – 11.9%; taxes on income - 2.9%; VAT –4.8%. Source: IMF, *Government Finance Statistics* provided by the Ministry of Finance. The statistics obtained from the Ministry of Finance indicate that in 2002 total tax revenue amounted to T 458,227.1 million. Hence the ratio of total tax revenue to GDP is 13.9%. Taxes on income were T 209,755.1, representing 6.4% of GDP and domestic taxes on goods and services amounted to T 208,453.9, representing 6.3% of GDP. It appears that the collection of income taxes (corporate) has improved considerably.

In the document USAID*'s Assistance Strategy for Central Asia, 2001-2005*, p. 103, the targets for 2000, 2001, 2002, and 2003 are given as 14.3%, 14.8%, 15.3%, 15.8, respectively. The IMF statistics indicate that tax revenues as percent of GDP were 11.3% in 2000, 11.9% in 2001, and according to the statistics provided by the Ministry of Finance for 2002 the ratio was 13.9%. The actual figures indicate that there has been an increase in the tax collection, however not as much as the targets set by USAID.

[vii] The outputs that are available to the staff of the Ministry are as follows: (i) audit manual; (ii) training in audit process and selection of desk audit; (iii) training in compliance audit; (iv) manual in appeals; (v) training in appeal process; (vi) public education on appeals; and (vii) training of the staff on the basis of manuals.

[viii] Number of income taxpayers:

Years	1998	1999	2000	2001	2002
Corp.income	211,241	178,388	196.827	203,194	218,796
Indiv. Income	190,190	198,822	227,915	265,143	350,516

Source: Courtesy of Ministry of Finance. (VAT figures were unavailable)

[ix] Despite the Ministry's efforts to increase transparency, different segments of the society perceive the tax administration as corrupt. It is interesting to note that of the parliamentarians who were interviewed 95% stated that tax inspection and customs are corrupt and 65% stated that the Ministry of Finance was corrupt. See, UNDP, *Perceptions of Corruption in Kazakhstan*, Almaty 2003, p. 21.

[x] The Government is seriously contemplating to raise substantially the pay of the civil servants. It is highly likely that this measure will be taken in 2004.

[xi] The prevailing thought at the time was that the code of Kazakhstan should be the blue print for all other Central Asian Republics. In fact, very many IMF publications also so stated.

[xii] The code creates two distinct levels for SMEs. An enterprise, whose gross receipt is US$ 7,000 or less, is subject to a patent tax, whose rate changes according to geographical location and type of activities. Enterprises with gross receipts are between US$ 7,000 and US$ 20,000 are subject to a gross receipt tax, in lieu of the income tax, VAT, excise and social taxes. Laudable in its spirit, it must be kept in mind that the development of SMEs is a function of a host of conditions other than tax treatment alone. This measure is fairly new, and the tax authorities do not exactly know the number taxpayers who will be subjected to this provision. UNDP is currently carrying out a study, and according to the preliminary figures in 1996 there were some 80,000 SMEs, and in 2002 their number increased to 267,000, a growth of about 33% per year.

[xiii] It is interesting to note that while corruption in many FSU countries is on the decline, it is on the rise in the Kyrgyz Republic. See The World Bank, *Report on Progress under the CIS-7 Initiative*, April 2003, p. 5.

[xiv] In an interview a very high tax official expressed his view as "the best help that USAID can give us is to advise us how to return to the 1996 tax code."

[xv] Based on figures given in IMF, *Government Finance Statistics*, 2002.

[xvi] This is not only a deduction, but also the appreciation of high-level tax authorities.

[xvii] In the Large Taxpayer Unit, for example, there are only 10 auditors who deal with 83 large taxpayers, but there is one computer for every three officers. In many rayons the only basic tool is the abacus.

[xviii] In 2001 total tax arrears amounted 4.3% of the total tax collections.

APPENDICES

Page No.

Appendix I Scope of Work I-1

Appendix II List of People Interviewed II-1

Appendix III Materials Reviewed III-1

Appendix IV Tax Policy IV-1

Appendix V Fifteen Questions V-1

APPENDIX I
SCOPE OF WORK

ACTIVITY TO BE EVALUATED

The Fiscal Reform program is currently implemented by the Bearing Point Barents Group (formerly KPMG Consulting Barents Group) under contract OUT-PCE-I-822-99-00006 in Kazakhstan and Kyrgyzstan. The current contract started in January 2002 and its estimated completion date is July 2003. It is envisioned that the Kazakhstan portion of the activity will not be extended beyond the current completion date. The Mission seeks an independent evaluation of the state of the fiscal reform in Kazakhstan and the Kyrgyz Republic to inform its current and future decision making.

BACKGROUND

The current USAID/CAR strategy aims at expanding opportunities for the citizens of the Central Asian Republics to participate in improving their governance, livelihoods, and quality of life. Under the Strategic Objective (SO) 1.2 Increased Soundness of Tax and Budget Policies and Administration, and later under SO 1.3 Improved Environment for the Growth of Small and Medium Enterprises[1], USAID designed and is currently executing its Fiscal Reform activity in Kazakhstan, Kyrgyzstan, and, most recently has expanded this program into Tajikistan and Uzbekistan. Because more work has been done in Kazakhstan and Kyrgyzstan, this evaluation will focus on the state of fiscal reform in these two countries.

The objectives of the Fiscal Reform activity are: to streamline the tax systems and improve the management capabilities of the state tax authorities; rationalize budgetary procedures and improve the quality of budgetary and fiscal analysis; further strengthen intergovernmental fiscal relations; and build the budget execution capacity of local-level tax authorities.

This activity has five major components: tax policy, tax administration, budget reform, fiscal analysis, and intergovernmental fiscal reform.

TAX POLICY

USAID has been assisting both countries in their tax policy reform efforts since 1995, and these efforts have achieved substantial progress, which is particularly notable in Kazakhstan. In 2000, the USAID Fiscal Reform project helped Kazakhstan to simplify the tax code, eliminate special exemptions in the code, and improve its provisions with respect to non-profit organizations. The new code came into effect on January 1, 2002.

However, in order to create an environment more conducive to private sector development, the project continues to provide recommendations to the Ministry of Finance that seek to further improve this legislative document and its implementing regulations. Similar work is being done

[1] SO 1.2 was merged with SO 1.3 in FY 2002

in Kyrgyzstan, where the fiscal advisors helped the country's legislators to draft and adopt a number of positive changes to the tax system. For example, one amendment granted local elected powers the authority to set the tax rates on land, and another introduced a mandatory patent system for difficult-to-tax sectors to reduce tax evasion. In close collaboration with the Parliamentary Tax Committee of Kyrgyzstan, the project worked on developing the new State Property Tax, and is currently collecting government support for a city-administered real property tax plan. Among other activities over the past two years, the program's tax policy reform component also concentrated heavily on preventing legislation that reduces tax revenues.

TAX ADMINISTRATION

The project works closely with the Ministry of Finance in Kazakhstan and the State Tax Inspectorate in Kyrgyzstan to improve key areas of relationships between the tax authorities and the taxpayer, such as declarations, the appeals process and collecting taxpayer information.

Over the past years, both countries have made significant progress in organizational development of tax administration bodies. The two states have consolidated the customs and tax collection functions under a single agency: the Ministry of Finance in Kazakhstan and the Committee on Revenues in Kyrgyzstan (Kazakhstan's Ministry of Revenues was abolished and its functions, except for customs, were brought under the Ministry of Finance in September 2002, and the Committee on Revenues in Kyrgyzstan was created around the same time). In addition, the project helped the Kyrgyz State Tax Inspectorate reorganize its infrastructure to increase efficiency of its operations. In Kazakhstan, the fiscal reform consultants helped the Ministry of Revenues (now under the Ministry of Finance) in their efforts to improve efficiency of the Ministry's headquarters in Astana, and provided training in audit, collection, and tax treaty benefits.

In Kyrgyzstan, the project's advisors helped draft an amendment to the country's tax code that introduced a new simplified tax regime for small and medium enterprises, which took effect in January 2002. This new system replaces four complex taxes – income, sales, road and emergency – with an optional simple calculation based on gross receipts for small businesses, reducing both record keeping requirements and the taxpayer-tax official contacts that often result in corruption.

The fiscal advisors have also assisted the tax agencies of Kazakhstan and Kyrgyzstan with the development of a centralized computer-based tax processing system. Kyrgyzstan has completed its central system and has two pilot regions with direct links to the central system. In Kazakhstan, the fiscal reform project also began working with the government to carry out a computerization implementation plan. Assistance in this area was then expanded to include a computerization strategy for the entire Ministry of Revenues. The positive impacts of these reforms included increased tax compliance and a revenue increase. Another significant achievement in Kazakhstan was the development of new electronic tax return forms that now can be filed directly with tax authorities.

The project continues to provide training to the government personnel of both countries in internal audit processing, and implementation of transfer pricing legislation and tax treaty administration, and helps the two agencies in the implementation of their computerization plan. Assistance is also continuing to introduce and implement a new appeals system in the two

countries, which will serve as a tool for businesses to request from tax authorities a justification of their calculated tax levels.

BUDGET REFORM

The project assists the Ministry of Finance with formulating budgets with a strong emphasis on program budgeting, expenditure control, and transparency of the budget development and execution processes. Assistance includes building the capacity to make medium-term economic forecasts, developing performance indicators, and improving capital planning.

During FY 2002, the Government of Kazakhstan introduced regulations under the budget system that further institutionalize the requirement for agencies to prepare program budgeting documents specifying program and sub-program goals, objectives, legal authority, activities, resource allocation and performance measures. These regulations also establish quarterly performance reporting of budget programs and thus strengthen the linkage of budgets to program performance. Building on its national-level work, the project also provided technical assistance on budget reform to two pilot regions – Pavlodar and Ust-Kamenogorsk. A number of regional (oblast) and city administrations received training in budget development and execution.

