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**Fiscal Decentralization in  
Centralized States:  
The Case of Central Asia**

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## Content

Content.....	1
Abstract .....	v
Introduction.....	1
Chapter 1. Theoretical Considerations .....	2
Chapter 2. First insights.....	5
Chapter 3. Status Quo and Reforms in Administrative and Fiscal Decentralization .....	9
Chapter 4. Analysis of Expenditure assignment.....	15
Chapter 5. Analysis of Revenues assignment and Sharing .....	25
Chapter 6. Intergovernmental transfers/grants.....	32
Chapter 7. Sub-national debt/borrowing.....	41
Appendix A.....	43
Appendix B.....	46
References.....	49

## List of Tables

Table 1.	Major indicators of Fiscal decentralization in Central Asia .....	6
Table 2:	Kazakhstan: Share of local expenditures in the Consolidated budget* (%)	16
Table 3:	Kazakhstan: Structure of local budget expenditures* (%) .....	17
Table 4:	Uzbekistan: Share of local expenditures in Consolidated budget* (%) .	18
Table 5:	Uzbekistan: Structure of local budget expenditures* (%) .....	19
Table 6	Turkmenistan: Share of local expenditures in Consolidated budget (%) .	20
Table 7:	Turkmenistan: Structure of local budget expenditures (%).....	21
Table 8	Coefficient of variation of local per capita expenditures Kazakhstan* ..	23
Table 9	Coefficient of variation of local per capita expenditures Turkmenistan.	23
Table 10	Coefficient of variation of local per capita expenditures Uzbekistan* ...	24
Table 11	Structure of local revenues in Kazakhstan* (%) .....	25
Table 12	Structure of local revenues in Turkmenistan (%) .....	28
Table 13	Structure of local revenues in Uzbekistan* (%) .....	29
Table 14	Revenue shares for centrally assigned taxes* (Turkmenistan) .....	30
Table 15	Revenue shares for centrally assigned taxes* (Uzbekistan) .....	31
Table 16	Kazakhstan GDP per capita by oblast ( <i>indexes</i> ).....	33
Table 17	Uzbekistan GDP per capita by oblast ( <i>indexes</i> ).....	34
Table 18	Local Revenues of Turkmenistan by oblast (thous. manat per capita)	36
Table19:	Vertical imbalance structure.....	37
Table 20	Coefficient of variation of regional per-capita revenues by oblast .....	39
Table A1	Kazakhstan : Assignment of tasks to the local level.....	43
Table A2a	Uzbekistan: De-facto assignment of tasks in, According to the law "On the budget system" effective from 2001 .....	44
Table A2b	De jure assignment of tasks in <i>Uzbekistan</i> , According to the law "On budget system" effective from 2001 .....	44
Table A3	Turkmenistan: Assignment of tasks to the local level.....	45

## List of Figures

Graph1:	International Comparison of Fiscal Decentralization .....	5
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## **Abstract**

The resource-based Central Asian countries Kazakhstan, Turkmenistan, and Uzbekistan constitute a special case for fiscal decentralization. Political and administrative centralization is accompanied by the centralized administration of resource rents and weak governance structures on local levels.

Following best practices, fiscal decentralization is on the reform agenda in all three transition countries. As advocated in economic literature and indicated in empirical evidence, policymakers expect positive results on macroeconomic outcomes as well as on overall state governance. But the mechanism for the positive effects of fiscal decentralization is the creation of appropriate incentives by transferring information rights and authority to the local levels. How do the centralized states of Central Asia apply fiscal decentralization and what are the outcomes of their policies?

To answer this question, we analyze the progress of fiscal decentralization in Kazakhstan, Uzbekistan, and Turkmenistan since independence. In all three countries we observe high levels of fiscal decentralization. The de-facto institutional design of fiscal decentralization, however, is not appropriate to make incentive mechanisms work. Fiscal autonomy at the revenue and expenditure side is almost absent, and the transfer system lacks transparency and predictability. Administrative and political centralization are the drivers of this institutional design and create obstacles for the merits of fiscal decentralisation to materialize.

## **Acknowledgements**

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## **Introduction**

Economic literature generally favours a substantial degree of fiscal decentralization along the principle of subsidiarity. Tailoring outputs to local needs, fostering intergovernmental competition, experimentation and innovation in locally provided goods and services, and the promotion of efficient use of resources constitute the merits of fiscal decentralization. However, the merits will not realize unless fiscal decentralization is implemented together with administrative and political decentralization and strong governance-structures. Empirical evidence of transition countries shows how weak governance and limited political competition may create adverse effects of fiscal decentralization. However, the Chinese example demonstrates the fiscal decentralization can prove efficient in centralised states as well.

Against this background the resource-based Central Asian countries Kazakhstan, Turkmenistan, and Uzbekistan constitute a special case. Political centralisation is accompanied by the centralised administration of resource rents and weak governance structures on local levels. Fiscal decentralization is on the reform agenda. Following minor reforms of the fiscal sphere new Budget Laws came into force in all countries (Turkmenistan 1996, Uzbekistan 2001, Kazakhstan 2005). Recently these laws have been supplemented by laws on administrative decentralization. Soon they will be followed by the increasing of voter control. In Kazakhstan, formerly appointed regional governors are going to be elected starting in 2006, in Uzbekistan this is planned for 2006 or 2007. Even in Turkmenistan governors of smaller administrative entities will be elected during 2006/2007, and governors of regions in 2008. At the same time, democracy scores for all these countries show a clear downward trend and the economic dependency from revenues accrued in natural resource production grows. This casts doubt on the political willingness to transfer rights to the local level and the voters.

Under these circumstances, can fiscal decentralization in Central Asia constitute an efficient solution to fiscal and administrative problems? Do we observe real fiscal decentralization in these countries? How far do the Central Asia states follow the successful model of fiscal decentralisation in centralised China? To answer these questions, we analyze the quality of progress towards fiscal decentralization in Kazakhstan, Uzbekistan and Turkmenistan. Chapter I starts with insights from literature, Chapter II provides an overview on fiscal decentralization and major reforms in the countries under consideration. Chapter III is devoted to administrative decentralization. Chapter IV analyzes expenditure assignment. Chapter V describes the pace of revenue sharing and assignment, the effectiveness of the solution of vertical and horizontal imbalances is discussed in Chapter VI. Chapter VII is devoted to the sub-national borrowing in three countries.

## Chapter 1. Theoretical Considerations

Traditional economic theory generally is in favour of administrative and fiscal decentralization. According to Hayek (1945), better access to local information will improve the efficiency of providing public goods. Tiebout (1965) argues that competition among jurisdictions has a positive influence on the quality of public goods provision as citizens are able to “vote by feet”. Welfare can be increased if an appropriate assignment of taxes and responsibilities is chosen (Musgrave, 1959). A higher degree of decentralization is assumed to enhance the accountability of local governmental bodies (Oates, 1972). Underlying assumptions of these models include a benevolent state and benevolent state agents, factor mobility, and skilled human capital at the local level – conditions that will hardly be met in the Central Asian transitional economies.

Second generation theories of decentralization come closer to Central Asian reality and question the benevolence of government officials. They focus on the incentives created by decentralization. The seminal papers of Weingast (1995), Weingast/Qian (1997) and Qian/Roland (1997) on “Market preserving federalism” apply advances in the new theory of the firm to questions of decentralization. They argue that the appropriate decentralization of information and authority will limit the “state predation” problem (North, 1990) by setting positive incentives for individuals to take risk and make effort today. On the other hand, appropriate decentralization will reduce the “soft budget constraint” problem (Kornai, 1986) by setting negative incentives for officials for bailing out inefficient projects or firms. In both cases, the credibility of the central government’s commitments to the local level plays a decisive role. High transaction costs for central government intervention, e.g. the political costs of confiscating local tax revenues above the planned level, will be essential for this credibility. The experience of fiscal decentralization in China serves for illustrating incentive mechanisms through decentralization.

Based on both strands of theory, a growing albeit contradictory literature discusses the effects of decentralization on corruption and overall governance. Both indicators rank comparatively low for Central Asian countries and might get better via mechanisms of decentralization. If “voting by feet” can take place, decentralization will induce less corruption (Breton, A. 1996). In contrast, Shleifer and Vishny (1993) based on the theory of industrial organisation argue that decentralization may lead to an cumulative overgrazing of the bribe base, if the central government is too weak to control and punish lower levels of government. Tanzi (1995) adds from political economy, that decentralization under limited political competition causes a mutual dependence between local elites and inhabitants, which leads to an aggravation of corruption on the local level if decentralization is not controlled.

The discussion of effects on overall governance is similar. If local politicians will be punished by voters in case of mismanagement, fiscal decentralization is expected to improve overall governance (Seabright, P., 1995; Persson and Tabellini, 2000). This is rejected by Blanchard and Shleifer (2000), who point out the risks of local capture of political power (buying of political decisions by business and individuals) resulting from

the proximity of the involved parties. Contrasting Russia and China in a small model, the authors argue for strong political control and even political centralisation accompanying decentralization in countries with weak democratic institutions. This argument is based mainly on Riker (1964), who argued that the strength of the national party system is more important for controlling local politicians than administrative regulations or constitutional arrangements. Hence, in the centralised states of Central Asia, we should generally expect a positive influence of fiscal decentralization on corruption and governance.

The empirical literature on effects of decentralization produced highly mixed results. Relating decentralization to growth, cross-country studies in general support the existence of positive effects of fiscal decentralization (Huther and Shah, 1996). Studies examining developing countries apart find no links between decentralization and growth (Woller and Philipps, 1998), and some even report a slightly negative relationship (Davoodi and Zou 1998). Single-country studies for China show positive (Lin and Liu, 2000) as well as negative (Zhang and Zou, 1998) relationships.

Regarding corruption and governance, one finds more consistent results in cross-country-studies. Fisman and Gatti (2002) as expected observe a strong negative relationship between fiscal decentralization in government expenditure and corruption. However, corruption and governance deteriorate, if the reliance on the local revenue base exceeds a certain level, local capture being the most probable explanation (de Mello/ Barenstein, 2001). These somewhat contradictory results illustrate the problems of the measurement of fiscal decentralization, discussed by Ebel and Yilmaz (2002). Linking fiscal decentralization and political institutions by testing Rikers theory, Enikopolov and Zhuravskaya (2003) find out, that weak parties worsen the effect of fiscal decentralization. Most interesting, their results show positive effects of centrally appointed versus locally elected local politicians on overall growth and quality of government.

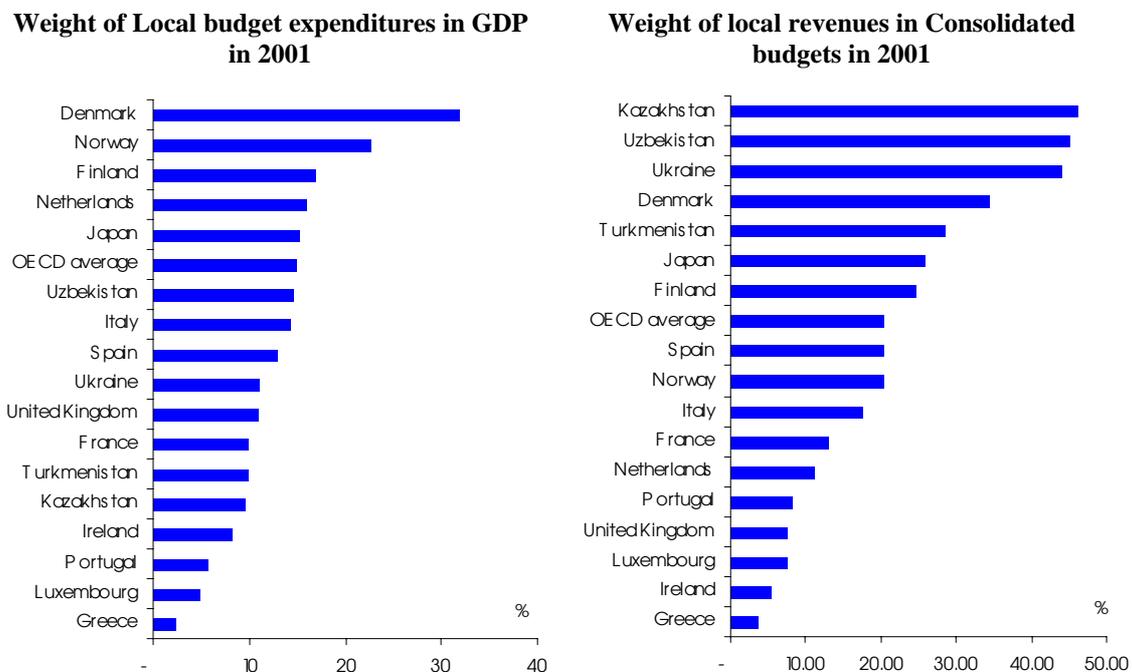
Empirical research on fiscal decentralization in post-soviet transition countries so far is restricted to Russia and an empirical testing of the incentive-mechanisms. Using panel data from 2118 Russian municipalities, Slinko (2002) shows, that regional disparities increased with fiscal decentralization, because delayed enterprise restructuring and lacking market institutions hampered the positive results of better incentives on the local level. Timofeev (2002) tests this effect of decentralization on soft-budget-constraints of local enterprises using panel data of 72 Russian regions from 1995-1997. His results demonstrate, that only retained taxes grant for less subventions, whereas decentralization via increased transfers or shared taxes worsens soft budget constraints substantially. Desai, Freiman and Goldberg (2005) extend this relationship to regional growth indicators using a comparable data set and produce similar results. Resource-rich rentier regions as well as extremely poor regions are identified as vulnerable because of their "unearned income streams" who limit the positive possible effects of fiscal decentralization. On the other hand, Zhuravskaya (2000) by analyzing Russian panel data from 1992-1997 shows that expansions of the local tax base were almost entirely offset by reduced central transfers in the following year. This ratchet effect clearly creates no incentives on the local level.

