

## SECTOR ASSESSMENT (SUMMARY): PUBLIC SECTOR MANAGEMENT

### A. Sector Performance, Problems, and Opportunities

1. The proposed loan will support the extensive government development programs in mitigating the sudden and significant negative economic impact caused by the steep fall in oil prices and the economic slowdown in the Russian Federation. These planned development expenditures for fiscal stimulus will help Kazakhstan stabilize and continue its economic growth trajectory while targeting fiscal sustainability in the medium term. The development programs will contribute to employment creation, social services provision, and poverty reduction; expand and modernize physical infrastructure; and promote inclusive private sector development. Effective and efficient public finance management is critical for countercyclical program success. Strong public procurement, assessment of the risk and analysis of the costs and benefits of various investment programs, and evaluation of their outcomes will help ensure results. Government programs will need to (i) be consistent with the medium-term non-oil fiscal deficit target; (ii) be transparent and cost-efficient; and (iii) address absorptive capacity constraints for infrastructure, employment, and economic diversification.

2. Kazakhstan has a comprehensive consolidated republican budget. It reflects national fiscal policy and budgets from local governments, including the oblast (province), city, and rayon (district) administrations. A system of intergovernmental transfers is deployed to harmonize oblast budgets and promote broader revenue distribution. The republican budget finances development activities. The government provides cash transfers to migrants to settle in target areas, particularly in northern Kazakhstan, to spread growth more evenly and reduce gaps between regions. In 2014 the government further increased the social orientation of the budget, with larger allocations for education and access to health care for low-income families.<sup>1</sup> The government also increased taxes on real estate and luxury goods in 2014. In 2015 the government further increased allocations for social assistance.

3. The republican budget does not cover all fiscal activity. Budget execution and accounting procedures are not regularly applied to development programs, especially if they are financed through direct transfers from the National Fund of the Republic of Kazakhstan (NFRK).<sup>2</sup> The situation improved after the introduction of the 2013 fiscal strategy, but several development programs remain in the quasi-fiscal sphere (footnote 2). Transparency is particularly important to bring contingent fiscal liabilities into the broader fiscal and macroeconomic framework. Kazakhstan's score in the Open Budget Index, which measures budget transparency, has improved consistently since 2008.<sup>3</sup> The integration of the NFRK into the fiscal accounts and making a clear distinction between oil and non-oil revenues would help in targeting and monitoring non-oil fiscal deficits, and further enhance budget transparency.

4. Fiscal measures to counter external economic developments serve to widen the non-oil deficit. While the overall budget deficit remained between 2.0% and 3.0% of gross domestic product (GDP) during 2011–2014, the non-oil deficit fluctuated between 6.4% and 7.7% of GDP. The non-oil deficit is expected to increase in 2015, and then fall to a sustainable medium-term rate. Measured on IMF methodology, the non-oil deficit is projected to fall to 8.7% of GDP by 2020, which compares to an estimated medium-term sustainable non-oil deficit 5.5% on GDP. The authorities indicated that they remain committed to their goal of reducing the non-oil deficit

<sup>1</sup> International Monetary Fund. 2014. *Kazakhstan Special Issues Paper*. Washington, D.C.

<sup>2</sup> International Monetary Fund. 2014. *Republic of Kazakhstan: 2014 Article IV Consultation—Staff Report*. IMF Country Report No. 14/242. Washington, D.C.

<sup>3</sup> International Budget Partnership. 2012. *Open Budget Survey*. Washington, D.C.

of the unconsolidated budget (not accounting for NFRK) to 2.8 percent of GDP by 2020 (footnote 2). Total revenue in 2014 was 15.1% of GDP, up from 14.9% in 2013, and reflecting a significant increase in corporate income tax collection, higher property and vehicle tax rates, and higher transfers from the NFRK. However, following the downward adjustment of the tenge exchange rate with major currencies, a pay rise, higher pensions and social transfers boosted public expenditure from 17.0% in 2013, to 17.9% of GDP in 2014.

