

**Document of
The World Bank**

Report No.: 62994

**WORLD BANK SUPPORT FOR REVENUE POLICY REFORM IN
EASTERN EUROPE AND CENTRAL ASIA:
with
PERFORMANCE ASSESSMENT REPORTS
OF ESW
IN GEORGIA, KAZAKHSTAN AND KYRGYZ REPUBLIC**

June 29, 2011

IEG Country, Corporate, and Global Evaluation
Independent Evaluation Group

Currency Equivalents (annual averages)

GEORGIA: CURRENCY UNIT = GEORGIAN LARI (GEL)

2000	US\$1.00	Lari 1.96
2005	US\$1.00	Lari 1.81
2009	US\$1.00	Lari 1.65
2010	US\$1.00	Lari 1.78

KYRGYZ REPUBLIC: CURRENCY UNIT = KYRGYSTAN SOM (KGS)

2000	US\$1.00	Som 47.69
2005	US\$1.00	Som 41.08
2009	US\$1.00	Som 42.08
2010	US\$1.00	Som 45.78

KAZAKHSTAN: CURRENCY UNIT = KAZAKHSTAN TENGE (KZT)

2000	US\$1.00	Tenge 142.18
2005	US\$1.00	Tenge 132.86
2009	US\$1.00	Tenge 147.46
2010	US\$1.00	Tenge 147.36

Abbreviations and Acronyms

AAA	Analytic and Advisory Activities	IEG	Independent Evaluation Group
BEEPS	Business Environment and Enterprise Performance Survey	IFC	International Finance Corporation
CASCR	Country Assistance Strategy Completion Report	IMF	International Monetary Fund
CAS	Country Assistance Strategies	ITD	International Tax Dialogue
CEM	Country Economic Memorandum	JERP	Joint Economic Research Program
CIDA	Canadian International Development Agency	LAC	Latin America and the Caribbean
CIT	Corporate Income Tax	METRs	Marginal Effective Tax Rates
CSAC	Consolidation Structural Adjustment Credit	NLTA	Non-lending Technical Assistance
DEC	Development Economics Department	OECD	Organization for Economic Co-operation and Development
DFID	Department for International Development	PARs	Performance Assessment Reports
DPL (PRSO-1)	Development Policy Lending/Loan (Poverty Reduction Support Operation-1)	PER	Public Expenditure Review
DPOs	Development Policy Operations	PIT	Personal Income Tax
ECA	Europe and Central Asia (Region)	PREM	Poverty Reduction and Economic Management
ESW	Economic and Sector Work	PREM-PS	Poverty Reduction and Economic Management - Public Sector
FEZs	Free Economic Zones	PRSO-1	Poverty Reduction Support Operation
FSU	Former Soviet Union	RAPTG	Revenue Administration and Policy Thematic Group
FTZ	Free Trade Zone	SAC	Structural Adjustment Credit
GDP	Gross Domestic Product	SALs	Structural Adjustment Loans
GoG	Government of Georgia	SME	Small- and Medium-Scale Enterprise
GoKz	Government of Kazakhstan	ST	Social Tax
ICR	Implementation Completion Report	USAID	United States Agency for International Development
		VAT	Value-Added Tax
		WBG	World Bank Group

Fiscal Years

Government of Georgia:	January 1 to December 31
Government of Kyrgyz Republic:	January 1 to December 31
Government of Kazakhstan:	January 1 to December 31

Director-General, Independent Evaluation	: Mr. Vinod Thomas
Senior Manager, IEG Country, Corporate, and Global Evaluations	: Mr. Ali M. Khadr
Task Manager	: Mr. Ismail Arslan

Contents

1. Introduction.....	1
2. Tax Policy: Common Experiences and Potential Lessons.....	5
Revenue Policy Objectives.	5
Reform of Tax Policy and Administration in countries of the former Soviet Union	8
<i>Georgia</i>	11
<i>Kazakhstan</i>	16
<i>Kyrgyz Republic</i>	20
Summary and Potential lessons for Tax Reformers.....	25
3. World Bank Support for Tax Reform, 2000-10: Common Experiences and Potential lessons	29
Concepts for Evaluating WBG Support for Revenue Policy Reform.....	31
<i>Georgia</i>	32
<i>Kazakhstan</i>	34
<i>Kyrgyz Republic</i>	37
Summary and Potential Lessons for World Bank Tax Work	40

Boxes

Box 1. Kazakhstan’s Joint Economic Research Program.....	35
--	----

Tables

Table 1. Tax Revenue in ECA, as shares of GDP	10
Table 2. Georgia: Revenues as a share of GDP.....	12
Table 3. Georgia: numbers of registered taxpayers.....	13
Table 4. Kazakhstan Tax Revenues as percent of GDP 2000-90.....	16
Table 5. The PIT Rate Structure 2003, 2004, and 2007 Reform.....	19
Table 6. Kyrgyz Republic: Revenues as percent of GDP, 2000-10	20
Table 7. Revenue Policy Progress in the Kyrgyz Republic, Georgia and Kazakhstan, 2000-2010.....	25
Table 8. Bank loans and AAA supporting tax reform in Georgia.....	33
Table 9. Kazakhstan: World Bank activities related to taxation	35
Table 10. World Bank support for tax strengthening in the Kyrgyz Republic.....	38

<p>This report was prepared by Steven Webb, Carla Pazce and George Zodrow (consultants) who assessed the projects during a mission in November 2010. Agnes Santos provided administrative support.</p>
--

Annexes

Annex 1: PAR - Georgia: Public Expenditure Review, November 2002.....	47
Annex 2: PAR - Kazakhstan: Tax Strategy Paper.	62
Annex 3: PAR - Kyrgyz Republic: Fiscal Sustainability Report, 2000.....	78
Annex 4. Criteria for Rating Economic and Sector Work.....	94
Annex 5: Persons Interviewed	96

Preface

This review serves both as an in-depth assessment of three pieces of economic and sector work, so-called Performance Assessment Reports (PARs), and as an overall assessment of a thematic area, namely recent revenue policy reforms in three countries of the former Soviet Union (FSU)—Kazakhstan, Kyrgyz Republic and Georgia—and the support that the Bank provided to these efforts. The report focuses on the taxation of non-extractive business sectors, although it also considers energy pricing in Georgia and Kyrgyz, where energy pricing policy has been part of the fiscal reform agenda. Kazakhstan is the only one of the three countries with significant revenues from natural resources, primarily from oil and gas. The Government of Kazakhstan has not invited the Bank to examine that sector, but it did ask the Bank to review the mining sector in a 2002 report and the revenue stabilization fund in the 2004 Country Economic Memorandum. The report also discusses some of the work that the IFC has done on tax administration and policy in the three countries, which has recently become a more important part of the dialogue.

The main report evaluates the Bank's support for such reform in Kazakhstan, Kyrgyz Republic, and Georgia over the decade from FY00 to FY10, nested within a broader assessment of revenue policy reforms in the same period. To set the context, the report surveys the history of revenue policy work at the Bank since the 1980s. The report lays out a framework for assessing tax policy analysis and reform. Drawing on this framework as well as numerous country cases and discussions with tax experts at the Bank, the IMF, and academia, the report describes how the Bank diagnosed and assisted with revenue policy reform in Georgia, Kyrgyz Republic, and Kazakhstan and evaluates progress to date and directions for future reforms.

Georgia and the Kyrgyz Republic were chosen because they had development policy loans in the 2000s with prior actions on tax policy reform and because the Bank had previously done economic and sector work that included substantial work on tax policy. For contrast, Kazakhstan was chosen because it had received substantial economic and sector work on tax policy but had no development policy loan with prior action for tax policy. Evaluative evidence was gathered from reviewing reports, interviews with staff and country counterparts (within and outside the government), from a variety of Bank Group reports (in addition to the three being evaluated), and from task related documents filed in the report management system.

Annexes contain specific assessments of three pieces of ESW to these countries—in Georgia the 2002 Public Expenditure Review (PER), in Kyrgyz Republic the 2000 Fiscal Sustainability Study, and in Kazakhstan the 2008 Tax Strategy Paper. These assessments cover tax policy issues as well as all other aspects of the reports, as the two ESW in the Kyrgyz Republic and Georgia covered some non-revenue issues.

The evaluation team comprised Steven Webb (TTL), Carla Pazce, and George Zodrow, under the direction of Ali Khadr and Ismail Arslan. The Peer reviewers were Mauricio Carrizosa, Russell Krelove (FAD-IMF), and Rene Vandendries. Martha Ainsworth provided thorough and useful comments. The administrative assistants and economists in the World

Bank offices in Tbilisi, Bishkek, Astana, and Almaty provided valuable assistance to the mission that visited there in November 2010, which help the team gratefully acknowledges.