As for Central Asia, several conclusions can be drawn for our analysis of fiscal decentralization. First, the assumptions of traditional theories are too restrictive on the background of the countries under consideration. Decentralization per se cannot guarantee positive effects, as empirical studies show. Second, according to new theory it is the appropriate design of decentralization that matters. Only if information and authority are transferred to local levels and the credibility of the central government is sufficient, incentives mechanisms will work. Empirical evidence especially from Russia illustrates some pitfalls of fiscal decentralization. Hence we should consider not only quantitative indicators, but the quality of decentralization. Third, if strong democratic institutions and high factor mobility are missing, fiscal decentralization should be accompanied by strong political control to induce a positive influence on growth and governance indicators. Centralised states per se are not harmful to the merits of fiscal decentralization, as the example of China demonstrates. In rentier regions, incentive mechanisms of fiscal decentralization may be reduced. Again, it is the quality and the design of decentralization that plays a decisive role.

## Chapter 2. First insights

An international comparison of the status quo of decentralization indicators as presented in Graph 1 may lead to the conclusion that fiscal decentralization in Turkmenistan, Kazakhstan, and Uzbekistan is comparable with OECD countries. In 2001 the expenditures of local budgets of Turkmenistan, Kazakhstan, and Uzbekistan constituted 10%, 12%, and 15% of GDP respectively, which is comparable with OECD countries whose average weight of local budgets in GDP at this time constituted 14.9%. The weight of local budget revenues without transfers in the consolidated budget for the year 2001 in Turkmenistan constituted 29% which is slightly below the OECD average indicator of that year (32%).

Graph1: **International Comparison of Fiscal Decentralization\***



Source: OECD Economic outlook 2004: Fiscal relations across levels of government; Ministries of Finance (MoF) of Turkmenistan, Kazakhstan, Uzbekistan, Ukraine, own calculations.

Note: \* revenues and expenditures were taken net of intergovernmental transfers.

At the expenditure side, the picture of high indicators of fiscal decentralization is valid for the whole period of fiscal reforms in all three countries (Table 1). In Kazakhstan, the weight of local expenditures in GDP during fiscal reforms has increased from 7% in 1997 to 11% in 2004. Turkmenistan's ratio of local expenditures remained nearly unchanged in comparison to 1995 and constituted 10% for 2003. Uzbekistan's local expenditure to GDP decreased gradually from 18% in 1997 to 14% in 2004. The importance of local government expenditures in total state expenditures has even increased in Ka-

zakhstan and Turkmenistan in comparison to the 90<sup>th</sup> (up to 49% and 51% respectively), while for Uzbekistan the weight of local budget expenditures varies within the range of 51-56% for the last 7 years.

Table 1. **Major indicators of Fiscal decentralization in Central Asia**

	1995	1997	1998	1999	2000	2001	2002	2003	2004
Weight of State (consolidated) budget expenditures in GDP									
Kazakhstan	26	20	22	23	23	23	21	22	22
Turkmenistan	20	-	-	-	24	22	17	19	-
Uzbekistan	33	32	33	31	29	27	26	25	26
Weight of local expenditures in GDP									
Kazakhstan	-	7	9	11	12	12	10	11	11
Turkmenistan	9	-	-	-	11	10	9	10	-
Uzbekistan	-	18	17	17	15	15	14	13	14
Weight of local expenditures w/o transfers in GDP									
Kazakhstan	-	5	7	9	10	11	8	8	8
Turkmenistan	7	-	-	-	6	6	5	5	-
Uzbekistan	-	15	13	15	13	12	12	10	12
Weight of local expenditures in state budget									
Kazakhstan	-	34	41	46	50	52	48	48	49
Turkmenistan	43	-	-	-	47	45	49	51	-
Uzbekistan	-	56	51	54	52	55	55	53	55
Weight of local revenues w/o transfers in state budget									
Kazakhstan	-	23	36	47	44	47	36	38	36
Turkmenistan	35	-	-	-	26	29	27	29	-
Uzbekistan	-	55	48	51	45	45	45	41	43

Source: Own calculations based on WDI 2005, MoF of Kazakhstan, Turkmenmillichasabat (2005) "Decentralization of state governance and local self-government development in Turkmenistan", mimeo based on the data of Turkmenistan MoF, Nutridinov, Haydarov (2005) "Fiscal decentralization in Uzbekistan", Tashkent, mimeo

At the revenue side signs of increasing fiscal centralisation can be found. With respect to local budget revenues without central transfers during reforms, for Kazakhstan this indicator has decreased from 47% in 2001 to 36% in 2004. For Uzbekistan this ratio also decreased from 45% in 2001 to 43% in 2004 however remained far above OECD average. For all three countries any decline in the level of other than transfer

revenues in local budget funding after 1999 was compensated with a rise in intergovernmental transfers. This development may be explained by the fact, that centrally assigned tasks have been transferred to the local level. But it also implies a more limited scope of own responsibilities and a lack of autonomy for the regions.

In Central Asia these widely accepted measures of fiscal decentralization do not tell the true story. As further analysis will show, de facto levels of fiscal decentralization in all three countries are considerably lower than in the OECD area. A highly autocratic governance manner, non-transparency of fiscal operations, and discretionary distribution of revenues are only some of the reasons for qualitative distortion of the usual decentralization indicators.

The existence of extra-budgetary centralized funds mostly fed by resource rents adds a substantial quantitative distortion to the indicators. For two reasons this distortion will not be corrected for in this paper: First, the amounts of extra-budgetary funds can be estimated in Kazakhstan and, on far less secure grounds in Uzbekistan, but have to be guessed in Turkmenistan. Second, we aim at a qualitative evaluation of fiscal decentralization. In case of centralized funds, mostly under direct presidential control, the legal influence of local levels on their spending is zero, whereas the real influence based on personal ties, lobbying, extortion or bribing is hard to access.

### **Characterizing the starting points**

The collapse of the USSR led to a substantial worsening of the fiscal situation in the countries under consideration. During Soviet times, Turkmenistan, Uzbekistan, and Kazakhstan received substantial transfers from Moscow<sup>1</sup>. After the breaking up of the Soviet Union these transfer-dependent countries had to cope with a simultaneous collapse of incomes caused by transformation recession, and the unexpected need to finance expenditures stemming from the crash of the labour market and the social systems<sup>2</sup>. The fiscal imbalances led to debt accumulation, non-payments in the state sector and the accumulation of tax arrears, especially in value-added tax (VAT). Inefficient and not legalized institutional settings like mutual settlements between different tiers together with tax offsets began to establish and imposed a heavy burden on future fiscal reforms.

All FSU countries inherited the Soviet system of intergovernmental financing, often named as “Russian doll” model. The relationships between Moscow and the 15 republics were taken as a model and replicated in the republics at all levels of the govern-

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<sup>1</sup> For instance, after the break-up in 1992, Uzbekistan lost 18% of his GDP in kind of transfer from Moscow. Transfers from USSR budget to Kazakhstan constituted nearly 14% of GDP in 1990 (Source: The Economist (2003) “Kazakhstan: country profile”, *Economist Intelligence Unit*, Y 40251, pp. 30 //www.eiu.com.)

<sup>2</sup> Social spending obligations of local governments had to be increased due to release of state-owned enterprises (SOEs) from “objects of social infrastructure” that provided local infrastructure services in soviet times (for instance roads, heating, electricity, sewerage, health services, etc.). The states also had to finance pension systems.

ment. The negative elements of this system include a lack of local autonomy, a poor legislative basis of fiscal transactions, a high level of intended non-transparency, and excessive equalization between regions. The budgetary process and public administration were conducted within the framework of dual subordination of central and local governments and a general uncertainty concerning the responsibilities of different tiers. Although the expenditures assignment seemed appropriate, it lacked explicit rules for implementation. Expenditure needs in the FSU were determined by the application of quantitative expenditure norms that were not oriented towards ex-post audit and thus hampered local autonomy.

Concerning the revenue side, the local government had little autonomy as well. Revenue-formation of local levels was mainly based on shared revenues from turnover, enterprise profit tax (EPT) and progressive personal income tax (PIT) collected directly from state-owned enterprises according to the registration principle<sup>3</sup>. The latter source of revenues was dwarfed by the wage ceilings essential for revenues collections due to the high share of public sector in the economies

Different kinds of direct and indirect subsidies provided on ad-hoc gap-filling basis and supplemented by soft budget constraints and mutual settlements served for solving issues of vertical and horizontal imbalances. During budgeting, the called amounts were cut according to the revealed revenue capacity of the regions. This made it impossible for local governments to plan and execute their budgets efficiently. Due to the lack of legislative provisions, bargaining became an integral part of the budget process. The outcome to a great extent depended on the political influence of the head of a particular oblast and his personal ties to upper levels of the government. In general, the system of tax sharing, subsidies and transfers was non-transparent, incompatible with the principles of predictability and stability, and created an adverse incentive structure at the local level.

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<sup>3</sup> the registration principle implies that the tax is collected according to the place of the official registry of the enterprise

## Chapter 3. Status Quo and Reforms in Administrative and Fiscal Decentralization

### Kazakhstan

*Status Quo:* The Constitution of the *Republic of Kazakhstan* adopted in 1995 laid the foundations for upcoming administrative reforms. It defines Kazakhstan as an unitary state with a strong position for the President and two houses of parliament. The local administration consists of elected local self-administrative bodies *Maslikhates* who should represent the interests of the population and define measures that are necessary to defend these interests, and appointed by the president local executive bodies *Akimates*, responsible for the social and economic development of the respective territory and subordinate to state organs. *Akym*s of regional and district level de jure could be dismissed by a 2/3 majority of the *Maslikhat*. In practice the country lacks democracy and law enforcement. President Nazarbayev has headed the country since independence and strengthened his power via frequent amendments to the Constitution<sup>4</sup>. The legislative provisions that allow the execution of local government de facto are not applied<sup>5</sup>. The *Maslikhates* function without own budgets and enjoy no fiscal autonomy.

The administrative territory of Kazakhstan is divided into three tiers: 14 oblasts plus two cities with special status (Astana and Almaty), 160 regions and 79 cities that have status of a region, and villages (200 villages and 2150 village districts). Local budgets and the budget of the Republic function independently and after consolidation represent the state budget. De jure, all administrative tiers are involved into the process of budgeting. De-facto and de jure the local governments lack the power to set up their budgets. The MoF determines revenues and expenditures of the budget by applying norms for expenditures. The local budgets formally are to be approved by the respective *Maslikhates* once the republic level budget is approved and the volume of intergovernmental transfers is set. Local budgets execution reports are to be published quarterly in the press. An auditing commission of the local *Maslikhat* should conduct control over the local budget execution.

*Administrative Decentralization:* In fact the country has undertaken several measures to strengthen the power of local levels via legislation. Major legislative acts concerning these questions are the laws "On the budget system"(1991) and "On local representative and executive bodies of Republic of Kazakhstan"(1993). These laws empowered local representatives to decide on subnational budgets and to control the use of their funds. They announced subnational budgets as independent, and prohibited the interference of the higher governmental levels. In fact the laws failed to define the division of tasks between oblast and rayon levels as well as between center and regions. According to the

<sup>4</sup> Economist Intelligence Unit (2003) "Kazakhstan: country profile", Y 40251 //www.eiu.com

<sup>5</sup> For example, the right to dismiss *Akym* has never being executed by any *Maslikhat*. Source: RGP Institute for Economic Research (2005) "Fiscal decentralization in Kazakhstan" Almaty, mimeo

1995 Constitution within two years the law on local self-governance should have been adopted. However, the legislative loop-hole has not been filled yet, the law is still in the drafting process. Other major legislative acts of these times aiming at decentralization were the laws “On the system of local representative and executive bodies under the circumstances of administrative and territorial settings”, and the law “On the budget system” (1996). At the same time however the President was successful in further strengthening his central power with the approval of the Order “On the governance of the Republic of Kazakhstan” that had the power of a Constitutional law. Only in 2001 the new law “On Local state administration in the Republic of Kazakhstan” was adopted. This law set major definitions, tasks, requirements, and limitations for local representative and local state executive bodies. In the same year, in 28 districts experimental elections of *Akym*s took place.<sup>6</sup> Till now, however, formal decentralization is counter-vailed by the centralization of power at the presidential and ministerial level.

*Fiscal Decentralization:* The history of fiscal reforms is comparable to that of administrative reforms. The year 1995 saw a major tax reform towards international standards with the adoption of the law “On taxes and non-tax payments” (1995). The number of taxes was reduced from 50 to 11. The law also changed the major tax rates and defined local taxes. But once again the central government retained substantial power in the settings of these local taxes and the independence of local budgets did not increase to a substantial level. The new law “On the budget system” (1999), brought several innovations for intergovernmental relations. First, the law eventually provided the legislative basis for the division of tasks among different levels of government. Second, the local budgets have been assigned new significant revenue sources in the form of a social tax. Third, more responsibilities were pushed down to the local level. Fourth, extra-budgetary funds were incorporated into the budget. Fifth, the system of dotations and withdrawals was introduced. The new Tax Code 2002 and the Budget Code 2004 once again reformed the local revenues and modified local borrowing regulations. The Budget Code clarified rules of local budget drafting, established a unified budget classification, and explicitly assigned the tasks among second and third government tiers. The law contains provisions that favor more openness and transparency of public finance. Transfers without formula basis were defined for the period of 3 years (instead of one), and the principle one tax for one budget was set. Extra-budgetary funds do not exist any longer. However, the Oil-stabilisation fund, established in 2001 and fed by rents from natural resource extraction, continues to grow to substantial amounts and constitutes a shift towards the centralization of financial resources.