Complementing efforts to improve the budget process, in May 2002, the USAID Fiscal Reform project began working with the GOK Accounts Committee, the fledgling supreme audit institution, to help develop its mission and specify short and medium term priorities. One of the fiscal experts is helping the Accounts Committee develop policies and procedures for performance auditing. The Accounts Committee has committed itself to carrying out its first performance audit of a public program in Kazakhstan, and the targeted program has been selected in the health area. An additional program will selected in the education area.

In Kyrgyzstan, the project's success in promoting program budgeting has also been noteworthy. All national level government agencies have adopted program budgeting principles demonstrating both the increased capacity and understanding of the methodology developed among agency staff by our fiscal advisors, as well as the value placed on this information by the Ministry of Finance and Parliament.

The project continues to provide assistance in developing the automated tax information system and streamlining government budget planning at the national and local levels in Kyrgyzstan.

FISCAL ANALYSIS

Over the past four years, the project has helped the Ministries of Finance and the Parliaments of the two countries to establish their Fiscal Analysis Units, which have primary responsibility for conducting baseline receipts forecasts and estimating the revenue impact of tax policy proposals. This component of the Fiscal Reform activity seeks to strengthen the capacity of these nascent entities through training in areas such as policy analysis techniques and public finance theory, and direct technical assistance. Therefore, particular emphasis under this part of the project is placed on delivering the training, which includes sessions on revenue forecasting and monitoring techniques; tax expenditure analysis; tax burden distribution analysis; the role of tax policy in economic development strategies; and budget forecasting.

In addition to the training, fiscal reform advisors also help the units with developing and evaluating their quarterly forecasts of revenues and expenditures.

INTERGOVERNMENTAL FISCAL REFORM

The Fiscal Reform Project seeks to improve the current state of intergovernmental fiscal finance in the two countries by developing a methodology for computing transfers and subventions sensitive to changes in economic conditions. The methodology has been developed and is expected to increase the transparency of the process that determines transfers and subventions.

The Government of Kazakhstan has committed to changing its currently non-transparent system of allocating revenues to the regions to a rule-based system recommended by Fiscal Reform advisors.

In Kyrgyzstan, there has not been much progress in this area. Most local governments are almost completely reliant on subventions, because the majority of economic activity takes place in Bishkek and Osh. Currently, the subventions are equalization grants and are not based on the economic needs or goals of the local government, and there's still a need to rationalize the system. In October of 2002, the project conducted a needs assessment for assistance in intergovernmental finance, and currently this component of the program is in the beginning stage.

KEY INFORMANTS

KAZAKHSTAN:

- Minister of Economy and Budget Planning; Deputy Minister for Budget Planning
- Minister of Finance, and Deputy Minister on Tax Policy
- Head of Administration in the Ministry of Finance
- Chairman and Deputy Chairman of Parliamentary Committee on Budget Planning and Execution
- Members of the Parliamentary Fiscal Analysis Unit
- International donors

KYRGYZSTAN:

- Deputy Minister of Finance
- Chief of State Tax Inspectorate
- Members of Fiscal Analysis Unit in the Parliament
- Head of the Parliamentary Tax Committee
- Head of the Parliamentary Budget Committee
- International donors

The contractor shall interview key informants specified above. The contractor is not limited to this list of informants and is responsible for selecting the interviewees and obtaining the necessary documents as appropriate for achieving the tasks outlined in this scope.

EVALUATION OBJECTIVE

The evaluation conducted by the contractor should seek to inform the Mission of the current state of fiscal reform in Kazakhstan and Kyrgyzstan, the impact of USAID assistance, lessons learned and provide recommendations where needed to achieve greater program impact. The evaluation should answer the following questions:

1. How has the activity in Kazakhstan and the Kyrgyz Republic contributed to the economic development of each country?

2. What was the contribution of the USAID fiscal reform activities towards increasing the soundness of tax and budget policies and administration in the two countries?

3. What factors explain the differences in the achievements of fiscal reform in the Kyrgyz Republic and Kazakhstan?

4. Did the changes/improvements in the tax legislation bring more transparency, and as a result, reduce the potential for corruption in tax authorities?

5. Have the fiscal reform activities contributed to the growth of private business, particularly small and medium enterprises, and if so, how? What can be done to increase the positive impact of fiscal reform on SMEs?

6. Is there a core group of professionals within tax authorities of the two countries that have sufficient capacity to continue training and further staff development? If not, are there any impediments to developing a core group of professionals?

7. What steps are necessary to reinforce the role of the Fiscal Analysis units in both countries in the overall tax and budget process? How accurate and useful are their budget forecasts? Has this component contributed to improved budget transparency, public accountability, and democratization?

8. How effective are the program's efforts at the local level vs. national level? What can be done to strengthen local-level work and reinforce its links with national-level developments?

9. Does the staff of tax collection bodies possess sufficient skills to effectively use the new computerized system of tax administration and fiscal data collection?

10. What are the constraints that impede reform of intergovernmental fiscal finance and what could be done to overcome those constraints?

11. In Kazakhstan, is there sufficient capacity in the Ministry of Finance and Parliament to end USAID assistance? If funds are available, would it be advisable to continue fiscal reform assistance at the local level while exiting at the national level?

12. In Kyrgyzstan, what are the priority needs for fiscal reform for the next two years? How well does the current and planned assistance address those needs?

13. What are the lessons learned of the tax and budget reform process that can be used in other countries of Central Asia?

The contractor is not limited to this set of questions. Additional questions may be suggested by the contractor as appropriate to achieve the overall objective of this evaluation. The final set of questions will be discussed and agreed upon with USAID.

METHODS

The contractor may use a variety and a combination of evaluation methodologies, including, but not limited to, focus group discussions, key informant interviews, and mini-surveys. Information needs and data collection techniques will be discussed and agreed upon with USAID. The contractor will submit a detailed evaluation plan, including a sampling plan to be used for evaluation techniques other than key informant interviews. Key informants will include key counterparts in the two Ministries of Finance, the Committee on Revenues in Kyrgyzstan, the Ministry of Economy and Budget of Kazakhstan, and the two parliaments. The contractor must interview or otherwise solicit input from the key government contacts proposed by the Mission and the Fiscal Reform program implementer. Data should be disaggregated by country whenever possible.

The contractor is responsible for requesting all necessary project background documentation and the list of counterparts from the Mission immediately upon award of this task order.

SUGGESTED TEAM COMPOSITION

This is a Tier 2 selection, and the qualifications of proposed personnel will determine selection, methodology and cost and budget considerations will determine selection.

The contractor should propose the most effective and cost-efficient team configuration, and must describe the role of each team member and explain how the suggested team composition will warrant successful completion of the task.

At the minimum, the team members must possess in-depth knowledge of the tax and budget sector issues, namely, tax policy, tax administration, budget development and intergovernmental finance. Knowledge of evaluation techniques and methods commonly used in USAID, as well as prior experience in USAID evaluations is required.

The Team Leader shall possess thorough understanding of all of the fiscal reform sectors involved, and shall have practical experience in governmental fiscal policy development. Team shall have in-depth knowledge of the tax sector with emphasis in tax policy and administration. Strong expertise in budget development and execution issues, and extensive knowledge in intergovernmental finance matters are also of extreme importance. Practical experience in a public sector fiscal institution is essential for all team members. At least two years of prior development experience in fiscal/ macroeconomic reform in countries of NIS or Central/Eastern Europe is highly desirable. Knowledge of Russian and/or Kazakh or Kyrgyz languages is desirable.

TIMEFRAME

The evaluation will start o/a April 28, 2003, and will last for approximately seven weeks, including four weeks in the field. Prior to arriving in Kazakhstan, the contractor will become familiar with key project documents, such as the project's statement of work and benchmarks.

The preliminary schedule of evaluation will be as follows:

April 28-30	Review of background materials and development of evaluation plan
May 1 – May 24	Fieldwork
o/a May 26	Oral presentation of findings
o/a June 5	Submission of draft report for comment
o/a June 12	Submission of final report

The contractor is responsible for ensuring logistical support to conduct this evaluation.

REPORTING REQUIREMENTS

The contractor shall discuss with USAID staff plans for conducting the evaluation, including data collection activities, logistics and staff support, and a tentative outline for the final report. The contractor will inform USAID when each stage of the evaluation is begun and completed, and report on any problems that may delay completion of the final report.

Five hard copies and two electronic copies of a final report in English will be submitted to USAID on or before June 12, 2003. The report should include the following:

1. Executive summary of principal conclusions and findings pertaining to the questions stated in the scope of work;

2. A Russian translation of the executive summary;

3. A brief discussion of data collection methodology (a more detailed presentation of methodological issues should be included as an appendix);

4. A thorough discussion of study findings and conclusions, including supporting evidence such as tables or graphics.

5. Recommendations for program improvements.

The report should be up to 25 pages long, 12 point. Additional materials, such as copies of field notes, interview protocols and questionnaires should be attached as annexes.

EVALUATION CRITERIA

EVALUATION CRITERIA – BEST VALUE

Selection will be done by the Contracting Officer in consultation with the Enterprise & Finance Office at USAID/CAR, Almaty using Best Value criteria as guidance to determine the proposal most advantageous to the Government. Technical evaluation factors are more important than cost or price. Contract Award shall be made to the responsive and responsible offeror whose combined technical and cost factor offer the best value to the U.S. Government.

Evaluation Criteria

1. Expertise in tax policy and tax administration issues
2. Expertise in budget development and intergovernmental finance issues
3. The team's solid knowledge of evaluation methods and techniques and practical experience in evaluations; USAID experience preferred
4. Prior experience in a fiscal institution
5. Prior development experience in fiscal/ macroeconomic reform in countries of NIS or Central/Eastern Europe (at least two years)
6. Evaluation methodology for this task
7. Familiarity with the Central Asian Region
8. Spoken Russian and/or Kazakh/Kyrgyz

The proposal should also include one copy of a previous evaluation report written by the evaluators proposed for this task order.