The rating criteria are laid out in Annex 4. Persons interviewed are listed in Annex 5.

Executive Summary

1. All the former Soviet Union (FSU) countries started from a similar point when the Soviet Union collapsed—they lacked a tax system—and made similar steps toward introducing a western style tax system. Since then, different economic endowments and domestic political dynamics, as well as international politics and economic forces, have led them to follow different paths in implementing tax policy. Kazakhstan has had substantial revenue from mineral resources and has had no major changes in political leadership since attaining independence. In contrast, Georgia and Kyrgyz Republic have little mineral revenue and depend substantially on business related to transit trade. Both countries have had substantial political turmoil in the 2000s, with external and internal origins.

2. The countries' experiences illustrate the tensions between the various objectives of revenue policy. The obvious objective of raising revenue is always tempered by other considerations: making the economy attractive to private sector investors, creating incentives for small firms to grow into the formal sector, spreading the tax burden equitably across tax payers, supporting the devolution of fiscal authority to subnational governments, and discouraging activities with negative externalities. These objectives are not in direct conflict, but there are usually trade-offs between them, and we can evaluate the efficiency of a tax system in terms of whether there are policy reform packages that could improve substantially the performance on one dimension without much sacrifice on the others. Of course, tax policy choices also have political dimensions, favoring some individuals and interest groups at the expense of others. Thus the histories of tax policy in these cases concerned whether and how political decision makers could overcome or recombine the special interests in order to improve the tax system on the dimensions listed above.

3. All three countries substantially increased fiscal revenue in the mid 2000s, but this slowed or reversed after 2008. The three still have significant gaps between (non-oil) tax revenue and spending. Kazakhstan makes up the difference with mineral revenue, which appears sustainable for the foreseeable future, even if mineral revenue is not as abundant as projected three or four years ago. In recent years, Georgia and Kyrgyz Republic have been filling the gap with aid flows, which the bilateral components have been granted primarily for geo-political reasons that might not persist in the long term. Government officials and experts in the two countries do not believe this approach is sustainable for the long term, as aid flows seem likely to diminish significantly, which motivates the quest for more tax revenue, subject to the constraints of international economic competition and domestic politics. All three countries also view improved tax administration as a route to increased revenue, but it is not clear whether this will be adequate to close the gap for Georgia and Kyrgyz Republic if aid flows fall significantly.

4. Governments in the three countries recognize the importance of tax reform as part of the agenda to improve the investment climate for the private sector. During the 2000s this concern increased in priority to take a place alongside revenue-raising as one of the two prime motives for revenue policy reform. The Doing Business ratings were getting front-page headlines in 2010. Despite this concern, the ambiguities in the tax code and occasionally excessively harsh enforcement measures still create problems for the private

sector. The countries and the World Bank Group (WBG), increasingly with the International Finance Corporation (IFC) in the lead, are now devoting more attention to this aspect of revenue administration. The new tax code in Georgia and the tax administration reform project in Kazakhstan, both supported by the WBG, have measures that aim to reduce this problem.

5. Equity considerations that would use tax policy to shift the tax burden from the poor toward the rich do not appear as primary concerns in any of the three countries. The tax reform programs to date have also not given much attention to the problem of horizontal inequity, where persons of similar income levels bear very different tax burdens. An obvious example of this is where upper middle income individuals pay different tax rates, depending on whether they earn wages in the formal urban sector, or are in the informal or agricultural sector. What attention there is to equity is mainly about raising revenue for social programs, which tend to be pro-poor in their incidence. In the area of energy pricing, where burdens on the poor are a concern, the unreformed subsidy policies usually give more benefit to the rich than to the poor. The Bank's analytic work has pointed out this issue and Georgia has made appropriate reforms.

6. The significance of revenue policy in the World Bank Group activities varies across countries and over time since 2000, the period covered in this report. In Georgia, there was some dialogue on revenue policy in the years just before the Rose Revolution in 2003, but not leading to results. Since then the government has forged ahead with its own motivation on the tax policy agenda, but the Bank played an important supporting role in endorsing the radical reform in 2005, which some other international financial institutions (IFIs) raised doubts about, and recently with support for tax administration reform (2010), especially to reduce the compliance costs of paying taxes. In Kazakhstan since 2006, taxes have been a major issue in the country program, which centers on a jointly funded program of analytic and advisory activities (AAA), and in FY10 there was an investment loan to support administrative improvements. In Kyrgyz Republic the government and the Bank showed interest in tax policy reform in 2000, but political changes derailed that effort. Since 2007 the IFC has picked up the tax dialogue there with a focus on treatment of small and medium enterprises (SMEs).

7. In Georgia, the Public Expenditure Review (PER) in 2002 was a good report in technical quality, including its chapter on tax policy, but the government at the time showed little interest in the recommended reforms and there was little dissemination. Following the Rose Revolution, a new government in 2004 took a positive attitude toward reform. They implemented a major tax reform along the lines of what the tax chapter of the PER had recommended, although the reform was more radical and led to more successful results than would have been expected from the implementation of the report's recommendations. Many ideas from the PER were incorporated in the Bank program after 2004, although usually without explicit reference to the report. Thus, the results are rated *moderately satisfactory*. Although the PER was strategically right in identifying improved revenue mobilization as a key condition for improving expenditure management and carrying out effective poverty reduction programs, the report was delivered at a time when there was not a coherent country assistance program and when the government was ready to act on the recommendations. There was no evidence of strong interest by the government, and no engagement of civil

society. Thus the strategic relevance and ownership are rated *moderately unsatisfactory*. The report is solid in its analysis, bringing in a lot of comparative information for Georgia and other FSU countries, and collecting and analyzing new data on health spending in Georgia, using pilot expenditure tracking surveys. The report made recommendations in all the policy areas covered; they were especially clear and actionable on taxes, financial management and intergovernmental fiscal relations. Thus, quality is rated *satisfactory*. Dissemination and dialogue are rated *unsatisfactory* since there was no dissemination outside the government and dialogue essentially ended when the person of minister of finance changed.

8. In Kazakhstan, the bulk of the work on taxes has been through AAA, mostly under the Joint Economic Research Program, which the government co-finances. The Tax Policy and Administration Study, published in 2008, was the centerpiece. Volume I on tax policy was largely completed a year earlier and served as a guide for revising the tax code in 2007. Volume II on tax administration set the main parameters for the 2010 Tax Administration Reform Project loan. Other AAA on taxes included a chapter in a 2002 Review of the Mining and Mineral Sector and a 2010 study of SME taxation. The report brought positive results in tax policy, with many but not all of the recommended reforms being implemented, and the 2010 Tax Administration TA loan seems on track to support implementation of most of the recommendations for tax administration. The report has had a highly positive result in the Bank program, with a central place in the Joint Economic Research Program and follow-on economic and sector work (ESW) and lending, for tax administration reform. Thus, the task is rated *satisfactory* for results. It was timely to do this report while the oil revenues were high and the country could focus on improving the efficiency of the tax system and its effects on the business environment. The government ownership of the study was strong and it financed over half of the study. Thus the strategic relevance and ownership were *satisfactory*, and would have been better if the study had included something on the petroleum sector, in order to have a full discussion of the country's revenue strategy. The *highly satisfactory* technical quality makes report this report valuable not only for Kazakhstan, but also as an example and possible template for tax work in other countries. The chapters on capital taxation and the value-added tax (VAT) were especially strong. Dialogue with the government counterparts was well supported by the study, although dissemination beyond the government and its close associates was more limited. The task is rated *satisfactory* for dissemination and sustained dialogue.

9. In Kyrgyz Republic, both the Fiscal Sustainability Study (with a chapter on revenue policy) and a related structural adjustment credit were done in 2000 with a government that seemed open to reform but that did not stay in office long enough to implement most of the reforms. Unfortunately, the subsequent governments, including two brought in with revolutions in 2005 and 2010, dropped ownership of the Fiscal report. On government programs there was modest impact over the long term. Although the government at the time was receptive to the ideas in the study, it did not stay in power, and thus little was done in direct response to the report. Over the next decade the government took some reforms recommended in the report, but without reference to the report, and there was some backtracking. Most of the basic problems identified in the report have persisted, however, especially fiscal imbalances (before grants), distorting taxes, and energy prices too low to cover costs. The most important positive result was probably the rescheduling and partial reduction of Kyrgyz Republic's official debt—a major recommendation of the report. On the

Bank's program, there was modest impact in that many of the ideas from the fiscal study showed up in the next Country Assistance Strategy (CAS), but there was no attribution to the study. Thus the results are rated *moderately unsatisfactory*. The report was timely in identifying key development constraints and was delivered at what seemed to be an appropriate time. It had government ownership when it was prepared, although within less than a year that government was out and the successor governments did not give it much regard. Still, the issues it identified remained relevant throughout the decade, so the strategic relevance and ownership is rated *moderately satisfactory*. The fiscal sustainability section was of high technical quality, using state of the art analytical techniques and making good use of local data. The tax policy analysis was satisfactory—describing the tax system and its problems. The discussion of infrastructure and utility enterprises was satisfactory on the main sectors, energy and water. The chapter on safety nets dealt well with the problem of assuring affordable access by the poor to essential infrastructure services. Recommendations were clear and actionable. Thus the quality of the ESW is rated *satisfactory*. Dissemination and sustained dialogue are rated *moderately unsatisfactory*, however, because the initially good dialogue—reaching the right audiences with the government and private sector—was not sustained after the change of government, less than a year after completing the report. The report was not revised or kept alive for use with subsequent governments.