## **Turkmenistan**

*Status Quo:* According to the constitution, Turkmenistan can be defined as a democratic and presidential republic. De jure the power is divided into executive, legislative repre-

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<sup>6</sup> Public Policy Research Center (2004): “Razvitie mestnogo samoupravlenija. strategiceskie voprosy., Policy studies No. 2, Almaty, June 2004

sented by the *Khalk Maslakhaty* (peoples' council) and judicial power. On the local level, the executive powers rest in the hands of the *hyakims*, who are assigned and dismissed by the President<sup>7</sup>. Local self-governance is carried out by the so-called *Gengeshes* (peoples councils), elected for the term of 5 years and governed by the *Archyn* (mayor), is elected by and accountable to the members of *Gengesh*. The *Gengesh* should define the major guidelines of the social and economic development, approve the budget and the report on its execution, supervise the local tax administration, etc. The relations and division of responsibilities between *hyakims* and *Gengeshes* are defined by legislation. De-facto the local councils enjoy no autonomy or decision-making authority; the life-long President Nijasow concentrates the power in an autocratic manner upon himself<sup>8</sup>.

The territory of Turkmenistan is divided into five oblasts (velayats), and further into rayons and etraps. The budgetary system of Turkmenistan is represented by the Republican budget that formerly also incorporated the state targeted funds and local budgets. The *Gengeshes* are also allowed to create extra-budgetary funds. Local budgets include the budgets of oblast level, the budgets of cities of republic subordination, the budgets of rayons, and the budgets of cities of rayon subordination, settlements, and villages.

*Administrative Decentralization:* The legislative basis for the administrative decentralization was mainly elaborated in the mid-nineties. The laws "On the Cabinet of Ministers of Turkmenistan" (1995) and the law "On Hyakims"<sup>9</sup> (1995) define the foundations of these bodies and set their areas of responsibility and relations with the other government bodies. However, the legislation fails to define the procedure of responsibilities assignment. The constitutional base of the local self-governance (The law "On Gengesh") was developed only in 2003. In spite of formal administrative decentralization, a process of de facto administrative centralisation can be observed. Local hyakims are appointed and dismissed by the president in shortening intervals of time with and without reasonable explanations. Under these circumstances, competition among regions and incentives on the local level do not play a role. The effective legislation contains provisions that do not form grounds for independency of the local government formation<sup>10</sup>.

*Fiscal Decentralization:* As in Kazakhstan, fiscal decentralization has been on the reform agenda for several years. During 1991-1993 major shared taxes such as VAT, PIT, and EPT were introduced and reformed. A resolution of the President set an exhaustive list of local taxes. The Law "On the budget system" was introduced in the year 1996, but its provisions poorly addressed the issues of fiscal decentralization. Its contribution to the clarity of tasks was very moderate. The problem of vertical imbalance was tried to

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<sup>7</sup> There are 6 hiakims of velayats, 47 hiakims of etraps, 7 hiakims of city subordination etraps, and 12 hiakims in the cities of velayat subordination.

<sup>8</sup> The Economist (2003) "Turkmenistan: Country profile", *Economist Intelligence Unit*, Y 38183 p. 31 //www.eiu.com; in fact, Turkmenistan constitutes one of the strictest dictatorships in the world

<sup>9</sup> Hyakims are representatives of the President at the local levels

<sup>10</sup> Local representative assembly in Turkmenistan, *Economist Intelligence Unit* (2003) "Turkmenistan: Country profile", Y 38183, pp. 31 //www.eiu.com

be solved with non-transparent methods such as revenue sharing and non-formula based transfers. The tax reform of 2000 allowed a reduction in the number of the numerous local taxes with little revenue potential. This decision was secured by law only in 2004 with the approval of the Tax Code 2004. However, for the local budgets these reforms implied only a marginal increase in revenue autonomy and hence did not contribute to predictability and stability of local revenues.

The existence of extra-budgetary funds aggravates the de facto centralization of the fiscal sphere. Although in 1994 all extra-budgetary funds were incorporated into the budget, in the years 1996-2000 Turkmenistan has developed a complicated system of state-purpose funds<sup>11</sup>. Although these funds once again became part of the consolidated budget in 1998, they are governed in a non-democratic manner solely depending upon decisions of the President. In addition to these official funds several unofficial and unreported presidential funds serve the purpose of accumulating rents from resource extraction.

## **Uzbekistan**

*Status Quo:* The administrative reforms in Uzbekistan started with the adoption of the Constitution (1992), which defined three branches of power and three administrative tiers. As in the other Central Asian countries, the President has been provided with substantial competence. Structure and responsibilities of local governments are fixed in the law “On local State governance” (1993). In 1996 the President undertook some steps towards re-concentration and eliminated the administrations of cities of district subordination. The state representative body in oblasts, rayons, and cities is the council of peoples deputies headed by the *hokim*; both de jure are in duty for a term of 5 years. Oblast level-*hokims* and the *hokim* of Tashkent city are assigned and dismissed by the president, *hokims* of rayons and cities are assigned and dismissed by higher-level *hokims*. In practice, *hokims* on all levels do not stay in duty the whole term, but depend on presidential ad-hoc decisions. In 1995, President Karimov was successful in strengthening his power and prolonging his term of presidency from 5 to 7 years. Due to political turmoil and outbreaks of violence in the capital and the Ferghana valley during the last years, in spite of further decentralization measures a substantial tightening of political control and concentration of power can be observed. The local governors or *hokims* that concentrate local decision-making are in fact part of the system of the president.

In Uzbekistan, the traditional institutions of citizens’ local self-governance, the so-called *mahallas*, play a special role and supplement the system of local state bodies. The *mahalla* itself comprises a regional district with not more than 5000 inhabitants. The

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<sup>11</sup> 1996 The State fund of development of Agriculture;  
1999 The State Fund of development of Ashgabad  
1998 The State fund of development of health care in Turkmenistan  
2000 The State Fund of golden century development of Turkmenistan

administrative organ of this district is called *mahalla* committee or only *mahalla*. This institution represents a non-government non-profit organization, which traditionally served as a link between an individual and the rest of the world and performed the function of a self-governmental body.<sup>12</sup> Unlike in other Central Asian countries *mahallas* were formalized in Uzbekistan and assigned certain governmental functions<sup>13</sup>. The citizens' representatives of the *mahalla* select their executive bodies (head, advisors, commissions) themselves. On average about 25 inhabitants of one *mahalla* are engaged in self-governance<sup>14</sup>. However, with respect to decentralization, the local self-government in Uzbekistan is rather limited. In fact it performs the given policies of formal executive structures that oversee the execution of administrative orders by higher tiers.<sup>15</sup>

Uzbekistan is divided into 12 provinces, the city of Tashkent and autonomous republic Karakalpakstan. The system of local state executive bodies includes oblast, rayon, and city *hokimiyats*. The budgetary structure is represented by independently functioning local and republican budgets, the budget of the republic of *Karakalpakstan*, and state targeted funds. The local budgets also include budgets of rayons, cities, and oblasts. Budgets of rayons include rayon budgets and budgets of rayons of city subordination. The consolidated state budget is prepared by the MoF based on norms of expenditures and approved by the Parliament. After the state budget is centrally approved, the respective *hokimiyats* and other key spending units are informed about major parameters of the budget. The representative local governmental bodies approve the local budget and report on their execution. The structure of fiscal decentralization implies a dual link between local governmental bodies and central financial bodies. *Mahallas* serve as a link between the state and the recipients of aid.

*Administrative Decentralization:* Since 1996 little attention was paid to administrative decentralization. The only exception relates to the new law on local self-governance of citizens (1999) that increased the formal role of the *mahallas*. They became responsible for the delivery of allowances to non-working mothers of children under two years age and foodstuff to single pensioners. However, the *mahallas* have no access to autonomous financial resources. During 2002-2004 attempts towards governmental reforms were undertaken. In 2002, the President addressed a commitment to the Parliament (*Oliy Majlis*) aimed at de-concentration and gradual transfer of central powers and functions to lower state bodies and citizens' self-governance. However, the latter did not bring any concrete result yet.<sup>16</sup> In 2003 some re-concentration took place via incorporation of the urban district into the respective city *hokimiyat*. In the year 2003, new law "On the Cabinet of Ministers of the Republic of Uzbekistan" was adopted. Uzbekistan made sub-

<sup>12</sup> Traditional functions of mahallas include maintaining of social order, provision of aid, mediation of property disputes, dealing with family issues, and etc.

<sup>13</sup> However, it cannot be treated as an institution of local self-governance in a classical way. For instance, they have no access to autonomous financial resources stated by legislation.

<sup>14</sup> However, only two of them receive salary from the local budget. The rest are the volunteers.

<sup>15</sup> Nutridinov, Haydarov (2005) "Fiscal decentralization in Uzbekistan", Tashkent, mimeo

<sup>16</sup> Peter Epstein and Matthew Winter (2004): "Assessment of Intergovernmental Relations and Local Governance in the Republic of Uzbekistan". The Urban Institute, Washington, February 2004, p. 37

stantial steps towards reducing the number of government officials that also had implications for the structure of local representative bodies. Currently, Uzbekistan is on its way towards implementing a treasury, which would constitute a certain element of control of the fiscal process.

*Fiscal Decentralization:* Reforms in the fiscal sphere have been substantial. The mid-nineties were the times of establishing the tax system. The Tax Code (1997) and the structure of the Tax service (1997) were set. The Tax Code defined the list of local taxes and made the Cabinet of Ministers responsible for developing procedures for the calculation of local taxes and fees and their payment into the budget. Two important revenue sources (property tax and land tax) were defined as local taxes. At the time the Law “On the Budget system” (1999) replaced the soviet-time law “On the budgetary right of Republic of Uzbekistan and local councils of workers of the Republic of Uzbekistan”, major budgetary reforms were started. The legislative base for formation, allocation, and execution of budgets, and a (not sufficiently detailed) assignment of tasks to local government was set. However, this law mainly concerned the state and republic level budgets, provisions on the local budgets were scarce. Only in 2001 the order of the Cabinet of Ministers of Uzbekistan stated more detailed rules on the procedure of the compilation and the implementation of the state budget, as well as on the consideration of local budgets. Provisions in relation to an external budget audit were set in 2002.

To sum up, three facts characterize the decentralization process in the countries under consideration: First, administrative and fiscal decentralization proceeded with different pace, the latter progressing quicker. Second, provision and implementation of laws concerning decentralization differ a lot. Due to the lack of democracy in the administrative sphere this gap in the administrative sphere is wider than in the fiscal sphere.<sup>17</sup> Third, local self-governance as an element of political decentralization in spite of distinctive laws does not play a role. From three facts, it can be concluded that decentralization in the fiscal sphere in all countries is hampered by lacking administrative decentralization. As long as local budgets are compiled on centrally defined parameters and not on actual costs and local needs, fiscal decentralization is merely formal.

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<sup>17</sup> Evidence suggests that elections at all levels are highly falsified and often manipulated

## **Chapter 4. Analysis of Expenditure assignment**

A proper expenditure assignment is the first step for efficient decentralization. The clear assignment of governmental tasks allows avoiding a populist inspired discretion of local authorities. In general, the expenditures assignment for an efficient provision of public services should correspond with the principles of subsidiarity, territorial equivalency, economies of scale and the consideration of externalities.

These general principles of good fiscal decentralization imply that tasks of national dimension like defence, public order and justice, foreign relations, and tasks of education and health care of national importance should be assigned to the central level due to their spillover effect. Social redistribution tasks should be financed at the expense of central budget due to disparities in and possible inverse correlation of expenditures needs and the revenues base. On the local level, the provision of utilities and general education and health care services in proximity to the consuming population can improve the welfare of the population. Economic affairs tasks generally are to be accomplished by the central government, since sub-national governments are too small to finance and administer them efficiently.

In centralized states a political reluctance to assign tasks to the local level is inherent. Tasks with higher autonomy in spending, e.g. the carrying out of economic activities, tend to stay with the central government. Tasks with little spending autonomy like health, education and social protection can be transferred to the local level without losing control over their spending, especially if their volumes depend on centrally set standards.

### **Kazakhstan**

The legislative basis of expenditures assignment in Kazakhstan was brought about by the budget reform of 1999 (see Annex I, Table I.1). Previously, the division of tasks at the local level was not defined; the structure of expenditures at the lower level was subject to frequent changes and bargaining. For instance, in some oblasts schools were financed from the oblast budget while in others they were financed from the rayons' budget.<sup>18</sup> In 1999, the general clarification of assignment rules and budget transparency was improved by the incorporation of extra-budgetary funds that previously obscured the fiscal decision-making at all levels. The responsibilities of local budgets have been enlarged. According to the principle of territorial equivalency local governments became responsible for tasks like the construction and maintenance of roads and streets of local importance. However, some changes in the budget reform were arguable from the point of effectiveness of fiscal decentralization. For instance, as a result of the reform, the local government became responsible for provision of unemployment benefits and tar-

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<sup>18</sup> M. Mahmutova (2003) "Division of expenditure tasks between levels of budget system in Kazakhstan", Kazakhstan Institute of Management project research materials, p. 5)

geted social assistance payments, imposing a high administrative and fiscal burden to poorer regions.

The structure of local expenditures in 1998 shows that the general principles of subsidiarity were upheld even before the reform (Table 2). National dimension tasks such as defense and general public services were mainly assigned to the central government level. The share of economic affairs tasks (e.g. fuel and energy sector, agriculture) assigned to the local budgets seems substantial, but its weight in total local expenditures is tiny, which means local budgets do not have room for maneuver in this sphere. During the period of 1998-2004, the role of the local budgets in financing education and health care has increased from 78% to 88% and from 70% to 80% respectively. The share of social protection tasks financed at the expense of local budgets fell from 29% in 1998 to 7% in 2004. After 1998, when the extra-budgetary funds were eliminated, the Republican (Central) budget had to finance all the pensions on a pay as you go system, as well as categorical benefits and social allowances, while the local budgets had to finance poverty-related social assistance payments.