5. Reforms in audit and financial control are required to improve existing systems. In 2013 the government adopted public audit in Kazakhstan and prepared a draft law on public audit and financial control. The pending adoption of the law since 2013 delays the implementation of relevant audit standards and the setup of internal audit units. Provisions included in the draft law thus far regarding the Accounting Chamber do not comply with recommendations to ensure independence of the supreme audit institution.<sup>4</sup>

6. Procurement systems and legislation have improved. The legislation on public procurement—the Public Procurement Law—has been updated and elements of e-procurement have been introduced. However, there has not been a significant reduction in the number of areas exempted from the scope of the law. In January 2014 the Public Procurement Law, which is based on the United Nations Commission on International Trade Law Model Law on Procurement of Goods, Construction and Services (1994), was amended to reflect public procurement requirements of the Customs Union. Another amendment was made to establish a central purchase organization—the Public Procurement Committee, a single organizer of public procurement at the national level—within the Ministry of Finance to procure commonly used goods on behalf of several public entities, and for state investment projects. Procurement of commonly used goods, works and services by a single procuring entity began in July 2014 at the national level and in January 2015 at the regional level (by an entity appointed by the local governments). Procurement legislation for state-owned enterprises has not yet been adopted. A monitoring system for procurements, complaints and responses, and frequent violations and liabilities has been introduced (footnote 4). Procurement in Kazakhstan now is largely executed through the electronic government procurement web portal established in 2008. The web portal has significantly reduced the time and cost of public procurement, and increased process efficiency and transparency. Enhanced competition in the tendering process would further improve the quality of selected contractors in public procurement.<sup>5</sup>

7. Kazakhstan's ranking in the Transparency International's Corruption Perception Index declined slightly, from 120<sup>th</sup> (out of 180 countries) in 2009 to 126<sup>th</sup> (out of 175 countries) in 2014.<sup>6</sup> Kazakhstan has a legal and institutional framework for combating corruption. The anti-corruption law (Law on Fight Against Corruption) was adopted in 1998. It defines the core principles underlying the anticorruption effort, types of corruption crimes, and responsible agencies. Whistle blowing is supported and protected under the law. The criminal code criminalizes active and passive bribery, attempted corruption, extortion, money laundering, abuse of office, and bribe facilitation by third parties.

8. Anti-corruption institutions require strengthening to fully implement the legal framework. On 6 August 2014 the Agency of the Republic of Kazakhstan on Fighting Economic and Corruption was dissolved by a presidential decree, and the function for fighting corruption was

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<sup>4</sup> Organisation for Economic Co-operation and Development. 2014. *Anti-Corruption Reforms in Kazakhstan*. Paris.

<sup>5</sup> Governance risk assessment in ADB. 2012. *Country Partnership Strategy: Kazakhstan, 2012–2016*. Manila.

<sup>6</sup> Transparency International. 2014. *Corruption Perceptions Index 2014*. Berlin and Transparency International. 2009. *Corruption Perceptions Index 2009*. Berlin.

transferred to the newly established Agency for Civil Service Affairs and Fight Against Corruption.<sup>7</sup> The new agency is responsible for preventing, detecting, suppressing, investigating and solving corruption crimes and offenses. Kazakhstan joined the ADB and Organisation for Economic Co-operation and Development (OECD) Anticorruption Initiative for Asia–Pacific in May 2002, the OECD Istanbul Anti-corruption Action Plan in 2003, and acceded to the United Nations Convention Against Corruption in June 2008. ADB’s Anticorruption Policy (1998, as amended to date) was explained to and discussed with the government.

9. The business environment for micro, small and medium-sized enterprises (MSMEs) has improved, but obstacles remain. Following the global financial crisis, the government simplified procedures and regulations for starting a business,<sup>8</sup> registering property, protecting investors, enforcing contracts and paying taxes. Nevertheless, MSMEs continue to face constraints to development. Corporate governance and related regulatory environment measures for Kazakhstan are below the standards of the OECD countries, and are lower than the average for transition economies. Kazakh firms indicate that business licensing and permits, inspections, trade regulations and access to finance are the main obstacles for business development.