10. The experiences point to some lessons about tax policy. First, tax policy needs to balance various objectives, even if the specific analysis at hand puts most of the focus on only one or two objectives. When either revenue raising or projecting an investor-friendly tax environment was overemphasized, it caused subsequent problems, either by discouraging growth or by losing so much revenue that inefficient taxes or extremely zealous collection and enforcement become necessary. The revenue and investment climate considerations can be reconciled, as was done some of the time in Georgia and Kazakhstan.

11. Second, strengthened tax administration was important in not only for implementing the policy reforms, but also because the increased revenue gave the government the fiscal space to take some decisive policy actions, even if they would pay off with revenue gains only in the medium term. The main focus of this enforcement effort was through units that specialized in large taxpayers; these brought in the majority of the revenue.

12. Third, one should consider the whole tax system. Simplifying the structure and lowering the level of rates for the formal sector are beneficial, all else equal, but the treatment of micro and small enterprises is also critical for limiting evasion out of the small-scale end of the tax net. The focus on medium and large taxpayers in the three countries was achieved partly by leaving micro and small enterprises (and some medium) in exceptional regimes, requiring few resources for compliance or enforcement. These regimes also had much lower effective tax rates than the regular regimes, creating strong incentives and opportunities for enterprises to use them as channels for evasion. Georgia has already started to address this problem with the 2010 tax code, going into effect in 2011, and the Bank Group's AAA has drawn attention to the issue in Kazakhstan and the Kyrgyz Republic.

13. In programming WBG support for tax policy reform, the three country experiences show the value or potential value of good analytic work. The AAA since 2006 in all three countries has had positive results. Political upheavals disrupted the results from earlier AAA

on taxes in Georgia (2002) and the Kyrgyz Republic (2000), but the analysis and recommendations pointed in the right directions, and one could not have known ex ante that the political events would limit the usefulness of good AAA.

14. Lending (or grants) was not used to support sustained tax reform. Lending to Georgia in 2004-10 helped give a little more fiscal space to embark on some reforms that might have cost the government some revenue in the short term, but the government was already committed to the course of reform. In Kazakhstan, there was no policy based lending related to tax reform. The government asked for and helped pay for the analysis and advice of the Bank on taxes. The Joint Economic Research Program in Kazakhstan, agreed on with a medium term vision and co-financed by the government, seems to be a model that other upper-middle income countries might consider.

15. The WBG, rather than the International Monetary Fund (IMF), has taken the lead on tax policy issues in all three countries in the 2000s. This shows the value of having independent tax policy capacity at the Bank.

Vinod Thomas
Director-General
Evaluation

1. Introduction

1.1 Georgia, Kazakhstan, and to a lesser extent The Kyrgyz Republic have significantly improved their tax systems since 2000, increasing revenue collection as a share of gross domestic product (GDP), while streamlining the structures and lowering the rates of their main taxes, eliminating many of the exemptions to income and value added taxes, and eliminating many small nuisance taxes. The revisions of the 2000s aimed to correct shortcomings of the urgent and hasty set up of tax systems in the 1990s, following the countries' establishing independence from the Soviet Union and the dismantling the old socialist economies. This report discusses the achievements and limits of these reform efforts in the three countries and assesses how the World Bank supported these efforts.

1.2 In the 2000s, all three countries moved to single unified rates on personal income taxes (PITs), not progressive, and these rates are down to the 10-20 percent range. Previously the upper ends of the progressive tax rates were in the 30-50 percent range. This includes the social tax (for pensions and health) in Georgia, but the social tax is additional in Kazakhstan and The Kyrgyz Republic. Corporate profit tax rates are low at 10 to 20 percent, compared to over 30 percent before 2000, and previously differentiated VAT rates are unified at 12 to 18 percent. This structure applies for medium to large formal sector firms and employees; all three countries have quite different regimes for small to medium firms and individual entrepreneurs, leaving them to varying degrees in the informal sector, as discussed below.

1.3 Although these improvements have appropriately received approval from domestic stakeholders and gained international accolades, some important problems remain. In addition to country-specific issues, there are four common problems with the tax systems and their administration:

- First, all three countries still see a significant gap between tax revenues and what seems to be the minimum level of spending that the political situation requires. In the latter 2000s Georgia and the Kyrgyz Republic received sufficient donor grants and lending to cover the gap, but the authorities do not see this as sustainable and anticipate they will have to raise more revenues. Kazakhstan has filled the gap with mineral revenues, which is sustainable for the time being, and for a time even ran surpluses.
- Second, the regular corporate tax regime, which applies to all large firms and toward which medium-sized firms should migrate as they grow, is complex and difficult for administrators and firms to interpret, especially since the codes and bylaws often contain contradictory articles. The resulting ambiguity leads to diverse interpretations, and neither the courts nor the administration give definitive interpretations that remain constant over time and are applied uniformly across cases. The situation has been aggravated by the tax code being frequently amended.

- Third and closely related to the second point, the tax authorities sometimes seem to take advantage of the lack of clarity in the tax law, as they are often unreasonably aggressive in dealing with firms that make mistakes in filing, exacting fines well in excess of alleged underpayment or demanding bribes. (Interviews and surveys like BEEPS indicate that bribery has declined dramatically under the post-Rose Revolution government in Georgia and is declining in Kazakhstan; in the Kyrgyz Republic bribery remains more problematic and other aspects of enforcement are less strict.)
- Fourth, each country has two or more special simplified regimes for micro and small enterprises. Not only are the reporting requirements simpler under these regimes, which reduces both administrative and compliance costs—a good thing— but effective tax rates (often lump-sum annual payments) are much lower than under the regular regime, especially for firms that are near or above the legally defined threshold for small enterprises. The big differential in effective tax rates gives enterprises a strong incentive to stay out of the regular tax regime and out of the formal sector more generally, by under-reporting income and employment, subdividing their businesses, and using other tactics to avoid becoming subject to the regular tax regime. This runs counter to the Bank's standard SME strategy of helping such firms grow into fully legitimate firms that enter the regular corporate tax system and also abide by good standards in other areas, such financial transparency, labor practices, and environmental regulations. Since these SMEs are the most dynamic element of the three economies and responsible for a significant fraction of employment generation, their avoidance of full participation in taxation is one reason for the shortfall in aggregate revenues and a need for higher rates on larger enterprises. Thus usually results in greater pressure on tax authorities to extract more revenue from larger firms.

1.4 The second problem—the lack of clarity in the tax law and the overly aggressive enforcement—points to a more general issue about the distinction between tax policy and tax administration. The World Bank's policy based lending and AAA on tax policy generally focused on the number of taxes and the definition of their bases (including exemptions) and the tax rates applied to those bases. By comparison, the Bank's diagnoses and projects on tax administration have traditionally focused on the internal organization of the tax agency, its business processes, software and hardware—the back office of tax administration. Only more recently has attention turned to the legal basis and actual practice of how the revenue administration agency enforces the taxes—the front office of tax administration. One goal of the Bank's work in all three countries was the adoption of risk-based audits to ensure efficient utilization of the tax authority's resources, and by the late 2000s the WBG was giving more attention to the enforcement side of tax administration.

1.5 The broader issue is the legal predictability and the actual and perceived fairness of the tax enforcement process. The private sector representatives that met with the mission raised these issues as major concerns, especially in Kazakhstan and Georgia, where the tax enforcement regimes are increasingly strict. Certainly tax administration needs to be strict enough to assure high levels of compliance, which was a problem a decade ago in all three countries, and is still somewhat a problem in The Kyrgyz

Republic. On the other hand, improving the business environment—a concern of all three governments—requires that the tax administration be predictable and fair, and that penalties be commensurate with the seriousness of the offense. Indeed, private sector representatives in Georgia said that they would be willing to pay a somewhat higher tax rate, if the tax rules were clearer and enforcement practices more reasonable. In order to encourage long term growth of the economy and thus expansion of the tax base, the tax authorities must maintain an effective but reasonable standard of enforcement of a well-defined and clear set of tax rules.