AMENDMENT OF SOLICITATION/MODIFICATION OF CONTRACT

1. CONTRACT ID CODE	PAGE	OF PAGES
	1	2

2. AMENDMENT/MODIFICATION NO.	3. EFFECTIVE DATE	4. REQUISITION/PURCHASE REQ. NO.	5. PROJECT NO. (If applicable)
02	See Signature Block	N/A	

6. ISSUED BY CODE	7. ADMINISTERED BY (If other than Item 6) CODE
USAID/CAR Regional Mission Acquisition and Assistance Office Park Palace Building 41, Kazybek Bi Street Almaty 480100 Kazakhstan	

8. NAME AND ADDRESS OF CONTRACTOR (No., street, county, State and ZIP Code)	(X)	9A. AMENDMENT OF SOLICITATION NO.
		9B. DATED (SEE ITEM 11)
Development Associates, Inc. 1730N Lynn Street Arlington VA 22209-2023		10A. MODIFICATION OF CONTRACT/ORDER NO. AEP-I-00-00-00023-00 838
CODE FACILITY CODE	X	10B. DATED (SEE ITEM 13)

11. THIS ITEM ONLY APPLIES TO AMENDMENTS OF SOLICITATIONS

☐ The above numbered solicitation is amended as set forth in Item 14. The hour and date specified for receipt of Offers ☐ is extended, ☐ is not extended.

Offers must acknowledge receipt of this amendment prior to the hour and date specified in the solicitation or as amended, by one of the following methods:

(a) By completing Items 8 and 15, and returning _____ copies of the amendment; (b) By acknowledging receipt of this amendment of each copy of the offer submitted; or (c) By separate letter or telegram which includes a reference to the solicitation and amendment numbers. FAILURE OF YOUR ACKNOWLEDGMENT TO BE RECEIVED AT THE PLACE DESIGNATED FOR THE RECEIPT OF OFFERS PRIOR TO THE HOUR AND DATE SPECIFIED MAY RESULT IN REJECTION OF YOUR OFFER. If by virtue of this amendment you desire to change an offer already submitted, such change may be made by telegram or letter, provided each telegram or letter makes reference to the solicitation and this amendment, and is received prior to the opening hour and date specified.

12. ACCOUNTING AND APPROPRIATION DATA (If required) N/A

13. THIS ITEM APPLIES ONLY TO MODIFICATIONS OF CONTRACTS/ORDERS, IT MODIFIES THE CONTRACT/ORDER NO. AS DESCRIBED IN ITEM 14.

X	A. THIS CHANGE ORDER IS ISSUED PURSUANT TO: (Specify authority) THE CHANGES SET FORTH IN ITEM 14 ARE MADE IN THE CONTRACT ORDER NO. IN ITEM 10A.
X	FAR 52-243-3 Changes
	B. THE ABOVE NUMBERED CONTRACT/ORDER IS MODIFIED TO REFLECT THE ADMINISTRATIVE CHANGES (such as changes in paying office, appropriation date, etc.) SET FORTH IN ITEM 14, PURSUANT TO THE AUTHORITY OF FAR 43.103(b).
	C. THIS SUPPLEMENTAL AGREEMENT IS ENTERED INTO PURSUANT TO AUTHORITY OF:
	D. OTHER (Specify type of modification and authority) N/A

E. IMPORTANT: Contractor ☐ is not, ☒ is required to sign this document and return 1 copies to the issuing office.

14. DESCRIPTION OF AMENDMENT/MODIFICATION (Organized by UCF section headings, including solicitation/contract subject matter where feasible.)

The purpose of this Modification is to amend the Statement of Work of the Task Order.

Accordingly the following change is made:

Statement of Work, Evaluation Objectives, - delete in its entirety and substitute with Evaluation Objectives on page 2 of this Modification.

[Continued on page 2]

Except as provided herein, all terms and conditions of the document referenced in Item 9A or 10A, as heretofore changed, remains unchanged and in full force and effect.

15A. NAME AND TITLE OF SIGNER (Type or print)		16A. NAME AND TITLE OF CONTRACTING OFFICER (Type or print) John F. Lord Contracting Officer	
15B. CONTRACTOR/OFFEROR _____ (Signature of person authorized to sign)	15C. DATE SIGNED	16B. UNITED STATES OF AMERICA BY _____ (Signature of Contracting Officer)	16C. DATE SIGNED

Evaluation Objectives

The evaluation conducted by the contractor should inform the Mission of the current state of fiscal reform in Kazakhstan and Kyrgyzstan, identify the impact of USAID assistance, document lessons learned, provide recommendations, where needed, to achieve greater program, make recommendations regarding whether and what activities USAID should consider implementing as a follow-on to the Fiscal Reform activities in Kazakhstan and Kyrgyzstan. The evaluation should answer the following questions:

14. How has the activity in Kazakhstan and the Kyrgyz Republic contributed to the economic development of each country?

15. What was the contribution of the USAID fiscal reform activities towards increasing the soundness of tax and budget policies and administration in the two countries?

16. What factors explain the differences in the achievements of fiscal reform in the Kyrgyz Republic and Kazakhstan?

17. Did the changes/improvements in the tax legislation bring more transparency, and as a result, reduce the potential for corruption in tax authorities?

18. Have the fiscal reform activities contributed to the growth of private business, particularly small and medium enterprises, and if so, how? What can be done to increase the positive impact of fiscal reform on SMEs?

19. Is there a core group of professionals within tax authorities of the two countries that have sufficient capacity to continue training and further staff development? If not, are there any impediments to developing a core group of professionals?

20. What steps are necessary to reinforce the role of the Fiscal Analysis units in both countries in the overall tax and budget process? How accurate and useful are their budget forecasts? Has this component contributed to improved budget transparency, public accountability, and democratization?

21. How effective are the program's efforts at the local level vs. national level? What can be done to strengthen local-level work and reinforce its links with national-level developments?

22. Does the staff of tax collection bodies possess sufficient skills to effectively use the new computerized system of tax administration and fiscal data collection?

23. What are the constraints that impede reform of intergovernmental fiscal finance and what could be done to overcome those constraints?

24. In Kazakhstan, is there sufficient capacity in the Ministry of Finance and Parliament to end USAID assistance? If funds are available, would it be advisable to continue fiscal reform assistance at the local level while exiting at the national level?

25. In Kyrgyzstan, what are the priority needs for fiscal reform for the next two years? How well does the current and planned assistance address those needs?

26. What are the lessons learned of the tax and budget reform process that can be used in other countries of Central Asia?

27. What activities, if any, should USAID consider implementing as a follow-on to the Kazakhstan fiscal reform activity upon its termination (expected December 2003)?

28. What activities, if any, should USAID consider implementing over the next two years as a follow-on for the Kyrgyzstan fiscal reform activity after the current contract expires (January 2003)?

The contractor is not limited to this set of questions. Additional questions may be suggested by the contractor as appropriate to achieve the overall objective of this evaluation. The final set of questions will be discussed and agreed upon with USAID.

[End of Modification]

APPENDIX II
LIST OF PEOPLE INTERVIEWED

WASHINGTON DC:

BEARINGPOINT/USAID:

Fran Greaney	Managing Director
Howard "Skip" Nester	Director, Fiscal Analysis

USAID/CAR MISSION, ALMATY:

Mary Norris	Director, Office of Enterprise and Finance
Lewis Tatem	Senior Economist, Office of Enterprise and Finance
Aliya Ishmukhamedova	Project Management Specialist, Office of Enterprise and Finance

KAZAKHSTAN:

BEARINGPOINT/USAID:

Martin Bowen	COP
Henk Verbrugge	FRP, Bishkek
Gareth Davies	Former Chief of Party, Tax Specialist, Customs Administration
Igor B. Voznessenskiy	Institutional Liaison Advisor

LOCAL COUNTERPARTS:

Ministry of Economy and Budget Planning:

Bakyt Sultanov	Deputy Minister, Supervision includes budget planning
Vera Knukh	Director, fiscal Policy Department
Dina Shazhenova	Chief, Budget Methodology Office
Ardak Amangueldiev	Chief, Intergovernmental Finance Office

Ministry of Finance

Nurlan Rakhmetov	Vice Minister, Supervision includes IT and revenue analysis/forecasting
Serikbek Elshibedov	Deputy Chairman, Tax Committee, Ministry of Finance
Ruslan Dalenov	Chief, Analysis and current revenue forecasting
Kurman Gozhin	Chief Accounting and Audit, Methodology Office
Victoria Dudnikova	Chief, Tax Methodology Office
Elena Chekaeva	Chief, IT Office

Ministry of Industry and Trade

Vladimir A. Misnikov	Chairman, Ministry of Industry and Trade, Committee on Support of Small-Scale Business

Parliament--Senate

Musyrali Utabaev	Senator, Chairman, Senate Economy, Finance and Budget Committee
Saken Espaev	Chief, Economic analysis Office, Administration Dept, Senate of the Parliament of the Republic of Kazakhstan

Accounts Committee

Kosylkhan Kakamanov	Chief, Administrative Office
Almagul Mukhamedieva	Chief, Budget Execution, Performance Audit

KYRGYZSTAN:

BEARINGPOINT/USAID:

Arnold Hoitink	Current COP/Budget Specialist
Mitch Mohtari	Tax Specialist

LOCAL COUNTERPARTS:

Ministry of Finance

Arzybek Kozhoshev	Head, Local Governments Section/Intergovernmental	
Kanat Asangulov	Head, Budget Policy Department	
Akylbek Kasymaliev	Deputy Head of Revenue Committee/Tax	
Representative	Head Tax Forecasting Department	The entire group was present at the interview
Mr. Usubaliev	Head Tax Policy Dep.	
Mr. Nazyrbekov	Head of Revenue Dep.	
Murat Ismailov	Deputy Min Fin revenues	

Parliament

Akylbek Dzhaparov	Head of Tax Committee/Parliament
Mr. Abitov	Head of Fiscal Analyses Unit

Bishkek

Mr. Kadyrov	Head/Large Taxpayer Unit
Mr. Nishanov	Head of Bishkek Finance City Department

DONOR AGENCIES AND NGOS IN KAZAKHSTAN AND KYRGYZSTAN:

EBRD/Kazakhstan	Daniel Berg
World Bank/Kazakhstan	Pedro L. Rodriguez, Resident Senior Economist
World Bank/Kyrgyzstan	Chris Lovelace, Senior Manager Azamat Abdymomunov, Economist
DFID/Kazakhstan	Natasha Kryuchkova
UNDP/Kyrgyzstan	David Akopian
Urban Institute/Kyrgyzstan	Charles Underland, COP Local Government Initiative in Kyrgyzstan Bill Kugler, Local Government Initiative in Kyrgyzstan
Confederation of Employers of the Republic of Kazakhstan	Ekaterina S. Nikitinskaya, Executive Director

APPENDIX III
MATERIALS REVIEWED

USAID/CAR Performance Monitoring System 2001-1005

USAID's Assistance Strategy for Central Asia 2001-2005. USAID Regional Mission for Central Asia, July 2000.