## **B. Government’s Sector Strategy**

10. The government has identified economic diversification as critical to Kazakhstan’s long-term growth and resilience to external economic shocks. Institutional reforms in public sector management, with specific attention to public finance, are important to facilitate diversification and leverage resources at all levels of government. The main objectives are (i) efficient management of public resources to support MSME development and implement required infrastructure projects to facilitate business growth, (ii) improvement in public procurement to enhance transparency and value for money through fair competition, and (iii) broadening of the tax base to reduce the volatility of and dependency on revenue generated through the export of mineral products.

11. A government reorganization was instituted to improve implementation of development projects. In 2013, the Ministry of Economy and Budget Planning was reorganized and took responsibility for fiscal planning from the Ministry of Finance, while the function of budget planning was transferred to the Ministry of Finance.<sup>9</sup> A new extra-budgetary entity, Baiterek, was formed to combine the main development institutions in Kazakhstan that were formally under the state investment holding company Samruk Kazyna. Baiterek was established to provide financial and investment support for the non-oil and gas sectors, ensure sustainable development and diversification of the national economy, attract investment, develop business clusters, and improve corporate management in its subsidiaries.

12. A new anti-corruption strategy is being developed. In December 2014, Kazakhstan adopted the Anticorruption Strategy *Sectoral Program for the Fight Against Corruption* for 2015–2025. Key components include improving the legal framework, fighting corruption in the civil service and quasi-state and private sectors, strengthening enforcement and judicial systems, promoting public awareness, involving civil society in anticorruption activities by introducing public control initiatives, and expanding international cooperation to fight corruption. The anti-

<sup>7</sup> Decree of the President of the Republic of Kazakhstan No 883. 2014. *On further measures to improve the governance system in the Republic of Kazakhstan.*

<sup>8</sup> Kazakhstan is ranked 77 among 189 economies. The World Bank. 2015. *Doing Business*. Washington, D.C.

<sup>9</sup> The function of budget policy, public and publicly guaranteed debt policy, and investment projects policy functions remain with the Ministry of National Economy.

corruption policy is operational and is regularly monitored by the authorities. Its impact on the reduction of corruption, however, is not monitored (footnote 2).

13. The government promotes a prosperous MSME sector as the major creator of employment and driver of inclusive economic growth and diversification of the economy. The National Development Strategy 2050 aims to increase the MSME sector's contribution to GDP to 50% by 2050, from about 20% in 2014. The government has adopted important measures to address the challenges faced by MSMEs. The publication *Accelerated Industrial-Innovative Development of Kazakhstan 2010–2015*<sup>10</sup> sets the general policy framework, while the *Roadmap for Business–2020*<sup>11</sup> promotes sustainable growth of entrepreneurship in rural areas. The Damu Entrepreneurship Development Fund (Damu) is the government agency in charge of executing the roadmap, and is tasked with MSME development functions. Under the business roadmap, the government provides financial support on market terms or in the form of interest rate subsidies and partial loan guarantees to MSMEs in priority sectors.<sup>12</sup> In addition, Damu provides significant support in the form of training, a call center to answer questions, and a website. As of September 2014 about T87 billion was provided under the roadmap program, which helped create about 60,000 new jobs.<sup>13</sup>

### C. ADB Sector Experience and Assistance Program

14. ADB has been providing technical assistance (TA) in the public management sector. TA for Capacity Building for Public Investment Programming<sup>14</sup> helped strengthen the institutional capacity of the government to develop and deliver the public investment program. TA for Public Information and Education in Support of Pension Reform<sup>15</sup> assisted in a comprehensive and targeted public education and information campaign to ensure effective implementation of the pension system. In 2013 the government and ADB established the joint Knowledge and Experience Exchange Program (KEEP),<sup>16</sup> which is designed to facilitate a range of strategic knowledge options and global best practice that will enable Kazakhstan to respond to current and emerging development opportunities and challenges. As part of the lending program, in 2009 ADB provided a \$500 million countercyclical support facility to help Kazakhstan to mitigate the effects of the global financial crisis on the economy. ADB is also providing tenge-denominated public sector lending through banks to small and medium-sized enterprises under its Multitranche Finance Facility Small and Medium-Sized Enterprise Investment Program. Improved access to finance will help drive investment, increase employment, and generate income for small and medium-sized enterprises, particularly those businesses located in regional areas and/or operated by women.