1.6 Chapter 2 discusses the tax policy histories of the three countries in the 2000s, showing the similarity of issue and diversity in the ways they have gone about the reforms. There is rarely an overt line of causation between some AAA by the Bank and the policy changes that a government makes. To varying degrees countries may be inclined toward reform in an area before the work starts, and if the AAA increases their inclination to reform or refines their idea of how to design the reform, authorities vary in their willingness to attribute it to the World Bank. Thus, the policy events in chapter 2 are partially but not totally the results of the Bank’s policy dialogue, and the chapter focuses on the stories themselves. Then, chapter 3 focuses on how the World Bank Group has been active in all three countries in supporting the reforms to tax policy and administration, although the modalities and emphasis have varied.

1.7 Annexes 1 through 3 contain specific assessments of three pieces of ESW to these countries—in Georgia the 2002 Public Expenditure Review (PER), in Kyrgyz the 2000 Fiscal Sustainability Study, and in Kazakhstan the 2008 Tax Strategy Paper. These assessments cover tax policy issues as well as all other aspects of the reports, as the two ESW in the Kyrgyz Republic and Georgia covered some non-revenue issues.

2. Tax Policy: Common Experiences and Potential Lessons

Revenue Policy Objectives

2.1 The primary objective of tax policy is to raise revenue for activities of the state. Taxation also has multiple additional effects on the economy, however, and thus the design of tax policy must meet many other objectives. Moreover, since there is always an existing tax system, the agenda for reform of revenue policy consists of moving tax policy in the right directions, relative to the status quo, and toward international best practice in meeting these objectives as seen by the World Bank. What are these multiple objectives for tax policy and tax reform?¹

➤ *Raise sufficient public revenue.* This objective is not an end in itself, but is the means for financing delivery of essential public services, including utilities, while keeping current borrowing, total debt and aid flows at sustainable levels. Domestic taxes are a major and usually the main source of revenue and thus the focus of policy attention. Customs duties, natural-resource royalties, state-enterprise revenues, and fees for services are other potential revenue sources. Revenue policy should be coordinated across all these sources.

- *Achieve a stable revenue system.* The tax system should be designed to minimize revenue fluctuations and to be robust across economic cycles—both macroeconomic cyclical fluctuations as well as boom and bust cycles in mineral prices—and to have a countercyclical overall effect. This is facilitated by choosing and designing tax bases that are relatively stable over the business cycle (e.g., consumption rather than corporate income) and achieving revenue diversification by using different kinds of taxes (direct and indirect), taxes on spending, income and asset values, and by planning for variations in resource (both tax and non-tax (mineral royalty)) revenues.
- *Minimize transitional problems.* Changes in revenue policy need to be introduced in ways that maintain adequate revenue flows during the transition to the new tax structure while avoiding large economic disruptions, including large changes in asset values. Tax policy advice should thus include ways to monitor and manage the transition.
- *Facilitate tax administration and enforcement by the government and compliance by taxpayers.* The tax administration agency should be effectively organized and have sufficient capacity to administer and enforce the tax system effectively. The tax system should be as simple as possible, given other objectives, to facilitate both enforcement and compliance by businesses and individuals. In particular, tax administration, enforcement and compliance are facilitated if the legal

¹ A recent paper by the IMF Fiscal Affairs Department has a similar list of objectives, although not as formally spelled out (IMF 2011, pp. 4-5, 7-8).

specification of the tax system avoids unnecessary complexity while adopting consistent and easily interpreted rules that measure all tax bases accurately and apply the rate structure to those bases uniformly.

➤ *Improve the environment for private sector investment and growth.* In most cases, taxes distort business and individual decision making and create disincentives for economic growth and development (before considering the potential pro-growth effects of spending financed by the taxes). To the extent consistent with other objectives, tax policy should be designed to minimize these distortions and disincentives. This objective has several dimensions:

- *Reduce tax disincentives for investment and saving.* Tax reform should reduce the extent to which the tax system reduces the overall level of investment (from domestic and foreign sources) and thus the size of the capital stock in the economy. Tax reforms should also reduce the extent to which the tax system creates disincentives for household saving. In particular, taxes based on consumption are generally neutral with respect to household saving decisions, while taxes based on income or wealth are biased against saving while favoring current consumption.
- *Reduce tax disincentives for employment.* Reforms should reduce the disincentives for employment and labor supply, especially in the formal sector. More broadly, the tax system should minimize distortions of decisions regarding human capital formation, work effort, job choice, the form of compensation, and the uses of labor earnings. Eastern Europe and Central Asia (ECA) countries have been especially concerned about taxes on labor in the formal sector that are not offset by direct benefits tied to participation in the formal sector and thus encourage participation in the informal economy.
- *Reduce tax-induced distortions of the allocation of capital and investment.* Taxes can distort the allocation of capital and investment across different types of capital assets, business sectors and geographic areas, distort decisions regarding the method of finance (e.g., debt vs. equity), and distort decisions regarding the distribution of profits (e.g., retained earnings vs. dividends, and dividends vs. share repurchases)—distortions that lead to sub-optimal business decisions and reduce productivity, economic growth and development. Reducing such distortions should lead to growth of the overall tax base and revenues in the medium and long terms, although it may have short-term negative effects on formerly tax-favored activities. The extent of these distortions is often measured by calculating marginal effective tax rates (METRs) on capital income earned by prospective investments in different assets or sectors (or regions, or any other category of investment) that are financed in specific ways. The average level of METRs indicates the level of distortions of the overall level of investment, while

the variation in METRs across assets, sectors, or regions indicates the magnitudes of the tax distortions of the allocation of investment across these categories.²

- *Reduce tax-induced distortions of the allocation of labor.* Similarly, tax reforms should reduce the extent to which the tax system provides for differential treatment of labor across business sectors and regions (and any other category), and thus distorts the allocation of labor, reducing economic growth and development.
- *Achieve a fair distribution of the tax burden.* The fairness of a tax system is difficult to determine, given the wide variance in views regarding how to define fairness. However, there is general agreement that the tax system should:
 - *Achieve basic fairness within each income group.* The tax system should impose similar tax burdens on people who have the same taxpaying capacity, e.g., individuals who are at similar income levels and household situation. Middle and upper income individuals should not be able to easily reduce their tax burden by moving to or staying in the informal sector.
 - *Achieve the desired level of redistribution, taking into account both the tax and expenditure systems.* A public finance policy consistent with a poverty-reduction objective involves more than minimizing the tax burden on the poor. To assess the allocation of the total fiscal burden properly, one should not focus solely on taxes but also consider the spending side of fiscal policy, where the redistributive effects of public policies are usually most significant. Thus, the regressive effects of a tax system can be more than offset with a highly progressive expenditure system, for example, one that provides benefits that are roughly uniform on a per capita basis. In particular, designing the tax system to protect the poor and avoid tax regressivity often results in a tax system that does not raise revenue effectively (as often occurs in Latin America), with the result that the public sector lacks the resources to provide public services that would disproportionately benefit the poor and help to maintain their standard of living (World Bank 2002, 2004; Eduardo Engel et al., 1999).
- *Design a tax system consistent with the devolution of tax and expenditure responsibilities to subnational governments.* To the extent such devolution is consistent with other policy objectives, the tax system should facilitate it. This requires granting revenue sources to subnational governments that accord with their spending responsibilities, granting subnational governments considerably flexibility in designing tax and expenditure policies, and ensuring that subnational governments face a “hard” budget constraint, without an expectation of federal bailouts if they fail to balance their budgets.

² The tax system can increase (or decrease) incentives for private risk-taking. This is good to some extent as a means of fostering the innovation and invention that leads to economic growth and development. At the same time, the tax system should not encourage an inefficiently high level of risk-taking.

➤ *Discourage economic activities that generate negative externalities.* The primary example of a negative externality is pollution, and taxes on harmful emissions of pollutants can both improve resource allocation and raise revenue. Taxes on tobacco and alcohol consumption can also be justified as offsetting negative social externalities, although they are also often imposed on paternalistic grounds as well. On the other hand, certain activities may generate positive national externalities, such as productive research and development, and should thus receive preferential tax treatment (although great caution should be exercised to limit such tax preferences to activities with clear and significant positive externalities).