Government Finance Statistics Yearbook. IMF, 2002.

Kazakhstan and Kyrgyzstan Assessment of Local Government Programs and Opportunities. Revised Final Report. Prepared for USAID CAR Mission in Almaty. Submitted by ARD, Inc.

KAZAKHSTAN:

2003 Budget Law.

Budget Code.

MEBP Prepared Budget Code Training.

Training Agendas, Workshops, Seminars.

Lists of Reports Written by Fiscal Analysis Unit.

2000 Tax Revenue Data.

Igor Voznessensky. *Fiscal Reform Outputs: Information requested by the Evaluation team.* Fiscal Reform Project, Astana, Kazakhstan, Bearing Point, USAID.

Peter Armstrong. *Accounts Committee for Control over Execution of the Republican Budget.* End-of-Assessment Report. USAID, Audit Advisory Component of the Tax/Fiscal Reform Project, Astana, Kazakhstan, July 3, 2003.

Law of the Republic of Kazakhstan. Republican Budget 2003.

Law of the Republic of Kazakhstan on the Budget System. Dated April 1, 1999, No 357-1. (With amendments introduced by the Law dated 6 December 2001 No261)

Analysis of Pavlodar City Budget Programs.

Draft FY2001 Program Budget Forms Guidelines for Completion of Forms.

The Republic of Kazakhstan RK Parliament Majlis Explanatory Note to *the* RK Draft Law *On introduction of amendments and additions into Republican Budget 2003.* The Government of the Republic of Kazakhstan, April 24, 2003.

Budget Code Training. USAID Fiscal Reform Project in Kazakhstan, Power Point Presentations.

Expenditures of the 2003 Republican Budget at the Level of Subprograms.

USAID Fiscal Reform Project Seminar. *Medium Term Budget Planning and Other Modern Budget Practices.* Bearing Point, Almaty, Kazakhstan March 2003.

Performance Measures Handbook. Guidelines to Assist Agencies. USAID Fiscal Reform Project, Astana, Kazakhstan, March 2003.

Instructions on Compiling a Budget Program Passport.

Martin Bowen. *Review of the Revised Draft Kazakhstan Budget Code, Prepared Jointly by the World Bank and USAID Fiscal Reform Project.*

Martin Bowen. *Program Budgeting Basics-Presentations to Agencies.* Fiscal Reform Program, USAID/BearingPoint.

USAID Fiscal Reform Project, World Bank. *Assessment of the Draft Budget Code of the Republic of Kazakhstan.*

Michael Dunn, USAID advisor to the Parliamentary Fiscal Analysis Unit. *Some Comments to the Explanatory note of the Republican Budget 2003 Draft Law Decree*.

Fiscal Analysis Unit Comments and Suggestions on the Republican Budget for 2001 and 2002.

USAID Tax/Fiscal Reform Project, Fiscal Analysis Unit. Comments to the Report of the Government of the Republic of Kazakhstan on the Execution of the 2001 Republican Budget. Astana, June 2002.

The Removal of Constraints to Investment in Kazakhstan Project: Interim Report. USAID.

Martin Bowen. *Implementing a Medium Term Budget Framework (MTBF) in Easy Steps.* Fiscal Reform Project, USAID, BearingPoint, Astana, Kazakhstan, March 2003.

Medium Term Budget Frameworks. A Guide to Preparation for the Republic of Kazakhstan. USAID Fiscal Reform Project, August 2001.

European Bank for Reconstruction and Development Projects in Kazakhstan, 2003.

Draft Budget Code dated 30 May 2003. Kazakhstan.

Memorandum of Understanding Between the Apparatus of the Senate of the Parliament of the Republic of Kazakhstan and the USAID.

Oblast Budget for 2001. Kazakhstan, Pavlodar Oblast.

Oblast Budget for 2001. Kazakhstan, Ust-Kamenogorsk Oblast.

Dr. James H. Wooster. *Intergovernmental Fiscal Reform In Kazakhstan: Progress to Date and Recommendations for the Future*. Astana, Kazakhstan, December 2, 1999.

Dr. James H. Wooster. *Intergovernmental Fiscal Reform in Kazakhstan: The Law on Subventions and Budget Withdrawals, a Fresh Perspective.* Astana, Kazakhstan, May 22, 2000.

Dr. James H. Wooster. *Intergovernmental Fiscal Reform In Kazakhstan: It is Time to Rethink the Direction of Intergovernmental Fiscal Reform in Kazakhstan: Part I of Series.* Astana, Kazakhstan, January 29, 2001.

Dr. James H. Wooster. *Intergovernmental Fiscal Reform in Kazakhstan: Rethinking the Direction of Intergovernmental Fiscal Reform; Designing System of Equalizing Intergovernmental Transfers, Part II of Series.* Astana, Kazakhstan, March 12, 2001.

Resolution of the Government of the Republic of Kazakhstan. Intergovernmental fiscal issues.

The Law of the Republic of Kazakhstan "On Subventions and Budget Withdrawals"

Round Table on Improvement of the Mechanism of Inter-Government Fiscal Relations Organized by: Agency for Strategic Planning and Public Policy Research Center

Concept for Delimitation of Authorities between Levels of Government and Improvement of Inter-Government Fiscal Relations.

Tax Administration Training Series, Tax Appeals Workshop, Astana, Kazakhstan, June 1998.

KYRGYZSTAN:

Mitch Mokhtari. Forthcoming/Underway Institutional Change For Better Performance in Kyrgyz Republic

Work plan of the Committee on Budget and Economic Policy of the PRA and the Parliamentary Fiscal Analysis Unit /USAID for 2003-2004.

Training Course: Economy and State Budget. Seminars for the deputies and members of the Peoples' Representatives Assembly of the Jogorku Kenesh. USAID Fiscal Reform Project, Kyrgyzstan.

Draft Law on Basic Principles of Budget Development and Financial Management in the Kyrgyz Republic. May, 2003, Updated working draft.

Draft Law of the Kyrgyz Republic on Financial and Economic Basis of Local Self-Government. July, 2003

Tax Expenditures in Kyrgyz Republic: Concepts and Estimates For Legal Entities. USAID Fiscal Reform Project.

Draft, A Comparative Study of Tax Burdens: Are Kyrgyzstan Taxes Too High? USAID Fiscal Reform Project, the Kyrgyz Republic.

Peter Gusen. *An Equalization transfer for the Kyrgyz Republic*. October 2002.

Mitch Mokhtari. *Some Policy Options for Stimulating Investment: Reducing Corporate Tax Rate, Investment Tax Credit, and Accelerated Depreciation Allowance*. Fiscal Reform Project, Kyrgyzstan.

Agenda For Revenue Forecasting Methodologies Seminar. Fiscal Reform Project, USAID/BearingPoint, Kyrgyzstan.

Repealing the VAT exemption and VAT credit for supplies of Agricultural Produce. USAID Fiscal Reform Project.

Tax and Revenue Administration in Kyrgyzstan.

Revenue Forecasting in the Kyrgyzstan Ministry of Finance.

Forthcoming/Underway Institutional Change For Better Performance In Kyrgyz Republic.

Oblast-by-Oblast Tax Revenue Forecast for 2003. Kyrgyzstan.

Tax Policy Conception in the Kyrgyz Republic. Drafted by the workgroup pursuant to the Comprehensive development framework of the Kyrgyz Republic for 2000 – 2010.

Proposed Draft Law on Export of Services: Revenue Estimates and Related Discussions. Kyrgyzstan.

Economics and Government Finance. (in Russian)

Mamak Ashtari, Selcuk Caner, Mitch Mokhtari. *International Seminar on Forecasting*, Fiscal Reform Project, USAID, Almaty 2002.

Tax Expenditures in Kyrgyz Republic: Concepts and Estimates for Legal Entities. USAID Fiscal Reform Project, the Kyrgyz Republic.

Summary of Major Papers of Work Products. Fiscal Reform Project, Bishkek, Kyrgyzstan, Bearing Point, USAID.

Planned Training, August – December 2003 – Strategic Sub-National Training Initiative – Public Expenditure, Budget and Financial Management. Fiscal Reform Project, Bishkek, Kyrgyzstan, Bearing Point, USAID.

Arnold Hoitink, Mitch Mokhtari. *Fiscal Reform Outputs: Information requested by the Evaluation team.* Fiscal Reform Project, Bishkek, Kyrgyzstan, Bearing Point, USAID.

Review of Fiscal Reform Program, Kyrgyzstan. Bearing Point Memoir.

Budget Projections for 2003, Kyrgyzstan. Program Budgeting, Ministry of Health, Kyrgyzstan.

The Resource Agreement Between the Ministry of Education and Culture and the Ministry of Finance of the Kyrgyz Republic. Approved by the Decree of the Government of the Kyrgyz Republic as of September 3, 2002.