<sup>10</sup> Government of Kazakhstan. 2010. *The Accelerated Industrial-Innovative Development (AIID) of Kazakhstan 2010–2015*. Astana.

<sup>11</sup> Government of Kazakhstan. 2010. *Roadmap for Business–2020*. Astana

<sup>12</sup> Agriculture, light industry, furniture and construction material production, engineering, transport and storage, tourism, information and communication, scientific and technical work, education, public health and social services.

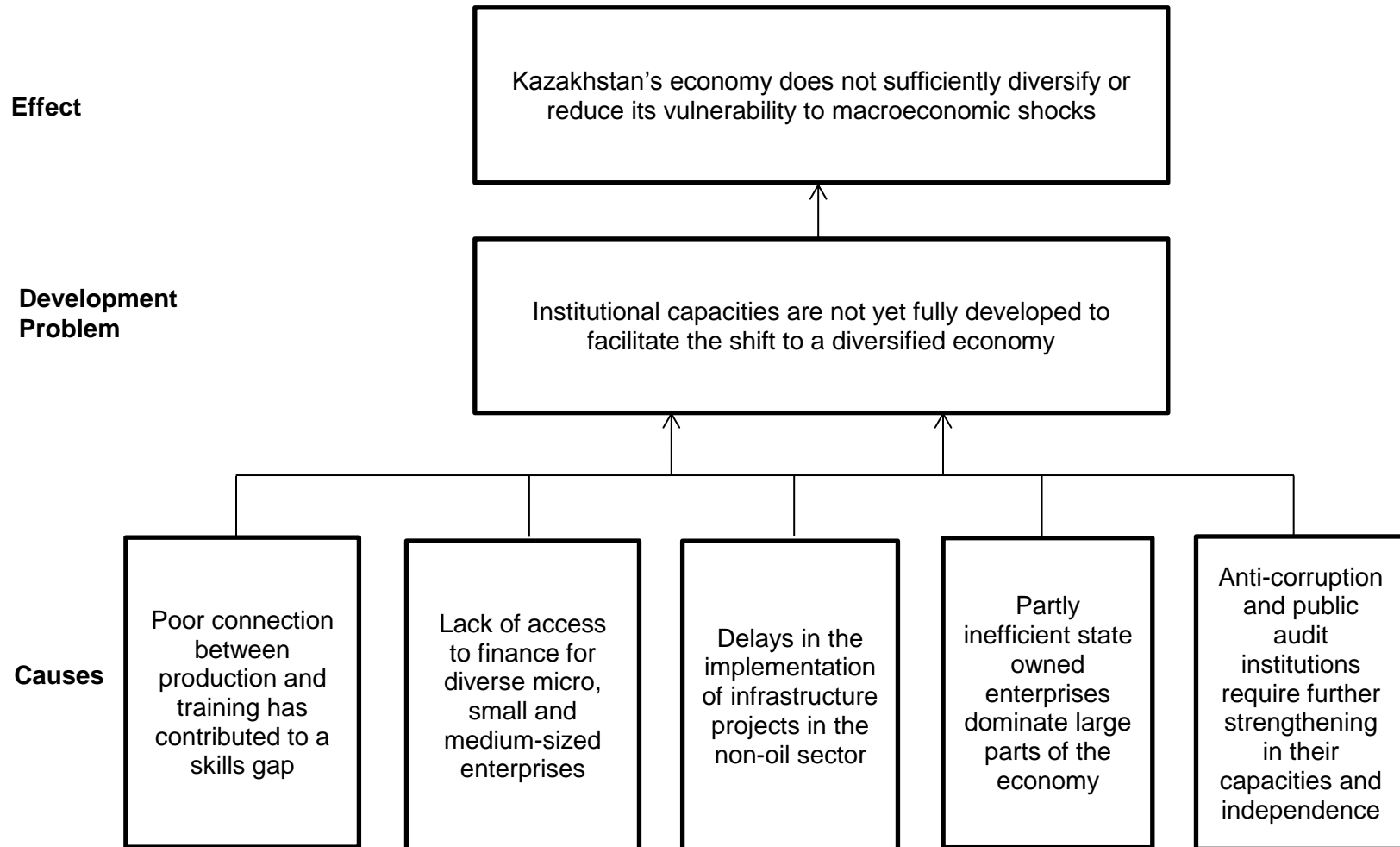
<sup>13</sup> The Entrepreneurship Development Fund Damu. 2014. *Progress Report on Business Roadmap 2020*. Almaty.