2.2 Often there are tensions between these multiple objectives, so that the political system within each country must determine how to weigh the many tradeoffs that must be made. The World Bank can add value in this process by helping policymakers and citizens anticipate the economic effects of different tax policies, clarifying the tradeoffs among objectives, and showing how to weigh the various criteria for a good tax system. In the cases examined, there were almost always possibilities to make the system more efficient in the sense of having policy packages that would improve the performance on one or more dimensions without sacrificing much on the others. Often the challenge in practice has been the political influence of special interests—essentially beneficiaries of inequities in the system. These include special tax regimes, product and sector exemption, and areas of weak enforcement of the tax code, sometimes because of corruption.

Reform of Tax Policy and Administration in countries of the former Soviet Union

2.3 The tax agendas in the countries of the former Soviet Union (FSU) have expanded emphasis in the last two decades from generating fiscal revenue to also improving tax administration and improving the investment climate, overall and especially for SMEs. Public finances in the Soviet Union had relied mainly on earnings from state-owned enterprises. As the Soviet Union broke up and state economic assets were privatized or simply looted by insiders, revenues plummeted, while many state spending responsibilities remained, at least on paper, although the prescribed levels of spending were rapidly eroded by inflation.

2.4 In the 1990s governments in the FSU focused on getting revenue to stabilize the state, and the World Bank, IMF and bilateral donors helped them to achieve this goal. By the late 1990s the IMF had developed a standard template—dubbed the tax code of the Transition Republic of Taxastan—from which each country could develop its own tax laws. This template was based for the most part on the tax codes of Georgia (1997) and Tajikistan (1998), and also drew on the tax codes of Kazakhstan (1995), Russia (1998), Kyrgyz Republic (1996) and Uzbekistan (1996). A good definition of tax policy for purposes of this report comes from the IMF template: “This Code establishes the principles of organization and operation of the tax system of the Republic of Taxastan, the procedure for introduction, change, and abolition of national and local taxes, determines the legal status of taxpayers, tax authorities, tax agents, and other participants in relations regulated by the tax legislation, institutes provisions for determination of the objects of taxation, fulfillment of tax obligations, and implementation of enforcement measures for national taxes and basic provisions on local taxes, tax accounting,

responsibility for tax offenses, and appeals against action (inaction) of tax authorities and their officials.” (Article 1) In the 2000s, following the lead from the Baltics in the 1990s, many other FSU countries adopted more or less flat income taxes, which can be defined as a “...flat rate (that is a proportional rate [not progressive]) on all sources of income and businesses, but avoids double taxation” (Saavedra 2007). In Georgia, Kazakhstan and The Kyrgyz Republic, the income taxes did not fully achieve this flat-tax ideal, but as detailed below they did move to a unified rate for all formal sector corporations and a unified rate (different from the corporate rate) for personal income above a certain threshold of those employed in the formal sector.

2.5 In FSU countries the typical fiscal picture went from free-fall in the early 1990s to problems of medium-term debt sustainability by 2000. By then there was an identifiable set of large private and semi-public enterprises that could be monitored and taxed by the tax authorities. Newly created large taxpayer units focused on them, and revenue flows increased. This solved most of the short-term fiscal problem, but farsighted officials and external advisors recognized the need to broaden not only the tax base but also the size of the formal economy, bringing SMEs out of the shadow economy and creating a path and incentives for some of them to grow in size and become subject to the regular tax system.

2.6 The FSU had a tradition of weak democratic checks on a strong state bureaucracy, although the government was often inefficient and corrupt. State tax services reflected this—with tax agents collecting revenue to meet quotas rather than enforcing a clearly specified set of tax laws. In particular, much of private sector employment was in SMEs in the informal sector, which usually paid some tax but at a lower effective tax rate (on profits or turnover) than larger firms in the formal sector, with a significant fraction of revenues finding their way into the pockets of tax inspectors and fiscal police, leaving much less for the state budget.

2.7 Given this situation, the story of tax policy in the 2000s in the three countries is necessarily integrally linked with the improvement of tax administration, which has at least two parts. The part of tax administration that World Bank projects usually address—restructuring the internal organization and business processes of the tax collection agencies and improving information systems—is not our concern here. Instead, we focus on the other part of tax administration—the part that is imbedded in tax policy as expressed in the tax laws which address questions such as which categories of taxpayers are taxed under which regime, how complex is the tax code under each regime, what legal authority does the tax administration have, and what is the effective legal treatment of taxpayers who are found in violation and of tax inspectors who demand bribes. These issues are covered in the definition of the Taxastan tax code, as mentioned above, and have been important dimensions of the tax policy reform agenda in Georgia, The Kyrgyz Republic and Kazakhstan in the 2000s. Since this dimension of tax administration *cum* policy affects directly the environment for private business, the Investment Climate group in International Finance Corporation (IFC) has taken a strong interest in this issue and has sometimes had the lead on this within the World Bank Group (WBG) (IFC 2007).

2.8 Table 1 gives a comparative overview of tax revenues and spending levels. One can see that tax revenues in Georgia and The Kyrgyz Republic are now around the median for the ECA region—23 to 25 percent of GDP, having come up from less than

15 percent of GDP in 2000. Kazakhstan relies on taxes on oil production to bring its revenues up to around the median; earlier in the decade, its tax revenues were higher—15 to 17 percent of GDP.

Table 1. Tax Revenue in ECA, as shares of GDP

<i>Country and year</i>	<i>Tax Revenue (non-mineral)</i>
Georgia (2009)	25
Kazakhstan (2009)	13 (23 with oil)
Kyrgyz Republic (2009)	23
Tajikistan (2009)	19
Poland (2008)	32

Source: IFC 2010 for Georgia, Kazakhstan, Kyrgyz Republic and Tajikistan. WB intranet for Poland.

2.9 We see the shift of orientation from raising revenue to improving business climate in the Kyrgyz Republic. The 2000 Fiscal Sustainability Study had a chapter on taxes, and in the Consolidation Structural Adjustment Credit (CSAC) 2000 the tax actions for Kyrgyzstan were grouped under the fiscal heading. In recent years, however, the IFC has taken over much of the WBG role on tax policy as part of its program to improve the business climate for SMEs (World Bank Group 2007). Similarly in Georgia, in 2002 the ESW covering taxes was a chapter in the PER, motivated by the need to increase the stability and level of government revenue, while by the time of the Poverty Reduction Support Operation in 2005 the prior actions on taxes in were in the section that focused on improving the investment climate. The IFC worked closely with the government to write the SME section of the new tax code in 2010; and in Kazakhstan they played a major role in designing the 2010 Tax Administration project.

2.10 In Kazakhstan, hydrocarbon revenues had made the government’s fiscal position strong enough by the 2000s that it was not borrowing with policy reform loans and instead used its own funds to help pay for AAA, including the 2008 study on taxes. The study recommended reforms that would “ease administration, motivate self-compliance, make the system pro-poor, encourage investment, [and] reduce corruption incentives” (p. i). Unlike Georgia and The Kyrgyz Republic, but like some other FSU countries, Kazakhstan has enough mineral income for the taxation of natural resources to be a major source of revenue, so that it has more flexibility in designing its taxes and emphasizing improvements in business climate, especially in the non-resource sector.

2.11 In general, shifting the tax policy dialogue toward issues of business climate is both consistent with the concerns of top policymakers—evident for instance in their attention to indicators like Doing Business, which was mentioned frequently during the mission—and with the practical concerns of business leaders, who see the actual implementation and enforcement of the tax code as major hindrances to economic growth and development. And reforms that improve the business climate—which follow the traditional prescriptions of broadening the base by eliminating exemptions and tax preferences and then lowering rates while improving tax administration—help to achieve the revenue, efficiency (reduction in tax distortions), fairness, simplicity, and transparency objectives outlined above. The country cases discussed below provide examples. They are ordered here according to the extent of revenue policy reform

achieved by the end of 2010: Georgia with the most, then Kazakhstan, and finally The Kyrgyz Republic. The timing of the start of the second round of revenue reform was chronologically different, however: The Kyrgyz Republic since 2000 off and on, Georgia since 2005, and Kazakhstan since 2006.

GEORGIA

2.12 ***Fiscal Context.*** Georgia's total fiscal revenue in 2000-01 averaged only about 16 percent of GDP, only 12 percent of which came from taxes. This was not fiscally or politically sustainable. New measures, starting a little before the Rose Revolution of 2003³ and accelerating thereafter, increased tax revenues to 18 percent in 2004 and to 25.8 percent in 2007, surpassing the target of 20-25 percent (see Table 2). The rise was even larger in absolute terms, as economic growth also accelerated, at least until the dual crises of 2008—the conflict with Russia and the global economic downturn. How was this possible? The GoG pursued a radical program of eliminating exemptions and special regimes, strengthening enforcement, and lowering tax rates. One important factor was that a higher percentage of firms and individuals were paying taxes.