Kyrgyz Republic Ministry of Finance. *Medium-Term Budget Framework, 2004 – 2006.* Bishkek, March 2003.

The Budget Code of the Kyrgyz Republic. Updated working Draft, May, 2002.

Arnold Hoitink. *Excerpt From World Bank Public Expenditure Review.* Fiscal Reform Project, Bearing Point, USAID, August 2003.

The Tax Law of the Kyrgyz Republic. Amended by all known subsequent amendments up to and including July 1, 1999. Bishkek 1996.

Urban institute

Law of the Kyrgyz Republic on Financial and Economic Basis of Local Self-Government. Draft, June 2003.

T.E. Omuraliev, Minister of Local Self Government. *Concepts of Reform Contained in the Law on Financial and Economic Basis of Local Self Government.* Urban Institute.

Bill Kugler, *email on Law on Financial and Economic Basis of Local Self Government.* Urban Institute.

Urban Institute Bishkek. *Local Government Initiative in Kyrgyzstan: Summary of Activities.* USAID.

UNDP, Perceptions of Corruption in Kazakhstan, Almaty 2003.

World Bank, Report on Progress under CIS-7 Initiative Washington, D.C., April 7, 2003.

IMF, Kyrgyz Republic: Selected Issues and Statistical Appendix February 2003.

Andic, Fuat and A. Shapleigh, Transition Economies and Fiscal Reforms, USAID, Washington, D.C. 1999.

APPENDIX IV
TAX POLICY

Table 1
Kazakhstan: Tax Policy

Stage	Building block	Comments
Basic Components	Tax Code.	Tax Code was prepared essentially with the efforts of the contractor, adopted by presidential decree in 1995. Task completed. Score: 3
	No internal consistencies in code.	No internal inconsistencies observable. Score: 3
	Implementing regulations consistent with code.	Regulations are not inconsistent with the code. However, interpretation of regulations is problematic for tax payers. Not enough jurisprudence accumulated as yet. Score: 3
Operationally Functional	Amendment review period established.	There is no specific period established. Amendments are made on the need basis. Score: 2.5
	Judicial appeals process reflects intention of the code.	Judicial appeal system reflects the intention of the code. However it is a long process and it is not free from corruption. Score: 2.5
	Consistent with laws and regulations.	It is consistent with the constitution. Consistency with other laws cannot be ascertained. Score: 3
Sustainable	Process established to prevent bills from being established without quantitative analysis.	The process is established in the Ministries of Budget Planning and Economy and Finance. Sufficient capacity is built in both ministries with sufficient staff. In parliament, an office for that purpose is also recently established, but the capacity to accomplish that purpose is yet to be formed. Score: 2.75
	Consistent for SME development.	Recent legislative amendments worked into the code are consistent with the government's overall policy for SME development. Score: 3

	Does not discourage foreign investment.	It does not, and it is consistent with the overall policy of the Government to encourage FDI. Score: 3
Effectively achieving objectives	Consistent with international norms, rates bases and depreciation.	In general, they are. Rates may be considered too high for the economic reality of the country. (There are some intentions to lower them.) Depreciation rules are in accordance with the importance of the sectors. Score: 3
	Fair horizontal/vertical equity.	The code does have provisions for horizontal equity (exemption on agricultural earning is an anomaly); it also has provisions for vertical equity. However, equity generally declined. The reasons can be found in weak income tax performance and heavy reliance on VAT. Score: 2.5

Score 2.75 = Close to achievement

Table 2 **Kazakhstan: Tax Administration**		
Stage	**Building Block**	**Comment**
Basic Components	Functional organization.	Completed in the early stage of TA. Score: 3
	Computerization completed.	Computerization completed; software, as the need arises, can be purchased by the respective ministries. Score: 3
	Staff adequately trained.	In general, yes. However, due to high turnover among the staff, there is a loss of capacity. But the ministries should remedy it internally. Score: 2.5
Operationally functional	High quality sufficient staff.	There is sufficient staff, but quality varies. Retention is problematic due to low remuneration. Score: 2.5
	Rules and regulations adequately disseminated to field.	Rules are disseminated. Whether the rules can be understood in the field cannot be ascertained. Score: 3
	Non-judicial appeals process completed.	Process in terms of legal provisions is complete. Tax payers' dissatisfaction with the process continues. Score: 2.5
Sustainable	Certification program financially sustainable.	Sustainable. Score: 3
	Tax administration consistent with code regulations.	Consistent. Score: 3
Effectively	Tax compliance consistent with international standards.	There is increasing compliance as attested by the increasing number of tax-payers (VAT, Personal Income Tax and corporation tax.). However, the prevailing view in Ministry of Finance is that there is considerable evasion. Score: 2.5

achieving objectives	Fair, consistent application of law.	There is no hard evidence that the law is applied fairly and consistently due to high degree of corruption, underreporting and evasion. Score: 2.5
	Compliance consistent with international standards.	No, It is not, nor should it be expected as yet. To comply with taxes is a new notion in the country. It does not depend only on administration but upon taxpayer education as well. Score: 2.5

Score 2.7 = Close to achievement

TABLE 3 KAZAKHSTAN: BUDGET REFORM/BUDGET		
Stage	**Building Block**	**Comment**
Basic Components	Modern budget systems law	Complete. The final version of a draft Budget Code is dated 30 May 2003. The Code has been submitted to the Parliament. Score: 3
	Unified treasury system	Completed, under IMF guidance. The treasury has installed a Financial Management Information System, but a project is being prepared to modify the existing system. Score: 3
	Budget group has authority	Complete. ME&BP has the authority that it needs to produce an annual budget, which it does produce. Score: 3
Operational-ly functional	Budget group staffed, trained	Complete. ME&BP central budget staff can, and does, fulfill the central responsibility of a budget staff: it produces an annual budget. Score: 3
	Medium and long-term expenditure plans	Complete. ME&BP has been working on a Medium-Term Fiscal Framework since 1999. USAID produced a manual for preparing one in August 2001. The draft Budget Code requires one. ME&BP produced a draft Mid-term Fiscal Policy, 2004-6, in June/July, 2003. MinFin officials say that they will continue to improve their planning methodology but that they could/would do so without USAID assistance. Score: 3
	Adequate analysis of expenditure plans and budgets	Not complete. USAID is now concentrating technical assistance upon improving performance indicators. Without good performance indicators, analysis cannot be adequate. Original training on development of indicators began two years ago. Score: 1
Sustainable	Annual budget executed	Complete. The Government produces an End-of-Year Report. The Accounts Committee, a joint executive/legislative group, reviews the Report. Score: 3
	No IFI borrowings required	Complete. The Government now has a USD 2.5 billion investment fund, built from oil revenues. Score: 3
Effectively Achieving objectives	Expendi-tures match targets	Complete. On an aggregated basis, the budget execution system, including the Single Treasury Account, keeps expenditures within collected revenue and expenditures within appropriations. Score: 3
	Capital spending goals met	Not complete. Investment is integrated into main budget in draft Budget Code and is sectoral specific. USAID consultants are only beginning to emphasize sectoral specific technical assistance in this area. By implication, the benchmark has not been met. Score: 1

	Social safety net funding goals met	Not complete. The use of a Mid-Term Fiscal Framework as a basis for budget preparation should give sectoral allocations that reflect governmental priorities. However, without good performance indicators, the Government cannot properly set goals. The international community is recommending that the government spend from its investment fund on social needs. Score: 1
	Education funding goals met	Not complete. The use of a Mid-Term Fiscal Framework as a basis for budget preparation should give sectoral allocations that reflect governmental priorities. However, without good performance indicators, the Government cannot properly set goals. The international community is recommending that the government spend from its investment fund on social needs. Score: 1

Score 2.33 = Significant progress (78%)

TABLE 4 KAZAKHSTAN: BUDGET REFORM/PROGRAM BUDGETING		
Stage	**Building Block**	**Comment**
Basic Components	ME&BP staff trained in program budgeting	Not complete. Training has, until very recently, concentrated upon the mechanics of budget preparation, e.g., the completion of forms and the procedure. Training is now emphasizing the definition of performance measures, which provides the basis for program budget analysis. As a result, training in efficiency analysis is just beginning. Training in effectiveness/policy analysis has not begun. Score: 1
	Local government trained in program budgeting techniques	Not complete. Training has been provided only to two cities and two oblasts. Score: 1
	Ministries trained in program budgeting techniques	Not complete. Since at least June 2000, training has been provided to ministries in the mechanics of program budgeting. As a result, ministries do now submit budgets in a program format and receive program budget "passports" for budget execution. However, concentrated training for ministries is just beginning in performance indicators and, therefore, efficiency analysis. It has not begun in effectiveness/policy analysis. Score: 2
Operational-ly functional	Budget development forms designed for program budgeting	Complete. Forms were designed at least as early as 2000 for the 2001 Budget. A program budget format is now used to produce the budget. Score: 3
	Ministries develop budget on program-matic basis	Complete. Ministries now develop their budgets on a programmatic basis. Program budget "passports" were used as the basis for budget execution in FY2002. Score: 3
	Oblast budget development on program-matic basis	Not complete. The central government has required all governments to submit budgets in a program format. As a consequence, they do. However, as a Barents's local economist pointed out in his review of the Pavlodar budget, cities seem to be more knowledgeable about program budgeting than the oblasts. Oblasts need more training and experience in developing a program budget. Score: 1