**Table 2: Kazakhstan: Share of local expenditures in the Consolidated Budget\* (%)**

	1998	1999	2000	2001	2002	2003	2004
General public services	21	31	30	30	28	32	26
Defense	14	17	20	18	18	15	17
Public order and justice	25	23	24	22	21	19	21
Education	78	83	84	81	86	88	88
Health-Care	70	81	86	78	83	83	82
Social protection**	84*	12	12	16	18	17	15
Utilities	100	100	100	100	100	100	98
Culture	45	74	73	68	64	62	65
Fuel and energy sector						14	43
Agriculture and hunting	19	17	23	14	13	16	13
Industrial construction	68	10	7	21	24	64	50
Transport	-	71	58	41	29	32	33
Other	34	39	71	54	83	73	53
Debt service		1	1	2	2	3	3
Total expenditures	41	46	50	52	48	48	49

Source: Own calculations based on data from MoF of Republic Kazakhstan

Note: \* The calculations do not take into account extra-budgetary funds.

The legislation that regulated intergovernmental relations was upgraded in 2005 with the approval of the new Budget Code. The latter provides a more detailed assignment of tasks assignment (e.g. it listed all types of social welfare payments that should be financed at the expense of local budgets). More importantly, the Budget Code of Kazakhstan defined the redistribution of tasks at lower than oblast levels of government such as rayons, cities, and re-assigned more social aid provisions to the central level of the government.

Table 3: **Kazakhstan: Structure of local budget expenditures\* (%)**

	1998	1999	2000	2001	2002	2003	2004
General public services	4	4	3	4	3	5	4
Defense	2	1	1	1	2	2	2
Public order and justice	5	4	4	4	4	4	4
Education	35	30	23	22	28	28	27
Health-Care	12	17	15	12	16	16	18
Social protection	29	9	7	8	10	9	7
Utilities	3	3	7	8	7	7	11
Culture	3	4	4	3	4	4	5
Fuel and Energy sector	-	-	-	-	-	-	1
Agriculture and hunting	1	1	1	1	1	1	1
Industrial construction	1	-	-	-	-	1	-
Transport	-	4	7	5	4	6	6
Other	5	5	7	8	8	6	4
Debt service	-	-	-	-	-	-	-

Source: Own calculations based on data from MoF of Republic Kazakhstan

Note: \* the total expenditures are net of transfers

## Uzbekistan

Uzbekistan so far shows little progress concerning the legal assignment of tasks among different budget levels according to the principles of clarity and subsidiarity (Annex I, Table I.2 a and b)<sup>19</sup>. The provisions of the budget legislation enforced in 1999 failed to assign several tasks even at the centre-oblast level, and even in relation to tasks like de-

<sup>19</sup> Center for Economic Research (2004) "The major directions of reforming the government at the local level" (in Russian) CER Report 2004/05, Tashkent, p. 17

fence and public order<sup>20</sup>. Expenditures of authorities below the oblast levels are still not assigned at all. In general, the budget reform implied an extension of local government responsibilities. The responsibility for some social aid provision was transferred down from the central to the local level. This aid is financed out of district budgets and administered through the *mahallas* to guarantee an optimal targeting. Although this aim seems to be reached,<sup>21</sup> in autocratic states the system obviously bears the risk of setting wrong incentives on the local level and is reportedly misused for political control.<sup>22</sup>

As stated earlier, the weight of local expenditures in the consolidated budget of Uzbekistan is quite high and has varied within the range of 51-56% for the period of 1996-2004 and constituted 54% in 2004 (Table 4). Disaggregated data corroborate the assumption, that albeit high indicators of decentralization, local levels in fact do not have substantial financial scope for own policies. The share of social sphere expenditures that include education, health-care, social welfare, culture, and sport expenditures financed from local budgets rose from 79% in 1996 to 84% in 2004. Its weight in local expenditures in the same period increased from 51% to 63% (Table 5). The same trend can be observed for social protection. 88% of all social protection expenditures have been pushed down from the central level to the regions. In sum, three quarters of all local budget expenditures are spent for social measures, which have to be provided according to centrally set laws and instructions. Adding the 16% for the execution of centrally planned investments, almost 90% of the local budgets are administered centrally.

Table 4: **Uzbekistan: Share of local expenditures in Consolidated budget\* (%)**

	1996	1997	1998	1999	2000	2001	2002	2003	2004
Total expenditures	53	56	51	54	52	55	55	53	54
Social sphere**	79	80	77	79	79	84	83	83	84
Social protection	61	75	69	70	75	74	78	75	88
Economic expenditures	51	37	30	38	40	52	50	39	23
Financing centrally planned investments	53	59	52	50	59	58	59	61	68
Maintenance of state government bodies and local bodies	3	4	3	4	3	3	4	4	2
Other expenditures	11	13	12	13	10	11	10	11	10

Source: Own calculations based on data from Nutridinov, Haydarov (2005) "Fiscal decentralization in Uzbekistan", Tashkent, mimeo

Note: \*The calculation does not take into account extra-budgetary funds,

\* Includes education, health-Care, social welfare, culture, and sport expenditures

<sup>20</sup> Nuritdinov, Haydarov (2005) "Fiscal Decentralization in Uzbekistan", Tashkent, p.16

<sup>21</sup> Coundouel, A./Marnie, S., : From Universal To Targeted Social Assistance: An Assessment Of The Uzbek Experience. In: Moct-Most Nr. 4, 1999

<sup>22</sup> Human Rights Watch (2003): "From House to House: Abuses by Mahalla Committees", Human Rights Watch Tashkent, September 2003, Vol 15, No.7 (D), Tashkent

On the other side, during the transition process many tasks of executing economic affairs formerly assigned to the regions have been shifted to the central level. The level of total economic affairs expenditures financed from the state budget remains high, but the share of economic affairs expenditures financed from the local budgets of Uzbekistan has decreased from 51% to 23% during 1996-2004. The share of funds spent for these purposes out of the local budgets decreased from 24% in 1997 to 6% in 2004. Because disaggregated data of this budget heading are not accessible, it is impossible to state, whether these shifts stem from a real centralization of tasks or from privatization and/or reduced soft budget constraints.

Table 5: **Uzbekistan: Structure of local budget expenditures\* (%)**

	1996	1997	1998	1999	2000	2001	2002	2003	2004
Social sphere**	51	51	54	56	54	57	57	60	63
Total expenditures	100	100	100	100	100	100	100	100	100
Social protection	13	13	12	12	11	10	11	11	11
Economic expenditures	12	8	10	8	7	8	8	9	6
Financing centrally planned investments	20	24	21	20	23	19	19	15	16
Maintenance of state government bodies and local bodies	0	0	0	0	0	0	0	0	0
Other expenditures	4	4	4	4	5	5	5	5	5

Source: Own calculations based on data from Nutridinov, Haydarov (2005) "Fiscal decentralization in Uzbekistan", Tashkent, mimeo

Note: \* The calculations does not take into account extra-budgetary funds

\*\* Includes Education, Health-care, Social Welfare, Culture, and Sport expenditures

## Turkmenistan

In Turkmenistan, the 1996 law "On the budget system" provides only a broad and not sufficiently detailed division of tasks among the central and the oblast level. Furthermore, the centralized tasks of production (commercial purpose) and construction imply a highly undesirable government intervention into business and local needs. Loopholes in the legislation related to the division of financial responsibilities at the levels lower than oblasts result in situations when expenditures assigned to the local level (especially oblast-rayon level) are in fact defined by the higher-level governmental tiers and subject to frequent changes and bargaining.

**Table 6 Turkmenistan: Share of local expenditures in Consolidated budget (%)**

	1991	1995	2000	2001	2002	2003
TOTAL	77	43	47	45	49	51
Financing economic affairs	22	34	0	1	1	1
Education*	73	82	90	89	89	89
Culture	50	41	39	44	40	44
Health-care	86	79	80	79	80	80
Utilities**	98	n/a	100	100	100	100
Social provision	1	1	-	-	-	-
Government	57	16	7	8	9	8
Defense	-	-	-	-	-	-
Public order	-	-	7	7	7	2

Source: Own calculations based on data from Turkmenmillichasbat (2005) "Decentralization of state governance and local self-government development in Turkmenistan", mimeo based on data from Turkmenistan MoF

Note: \* contrary to classification effective in Turkmenistan, education expenditures include payment of stipends

\*\* utility expenditures were excluded from economic affairs expenditures

In general, Turkmenistan shows a similar picture of high quantitative decentralization indicators without de-facto decentralization. While the weight of local expenditures in the consolidated budget falls from 77% in 1991 to 43% in 1995, it has revived to 51% in 2003 (Table 6). During this period, the local budgets have been assigned higher shares of education expenditures and health care. Expenditures for financing utility functions of Turkmenistan were 100% assigned to the local level. As water and natural gas in Turkmenistan are distributed to the population at no cost, this increases the dependency of the local budgets from centralized transfers and does not constitute decentralization. As in Uzbekistan, the assigning of social tasks to the local level was accompanied by a centralizing of economic affairs tasks. The share of economic affairs expenditures assigned to the local level declined from 22% in 1991 to mere 1%<sup>23</sup> in 2003. Since there has been almost no privatization of state enterprises, for Turkmenistan this shift can be explained only with centralization of formerly locally financed affairs. The structure of local budget expenditures shows respective changes for the period of independence (Table 7). Social services provision including education and health care became the priority of local budgets. While the share of local education expenditures constituted 17% in 1991, it reached 31% in 1995 and 51% in 2003. Health-care expenditures consumed nearly 23% of local budgets in 2000-2003. The weight of local economic expenditures approached to zero.

<sup>23</sup> Turkmenmillichasbat (2005) "Decentralization of state governance and local self-governance development in Turkmenistan" p. 23, mimeo, these expenditures were mainly directed for financing support to agrarian sector

Table 7: **Turkmenistan: Structure of local budget expenditures (%)**

	1991	1995	2000	2001	2002	2003
Financing economic affairs**	11	5	0	0	0	0
Education*	17	31	53	52	49	51
Culture	1	1	2	2	2	2
Health-care	10	17	23	23	22	22
Utilities	4	27	16	17	17	17
Social provision	0	1	1	1	1	1
Government	1	2	3	3	3	3
Public order	-	-	1	1	1	0
Other	56	16	0	0	5	4
TOTAL	100	100	100	100	100	100

Source: Own calculations based on data from Turkmenmillichasbat (2005) "Decentralization of state government and local self-government development in Turkmenistan", mimeo based on data from Turkmenistan MoF

Note: \* contrary to classification effective in Turkmenistan, education expenditures include payment of stipends

\*\* utility expenditures were excluded from economic affairs expenditures

In a comparative view, at the beginning of independence all countries under consideration lacked explicit legislative provisions that defined a division of responsibilities. In spite of this, the de-facto expenditure assignment to the local governments was generally in line with decentralization principles. During the reform years, against the background of Turkmenistan and Uzbekistan, Kazakhstan's reforms became the most prominent. Thanks to the Budget Code approved in 2004, Kazakhstan is now closest to a clear assignment of tasks at all levels, while the division of tasks in Turkmenistan and Uzbekistan remains unclear at lower than oblast level. However, in all countries the reforms undertaken in tasks assignment lack clarity and economic justification. Local budgets especially in Uzbekistan and Turkmenistan became heavily burdened with the financing of social tasks, whereas economic affairs financing keeps on decreasing. Without some autonomy in spending, incentive mechanisms will not work.

### **Is there spending autonomy on the local level?**

In all three countries the expenditure autonomy is limited in a number of ways. Norms and regulations issued by the central government are aggravated by un-funded mandates. Expenditure limits are set at the central level in all countries under consideration. In Uzbekistan, each distinct local budget request has to refer directly to a particular article of an official act as a justification for the expenditure. In Kazakhstan the provisions establishing expenditure limits became even stricter. The Budget Code of Kazakhstan that came into force in 2005 requires all expenditures of all programs and of all levels of

budgets to be based on the limits of expenditures<sup>24</sup>. These limits are to be approved by the budget commissions and are to be taken into account while composing the budget. Thus, one could expect little degrees of freedom of local self-governance to define expenditures.

For further examination of this question we look at the regional (oblast) variation of per capita expenditures according to the functional classification of expenditures. A high variation may reflect the ability of local governments to set own preferences and to conduct economic policy according to own needs. It may also reflect differences in the quality of local governance and administrative efficiency.

For Kazakhstan the coefficient of variation<sup>25</sup> shows rather low rates in 1998, who more than tripled during reforms (Table 8). This is mostly due to the introduction of official withdrawals, which became necessary as growing revenues from resource extraction had led to serious regional disparities. The regional per-capita variation of expenditures of Turkmenistan (Table 9) and Uzbekistan (Table 10) remained nearly at the same level since the mid nineties. Most interesting, the largest contribution to the variability in all countries stems from the smallest budget categories (e.g. financing tasks from economic affairs). Relatively high per-capita expenditures variations in the general public services seem to depend more on the number of administrative units<sup>26</sup> rather than on the quality of services delivered. Comparatively low levels of per capita expenditures variation at the oblast level in all countries can be observed in the most important categories such as education and health care suggesting about rather unified priorities and little spending autonomy.

This analysis hints at the important role of centrally set minimum expenditure requirements for education and health care sectors. To the other sectors the extremely scarce financial resources seem to be redistributed as a residual. Further analyses will show, along what lines this redistribution is organized. This suggests, that the influence of centrally set limits is significant, whereas the budgetary autonomy of local governments in all three countries in general is as limited as expected.

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<sup>24</sup> RGP Institute for Economic Research (2005) "Fiscal decentralization in Kazakhstan" Almaty, p 25, mimeo,

<sup>25</sup> the calculation of the coefficient is based on data on categorical local per capita expenditures by oblast

<sup>26</sup> A rather high negative correlation coefficient of expenditures per capita and population by oblast in each country is peculiar for Uzbekistan: it is close to -0.8. For Kazakhstan, it has increased in magnitude after the reform and reached -0.79 in 2000. However, it declined in 2004 down to -0.53. For Turkmenistan, it is still negative but less significant e.g. -0.39 for 2001 and -0.38 for 2003. At the same time, the variation of distribution of population among oblasts is the highest in Kazakhstan, and the lowest in Turkmenistan.