2.13 Improved enforcement was the most important factor in raising revenues, especially the elimination of corruption, which happened very fast. In less than a year, the regular police and fiscal police were reconstituted. Bribe taking by tax agents, as well as other public employees, stopped when the new fiscal police made publicized arrests of many high-profile businessmen for tax evasion, and everyone else started paying tax rather than paying smaller bribes for fear that they might be arrested. The simplified tax code also helped by making it clearer what people owed. The reduced tax rates, the end of petty corruption, and simplified regulatory rules made Georgia a more attractive destination for investment. From 2006 until mid 2008, foreign direct investment increased rapidly.

2.14 ***Tax Policy Timeline Summary.*** Georgia's post-independence tax system was set up in the 1990s, like that of all the FSU countries. The IMF's Taxastan model was based in part on Georgia's tax code enacted in 1997 (IMF 2000). It had the standard tax structure of a middle-income country—VAT, customs duties, excise taxes, a land tax, and personal and corporate income taxes—but the taxes were poorly implemented, weakly administered, rife with exemptions and special regimes, and plagued with corruption. Payments to revenue agents instead of directly to the treasury were common, creating a huge potential for corruption and adding to the cost and uncertainty of doing business, while bringing in relatively little revenue. The PER in 2002 noted these problems and made the standard recommendations for policy reforms—reducing the highest income tax rates and the number of rates and eliminating most exemptions to the VAT and the

³ “The peaceful Rose Revolution of late November 2003 was a popular uprising against years of mismanagement and corruption in government, triggered by frustration over fraudulent abuses in parliamentary elections. Presidential elections were held in early January 2004 and the new President, Mikhail Saakashvili, obtained 97 percent of the votes in an election considered by domestic and international monitors as largely corruption-free. The election results were interpreted as a strong endorsement of the call for a deep and far-reaching fight against corruption and poor governance.” (Georgia: PRSO I: PAD, 2005, p.1)

income tax. The government at the time, however, did not take significant action. As a result, electricity and other public services deteriorated badly, due to the prevalence of corruption and the shortage of revenues. Although there was some positive GDP growth after the 1998 Russian debt crisis (which affected the whole region), incomes in 2003 were still less than half of their pre-independence level. When the new government came into power in 2004 (following the Rose Revolution in November 2003), it decided to radically liberalize the economy, including public finances. New tax legislation simplified the Tax Code in 2005 and resulted in a substantial reduction of the tax burden on firms and individuals, that is, on those firms and individuals that were actually paying taxes, while increasing collections from those who had previously avoided or evaded tax.

Table 2. Georgia: Revenues as a share of GDP

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010f
TOTAL REVENUE	15.2	16.3	15.8	16.2	21.7	23.4	26.7	29.3	30.7	29.3	28.5
1. Total Tax Revenues	11.7	12.0	14.4	15.0	18.2	19.8	22.9	25.8	24.9	24.4	23.7
Personal Income	1.8	2.0	1.9	1.9	2.7	2.5	2.8	3.1	6.8	6.2	
Profit tax	1.3	1.0	1.1	1.2	1.6	1.8	2.5	3.3	3.1	2.9	
Social tax	...	...	...	...	...	2.7					
VAT	4.8	5.4	5.5	5.5	6.3	8.5	9.7	11.6	10.8	11.4	
Customs duties	0.9	0.8	1.1	0.9	1.2	1.1	1.0	0.3	0.3	0.2	
Excises	1.5	1.4	1.5	1.4	1.8	2.5	2.4	2.5	2.7	2.5	
Other taxes	1.4	1.4	1.6	1.4	1.1	0.7					
2. Non-Tax revenues *	3.5	4.3	3.9	3.9	6.9	3.6	3.8	3.4	5.7	4.9	4.9

Notes: * Other revenues and grants, including from donors.

2000-2004 data from "Georgia: Statistical Appendix". IMF, May 2006.

2009-2010 data from "Georgia: Sixth Review under the Stand-By Arrangement". IMF, July 2010.

2008 data from "Georgia: Fifth Review under the Stand-By Arrangement and Request for Modification of Performance Criteria". IMF, March 2010.

2007 data from "Georgia: 2009 Article IV Consultation and Second Review under the Stand-By Arrangement". IMF, April 2009.

2006 data from "Georgia: First Review under the Stand-By Arrangement". IMF, January 2009.

2.15 The flagship of Georgia's tax reform was a unified single rate for the personal income tax, which after 2008 also included the former payroll tax to finance social services. Until 2004 the tax rates on individual income ranged from 12 to 20 percent, and there was also a social payroll tax of up to 33 percent (not linked with benefit levels), resulting in a 45-53 percent tax burden on formal sector employment. In 2005 the PIT rates were all reduced to 12 percent and the payroll rate was reduced to 20 percent. In 2008 the two were merged with a flat rate of 20 percent. The corporate tax rate was reduced from 20 to 15 percent, the VAT from 20 to 18 percent, and the dividend tax from 10 to 5 percent. Numerous exemptions were eliminated to broaden the bases of all of these taxes. Excise taxes were all eliminated except on tobacco, beer, petroleum products and scrap metal,⁴ for which rates were increased to discourage usage.

2.16 In terms of tax policy, the key to the success of these measures was the elimination of virtually all exemptions, which not only broadened the base but also simplified compliance, administration and enforcement. Simplification of the income tax

⁴ The tax on scrap metal presumably aimed to discourage cannibalizing factories and structures, which had been a serious problem in the early post-independence years.

rate structure with the single flat rate helped sell the idea of reform, and the elimination of all exemptions was a critical legislative and fiscal success. The combination of reduced exemptions, stronger enforcement and economic growth greatly increased the numbers of tax payers, especially under the personal and corporate income taxes, as seen in Table 3. Most of the revenue came from centralized sources—half from the large-tax payer unit and three-fourths of the rest from the Tbilisi district (World Bank 2010, p. 3).

2.17 Tax enforcement, compliance and corruption. While the changes to the basic tax structure and rates represent a clear move toward traditional public finance ideals coupled with a business-friendly attitude, the implementation and administration of the taxes has been a more mixed story. Things have improved since 2004 in terms of stricter enforcement, streamlined payment procedures, and reduced corruption, but some problems remain—discouraging business investment and accentuating inequality.

Table 3. Georgia: numbers of registered taxpayers

<i>Year</i>	<i>Total Active tax payers</i>	<i>VAT</i>	<i>Personal Income tax</i>	<i>Corporate income (profit) tax</i>
2005	79,789	19,074	67,468	18,660
2006	111,964	22,897	93,116	23,094
2007	221,604	27,511	137,685	29,889
2008	236,965	30,446	146,631	35,335
2009	286,473	33,154	166,879	41,585
2010 (Jan-Oct)	252,726	32,994	169,381	44,647

Source: Revenue Service of Georgia

2.18 The main cause of the increased revenue after 2005 was more vigorous enforcement. First, as noted previously, demands for bribes and other petty corruption by public officials were eliminated in less than a year. Both supporters and critics of the administration acknowledge this improvement, not only in tax administration but throughout the public sector. In the police force and customs, for instance, such a large proportion of officers were considered corrupt that all were fired and a completely new set of personnel hired. The tax administration saw similarly sweeping changes, with agents focusing on collecting revenue for the state rather than for their own pockets. Second, and made feasible by the elimination of bribery, tax evasion was no longer tolerated. Those not paying taxes properly were arrested, often with great publicity for rich or otherwise high-profile offenders. People became afraid not to pay their taxes.

2.19 As of 2010 Georgia's tax regime still had important shortcomings, which have been largely overlooked by observers such as Forbes Magazine, which rated it highly. The World Bank's Doing Business, however, shows that difficulty in *paying taxes* is the first or second biggest problem for businesses (depending on the year, 2008-2010), and the government pays a lot of attention to this survey. Although the tax code of 2005 was clearer than its predecessor, it still had some ambiguities and contradictions between different articles and around 5000 amendments to the code have made matters worse. Taxpayers have difficulty getting a ruling from authorities on what is owed in complex cases, with sometimes conflicting interpretations issued in apparently similar cases, and

occasionally even on the same case at different times. Zealous tax police have made matters worse at times by freezing accounts, closing businesses for investigation, and seizing funds before wrong-doing was even proven. Steep fines and penalties are imposed even in cases where there was an honest misunderstanding or a faulty guess as to how the revenue authorities might interpret an ambiguity in the code. Some tax auditors and advisers recommend that their clients simply pay the highest reasonable amount to avoid the risk of being deemed non-compliant. The authorities have recognized that these problems discourage investors, and the government passed a new tax code in August 2010, that took effect in January 2011, that addresses some of these issues. The IFC Investment Climate group gave important advice in drafting this legislation. Its effects were not yet clear at the time of this evaluation.