Sustainable	Effective program budget indicators	Not complete. USAID technical assistance is beginning to emphasize the development of good performance indicators. The Performance Measures Handbook was revised and re-issued in March 2003 to guide further development in this area. Score: 1
	Program budgeting process adjusts for program-matic changes	Not begun. In interviews, no one indicated that re-programming has been a topic of technical assistance or training. Score: 0
Effectively Achieving objectives	Program budgeting used in all local governments	Not complete. Government instructions for preparing budgets require that all governments prepare program budgets, and all are. However, training in preparing a program budget has been given to only two cities and two oblasts. Effective program budgeting requires that training be given to all local governments. Score: 1
	Program budgeting meets spending goals	Not complete. The use of a Mid-Term Fiscal Framework as a basis for budget preparation should give sectoral allocations that reflect governmental priorities. However, without good performance indicators, the Government cannot properly set spending goals for program budgeting. Score: 0
	Budget can be used as a performance measure-ment tool	Not complete. The use of a Mid-Term Fiscal Framework as a basis for budget preparation should give sectoral allocations that reflect governmental priorities. However, without good performance indicators, the Government cannot properly set goals for program budgeting. In spite of this, the Accounts Committee recently completed a performance audit with USAID assistance. Score: 1

Score 1.27 = Reform initiated (42%)

TABLE 5 KAZAKHSTAN: INTERGOVERNMENTAL FISCAL RELATIONS		
Stage	**Building Block**	**Comment**
Basic Components	Clear expenditure and revenue assignments	Not complete. The Government focused work in this area on a grant allocation formula and delayed work on expenditure and revenue assignments. Recently a Government committee concluded that a satisfactory grants formula cannot be concluded until proper expenditure and revenue assignments are made. The Government may soon seek technical assistance to develop clear assignments. Score: 1
	Important basic functions-education and health assigned to local government	Not complete. The draft Budget Code includes assignments of some education responsibilities to all levels of government. Health responsibilities are assigned to the central, oblast, and capital city budgets; no health responsibilities are assigned to rayon budgets. It appears that these expenditure assignments are not based upon proper analysis. Score: 1
	Local authorities trained in basic budgeting	Not complete. Budget training has been provided only to two cities and two oblasts. Score: 1
Operational-ly functional	Transfers and subventions transparent	Not complete. The draft Budget Code addresses intergovernmental transfers but does not include an explicit formula. Work on a transparent formula has been delayed until proper revenue and expenditure assignments have been accepted by the Parliament. Score: 0
	Transfers and subventions adjust for changes in economic conditions	Not complete. Without an explicit formula, or at least an explicit and transparent methodology, there is nothing to "adjust." Score: 0

	Process provides local government with resources necessary to carry out local spending plans	Not complete. Without an explicit assignment of expenditure responsibilities to local levels, one cannot know whether the resources provided are equal to those "necessary to carry out local spending plans." (It is predictable with a high degree of confidence that local spending plans will always exceed the availability of resources, especially if those resources do not have to be raised from the local electorate by locally elected officials.) Score: 1
Sustainable	Process can adapt to increased decentraliza-tion	Not complete. By consensus, a satisfactory process that could be adapted is still to be determined. Score: 0
	Process meets the spending goals of local governments	Not complete. Without performance indicators, still being developed under program budgeting, the spending goals of local government are ill-defined and do not provide a reliable basis for providing revenue. Score: 0
Effectively Achieving objectives	Local government spending reflects priorities of citizens	Not complete. By inference, the movement to local program budgeting suggests that the international community believes that local spending does not now reflect priorities of citizens; and implementation of program budgeting at local levels is only beginning. Public hearings on the budget are a part of program budget training for local governments. Score: 1
	Local governments have revenue generating authority	Not complete. Local governments may generate a portion of their revenue, e.g., from the sale of property; but such revenue can probably satisfy only a portion of their need for revenue. Depending upon which expenditure responsibilities are eventually assigned to local governments, additional revenue generating authority will probably be needed to meet the requirements of decentralization. Score: 1
	Decentraliza tion	Not complete. Without expenditures and revenue assignments, decentralization is not complete. Score: 0

Score 0.5 = Reform initiated (18%)

Table 6 Kyrgyzstan: Tax Policy		
Stage	**Building Block**	**Comment**
Basic Compon-ents	Tax Code.	A comprehensive tax code was prepared and approved in 1996. Subsequent changes reduced its effectiveness. Score: 2
	No internal inconsistencies in the code.	From 1996 to 2003 the code was revised 700 times, bringing special treatments to interest groups in the form of exemptions, deductions etc. Latest revisions brought special treatments for SMEs and FDIs. Internal consistency is lost. Score: 2
	Implementing regulations consistent with code.	Regulations are frequently changed. Contradictory regulations are issued. Consistency is lost from time to time. Score: 1
Operational-ly Functional	Amendment review period established.	No such period is established. Frequent reviews usually follow special groups' pressure. Score: 1
	Judicial appeals process reflects intention of the code.	Judicial appeals are very rare due to poor auditing. Taxpayer prefers to settle out of court. However, appeal system as it is incorporated into the code is consistent with the intention of the code. Score: 1
	Consistent with other laws and regulations.	The original design of the code was consistent with other laws, including the constitution. However, frequent changes create inconsistencies. Score: 1
Sustainable	Process established that prevents bills from being established without quantitative analysis.	No such process is established. There is no capacity to carry out such quantitative analysis. Whenever parliament requires such analysis the recourse is the consultants of the Barents group. Score: 1
	Consistent with need for economic development of SME.	Special provisions for SMEs are in place and appear to be consistent with the intention. It is impossible to measure its effectiveness. No quantitative data exists. Min Fin does not even know the number of SMEs that exist in the country. Score: 1

Effectively achieving objectives	Does not discourage foreign investment.	Tax code does not. There are provisions to enhance it. But there are other non-fiscal conditions that discourage DFI. Score: 2
	Consistent with international norms in rates, basis and depreciation.	Rates are basically consistent with accepted norms (progressive income tax for example); tax base is not (major agricultural incomes are exempt); depreciation provision are not standardized. Score: 2
	Fair horizontal and vertical equity.	The code contains provision for equity both horizontal and vertical. But numerous exemption work against the equity principle. Score: 1

Score 1.5 = Reform initiated

Table 7
Kyrgyzstan: Tax Administration

Stage	Building Block	Comment
Basic components	Functional organization.	Complete. Score: 3
	Computerization completed.	Not complete. There are scarcity of computers and the lack of software. Score: 2
	Staff adequately trained.	Due to high turnover among the staff and the lack of necessary tools the present staff is not adequately trained. Score: 2
Operationally functional	High quality sufficient staff.	Staff quality is not very high. Due to very low remuneration staff turnover is high, in many departments (such as audit there is staff shortage). Score: 1
	Rules and regulations adequately disseminated to field.	Rules and regulations are frequently changed, hence there is some confusion at the headquarters. No field visit was possible but one deduces that in the field there must be the lack of information and confusion. Score: 1
	Non-judicial appeals process completed.	The system is in place; but, in general, tax payers prefer to settle with auditors so very few cases go to appeal. Hence the functioning of non-judicial appeal process can not be ascertained. Score: 1
Sustainable	Certification program financially sustainable.	No, it is not sustainable. Score: 1
	Tax administration consistent with code regulations.	In essence, administration is consistent with the code; and there are further efforts (such as uniting tax administration with that of customs) making it consistent. Score: 2
Effectively achieving objectives	Tax compliance consistent with international standards.	No, it is not. There several exemptions of dubious nature and tax evasion are prevalent. Score: 1
	Fair consistent application of law.	Application is neither fair nor uniform due to high level of corruption. Score: 1

	Compliance consistent with international standards.	Compliance is not consistent with international standards. Score: 1

Score 1.5 = Reform initiated

TABLE 8 KYRGYZSTAN: BUDGET REFORM/BUDGET		
Stage	**Building Block**	**Comment**
Basic Components	Modern budget systems law	Not complete. There is a Budget Law from 1998, but it is considered unsatisfactory by the Parliament and the executive as a mechanism for providing revenue to local government. A Budget Code was drafted in 2002, but the new Constitution will require that the draft be changed. Work has stopped on the Budget Code, and focus has shifted to the Law on the Economic and Financial Basis of Local Self-Government. Score: 2
	Unified treasury system	Completed, under IMF guidance. Score: 3
	Budget group has authority	Complete. MinFin has the authority that it needs to produce an annual budget. Score: 3
Operational-ly functional	Budget group staffed, trained	Complete. MinFin central budget staff can, and does, fulfill the central responsibility of a budget staff: it produces an annual budget. Score: 3
	Medium and long-term expenditure plans	Not complete. MinFin produced a Medium-Term Budget Framework for 2004-2006 but was heavily dependent upon IMF, the World Bank, and USAID to do it. Score: 1
	Adequate analysis of expenditure plans and budgets	Not complete. Performance indicators are just beginning to be developed in earnest. Without performance indicators adequate analysis of plans and budgets is not possible. Indicators have not been developed for all programs, and those that exist are being improved. Score: 1
Sustainable	Annual budget executed	Complete. The Government produces an End-of-Year Report. The Parliament reviews the Report and, if it is acceptable, passes an acceptance law. Score: 3
	No IFI borrowings required	Not complete. The Republic continues to borrow to offset its budget deficit. Score: 1
Effectively Achieving objectives	Expend-itures match targets	Complete. On an aggregated basis, the budget execution system, including the Single Treasury Account, keeps expenditures within collected revenue and expenditures within appropriations. Score: 3
	Capital spending goals met	No data. Score: 0

	Social safety net funding goals met	Not complete. Under World Bank leadership, the Government is initiating a poverty reduction program. The movement to program budgeting suggests that social safety net funding goals are only now being defined. Score: 1
	Education funding goals met	No data, but the movement to program budgeting suggests that education funding goals are only now being defined. Score: 1

Score 1.8 = Reform initiated (61%)