Table 8 **Coefficient of variation of local per capita expenditures Kazakhstan\***

	1998	2002	2003	2004
<b>Total</b>	<b>0.22</b>	<b>0.76</b>	<b>0.69</b>	<b>0.60</b>
General public services	0.29	0.32	1.12	0.33
Defence	0.42	0.48	0.31	0.40
Public order and justice	0.44	0.38	0.33	0.35
Education	0.27	0.29	0.25	0.26
Health Care	0.34	0.33	0.30	0.24
Social welfare	0.22	0.31	0.29	0.20
Utilities	0.62	2.06	1.55	0.97
Culture	0.32	0.69	0.61	0.49
Fuel and energy complex	-	-	3.87	3.09
Agriculture and forestry	0.75	0.61	0.41	0.33
Industry	1.22	1.75	2.11	1.51
Transport	-	0.83	0.94	1.05
Other	1.43	0.69	0.92	0.68
Debt servicing	2.24	2.35	2.93	2.71
Official transfers	-	2.17	2.10	2.17

Source: Own calculations based on data from MoF of Republic Kazakhstan

Note: \* the calculations do not taking into account Astana city due to its exceptional status.

Table 9 **Coefficient of variation of local per capita expenditures Turkmenistan**

	2001	2002	2003
<b>Total</b>	<b>0.21</b>	<b>0.15</b>	<b>0.20</b>
General public services	0.30	0.23	0.35
Public and social services	0.17	0.14	0.16
Education	0.07	0.13	0.10
Health care	0.26	0.25	0.24
Social	0.22	0.28	0.24
Utilities	0.95	0.83	0.92
Culture	0.43	0.39	0.42
Economic affairs	1.40	1.92	1.40
Transfers	1.08	2.45	2.27

Source: Own calculations based on data from Turkmenmillichasbat (2005) "Decentralization of state government and local self-government development in Turkmenistan", mimeo based on the data from MoF of Turkmenistan

Table 10 **Coefficient of variation of local per capita expenditures Uzbekistan\***

	1996	1997	1998	1999	2000	2001	2002	2003	2004
<b>Total</b>	<b>0.14</b>	<b>0.15</b>	<b>0.15</b>	<b>0.13</b>	<b>0.13</b>	<b>0.10</b>	<b>0.12</b>	<b>0.12</b>	<b>0.13</b>
Social sphere	0.10	0.12	0.11	0.11	0.11	0.11	0.12	0.11	0.13
Social protection	0.16	0.09	0.22	0.15	0.15	0.16	0.17	0.19	0.20
Economic expenditures	0.46	0.43	0.46	0.44	0.46	0.40	0.47	0.44	0.48
Financing centrally planned investments	0.68	0.70	0.51	0.36	0.29	0.41	0.33	0.24	0.26
Maintenance of state Government bodies and local bodies	0.36	0.29	0.32	0.30	0.35	0.25	0.25	0.28	0.43
Other expenditures	0.32	0.48	0.36	0.37	0.37	0.36	0.52	0.25	0.34

Source: Own calculations based on data from Nutridinov, Haydarov (2005) "Fiscal decentralization in Uzbekistan", Tashkent, mimeo

Note: \* the calculations do not take into account Tashkent city due to its exceptional status.

## Chapter 5. Analysis of Revenues assignment and Sharing

According to conventional wisdom, the core for local revenues should consist of easily administered taxes with an immobile tax base, a predictable revenue yield, and visible sub-national government liabilities. Local governments should have an access to genuine local revenues that are compatible with their responsibilities and they should have the right to define the tax base/rate within the limits established on their own. Taxes that are redistributive in nature, have important economies of scale, are sensitive to cyclical fluctuations, and/or unevenly distributed such as value-added tax (VAT) and enterprise profits tax (EPT) should be centralized. The progressive personal income tax (PIT) in fact performs redistribution functions and in the presence of high regional disparities may exacerbate the difference in the quality of public services provided locally. Rents for natural resources extraction are generally treated as payment for ownership; in case of the countries under consideration these resources constitute national wealth and the rents should be assigned to the central level as well.

If revenues are assigned to create incentive effects at the local level, a certain share of EPT and PIT should remain at the local level. This makes local governments interested in creating a business-friendly environment and promoting local growth. However, long-term credibility of the central governments commitment not to withdraw unexpected surpluses from the local level is essential to make incentive mechanisms work. For nations rich in point-source natural resources this commitment creates a trade-off between the promotion of local growth and growing regional disparities.

Table 11 **Structure of local revenues in Kazakhstan<sup>\*</sup> (%)**

	1998	1999	2000	2001	2002	2003	2004
EPT	14	13	26	20	0	0	0
VAT	8	4	4	2	3	2	1
PIT	17	16	16	17	20	19	16
Excises	8	2	1	1	6	4	4
Social tax	0	31	25	32	35	33	28
Privatization and operations with capital*	0	0	0	1	1	1	2
Non-tax revenues	9	5	3	4	1	1	2
Other tax revenues	19	15	10	10	14	13	12
Transfers	27	15	14	12	20	26	35
Total	100	100	100	100	100	100	100

Source: Own calculations based on the data from the MoF of Kazakhstan

Note: \* The receipts from the sale of fixed capital in Kazakhstan are represented by revenues from sale of state property, sale of goods from the state material reserve and sale of nontangible assets owned by the government

In Kazakhstan the pre-reform tax legislation enforced more than 50 taxes. In 1995 their number was cut to 11 and defined so-called “regulatory” (shared) and local taxes. The list of local taxes included property tax, vehicle owner tax, land tax, and several kinds of non-tax revenues. These genuine local taxes provided a small revenue base potential. The sub-national governments even for local taxes (with the exception of land tax) had no power to set the tax rates. With enforcement of the tax code in 2002, the local administrations got the right to raise the standard rates of local taxes set by the Tax Code by up to 50% and to set own rates for fines and administrative sanctions. (Appendix II.1). These genuine local revenues over which the local government had some degree of discretion allowed funding slightly more than 10% of local budgets. Thus, local tax autonomy stayed limited.

As a result of the small genuine local tax base, the lion’s part of local revenues is presented by the shared taxes VAT (including VAT on imports) and EPT (Table 11). In 1995 the assignment of tax revenues among regions became based on operational indicators of an enterprise (depending on the part of the wage bill of the enterprise directed to a particular region, the assets location, etc.) replacing the original principle based on the administrative subordination of the enterprise. Thus the accountability for local budgets grew, and incentives for the promotion of enterprise development might have resulted. However, due to yearly changes in the assigned shares, the predictability for the local level has been low.

The 1999 reforms brought major changes in the assignment of shared taxes. The assigned shares of taxes had been fixed in the annual Budget Laws and were unified for all regions. The introduced so-called “social tax”<sup>27</sup> began to provide nearly 30% of funding for the local budgets and as a tax paid by enterprises set positive incentives. But its design as a central tax, 100% assigned to the local budgets makes it a financing source dependent on decisions taken centrally. By and by all vulnerable taxes were assigned to the central level. For instance VAT (in 1997) and EPT (in 2002) previously collected by the local budgets began to flow to the central level. A tendency of centralization was included in the redirection of 50% of excises to the central level. The weight of progressive PIT in local revenues increased from 16% in 1999 to 20% in 2002. The tax reform of 2004 replaced the progressive PIT with a 10% flat rate and thus contributed to reduction of its weight in local revenues to 16%. A mere administrative feature concerning the shared taxes adds to the dependency of the local budgets from the center – all shared taxes collected on the local level have to be 100% directed to the center, and only afterwards are redirected to the regions. In times of high inflation, this process additionally deprived the regions of already earned revenues.

In contrary to the mentioned standard arguments of tax assignments among different tiers, after 1999 we find many unified redistributive taxes on the local level. Due to growing differences in revenue capacities of the regions, this led to an increase of revenue disparities and horizontal imbalances between the regions. Consequently, the weight of transfers in local revenues, which had decreased from 27% in 1998 to 15 % in 1999, rose considerably and reached 35% in 2004.

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<sup>27</sup> the social tax is in fact a payroll tax and is contributed by the local employers

According to the Budget Code 2004, above-plan revenues collected at the local level can not be withdrawn by the center and stay at the local level, which enjoys spending autonomy. However, interviews with local hokims revealed, that spending autonomy for these revenues in reality is very limited because they have to be spend for under- and unfunded mandates.

## **Turkmenistan**

In Turkmenistan, the genuine local taxes have a low revenue potential and constitute only a negligibly small share of local revenues. Since 1993 Turkmenistan had 17(!) local taxes with little revenue potential. Only in 2000 the number of local taxes was cut to 5 (advertisement tax, targeted duty for developing territories of cities, settlements, and villages, duty that paid by the owners of car parks, duty for sale of cars, and duty from dog keepers). As it is presented in the Table 12 below, their share in the total local revenues constituted about 3% in 2001-2003.

EPT shares assigned to the local governments according to the registration place of enterprise and VAT shares remained revenues of crucial importance for sub-national budgets. A part of local revenues comes in the form of royalty for natural resource extraction. The assigned shares depend on the regional fiscal capacity and are set on a yearly basis. Reportedly they can be changed even during the fiscal year on an ad-hoc-basis. Revenues above the planned level are withdrawn by the center. This design of shares taxes does not create incentives on the local level. In 1995, the shares of EPT and VAT in local revenues constituted 37%. Although the importance of these revenues diminished to 24% in 2003, their role in local budgets funding still remained substantial.

The tax reform of 1997 highlights the dependency of local budgets from centrally taken decisions. It brought about the increase of the VAT rate from 18% to 20% and a two-stage decrease in the EPT rate from 37% in 1996 to 35% in 1998 at the same time. It also changed the flat 8% PIT to a eight-bracket progressive PIT with the range of rates from 8%-25%. Thus, the share of PIT in local budget funding rose from 8% in 1995 to 21% in 2003. With the approval of the Tax Code 2004, the progressive rates for eight brackets were replaced with a flat 10% rate, making local revenues shrink anew. Additionally, the centralized wage setting in the huge public sector of Turkmenistan<sup>28</sup> makes PIT an almost exogenous parameter for local budgets. Above-plan revenues can not be withdrawn by the center and stay at the local level, which has a spending autonomy concerning these revenues.<sup>29</sup> However, no such cases are reported so far, because in case of unexpected revenues the level of assigned expenditures is raised during the fiscal year.

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<sup>28</sup> In Turkmenistan, only few enterprises were privatized. In mid 2000, 200 small-scale companies of the list consisting of 4300 were privatized. For the medium-scale enterprises this ratio constituted 6 out of 280. Source: Economist Intelligence Unit (2003) "Turkmenistan: Country profile", Y 38183 p. 26 //www.eiu.com

<sup>29</sup> Turkmenmillichasbat (2005) "Decentralization of state governance and local self- governance development in Turkmenistan", mimeo, p.5

A structure of local revenues that leaves nearly 95% for shared revenues and official transfers suggests that the role of the genuine local revenues in local budgets funding in Turkmenistan is negligible. Regions are fully dependent of centrally set limits and central financing. The assignment of transfers (dotations and subsidies) is used to balance local budgets.

Table 12 **Structure of local revenues in Turkmenistan (%)**

	1995	2000	2001	2002	2003
VAT	17	20	20	16	15
EPT	20	10	10	9	9
Property tax	1	4	5	5	3
PIT	8	17	17	18	21
Local taxes		2	3	3	3
Non-tax revenues	1	1	1	1	1
Transfers	23	45	40	45	45
Other revenues	30	2	3	2	3
Total	100	100	100	100	100

Source: Own calculations based on data from Turkmenmillichasbat (2005) "Decentralization of state governance and local self-governance development in Turkmenistan", mimeo, based on the data from MoF of Turkmenistan

## Uzbekistan

In Uzbekistan we find a broader tax base for genuine local revenues. The adoption of the Tax Code 1997 allowed to increase their share in local budget revenues from 11% on 1997 to 18% in 1999<sup>30</sup>. In 1999 property tax and land tax were defined as local, making rise the share of genuine local taxes to 20% for the years 2000-2003. New taxes including property, infrastructure development, and environmental taxes got more importance. However, the legislative provisions of local taxes were not workable in terms of fiscal decentralization. Some of the "local" tax rates and bases were defined centrally. The Cabinet of Ministers defines the rates of land tax and property tax each year with the approval of the yearly Budget law. Furthermore, the latter had substantial administration costs thus its net revenues approached zero<sup>31</sup>.

<sup>30</sup> Nutridinov, Haydarov (2005) "Fiscal decentralization in Uzbekistan", Tashkent, p. 30, mimeo

<sup>31</sup> Ibid., p. 25

Table 13 Structure of local revenues in Uzbekistan\* (%)

	1995	1996	1997	1998	1999	2000	2001	2002	2003
VAT	19.7	16.1	24.3	21.0	17.1	20.4	18.3	18.9	15.8
EPT	32.0	29.6	20.8	13.3	0	12.7	8.6	7.5	6.9
Entrepreneurial activity	0.7	0.1	1.3	2.1	2.6	3.6	4.0	3.4	2.6
PIT	13.5	15.5	21.4	13.6	19.0	14.9	14.4	14.0	14.2
Property tax physical persons	0.3	0	0	0.8	0.9	1.0	0.9	0.5	0.6
Property tax legal persons	5.2	2.9	4.0	4.7	4.8	6.4	4.7	2.9	5.3
Excise tax	8.7	4.8	14.1	16.3	17.5	19.5	12.1	10.6	10.0
Environmental tax	0	1.1	4.4	4.4	3.8	4.8	4.1	4.2	5.0
State duty	1.2	1.0	1.4	1.0	0.9	1.0	0.7	0.6	1.7
Land tax	5.9	0.3	6.3	6.9	7.5	7.3	5.4	3.7	3.7
Infrastructure development	1.8	1.6	0.3	2.0	1.8	2.5	2.4	3.9	3.3
Water tax	0.7	0.6	0.6	1.0	0.7	1.1	0.7	0.6	0.7
Duties and non-tax revenues	3.9	2.7	2.6	5.1	4.8	9.5	7.9	11.4	11.2
Transfers	3.0	14.1	18.8	22.2	10.6	17.1	16.9	18.6	21.1
Total*	97	90	120	114	92	122	101	101	102

Source: Own calculations based on data from Nutridinov, Haydarov (2005) "Fiscal decentralization in Uzbekistan", Tashkent, mimeo.