2.20 Some of the changes in the new tax code would seem to have positive effects, but the effects of other changes seem less certain. Some previously scheduled rate reductions have been postponed for revenue reasons; however, some private sector representatives indicated they would not mind paying somewhat higher rates if the law became more certain. Most of the legal changes pertain to how the rate structure will be implemented, and it remains to be seen how these changes themselves will be implemented. The main changes under the 2010 code are the following:

2.21 Micro enterprises (defined as those with no employees other than the proprietor and revenues and assets under certain thresholds) were completely exempted, which removed them from the tax system. This makes their informal operations legal from the tax viewpoint, eliminating both their compliance costs and enforcement costs for the government. However, borrowing a page from the credit-invoice VAT, the income tax code specifies that firms in the tax system will not be able to count as costs (for purposes of calculating the income [profits] tax) the inputs they buy from micro operations, which may result in the loss of business for micro firms, such as farmers who were selling produce to restaurants. Small businesses (not micro) will be in the tax system, but can opt to pay a simple 5 percent turnover tax on gross revenue and not keep detailed records. Their sales will still be deductible as costs for firms in the regular regime. Micro enterprises can opt into the small business regime and will apparently have incentives to do so once they expand to the point that they want to sell to firms in the full formal sector.⁵ From a tax system point of view, the Georgian arrangement is better than the patent systems for micro-enterprises in the Kyrgyz Republic and Kazakhstan, described below, where businesses of small and even intermediate size (actually but not

⁵ After January 2011 one may see the emergence of middle-man firms in the SME regime that buy from various micro firms and then sell the products (e.g., produce) to firms in the regular regime. Since the middle-man firms would not need to record costs to reduce taxable profit (since they pay only on the basis of turnover), buying from the micro firms will not pose too much of a problem, and when they sell onward to (larger) firms in the regular regime, that cost will be accountable for the buyers. Size thresholds for the SME regime, along with strict enforcement, will probably prevent this from becoming a problematic hole in the tax net.

officially) have strong incentives to stay in the patent regime and thus fight politically to continue and expand it.⁶

2.22 Firms can get binding advance rulings on how a certain transaction will be taxed, which will reduce the uncertainty of doing business. The revenue service will charge a fee to do each ruling, however, and the ruling applies only to the specific transaction of the firm that pays for it. Big firms will find this arrangement advantageous, but small firms will generally find it too expensive and will be left with the same uncertainty as before and with a comparative disadvantage relative to larger firms. (It is not clear whether rulings will be published in order to provide guidance, if not guarantees. Such publication would in principle go a long way to clarifying the application of the tax code and reducing uncertainty among small firms.) Also, a firm can pay for the services of a tax advisor within the revenue service—a benefit to those who can afford it, and a competitive disadvantage to those (smaller firms) that cannot afford it. The advice of the advisor, unfortunately, will not have the status of a guaranteed ruling, so uncertainty may continue.

2.23 The law creates the office of Tax Ombudsman, to help taxpayers deal with what they feel are abuses by the Revenue Service. The effectiveness of the ombudsman's office will depend on the degree of independence it has and on the extent to which the Revenue Service responds to its requests.

2.24 The Georgian case shows that ending corruption, strengthening enforcement, removing exemptions and simplifying the tax system in other ways, and then reducing tax rates are important positive steps for increasing revenue generation and improving the business climate. As these steps are achieved, the details of the tax law and its implementation become more important as determinants of the business climate. Georgia has become much stronger internally since 2004 and is reaching accommodations with large businesses, both domestic and multinational. The next challenges are to avoid politicization of the tax relationship with business (corruption on a grander scale) and to avoid having the tax system create or magnify existing biases against small business. Georgian authorities have agreed to address these problems, with support of the program of development policy operations with the World Bank, discussed below in chapter 3.

2.25 ***Energy utility finances.*** In the 1990s and early 2000s, tariff revenues for Georgia's state owned energy companies—electricity and natural gas—failed to cover the costs of production, even current operating costs. As a result, citizens suffered frequent blackouts, and the government had to provide subsidies to cover at least part of operating costs. The nationwide average of electricity service hours in 2003-04 was only 7 hours/day, and it was much lower in many areas. Since the Rose Revolution, the government has tackled the fiscal problem of the energy companies by raising rates and insisting on payment, and put the companies under private managements that improved service. The target of having 24/7 electricity service for paying customers was met in 2007, earlier than originally envisioned. Both a cause and effect of the electricity service

⁶ The patent systems date back to the 1990s and before, when individual entrepreneurs paid a flat annual fee to be allowed to practice their trade, and this patent fee was in lieu of further VAT or personal and corporate taxes.

performance was that the tax collection rate, which was about 35 percent in 2003, reached at least 90 percent by the end of 2007, well above the original target of 65 percent.

2.26 *Interdependence of reforms.* The government undertook reforms more or less simultaneously on many fronts in the face of various opposing interests, including both sweeping tax reforms and rationalizing spending and downsizing the mandate and scope of government. While this seemed politically risky, and ran counter to the frequently espoused strategy of first picking the low-hanging fruit and gradually building a constituency for reform, the multiplicity of reforms reinforced each other politically. For instance, the obvious improvement of services provided by the energy utilities helped convince people, especially business leaders that paying utility bills and taxes had a positive effect on performance. Improving services would not have been possible without increased revenue inflows, and people would have resisted paying higher rates without tangible evidence of results. Of course, strengthening tax administration and ending bureaucratic corruption also played important roles.

KAZAKHSTAN

2.27 *Fiscal context.* With the oil boom swelling revenue coffers in 2004–08, GoKz did not have urgent needs then for revenue from non-mineral taxation, and the new administration in 2006 (under the same president) looked to tax reform as a way to improve the business climate and attract foreign direct investment, even if it cost the treasury some revenue in the short term. As a result of that and the global economic turn down, non-oil revenues have fallen since 2008, although there was a modest rebound in total revenues in 2010 (See Table 4). Since 2009, the lower petroleum revenues have revived the interest in getting more tax revenue. This has created some conflict with the agenda of further tax cuts, and the government has mostly tried to make up for lost revenues by intensifying collection and enforcement efforts.

Table 4. Kazakhstan Tax Revenues as percent of GDP 2000-90

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010f
TOTAL REVENUE	21.6	25.6	22.5	25.4	24.6	28.1	27.5	29.3	27.9	23.7	23.9
1. Total Tax Revenues	20.0	22.3	21.0	23.2	22.3	26.3	26.5	26.8	27.7	22.6	23.3
Oil revenue	3.3	6.6	4.4	6.0	7.0	10.6	10.2	9.6	12.4	9.8	11.2
Non-oil revenue	16.7	15.7	16.6	17.3	15.2	15.7	16.3	17.3	15.3	12.8	12.1
2. Nontax revenue	1.5	3.1	1.2	1.9	1.0	1.3	0.6	2.2	0.0	0.9	0.4
3. Income from capital transactions	0.1	0.3	0.3	0.3	0.3	0.4	0.4	0.3	0.2	0.2	0.2

Notes: 2010f refers to a forecast.

2007-2010 data from ""Kazakhstan: 2010 Article IV Consultation". IMF, July 2010.

2006 data from ""Kazakhstan: 2009 Article IV Consultation". IMF, October 2009.

2005 data from ""Kazakhstan: 2008 Article IV Consultation". IMF, August 2008.

2003-2004 data from ""Kazakhstan: 2007 Article IV Consultation". IMF, July 2007.

2002 data from ""Kazakhstan: 2006 Article IV Consultation". IMF, June 2006.

2001-2002 data from "Statistical Appendix". IMF, July 2005.

2000 data from ""Statistical Appendix". IMF, November 2004.

2.28 *Timeline Summary of tax policy.* In the 1990s Kazakhstan had built from scratch a modern tax system, reflected in the Tax Code of 1995. Although not exemplary, given its many distortions and unnecessary complexities, it had the basic standard taxes on imports, value-added, personal and corporate income, as well as taxes on mineral production (and export). Oil is the most important export, but the mining sector is also important. In the early 2000s exemptions and special regimes proliferated in the tax system, at the same time as the government was bringing down some of its tax rates. For example, in November 2003, the Law on Changes to Tax Code was adopted, under which the single value added tax rate fell from 16 percent to 15 percent, the social services payroll tax was reduced from 21 percent to 20 percent, and the personal income tax declined from 30 percent to 20 percent. In July 2006, the tax rate on personal income was reduced even further to a flat rate of 5 percent for income in the form of dividends and 10 percent for other personal income, including capital gains and interest. Kazakhstan furthered its reforms by adopting a new land code in June 2003 and a new customs code in April 2003. In 2009 the government passed a tax reform package, which implemented many of the reforms recommended in the World Bank's two volume Tax Strategy Paper, completed in 2008.