TABLE 9 KYRGYZSTAN: BUDGET REFORM/PROGRAM BUDGETING		
Stage	**Building Block**	**Comment**
Basic Components	MoF staff trained in program budgeting	Not complete. MinFin staff trained in the mechanics of preparing a budget in a program format. (Nov.-Dec. 2002.) 2003 National Budget organized secondarily in a program format. Training in efficiency just beginning. Training on effectiveness/policy analysis not begun. Score: 1
	Local government trained in program budgeting techniques	Not complete. Training has just begun with pilot projects in three cities. MinFin has planned to extend training to 460 local governments and 23 cities. Training in three cities concentrated upon mechanics of preparing a budget in program format. Score: 1
	Ministries trained in program budgeting techniques	Not complete. To date, training for ministries limited to mechanics of preparing a budget in program format. Training in efficiency and effectiveness not begun. Score: 1
Operational-ly functional	Budget development forms designed for program budgeting	Complete. The 2003 National Budget was prepared by ministries and submitted to the Parliament in both line item and program formats. A bound version of the program budget submission was prepared for public hearings (with USAID logo on the cover). The forms have been developed and are being used. Score: 3
	Ministries develop budget on program-matic basis	Not complete. Ministries seem able, in general, to present data in program format. However, review of National 2003 budget shows numerous blanks in ministry budget descriptions indicating more experience needed. Much more training and experience needed in defining and using performance indictors to improve efficiency. No training yet to improve effectiveness through policy and program analysis. Score: 2
	Oblast budget development on program-matic basis	Not complete. Pilot projects on program budgeting have been undertaken in only three oblasts. Score: 1
Sustainable	Effective program budget indicators	Not complete. Central ministries are in early stages of developing effective indicators, although the subject was introduced about two years ago. Score: 1

	Program budgeting process adjusts for program-matic changes	Not begun. In interviews, no one indicated that re-programming has been a topic of technical assistance or training. Score: 0
Effectively Achieving objectives	Program budgeting used in all local governments	Beginning. Training has been provided only to three cities. Score: 1
	Program budgeting meets spending goals	Not begun. The process is still defining spending goals. Score: 0
	Budget can be used as a performance measure-ment tool	Not begun. Performance indicators are still being developed. Score: 0

Score 1.0 = Reform initiated (33%)

TABLE 10 KYRGYZSTAN: INTERGOVERNMENTAL FISCAL RELATIONS		
Stage	**Building Block**	**Comment**
Basic Components	Clear expenditure and revenue assignments	Not complete. The Law on Economic and Financial Basis of Local Self-Government is intended to provide clear assignments. The draft law passed both houses of the Parliament in July 2003 and is awaiting presidential action. (Some MinFin officials seem to believe that the assignments are already clear enough.) Score: 2
	Important basic functions-education and health assigned to local government	Complete. Clear assignment of responsibilities to cities, villages, and settlements has been made. The Law on Economic and Financial Basis of Local Self-Government is intended to provide revenue sources to local government to match the responsibilities. Score: 3
	Local authorities trained in basic budgeting	Not complete. Training has been given only to three pilot, local governments. A sub-national training program has been developed to provide a "threshold of public expenditure management" to 483 local governments below oblasts and rayons. USAID has funded three regional centers to training local government personnel. Score: 1
Operational-ly functional	Transfers and subventions transparent	Not complete. The are equalization and categorical grants, and MinFin is working on a matching grant system. Apparently, a formula does exist, but the formula provides funding only to the oblast and, perhaps rayon, level. Explicit grants dedicated to local governments below the rayon and that are developed transparently through a formula do not exist. Development of such a formula after passage of the Law on Economic and Financial Basis of Local Self-Government is needed. Score: 1
	Transfers and subventions adjust for changes in economic conditions	Not complete. A satisfactory, transparent formula that could adjust does not exist. Score: 0

	Process provides local government with resources necessary to carry out local spending plans	Not complete. It is reported that oblasts and rayons arbitrarily keep resources beyond their service needs, meaning that cities, villages, and settlements do not get necessary funding. This situation provides part of the rationale for the new law. Score: 2
Sustainable	Process can adapt to increased decentraliza-tion	Not complete. If the new law passes as currently drafted, a new "process," i.e., a new, transparent formula, will be needed. Score: 2
	Process meets the goals of local governments	Not complete. Local governmental officials complain that they do not get enough resources, including financial officials in Bishkek, the source of most of the funds that are transferred to other local governments. Score: 2
Effectively Achieving objectives	Local government spending reflects priorities of citizens	Not complete. By inference, the movement to local program budgeting suggests that the international community believes that local spending does not now reflect priorities of citizens; and implementation of program budgeting at local levels is only beginning. Public hearings on the budget are a part of program budget training for local governments. Score: 0
	Local governments have revenue generating authority	Complete. Local governments have recently been given authority to impose a real property tax. Outside of Bishkek, local governments do not have much wealth on which to base revenue generation. Giving local governments authority to impose a property tax may be all that is required for the foreseeable future. Score: 2
	Decentraliza tion	Not complete. Score: 1

Score 1.45 = Reform initiated (48%)

APPENDIX V
FIFTEEN QUESTIONS

QUESTION 1: How has the activity in Kazakhstan and the Kyrgyz Republic contributed to the economic development of each country?

The Fiscal Reform Project for taxation has had a good impact on the economic development of Kazakhstan. The tax code adopted in 1995 was economically neutral, meaning that the governmental tax structure did not distort allocation of resources in the economy and, as a result, protected economic efficiency and, thereby, promoted development. Since then the tax code, which shapes the fiscal policy, has been amended in ways that are favorable to SMEs and DFI.

In Kyrgyzstan the Project's impact is much less appreciable due to the conditions beyond the Project's sphere of influence. In this context the lack of political commitment, weak institutions, low human development, very small base of sufficiently trained personnel, and high turnover of staff due to low salaries in the public sector may be mentioned.

QUESTIONS 2: What was the contribution of the USAID fiscal reform activities towards increasing the soundness of tax and budget policies and administration in the two countries?

In both countries USAID's fiscal reform activities contributed greatly to the efforts towards increasing the soundness of tax policies and administration. While in Kazakhstan the impact was appreciable, in Kyrgyzstan the impact is yet to be felt.

In Kazakhstan budgeting, USAID: (1) helped MinFin to nearly complete the capacity needed for budgetary management of fiscal policy; (2) introduced MinFin and pilot local governments to and provided virtually all technical assistance used on the mechanics of program budget preparation; and (3) assisted Parliament to become aware of its need for quality information (and, therefore, of its need for a staff that can produce such information) separate from that provided by the Executive.

In Kyrgyzstan budgeting, USAID: (1) helped MinFin to initiate development of the capacity needed for budgetary management of fiscal policy; (2) introduced MinFin and pilot local governments to the mechanics of program budget preparation: and (3) assisted Parliament to become aware of its need for quality information (and, therefore, of its need for a staff that can produce such information) separate from that provided by the Executive.

QUESTION 3: What factors explain the differences in the achievements of fiscal reform in Kyrgyz Republic and Kazakhstan?

Resources and strong leadership. Kazakhstan has strong executive leadership that listens to the international community but acts independently. After deciding what it wishes to accomplish, Kazakhstan has the resources (money, trained personnel, facilities, etc…) and discipline to execute the decision in a timely manner. Kyrgyzstan does not have the resources or consistent leadership and political consensus.

QUESTION 4: Did the changes/improvements in the tax legislation bring more transparency, and as a result, reduce the potential for corruption in tax authorities?

There are appreciable improvements with respect to transparency in Kazakhstan and Kyrgyzstan. In Kazakhstan, by publishing a major taxpayers list and the amount of tax paid by them, the one stop-shop principle was established and contributed to transparency. However, continuous contact between the taxpayers and tax officials is very conducive to corruption. It is impossible to state that the project contributed to the reduction of corruption. In fact, according to the World Bank, overall corruption in Kyrgyzstan is on the rise. Tax administration in both countries is designed in such a way that it aims to reduce corruption.

QUESTION 5: Have the fiscal reform activities contributed to the growth of private business, particularly small and medium enterprises, and if so, how? What can be done to increase the positive impact of fiscal reform on SME's?

Some fiscal reform activities have aimed to contribute to the growth of private sector activities. Provisions for SMEs and for FDI are two good examples. In the future, SME provisions must be revised to reflect economic realities. As the economies expand and inflationary pressure is felt, the rules determining SME status must be changed. Otherwise, SMEs may curtail their activities so as not to find themselves in tax categories that increase their tax burdens disproportionately. In Kyrgyzstan, none of the economic institutions have capacity to provide sufficient fiscal analysis, which is a major impediment for the formulation of economic policy. Hence, rational future revisions of fiscal policy vis-à-vis SMEs and DFI is in doubt.

However, the Governments appear not to have given priority to economic development in their fiscal reform activities. In the tax area, where most of the contribution would have been made, priority seems to have been given to following prescribed international agendas, i.e., the standard tax code, and to creating a tax structure that would generate revenue. There appears to have been little or no effort to produce analyses from which a comprehensive tax structure could be selected. As a result, the approach to economic development in both countries appears to have been ad hoc and political. That is, it was determined by interested parties bringing proposals to the Parliament and pleading their causes. As a result, special breaks were given; and the standard tax code concept deteriorated. (The standard tax code embraces economic neutrality.)

To increase the impact, the Governments could undertake more analyses of proposals to modify the Tax Code based upon the criteria of yield/adequacy, equity, economic development, and administrative ease. Given the political importance of taxes, it would probably be preferable if the analyses were undertaken as a joint exercise of the Executive Branch and the Parliament. Parliamentary leaders need to be part of the analytical and decision-making process, invest in it, and be committed to defending its results.

QUESTION 6: Is there a core group of professionals within tax authorities of the two countries that have sufficient capacity to continue training and further staff development? If not, are there any impediments to developing a core group of professionals?

In Kazakhstan, such a core group exists, and further staff development with internal resources is feasible. In Kyrgyzstan, the core group is disproportionably small and is in dire need by capacity

enhancement. The basic impediment in Kyrgyzstan is that there are few tax professionals who are good enough to train others.

QUESTION 7: What steps are necessary to reinforce the role of the Fiscal Analysis units in both countries in the overall tax and budget process? How accurate and useful are their budget forecasts? Has this component contributed to improved budget transparency, public accountability, and democratization?