<sup>14</sup> ADB. 2000. *Technical Assistance to the Republic of Kazakhstan for Capacity Building for Public Investment Programming*. Manila.

<sup>15</sup> ADB. 1997. *Report and Recommendations of the President to the Board of Directors on a proposed loan and technical assistance grant to the Republic of Kazakhstan for the Pension Reform Program*. Manila.

<sup>16</sup> ADB. 2013. *Technical Assistance Report: Republic of Kazakhstan: Joint Government of Kazakhstan and the Asian Development Bank Knowledge and Experience Exchange Program, Phase 1*. Manila.

## PROBLEM TREE FOR PUBLIC SECTOR MANAGEMENT



### Sector Results Framework for Public Sector Management

Country Sector Outcomes		Country Sector Outputs		ADB Sector Operations	
Outcomes with ADB Contribution	Indicators with Targets and Baselines	Outputs with ADB Contribution	Indicators with Incremental Targets	Planned and Ongoing ADB Interventions	Main Outputs Expected from ADB Interventions
<p>Fiscal sustainability improved</p> <p>Increased private sector investment in industry and other key sectors of the economy to support higher GDP and employment</p>	<p>By 2016</p> <p>a. Budget deficit is reduced to 2.4% of GDP in 2016 (2014 baseline: 2.7%)</p> <p>b. Non-oil deficit is reduced to 7.0% in 2016 (2014 baseline: 7.7%)</p> <p>Unemployment levels remain below 5.0% in 2015 and 2016</p>	<p>Policies to improve diversification of the economy approved.</p> <p>Countercyclical employment generation programs of the government are sufficiently financed.</p>	<p>Contribution of MSME sector gross domestic product increased to 21.0% of GDP in 2016 (2014 baseline: 20.0%)</p> <p>Employment in MSME sector increased from 2.9 million people in 2014 to at least 3.1 million people in 2016</p> <p>Budget expenditures for social expenditures (education, healthcare, social assistance, and provision/social security and social aid) in percent of total expenditures are maintained or increased (2015 baseline: 39.1% of total expenditures)</p>	<p><b>Planned key activity areas</b></p> <p>Countercyclical Support Facility Lending (\$1 billion equivalent)</p> <p>MFF SME Tranche 3 additional financing (\$98 million equivalent)</p> <p>MSME enterprise support (\$200 million)</p> <p>MFF Financial Sector Development through ICT Enhancement Program (\$410 million, of which ADB will provide \$205 million and the government \$205 million)</p> <p>MFF SME Tranche 3 (\$228 million equivalent)</p> <p><b>Ongoing projects with approved amounts</b></p> <p>MFF SME Tranche 2 (\$122 million equivalent)</p>	<p><b>Planned key activity areas</b></p> <p>By 2016: SME loans by PFIs increased by T30 billion (baseline: tbd by PFIs at the time of loan signing)</p> <p><b>Ongoing projects</b></p> <p>By 2015: SME loan accounts opened by PFIs increased to 3,500 (baseline: 2,000 loan accounts in 2013)</p>

ADB = Asian Development Bank, GDP = gross domestic product, ICT = information and communications technology, MFF = multitranche financing facility, MSMEs = micro, small and medium-sized enterprises, PFI = participating financial institution, SMEs = small and medium-sized enterprises, tbd = to be determined  
Source: Asian Development Bank.