Note: \* These officially reported data are obviously inconsistent in some queues. Therefore care has to be taken in the interpretation of single lines

The role of shared taxes in local budget financing in Uzbekistan decreased steadily (Table 13). The share of EPT and VAT, that constituted 52%<sup>32</sup> in local revenues in 1995, fell to 23% in 2003. Tax rates other than VAT and PIT were approved each year in the budget resolution. For example, the EPT rate declined gradually each year from 35% in 1998 to 18% in 2004. The lowest and upper PIT bracket decreased in 2001 from 15 to 12 minimum wages and from 40 to 36 respectively. In 2004, upper and lowest PIT brackets equaled 13 and 30 minimum wages. Thus, the contribution of progressive (four

<sup>32</sup> Actually during 2000-2003 nearly 90% of local revenues were represented by PIT, VAT, CIT, and transfers – Turkmenmilichasbat (2005) "Decentralization of state governance and local self-governance development in Turkmenistan" p. 50, mimeo

brackets for rather high rates of 15%-40%<sup>33</sup>) PIT has increased from 14% in 1995 up to 19% in 1999 while falling to the initial level of 13% in 2004. These frequent changes in the tax legislation, added by frequent changes in the assigned revenue shares (Table 15) made the contribution of shared taxes unpredictable for the regions.

The center provides only weak commitments concerning above-plan revenues. Although those revenues may to be withdrawn by the center, at the same the local level has no spending autonomy for additional revenues, and spending has to be agreed with upper levels. In practice, in case of above-plan revenues the level of centrally planned expenditures is raised during the fiscal year.<sup>34</sup> Clearly this mechanism does not create incentives to raise local tax revenues.

In Turkmenistan and Uzbekistan the assignment of shared taxes so far has not been unified, i.e. different regions receive different shares of these taxes. Local administrations de jure have influence upon this process, but de facto can use social capital (personal connections) to push their interests at higher levels. That leads to the question, whether centrally assigned taxes in fact served the role of equalizing intergovernmental transfers or whether have been used for political ends (either gratification or punishment of local rulers). The negative correlation of regional GDP and assigned shares in general corroborates the equalizing assumption: Higher shares are assigned to less developed regions (Table 14, Table 15).

Table 14 **Revenue shares for centrally assigned taxes\* (Turkmenistan)**

Velayat	2001			2002			2003		
	EPT (%)	VAT (%)	Per capita revenues (m manat)	EPT (%)	VAT (%)	Per capita revenues (m manat)	EPT (%)	VAT (%)	Per capita revenues (m manat)
Ahalskiy	80	80	0.6	80	80	0.7	80	80	0.9
Ashhabad	31	31	2.1	14	14	3.0	25	25	2.2
Maryskiy	80	80	0.7	80	80	0.7	80	80	0.9
Dashoguzskiy	80	80	0.6	80	80	0.6	80	80	0.9
Balkanskiy	49	49	1.4	20	20	1.6	41	41	2.5
Lebapskiy	80	80	0.6	80	80	0.8	80	80	1.0
<i>Correlation</i>	<i>-99</i>	<i>-99</i>		<i>-94</i>	<i>-94</i>		<i>-92</i>	<i>-92</i>	

Source: Own calculations based on data from Turkmenmillichasbat (2005) "Decentralization of state governance and local self-governance development in Turkmenistan", mimeo based on data from MoF of Turkmenistan

Note: \* correlations for shares of central taxes assigned to the oblast and GDP per capita in the oblast in the respective year.

<sup>33</sup> The brackets were targeted to the minimum wage level after to 1998. Prior, the brackets were set in absolute terms.

<sup>34</sup> Nutridinov, Haydarov (2005) "Fiscal decentralization in Uzbekistan", Tashkent, p. 41, mimeo

Table 15 Revenue shares for centrally assigned taxes\* (Uzbekistan)

Veloyat	2001				2002			
	VAT	EPT	PIT	GDP per capita	VAT	EPT	PIT	GDP per capita
Karakalpakstan republic	100	100	100	0.41	100	100	100	0.38
Andijanskaya	100	100	100	0.87	100	100	100	0.82
Buharskaya	23	20	50	1.01	32	20	50	1.06
Djizzakskaya	100	100	100	0.64	100	100	100	0.68
Kashkadaryinskaya	69	64	100	0.77	100	99	100	0.78
Navoinskaya	58	54	50	1.36	72	54	50	1.54
Namanganskaya	100	100	100	0.61	100	100	100	0.59
Samarkandskaya	100	100	100	0.69	100	100	100	0.69
Surhandarjinskaya	100	100	100	0.76	100	100	100	0.76
Syrdarjinskaya	100	100	100	0.85	100	100	100	0.78
Tashkent	56	51	50	1.04	61	56	50	1.05
Fergananskaya	39	34	100	0.85	80	65	100	0.84
Horezmskaya	100	100	100	0.75	100	100	100	0.71
Tashkent	14	10	16	1.75	6	6	17	1.62
Correlation*	-76	-75	-89		-80	-82	-89	

Source: own calculations, Nuriev (2003) "The questions of fiscal decentralization in Republic of Uzbekistan", *Finance* p.11, p.22

Note: \* correlations for shares of central taxes assigned to the oblast and GDP per capita in the oblast in the respective year.

In a comparative view, it can be stated, that despite high quantitative decentralization indicators in all countries under consideration at least 85-90% of local budget revenues depend on decisions taken by the central government. Genuine local taxes, although introduced to all countries, play a minor role in financing and depend on centrally set rules. A common feature of all three countries is the substantial reliance on revenue-sharing mechanisms. This situation is undesirable in terms of fiscal decentralization, since high reliance on variable taxes affected by frequent changes of the central tax policy exposes the local budgets to uncertainty and poor predictability of fiscal flows. This implies a lack of fiscal choice depriving local government accountability and incentives. By and by, the countries approved provisions that allowed sub-national governments to keep the revenues received above the plan. However, due to underfunding and/or limited spending autonomy de facto no incentives arose from these provisions.

## Chapter 6. Intergovernmental transfers/grants

The two major dimensions of intergovernmental transfers include vertical (central versus local government) and horizontal (units of the same levels of government) imbalances. The system of transfers should ensure not only the correction of vertical/horizontal imbalances, but also the predictability, understandability, and timeliness of local budgeting. Strict and democratically legitimized rules of transfer assignment should leave no room for corruption and illegal negotiation processes. Stability in transfer setting is a prerequisite for incentive creation at the local level. If, in case of donor regions, additional revenues are completely withdrawn by the center or, in case of receiving regions, deficit covering by central transfers is anticipated as an automatism, no incentives are created.

Inherited by the FSU system, the intergovernmental transfers at the early stages of transition in Kazakhstan (“*subsidies*”)<sup>35</sup>, Turkmenistan (“*dotations*”), and Uzbekistan (“*subsidies*”) represented either general-purpose or targeted intergovernmental grants. The vertical imbalance was solved with the help of gap-filling intergovernmental transfers that could be negotiated during the fiscal year. The amount of the transfers has been fixed every budget year anew. The system of transfers was supplemented with a mutual offset mechanism and soft budget constraints set by the central budgets, especially in Turkmenistan and Uzbekistan. Although the early budget reforms pushed the countries to distinguish between general-purpose and targeted grants, equalization transfers still were not formula-based and did not account for regional particularities as changes in the number of population. Till nowadays, no clear mechanisms of targeted funds allocation have been set up. The calculation of “needed expenditures” is still based on the extrapolation or of last years expenditures. Standards and norms for cost calculation in service provision are missing, which creates a high risk for underfunded mandates at the local level.

### Regional disparities

The need for intergovernmental transfers stems from differences of the regional fiscal capacities. In the resource-based economies of Central Asia these disparities are mostly based on the fact of an uneven geographic distribution of the natural point-source natural resources.

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<sup>35</sup> IMF observance of standards and codes of Fiscal transparency in Kazakhstan “The role and types of the transfers were not clearly specified by law. However, evidence suggests that some of the transfers were conditional (for instance, contingent on satisfactory tax collection standards being achieved), the others appeared to be block transfers, and the investment earmarked transfers”

## Kazakhstan

In Kazakhstan the disparities of per capita regional fiscal capacities have intensified since the development of the countries oil reserves has taken up pace since 1998. High average per capita income figures characterize those areas where oil was extracted, while the corresponding figures for the other regions remained very low. The regions Jambyl, Almaty, South Kazakhstan, North Kazakhstan, and Akmola remain constantly poor. In 1998 the GDP per capita in Atyraurskaya oblast was 5 times higher than in Jambylskaya oblast. Until 2004, the regional disparities driven by the oil boom increased further. The coefficient of variation of GDP per capita has increased from 0.52 to 0.78, while the difference between minimum and maximum GDP per capita climbed to 12.

Table 16 **Kazakhstan GDP per capita by oblast (indexes)**

	1998	1999	2000	2001	2002	2003	2004
<b>Kazakhstan</b>	<b>1.00</b>						
Akmola	0.53	0.73	0.61	0.64	0.64	0.56	0.58
Aktyubinsk	1.17	1.02	1.00	1.00	1.13	1.08	1.20
Almaty	0.54	0.48	0.45	0.48	0.48	0.43	0.42
Atyrau	2.08	2.38	3.42	3.33	3.72	4.05	4.18
East Kazakhstan	1.09	1.03	0.90	0.85	0.78	0.72	0.74
Jambyl	0.41	0.36	0.33	0.31	0.36	0.35	0.35
West Kazakhstan	0.85	0.96	1.16	1.21	1.40	1.20	1.28
Karaganda	1.18	1.25	1.21	1.10	1.03	1.03	1.04
Kzyl-Orda	1.05	1.01	0.95	0.85	0.76	0.79	0.81
Kostanai	0.57	0.49	0.55	0.56	0.79	0.71	0.81
Mangystau	1.68	2.05	2.47	2.26	2.84	2.18	2.38
Pavlodar	1.49	1.13	1.23	1.23	1.10	1.15	1.23
North Kazakhstan	0.75	0.75	0.58	0.68	0.60	0.55	0.59
South Kazakhstan	0.44	0.45	0.49	0.50	0.44	0.42	0.38
Almaty City	2.39	2.34	2.03	2.26	2.02	2.32	1.88
Astana	1.44	1.81	1.82	1.73	1.76	2.05	2.03
Min	0.41	0.36	0.33	0.31	0.36	0.35	0.35
Max	2.08	2.38	3.42	3.33	3.72	4.05	4.18
Difference	5.10	6.58	10.42	10.79	10.28	11.64	12.04
Coefficient of variation	0.52	0.57	0.69	0.68	0.74	0.79	0.78

Source: own calculations based on data from the Statistic committee of Kazakhstan

## Uzbekistan

Regional disparities in Uzbekistan are less severe, but show the same trend. In Uzbekistan, natural resource extraction so far contributes only a minor part to the regional disparities. The major part stems from the distorted industrial structure inherited by the Soviet Union, which had brought about some industrial giants located in strategically selected regions. Thus the oblasts Buhara, Navoi, Tashkent, and Tashkent city remain stable above the national average. The development of Tashkent city is defined by its status as capital, the oblast Navoi is a center of gold and uranium mines. Oil and gas production so far are dispersed throughout the country, the same is the case for the agrarian sector. The autonomous republic of Karakalpakstan and the oblast of Horezm are burdened with the Aral Sea problems. The oblast Surhardarjo located at the Afghan border has only limited access to transport infrastructure, the densely populated oblast Ferghana lacks land resources.

Table 17 **Uzbekistan GDP per capita by oblast** (*indexes*)

	1997	1998	1999	2001	2002	2003	2004
<b>Uzbekistan</b>	<b>1.00</b>						
Karakalpakstan republic	0.53	0.53	0.58	0.41	0.38	0.42	0.42
Andijanskaya	0.79	0.79	0.87	0.87	0.82	0.76	0.74
Buharskaya	0.93	0.95	1.19	1.01	1.06	1.11	1.08
Djizzakskaya	0.66	0.63	0.66	0.64	0.68	0.80	0.77
Kashkadaryinskaya	0.92	0.78	0.74	0.77	0.78	0.74	0.75
Navoinskaya	1.14	1.10	1.22	1.36	1.54	1.66	1.70
Namanganskaya	0.65	0.55	0.59	0.61	0.59	0.60	0.45
Samarkandskaya	0.64	0.68	0.72	0.69	0.69	0.64	0.60
Surhardarjinskaya	0.60	0.66	0.70	0.76	0.76	0.69	0.66
Syrdarjinskaya	0.82	0.81	0.86	0.85	0.78	0.78	0.77
Tashkentskaya	0.94	0.93	0.93	1.04	1.05	1.01	1.03
Fergananskaya	0.93	0.87	0.90	0.85	0.84	0.79	0.76
Horezmskaya	0.92	0.88	0.97	0.75	0.71	0.69	0.67
Tashkent	1.57	1.59	1.65	1.75	1.62	1.67	1.68
Max	1.57	0.59	1.65	1.75	1.62	1.67	1.70
Min	0.53	0.53	0.58	0.41	0.38	0.42	0.42
Difference	2.95	2.08	2.11	3.30	4.03	3.92	4.02
Coefficient of variation	0.31	0.32	0.33	0.38	0.39	0.42	0.46

Source: Nutridinov, Haydarov (2005) "Fiscal decentralization in Uzbekistan", Tashkent, mimeo, based on data from Statistic committee of Uzbekistan

During transition, the increasing importance of the extracting industry against the background of an declining manufacturing industry became the driving force of the uneven regional development. From 1997-2004 the coefficient of variation of regional disparities has increased from 0.31 in 1997 to 0.46 in 2004. With natural resource extraction taking up pace during next years, regional disparities will increase further, following the Kazakh path.