Accuracy and usefulness. Methodologies introduced are of professional quality and employ standard techniques. In practice, the methodologies yield different results; but the range in variation is acceptable, given the status of data. Executive and legislative branch officials in both countries report satisfaction. For the Parliament, the key is to have an alternative forecast to challenge the forecast of the Executive.

Transparency, public accountability, and democratization. Yes, this component has contributed to transparency, public accountability, and democratization. The Parliament is the agent of the voting public. By giving the Parliament an alternative view, the people's representatives are able to challenge the executive and hold the executive accountable. This is a contribution to democracy. If the public wishes, it can observe the process of challenging. Thus, the decision-making process has become more transparent.

Steps. In both countries, in return for continuing assistance, USAID could require a plan for institutionalization of Parliamentary fiscal analysis capacity and establish a schedule for phasing-out USAID assistance. As part of the agreement, USAID could require Parliamentary officials to spend from their institutional budgets to support meeting the phase-out schedule (so that each Parliament would be investing its own resources and expect to see a return on the investment). USAID assistance could consist primarily of an ex-patriate advisor to the head of the Parliamentary professional staff; and the head would have responsibility and authority to use the resources at his disposal, i.e., his Parliamentary budget and the expat., to institutionalize the capacity. It should be clear to USAID, the Parliament, and the public that institutionalizing the capacity lies with the head of the Parliamentary professional staff. Finally, as part of the agreement, USAID could require that the Parliamentary staff report to a multi-partisan commission, so that no political party could control the "non-partisan" staff.

QUESTION 8: How effective are the program's efforts at the local level vs. national level? What can be done to strengthen local-level work and reinforce its links with the national-level developments?

In budget reform, the mechanics of program budgeting have been introduced locally in both countries, but the process is only beginning. In fiscal analysis, virtually nothing has been accomplished at the local level. In Intergovernmental Fiscal Relations, the only accomplishment to date is institution of the local real property tax in Kyrgyzstan. (A draft law with important implications for local government is pending in Kyrgyzstan.)

Overall, then, the program has not been very effective at the local level. However, relatively few resources have been directed to the local level. The prognosis for impact at the local level is now much better in both countries. In Kyrgyzstan, the plan is to direct more resources to the local

level. In Kazakhstan, the Intergovernmental Fiscal Relations procedure now seems to be on track with immediate priority being given to reassignment of expenditure responsibilities.

The major requirement is to alter the intergovernmental fiscal relationships so local governments have responsibility for providing local services and have more resources for executing these responsibilities. The mechanism providing the resources could require that some (small) portion of them be designated every year to financial management improvement. Then, at the national level, a MinFin body to encourage and guide local level financial management improvement (and review results) could be established.

QUESTION 9: Does staff of tax collection bodies possess sufficient skills to effectively use the new computerized system of tax administration and fiscal data collection?

In Kazakhstan tax collection bodies possess sufficient skill as well as access to hardware and software. In Kyrgyzstan the reverse is the case (in the audit department, for examples, every third auditor has a computer. In the oblasts, the situation is much worse.)

QUESTION 10: What at the constraints that impede reform of intergovernmental fiscal finance and what could be done to overcome those constraints?

Constraints. (1) Desire for political flexibility: political decision-makers don't want transparent and established rules. They want the political flexibility given by making ad hoc political agreements. (2) In reform, some governments will lose power/money, and some governments will gain power/money. The losers resist the change.

Actions. The best strategy is to rely upon a democratic political process. Develop explicit expenditure and revenue assignments, and develop explicit transfer formulas with results estimated. Place the assignments and formulas with results in the public domain, and let the political process determine the outcome. Parliamentary leaders should first strive for common agreement upon principles, e.g., that some degree of equal fiscal capacity among local governments is a good thing, and then let the politicians negotiate an acceptable definition of degree.

Caveat. In a country where it is difficult to develop a stable political consensus, as Kyrgyzstan apparently is, reducing the political flexibility of decision-makers may contribute to deadlock. Moreover, in a country where fiscal capacity is centralized, as Kyrgyzstan is with Bishkek, intergovernmental transfers consist of transferring wealth from only one local government, i.e., Bishkek, to other localities. This raises questions of political practicality and justice.

QUESTION 11: In Kazakhstan, is there sufficient capacity in the Ministry of Finance and Parliament to end USAID assistance? If funds are available, would it be advisable to continue fiscal reform assistance at the local level while exiting at the national level?

Capacity. The MinFin position seems to be that reform has progressed far enough that MinFin officials understand the process and its objectives and could continue it. They have the money; and, if they need technical assistance, they believe that other donors would provide it. The Parliament, on the other hand, does not seem to be in position to progress without continuing technical assistance. USAID could consider continuing a technical assistance program that is

built around a schedule for USAID withdrawal and placing clear responsibility for building a fiscal analysis capability upon the head of the professional Parliamentary unit.

Local. USAID should work at MinFin to create an institution dedicated to continuing financial management improvement, and that institution should be responsible for supporting reform at local and national levels.

QUESTION 12: In Kyrgyzstan, what are the priority needs for fiscal reform for the next two years? How well does the current and planned assistance address those needs?

First Priority: Technical assistance to Intergovernmental Fiscal Relations.

- Assistance to help local governments implement the local property tax.
- Assistance to develop acceptable transfer formulae.
- Assistance to ensure that at least a portion of increased local revenue is dedicated to improving continually local financial management.
- Local budget training in costing and accountability (for unit costs), in a program budget format.
- Assistance to develop a MinFin mechanism for monitoring local spending.

Second Priority: Technical assistance to tax policy and administration.

- Assistance for revising the tax code. As it is, the code is inconsistent, containing too many contradictory clauses.
- Redesign the training program after a careful need assessment and tailor the training to remedy the basic weaknesses of the staff.

Third Priority: Technical assistance to budget reform.

- Focused budget reform, e.g.., the Medium-Term Budget Framework, so as to complete each stage in succession until "Sustainability" is complete.
- Undertake institutional development in conjunction with focused reform.

Fourth Priority: Technical assistance to program budgeting.

- Allow national budgeters to absorb and operationalize past program budget training.
- Introduce program budgeting to local levels in conjunction with costing and accountability. (Budgeters should know that they are budgeters and not program planners.)

As we understand it, there is no plan to give Intergovernmental Fiscal Relations a priority. We think that a priority in this area is necessary to support a USAID priority, decentralization. Moreover, with the passage of the new law, the time will be right.

At the same time, we believe that technical assistance priority on program budgeting at the national level can be reduced. Program budgeting at the local level should continue because it has been "sold" well, and the Government is enthusiastic about it. Therefore, budget technical assistance at the local level should follow a two-stage path.

- Stage 1: Program budgeting mechanics and procedures.
- Stage 2 (to follow quickly after Stage 1): Unit costing and accountability.

The priorities given here are based upon need (the need for better operating performance and the need for technical assistance to get that performance) and do not consider the probability of successful and sustained operating performance.

QUESTION 13: What are the lessons learned of the tax and budget reform process that can be used in other countries of Central Asia?

No technical assistance for tax policy and administration should be provided without needs assessment taking into consideration the differences in economic preparedness, resource endowment, staff's existing capacity, and absorption potential.

Program budgeting is primarily for program planners. However, if the results of program planning are to be effective and operationalized, the budget format should be compatible with the program plan, i.e., there should be a program format in the budget. Therefore, comprehensively, program planning for the ministries and program budgeting for the central budget office should be undertaken simultaneously. (This project does not recognize the need for program planners, separate from budgeters, in the line ministries. It seems to assume that program budgeting is only for budget offices.)

Major reform requires institutional development, not just training; and it must be long-term, with a plan to overcome obstacles, e.g., the absence of professionally educated people in Kyrgyzstan. Institutional development is a discipline and requires putting in place:

- Missions statements and policies
- Organization structures
- Staffing (numbers and types)
- Budgets
- Facilities and supplies
- Systems and procedures
- Data
- Technical assistance

With institutional development, change will not be effective, sustainable, or continuing.

QUESTION 14: What activities, if any, should USAID consider implementing as a follow-on to the Kazakhstan fiscal reform activity upon its termination (expected December 2003)?

For tax policy and administration, USAID can now exit from Kazakhstan at the national level. Short-term well-focused technical assistance may be considered if Kazakh authorities are willing to formulate the need.

For budget reform and intergovernmental fiscal relations reform, USAID could consider technical assistance to create a Ministry of Economy and Budget Planning (MEBP) organization dedicated to on-going reform, per Point 3.3.4. MEBP would use the new organization to institutionalize the reform process and ensure continued financial management improvement, including extending financial improvement into local government and providing short-term expertise in Intergovernmental Fiscal Relations. USAID could also consider a very reduced technical assistance program to the Parliament. The assistance would provide one expatriate advisor to help the head of the Parliamentary professional staff to develop an internal fiscal analysis capability. See the answer to Question 7 above.

QUESTION 15: What activities, if any, should USAID consider implementing over the next two years as a follow-on for the Kyrgyzstan fiscal reform activity after the current contract expires (January 2003)?

Kyrgyzstan is in dire need of assistance for tax policy and tax administration. For the next two years, the need for assistance and capacity enhancement in these two areas will remain high. Without additional technical assistance in these areas, progress achieved to date probably cannot be sustained.

Priority should be given to Intergovernmental Fiscal Relations and Basic Budget Reform. Reform for Program Budgeting should play a supporting role over the next two years. Reform for the Parliament should be continued only if the Parliament will provide an explicit agreement to:

- Create a multi-partisan commission as the governing body of the non-partisan fiscal analysis staff.
- Clearly place responsibility for creating a capable internal fiscal analysis staff upon the director of the non-partisan staff rather than upon the USAID advisor.
- Devote some of its own resources to creating the internal capability.

For specific activities to execute the above, see the answer to Questions 7 and 12.