## **Turkmenistan**

With respect to Turkmenistan, limitations on regional GPD data allow only an approximation of regional disparities. Here we use fiscal capacity, i.e. major revenues assigned to the local budgets (here for simplicity we assume that 100% of revenues are collected by the local budgets) without transfers as a proxy for disparities. Over the past decade, the regional development in Turkmenistan has been driven by gas extraction activity, mainly concentrated in the Amu Darya basin and near the Caspian Sea. The enterprises of the gas sector became major contributors of Turkmenistan's consolidated budget (47% in 2003 and 34% in 2004)<sup>36</sup>. Unfortunately, the revenues of local budgets are not perfectly related to the economic development of the respective regions. Major taxes assigned to the local budgets are paid centrally, still based on the registration principle of the big enterprises like "Turkmengaz", "Turkmenneftegaz", and "Turkmenneft". Thus, although Maryyskiy and Akhalskiy velayats are the places where the natural gas is extracted, the revenues flow into Ashgabad and Balkanskiy local budgets. The tax from the use of earth interiors is collected mainly to the Akhalskiy and Balkanskiy velayats.

There are significant disparities in the distribution of per capita revenues that are sometimes inversely correlated with the expenditure needs. The largest expenditure needs are in Lepubskiy, Maryyskiy, and Dashoguzskiy velayats due to the high number of administrative units and population density. Furthermore, the expenditure needs of Lepubskiy and Dashoguzskiy velayat are growing at faster rates<sup>37</sup>. At the same time, the highest local fiscal revenues per capita are observed in Ashgabad and Balkanskiy velayat. Fiscal capacities of Maryyskiy, Dashoguzskiy, and Lepubskiy velayats are rather limited (Table 18).

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<sup>36</sup> VAT collected from the gas sector in 2003 constituted 57% of total VAT collections. For the year 2004, this rate constituted 29%. In the year 2003, EPT collections from the gas sector reached 61% of the total EPT collections. For the year 2004 this weight reached 33%.

<sup>37</sup> The sizes of local budgets of Turkmenistan increased unevenly during recent years. In comparison to the year 2001, the expenditures of the local budgets increased by 75.8% for Akhalskiy velayat, by 36.6% for Ashgabad city, by 38.8% for Maryyskiy velayat, by 53.4% for Dashoguzskiy velayat, by 74.5% for Balkanskiy velayat, and by 94.1% for Lepubskiy velayat.

Table 18 **Local Revenues of Turkmenistan by oblast**  
 (thous. manat per capita)

	2001			2002			2003		
	EPT	VAT	Other revenue	EPT	VAT	Other revenue	EPT	VAT	Other revenue
Akhal	89	235	299	71	167	425	71	167	686
Ashgabad	631	988	463	1,406	1,173	470	516	839	812
Maryyskiy	45	128	551	46	124	482	34	123	736
Dashoguzskiy	29	69	516	27	79	512	23	90	744
Balkanskiy	223	607	528	366	684	604	674	986	798
Lepubskiy	9	34	526	33	79	646	115	198	735
Total	129	260	490	246	295	523	170	304	745
Variations	1.39	1.10	0.19	1.68	1.17	0.16	1.18	1.00	0.06
Min	9	34	299	27	79	425	23	90	686
Max	631	988	551	1,406	1,173	646	674	986	812
Max/Min	73	29	2	51	15	2	30	11	1

Source: Turkmenmilichasbat (2005) "Decentralization of state governance and local self- governance development in Turkmenistan", mimeo based on data from Turkmenistan MoF,

Note: Other revenues do not include transfers<sup>38</sup>

### Vertical imbalances

For the period under consideration, the indicators of vertical balance<sup>39</sup> (shares of all local revenues net of transfer in local expenditures) in Uzbekistan and Kazakhstan were comparatively lower than in Turkmenistan. All three countries exhibited an improvement of this indicator during recent years (see Table 19). Most interesting, this process was accompanied by a further increasing in regional disparities. The latter had the highest magnitude in Kazakhstan. More narrow definitions of vertical imbalance like the mismatch between genuine local revenues and expenditures, demonstrate a very sub-

<sup>38</sup> Data limitation does not allow us to analyze horizontal imbalances with ex-ante fiscal revenues

<sup>39</sup> Vertical imbalance is measured as a share of local revenues without transfers in local expenditures. Vertical imbalance coefficient equal to 1 means perfect vertical balance. However, we should mention about biases in the vertical imbalance measure we use. From the one side, the calculated coefficient of vertical imbalance might be underestimated due to the evidence of local budget arrears and substantial quasi-fiscal activities especially common for the early 90<sup>th</sup>. Furthermore, the vertical imbalance might be larger taking into account still limited possibilities of local governments to borrow from other sources except higher-level budgets and soft constraints that existed until recent years. This issue was most acute for Uzbekistan and Turkmenistan

stantial size of imbalances for all three countries. Taking into account the level of genuine local revenues available to the local governments, the vertical balances of Uzbekistan will be around 0.15, for Turkmenistan it would be close to 0.05. Recent tax innovations (2002) of Kazakhstan allowed it to reach a level at approximately 0.14.

Table 19: **Vertical imbalance structure**

	1991	1995	1998	1999	2000	2001	2002	2003	2004
Turkmenistan	0.50 <sup>40</sup>	<i>n/a</i>	<i>n/a</i>	<i>n/a</i>	0.55	0.65	0.56	0.55	<i>n/a</i>
Uzbekistan	<i>n/a</i>	0.89	0.74	0.87	0.81	0.83	0.82	0.80	0.80
Kazakhstan	<i>n/a</i>	<i>n/a</i>	0.71	0.86	0.89	0.88	0.80	0.76	0.64

Source: own calculations based on the data of Ministries of Finance of Kazakhstan, Uzbekistan, and Turkmenistan

Kazakhstan made several attempts to develop a methodology for calculating transfers. The first one took place during the budgetary reform of 1999, when the calculation process started to be unofficially based on resolution No.529/99.<sup>41</sup> The second attempt happened in 2004. Resolution No. 916 from 2004 concerning the prognosis of official transfers started to work based on Law No. 602, concerning the volumes of official transfers 2005-2007 (2004). The new Budget Code for the first time established the volume of transfers for 3 years, thus providing a better predictability of revenues at the local level, less grounds for corruption during the negotiation process, and better incentives for revenue rising at the local level. In fact, the legislation concerning the calculation is poorly enforced and can be said to have a mere declarative character. According to local *hokims* and governors, in practice transfers till nowadays are just covering the budget gap<sup>42</sup> Targeted transfers, however, in fact are often used as a kind of flexible instruments for financing different funds and “private” joint stock companies (like the JSC “National Innovation Fund” or the JSC “International Airport of Astana City”) as quasi-budget institutions. The utilization of these funds is hard to trace.<sup>43</sup> However, the treasury regularly publishes cases that demonstrate, how money declared as spent on a certain measure is in fact is saved and stays with the local budgets.<sup>44</sup>

<sup>40</sup> Turkmenmillichasbat (2005) “Decentralization of state governance and local self-governance development in Turkmenistan”, mimeo, p. 27

<sup>41</sup> see in detail the discussion in Wooster, James (2000):” The Intergovernmental Fiscal Reform in Kazakhstan: Progress to Date and Recommendations for the Future” In: Kazakhstan Economic Trends 1<sup>st</sup> quartal 2000, pp 36-53

<sup>42</sup> based on personal interviews in Almaty, Karaganda and Astana oblasts

<sup>43</sup> “Budget Process in the Caspian Countries: Experience of Kazakhstan and Azerbaidjan.” Policy Studies No. 2 (07) April 2005, Public Policy Research Center, Almaty

<sup>44</sup> Schynbekov, D.:” Finansovye osnovy mestnogo chozjajstva: vzaimootnošenija s respublikanskim bjudžetom” In: Finansy Kazachstana No. 1, 2005, pp. 72-78

In Uzbekistan, at the time of the budgetary reform of the year 2000, two kinds of grants have been defined, namely dotations and subsidies. The first constitutes an equalization transfer. The second are targeted transfers, the objectives of which should be defined by higher levels of the government. Furthermore, there exists a non-transparent heading “mutual settlement grant”, which - like in Russia - <sup>45</sup>plays a non-transparent correction role during budget execution. The dotations of Uzbekistan are based on ad-hoc coverage of the deficit. Subsidies according to Uzbek authors bear a “subjective character” and lack concrete objectives, since regional programs are not elaborated.<sup>46</sup> All transfers remained to be negotiated either during the budget process or unofficially during the fiscal year. In Turkmenistan, the same characteristics of intergovernmental transfers can be observed, albeit with a still higher amount of discretionary decisions taken at the central level.

In spite of certain improvements in budget legislation, the transfer systems of Kazakhstan, Turkmenistan, and Uzbekistan poorly address the issues of vertical imbalances. Still not based on regional formulas and standards and norms for cost calculation at the local level, transfers do not ensure full funding of the local services to be provided to the population according to the national standards. This worsens the accountability of local administrations substantially. The main local tasks education and health care are chronically under-funded. Their functioning has significantly worsened over time<sup>47</sup> State programs are simply not implemented at the local level because of underfunding.<sup>48</sup> Additionally, the transfer system is not transparent and thus does not create incentives for revenue mobilization at the local level. In Uzbekistan and Turkmenistan, the transparency is aggravated by the presence of discretionary mutual offset mechanisms. In both countries, the problem of underfunding is often solved with the “voluntary” help of local state and even private enterprises<sup>49</sup> – a highly undesirable result in terms of a business-friendly environment.

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<sup>45</sup> as for Russia, it is stated, that “the nature of transfers included in “mutual settlements” is not clear at all”; Tabata, Shinichiro: “Transfers from Federal to Regional Budgets in Russia: A Statistical Analysis”. In: *Post-Soviet Geography and Economics*, 1998, 39, No. 8, pp.447-460

<sup>46</sup> Nuriev, Sch.(2003): “Voprosy fiskal’noj decentralizacii v Respublike Uzbekistan”. In: *Bozor, Pul, Va Kredit* No. 11, 2003, Tashkent

<sup>47</sup> Economist Intelligence Unit (2003) “Turkmenistan: Country profile”, Y 38183, pp. 16-24 //www.eiu.com; Economist Intelligence Unit (2003) “Uzbekistan: country profile”, pp. 13-19 //www.eiu.com; Economist Intelligence Unit (2003) “Kazakhstan: country profile”, pp. 21-28 //www.eiu.com; CER (2004) “Major directions of reform of government bodies at the local level in Uzbekistan”, Report 2004/05, Tashkent, p.34

<sup>48</sup> surveys undertaken in 2002 among hokims in Kazakhstan showed, that the number of settlements without medical care, who according to the Ministry of Health should have been reduced to 112, in fact still stood at 1094; Institut Ekonomiceskich Issledovanij (2003): “Analiz gosudarstvennyh funkcij, ich optimizacija, povysenie effektivnosti i kachestva ich predostavlenija”, Almaty, 2003, p.33

<sup>49</sup> Myradova, Ch. et al (2005): “Administrativnaja Reforma na Mestach”. In: *Ekonomiceskie Obosrenie* No. 1, (64) 2006, Tashkent

## Horizontal imbalances

The second important issue that should be addressed with intergovernmental grants are the horizontal imbalances between same levels of the budget. They are usually caused by non-homogeneous distribution of natural resources, problems of certain regions with climate and topography, and other regional peculiarities that are responsible for differing regional fiscal capacities. The correction of horizontal fiscal imbalances faces a trade-off: On the one hand, equity is welcomed as a means of poverty-fighting. On the other hand, excessive equalizing reduces incentives for increasing local productivity and labor migration and thus fosters poverty in the long term.

Table 20 shows, that the variation of regional per capita revenues before transfers in Kazakhstan and Turkmenistan has been substantial. After accounting for transfers<sup>50</sup>, this indicator shows an excessive equalization. With the help of intergovernmental transfers, the coefficient of variation in Kazakhstan was reduced by half from 1.06 to 0.56 in 2004. The latter became possible partially due to the system of withdrawals and subventions introduced in 1999. In Turkmenistan, the effect of intergovernmental transfers in was a bit slighter and allowed cutting the coefficient of variation from 0.76 to 0.24. In Uzbekistan the variation of regional per capita revenues is less severe before transfers. Accordingly, equalization after transfers is most obvious: In 2003, the intergovernmental transfers assignment resulted in a reduction of the coefficient of variation of revenues in Uzbekistan from 0.44 before to 0.12 after transfers.

Table 20 **Coefficient of variation of regional per-capita revenues by oblast**

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005_I
<b>Turkmenistan</b>										
Revenues before transfers							0.77	0.58	0.76	
Revenues after transfers							0.26	0.15	0.24	
<b>Uzbekistan**</b>										
Revenues before transfers	0.36	0.31	0.26	0.39	0.31	0.30	0.35	0.44	0.38	
Revenues after transfers	0.17	0.20	n/a	0.23	0.16	0.09	0.11	0.12	0.18	
<b>Kazakhstan*</b>										
Revenues before transfers			0.45				1.14	1.09	1.06	1.02
Revenues after transfers			0.32				0.71	0.67	0.56	0.53

\* not taking into account Astana city, \*\* not taking into account Tashkent city  
Data source: MoF of Kazakhstan, Turkmenistan, Uzbekistan, own calculations

<sup>50</sup> due to data limitations, we did not distinguish between equalizing non-targeted and targeted transfers here, albeit this is formally not correct; in the absence of a clear assignment of tasks and program financing however, we found it hard to distinguish between targeted and non-targeted grants per se even if the data were present. It should be noted, that due to the inclusion of targeted transfers equalization will be overestimated

The excessive equalization of regions observed in Uzbekistan and Turkmenistan may be considered as an heritage of Soviet times. At early stages of transition this excessive equalization could be justified to alleviate the distributive effects resulting from the severe output decline. That may still be a feature for the three countries under consideration. From the incentive point of view however, the degree of equalization in Turkmenistan and Uzbekistan is disappointing and intensifies credibility problems of the center concerning the withdrawal of local over-plan revenues.

## Chapter 7. Sub-national debt/borrowing

Local borrowing serves as a financing instrument for local development projects and provides financial autonomy and strong incentives to the local level. For the central level however, local borrowing bears high risks of non-transparent financial operations and defaults. It constitutes uncertainties for the macroeconomic management and for the control of sub-national and overall public debt. Therefore, sub-national autonomy should be explicit, legally and politically well-defined. Good administrative and managerial capacities at the local level and efficient governance structures are prerequisites for local borrowing.

At the very beginning of transition, in none of the countries under consideration restrictions on the size of the deficit, the level of debt, and the purpose of borrowing for the local budgets were existent. Due to underdeveloped financial markets and limited possibilities to borrow from the private sector, the sub-national governments had to bind themselves with loans from higher-levels of the government. Thus, local borrowing was under control of the center, but local autonomy kept to be restricted by decisions of the center on the other hand.

The local borrowing in Kazakhstan at the early stage of transition was mainly presented by short-term borrowing from the center (MoF). The loans provided by the central government were soft in the sense that they were interest-free and the MoF often “forgot” them. Major problems of debt redemption were experienced either with the poor oblasts such as Zhambyl, or with the oblasts that had the highest GDP and revenue per capita e.g. Kostanai and Pavlodar oblasts.<sup>51</sup> After the budget reform of 1999, Kazakhstan was the first of the Central Asian countries who set up rules for local borrowing. Ceilings for yearly local borrowing, for the debt for the current year, and for debt servicing payments have been set.<sup>52</sup> The purpose of borrowing was still under control by the center. The borrowed funds had to be spent on investment programs and other programs envisaged by the budget legislation. The local government had no power to provide state guarantees for borrowings. The first local bonds in Kazakhstan were issued by the boom-regions oblast Mangistau and the cities Astana and Almaty in the year 1999. Later this type of borrowing spread all over the country and borrowed amounts increased substantially.

With the adoption of the Budget Code in 2004 the conditions of borrowing have been restricted. The Budget code prohibited borrowings of local budgets from abroad. Additional ceilings for the total local debt have been fixed at the level of 25% of the revenues of the respective budget. The responsibility for the debt redemption and servicing was transferred completely to the local budgets. The borrowed funds are to be spent on implementation of investment projects and/or covering cash gaps. These restrictions are

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<sup>51</sup> World Bank (2000) “Kazakhstan Public Expenditure Review”, *WB Report 20489-KZ*, Vol. II, p. 92.

<sup>52</sup> At the end of the decade of the 90th, the Law of Kazakhstan “On State and Guaranteed state borrowing and debt” #464 from 2 August 1999 came into effect. In addition, some provisions were set by the law of Kazakhstan “On Budget System” (Article 22).

in line with international standards and do not hamper incentives for local development. However, due to the still underdeveloped and politically controlled credit market for poorer regions problems with access to credit reduce the overall efficiency of this instrument.

Up to 2001, the legislation of Uzbekistan allowed the local budgets to be approved even without defining a source of deficit finance. Sub-national borrowings were prohibited only in 2001 with enforcement of the “Law on the Budget system”. The law required the local budgets to be balanced. However, it allowed short-term borrowing from central government to cover temporary cash gaps. The same development can be observed in Turkmenistan. Till the year 1996, there were no formal restrictions for local debt and borrowing. After enforcement of the 1996 law “On the Budget system of Turkmenistan”, according to Article 13, the local budgets could not be planned with deficits any more, local borrowing in the open market was prohibited. Such state of affairs in Uzbekistan and Turkmenistan seems to restrict the sub-national government autonomy. However, the permission to borrow would have been meaningless for these two countries since nearly all their local expenditures have to be centrally approved.

## **Conclusion**

In Central Asia, we find high quantitative indicators of fiscal decentralization, but fiscal autonomy at the local level is close to zero, at the expenditure as well as at the revenues side. The transfer system lacks transparency and predictability. This is partly due to the legal transition status of the countries. Many new laws still lack backing by supporting administrative rules and thus enforcement is weak. However, the centralized state structure also plays a role. Administrative decentralization, which delegates competence to the local level is lagging behind in all three countries. Most parameters of the budget are set centrally. Especially in Turkmenistan and Uzbekistan, information and control rights rest completely at the central level. Local self-governance, which might play a role contrasting the state administrative bodies is underdeveloped in all countries and enjoys no fiscal autonomy at all. In a comparative view, Kazakhstan is well ahead of the other two countries, who lag behind in any term. Compared to other transition countries, however, Kazakhstan is lagging behind as well.

Clearly fiscal decentralization in Central Asia so far does not follow the Chinese model. Although like in China political parties would be strong enough to execute effective control at the local level, at the center there seems to exist a deep mistrust against delegation of information and authority. But it is just this delegation that makes incentive mechanisms work. If fiscal decentralization in Central Asia shall render positive effects on growth, governance and corruption, the design of fiscal decentralization has to be changed carefully together with administrative and political decentralization but without endangering control. Further research on the micro level is needed to clear the grounds of this magic triangle.

## Appendix A

Table A1 **Kazakhstan : Assignment of tasks to the local level**

<b>Law on The budget system (02.04.99)</b>	<b>Budget Code (1.1.2005)</b>
Pre-school, primary, secondary, additional and vocational education	Purchase and delivery of textbooks for state oblast educational organizations, additional sport education of youth, primary vocational education, general education, school Olympiads of local level, general vocational education, increasing qualification and re-training, rehabilitation and social adaptation of children.
Provision of health care services at local level Financing local health-care programs	Provision of guaranteed level of health care services, sanitary and epidemiological protection of population, purchase of medicines according to the Law of Kazakhstan, blood production for local health-care organizations, other tasks except those that are financed from the Republican budget
Military enrollment	Military enrollment
Local tasks of public order	Local tasks of public order
Targeted social welfare payments in accordance with the decisions undertaken by Maslikhats	Social welfare payments to orphans, old people, and disabled.
<b><i>Employment programs</i></b>	
Housing and utilities programs	Gasification of settlements
Local cultural programs	The list of responsibilities includes different cultural programs of local importance, e.g. support of theater and music art of local level
Industry and construction at the local level	Local construction programs
	Agriculture
<b><i>Local programs of environment protection</i></b>	
Local transport maintenance and construction	Transport and telecommunications
Debt servicing	Debt servicing
<b><i>SEZ programs</i></b>	
General public services of local importance	General public services of local importance
Transfers to the other budgets	Transfers to the other budgets
	Regulation of economic affairs, for instance support of entrepreneurial activity
	Water rescue service
	Elimination of emergency situations of local importance
	Other local importance programs

Source: the Law of Kazakhstan "On budget system", The Budget Code of Kazakhstan.

Table A2a **Uzbekistan: De-facto assignment of tasks in, According to the law  
“On the budget system” effective from 2001**

	<b>Local government</b>
Education	Kindergartens, Schools, Professional colleges
Health care	Hospitals, rural medical points, medical assistant and obstetric point, emergency aid, blood stations
Culture	Libraries of oblast importance, museums, theaters, editorial staff of local importance
Defense	Negligible expenditures on defense departments preparation of military specialists for “OSO “Vatanparvar””
Fire service	Departments of professional fire service
Public order	Traffic – patrol service
Justice	-
Utilities	Transfers to the enterprises that supply heating and hot water
Social welfare	Fully undertaken by local government
Agriculture	Maintenance of veterinary laboratories, stations for animals diseases’ control, anti-epizootic measures, state seed inspection

Source: Kuchkarov, Haydarov et. all (2004) “Local Budgets through prism of problems”, *Ekonomicheskoe obozrenie*, Vol. 6.

Table A2b **De jure assignment of tasks in Uzbekistan, According to the law  
“On budget system” effective from 2001**

<b>Local government</b>	<b>State government</b>
Science, education, culture, health care, sport Financing budget organizations that are financed by the Republic of Karakalpakstan, oblasts, and Tashkent city)	Science, education, culture, health care, sport Financing budget organizations that are financed by the State)
Social welfare, social protection	Social welfare
	Defense, public order
	Justice
Government bodies of state power in Karakalpakstan, and local government bodies	Government bodies of state power
Maintenance of budget organizations of Republic Karakalpakstan, and local government bodies of different economic sectors	Maintenance of budget organizations of state government bodies of different economic sectors
Maintenance of targeted programs and measures for development of economic sectors according to the legislation	Maintenance of targeted programs and measures for development of economic sectors according to the decisions of Cabinet of Ministers
	Development of agricultural sector
Other purposes	Other purposes

Source: The Law of Republic of Uzbekistan “On budget system” #158-II, Article 22-23.

Table A3 **Turkmenistan: Assignment of tasks to the local level**

<b>Local budgets</b>	<b>Central budget</b>
Production and non-production construction according to the plans of the territory development	Production and non-production construction, research and development, environment protection and other works
Accomplishment of cities, settlements, and villages	
Maintenance of housing, utility objects, roads of local importance	
Organizations of health-care, education, culture, and sport of local importance	Health-care, education, culture, and sport
	social provision
Maintenance of bodies of local self-government and local executive bodies, other purposes	Maintenance of bodies of state government
	Justice, defence, and public order
	Special fund for financing works for overcoming consequences of natural disaster
	Reserve fund
	Debt servicing
	Other measures that are to be financed in centralized manner.

Source: The Law of Turkmenistan "On the budgetary system" from 18.06 1996

## Appendix B

### B1 Revenues of Kazakhstan

In 1999 the Budget System Law was adopted. This law defines the revenue sources of the republican and local budgets as follows (Art. 7):

Tax	Shares (min – max (2003))	Term assigned
<i>Central taxes:</i>		
Corporate income tax (EPT)	50%	permanent;
Excise tax on alcoholic drinks	50%	permanent;
Individual income tax (PIT)	100%	permanent
Social tax	100%	permanent
Value-added tax (VAT)	100%	permanent

#### *Local taxes:*

Property tax;  
Land tax;  
Vehicle tax.

#### *Non-tax revenues:*

Share of profits of locally owned state enterprises;  
Dividends from locally owned joint-stock companies;  
Share of production sharing arrangements (PSAs);  
Environmental pollution fee 20% permanent  
Receipts from the lease of communal property and land.

#### *Local fees:*

Use of local roads;  
Registration fees of individual entrepreneurs;  
State registration of title to real estate and real estate transactions;  
Revenues from capital transactions

#### *Transfers from the republican budget*

General-purpose transfers  
Earmarked transfers  
Earmarked transfers for development

**B2 Revenues of Uzbekistan**

Nationally administered shared taxes with shares of up to 100 percent allocated to subnational budgets as specified on an annual basis in a resolution of the Cabinet of Ministers

Tax	Shares (min – max (2003))	Term assigned
<b>General national taxes</b>		
Excise tax		
Value added tax	100% - 6%	year
Corporate income tax	100% - 7%	year
Personal income tax	100% - 13%	year
Unified tax on SME		
Tax for the use of Earth interior		
Environmental tax		
Water use tax		

**Local taxes****Revenues allocated**

Property tax on enterprises  
 Property tax for physical persons  
 Land tax  
 Unified land tax on agricultural enterprises

**Local taxes and fees set at the provincial level within parameters established in the annual budget resolution**

Infrastructure development tax  
 Vehicle fuel consumption tax  
 Fees charged for the right to trade in commodities  
 Registration fee for entrepreneurial activity

**Non-tax revenues identified in various legislation, including**

Proceeds from privatisation  
 Revenues from leasing of local government property  
 Administrative fees  
 Revenues from economic activities  
 Revenues from auctions and lotteries  
 Voluntary contributions from enterprises and individuals  
 Deposits into extra-budgetary funds for local tax collection or frugality beyond official prognoses

**Transfers from higher tiers of government**

Intergovernmental transfers of general-purpose budgetary support  
 Targeted grants  
 Mutual settlements between budgets for deficit reduction (including forgiveness of budgetary loans from higher tiers)

**B3 Revenues of Turkmenistan**

Tax	Shares (min – max (2003))	Term assigned
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***List of general central taxes shared***

Value added tax	80% - 25%	year
Corporate income tax	80% - 25%	year
Payment for the use of Earth interior	0% 80%	year
Social tax		
Property tax		

***List of local taxes defined by the Order of the President as of 14.12.1993***

Tax for construction of objects of industrial purpose in recreation areas

Recreation duty

Trade permission duty

Licensed fee for the right to conduct trade of vine and vodka

Targeted duties for maintenance of militia, development of territories, etc.

Advertisement tax

Duty from dog keepers

Licensed fee for the right to conduct auctions and lotteries

Duty for issue of apartment voucher

Tax for re-sale of cars, computers

Duty for the use of local symbolic

Duty for operations conducted at stock exchange

Duty for participation in horse racing

Duty for participation in totalisator at the hippodromes

Duty for car parking

Duty for conducting filming and telephotography

***List of local taxes defined by the Tax code(2004)***

Advertisement tax

Targeted duty for developing territories of cities, settlements, and villages

Duty that paid by the owners of car parks

Duty for sale of cars

Duty from dog keepers

***Intergovernmental transfers:***

Dotations	(equalization grants)
Subventions	(targeted grants)

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