2.29 For the **VAT**, reforms in 2009 preserved the single VAT rate, reducing it to 13 percent, from 16 percent, and enlarging the domestic base, eliminating most exemptions (e.g., legal services, the construction of infrastructure projects for government, economic zones, technoparks, and newly created residential buildings). Farmers remained exempt. Reforms improved the VAT refund mechanism, introducing a deferred payment scheme for imports of capital goods and a system to expedite VAT refunds to exporters, although complaints about refund procedures persist. The input purchases of the mining sector, including imports, are zero-rated since most of the output of the sector is exported, but refunds occur often long after the purchases of inputs, especially for the initial investments; the mining sector charges a VAT only on products sold to domestic industry. (The World Bank report in 2002 recommended this approach.)

2.30 For the **corporate income tax (CIT)**, reforms have substantially broadened the base and lowered its rate from 30 to 20 percent in 2009. In 2006-08, when the World Bank prepared a comprehensive tax study, the treasury was flush with oil revenues, and the government's primary policy objective was to improve the business climate rather than increasing the revenue from domestic taxation. Previously announced moves to lower the rate further were put on hold after the onset of the global economic crisis in 2009. They also have deferred previously expected measures to broaden the CIT base by phasing out exemptions (for free economic zones, technoparks, the petrochemical industry, etc.) and replacing the previous highly discretionary system of Investment Tax Preferences with a general investment tax credit for everyone. This would have fewer distorting incentives across assets and business sectors.⁷ To help new companies and

⁷ To be fully neutral across sectors, the investment tax credits would have to be indexed for inflation and vary with the life of the assets. . Kazakhstan's 2009 reform did not introduce inflation indexation of depreciation allowances to reduce the upward pressure inflation exerts on the CIT burden. It also did not align depreciation schedules with economic depreciation, to avoid the negative effects of eliminating the current system on the manufacturing industry while improving the tax treatment of construction. Although

companies in highly volatile sectors, the period for loss carry-forward was extended to 10 years. Since 2009, with the fall of oil prices and the global economic slowdown, the need for tax revenue has returned as a primary objective. Due to the decline of private investment and employment, however, the government has not pursued its earlier plans to remove exemptions.

2.31 Firms and farms would qualify for the single simplified regime on the basis of a turnover threshold, and the unified rate could be based on turnover, but compliance remains a problem, as small firms that have grown large under-report turnover to stay under the simplified regime or do not report at all. The government has not phased out the 80 percent discount under the CIT for agricultural enterprises.

2.32 **Mineral extraction.** There are now extra fees on extraction in the mineral sectors, designed to capture the location-specific economic rents generated in that sector. The tax regime for mining is not differentiated from that of petroleum, to reflect the differences in the pattern of exploration and initial investment costs. This is contrary to the recommendation in the 2002 report on the mining and metallurgy sectors and to standard international practices (World Bank 2002b).

2.33 Thus, for firms in the regular tax system, the basic CIT and VAT rate structures have become more attractive, although not as favorable as the firms originally had hoped. The oil price boom that lasted until 2008 gave the government fiscal space to reduce rates—“the easy part”—but also reduced incentives to close loopholes. The CIT rate was reduced to 20 percent, but further reductions (toward 15 percent) were delayed because of revenue constraints during the global economic crisis and an unwillingness to eliminate exemptions. That is, because of the crisis, most special regimes and exemptions were not removed, in order to avoid discouraging investment in the sectors benefiting from these tax preferences. Indeed, industry lobbyists pleaded for the enactment of more special exemptions, but the government resisted most of those requests, and thus avoided losing more revenue or further fragmenting the tax system. Thus the crisis largely halted many changes to legal tax policy, some for better and some for worse. The emphasis shifted to tax administration, for which the government signed a TA loan agreement with the Bank in 2010.

2.34 **SME Regimes.** Kazakhstan has two regimes for SMEs. One simplified regime requires payment of three percent on turnover and record keeping of sales only. Firms with gross receipts of up to KzT 100 million (about USD 7,000,000) are eligible. Kazakhstan also has a patent system, with some differences from that of the Kyrgyz Republic discussed below. The legal limit on income to qualify under the patent system is TT 2 million (about USD 14,000). Patent holders must be individuals in permitted lines of business—small retailers, translators, and taxi drivers. They declare their gross receipts, pay 2 percent on that tax base, and do not have to keep financial records; as in the Kyrgyz Republic, firms often under-report their income in order to pay less tax and to stay eligible for the patent regime. If their payments, or some of them, go through a bank account, the tax authorities could in theory verify their eligibility for the simplified

inflation has remained in single digits, the lack of indexing nevertheless raises the cost of capital for investment, especially for equity-financed investment, and distorts the allocation of investment.

regime, but they do not seem to bother with such small firms. Payments in cash and to some credit cards are not usually traced by the authorities. The activities under the patent system are a smaller share of the economy than in the Kyrgyz Republic, and their owners seem to have less influence with the government.

2.35 For the **personal income tax (PIT)** the rate was changed in 2007 to a unified flat rate in that would apply to all workers of firms in the regular tax regime and with income above certain threshold. The rate is 10 percent, with an increased threshold that largely eliminates the PIT tax burden on the poor. The PIT has not been integrated with the **social tax**, under which an additional 11 percent is imposed on wage income—a different base from the PIT—since some persons in the small enterprise and patent regimes also pay the social tax, essentially voluntarily, in order to be eligible for benefits. In administration, the social tax payments are linked with the individuals, but the PIT is assessed on the company’s wage bill, typically without linking the tax obligation or payment to the identity of individual workers.

Table 5. The PIT Rate Structure 2003, 2004, and 2007 Reform

	<i>Before 2003-04 Reforms</i>	<i>Changes Effective 2004</i>	<i>2007 Tax Reform</i>
Threshold	60,000 KzT	110,400 KzT	116,400 KzT
Number of rates	4	5	1
Range of rates	5-30%	5-20%	10%

Source: World Bank 2008. *Kazakhstan Tax Strategy Paper*, p. 2.

2.36 **Tax enforcement, compliance and corruption.** Tax enforcement in Kazakhstan is almost as aggressive as in Georgia. Although the authorities do not close business to do inspections, they regularly freeze bank accounts of those accused of under payment, whether deliberately or as a result of misunderstanding the code. The tax code for firms in the regular regime is complex, contradictory between some of its articles, and constantly changing – partly to correct problems as they arrive and, since 2010, to satisfy the requirements of being in the customs union. Some of the changes are applied retroactively, making the tax environment even more uncertain for firms. Fines are often several times the amount of the alleged underpayment, and it has been difficult to resolve disputes definitively outside of the Supreme Court, because if the authorities lose in the court at one level, they usually appeal out of fear of being accused of corruption, until the case reaches the Supreme Court. Often taxpayers agree to settle, even if they believe they are right, to avoid waiting four or five years for a clear court settlement, according to interviews during the mission. Unlike Georgia, Kazakhstan has not seen many arrests of high-profile persons.

2.37 Bribery seems to have diminished as a problem for large firms in the regular system, but it seems to remain common for medium and small enterprises. Tax inspectors get marching orders to raise more revenue, especially since the global crisis made revenue-raising more urgent, but sometimes respond by taking bribes rather than fully enforcing taxes. According to interviews, firms in the patent and simplified regimes want

tax inspectors to stop harassing them for bribes, and to let them stay in the patent or simplified regime.

KYRGYZ REPUBLIC

2.38 **Fiscal context.** Since the early 2000s the Kyrgyz Republic has had considerable success in increasing revenues and increasing the number of firms, particularly large and medium sized, paying their obligations under the regular tax regime. Total tax revenue relative to GDP rose from 16 percent in 2001 to 23 percent in 2006-08, and 28 percent in 2009 (IFC 2010). The largest share of revenue came from the VAT (46 percent in 2008 but only 30 percent in 2009, due to a big rate reduction) and from the business and personal income taxes (18 percent in 2010 and 23 percent in 2009), as shown in Table 6 below.

2.39 Despite these increases in revenues, the Kyrgyz Republic still has a gap of 5 percent of GDP between current revenues and spending. For now, external donors are largely filling that gap, but observers and technical level officials recognize that this is not sustainable. They have not, however, done an explicit analysis to see what combination of tax and spending measures might close this gap.

Table 6. Kyrgyz Republic: Revenues as percent of GDP, 2000-10

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010f2
TOTAL REVENUE	14.2	16.1	18.0	18.2	22.3	23.7	21.8	28.1	28.0	27.7	28.6
1. Total Tax	11.7	12.4	13.9	14.2	18.3	20.0	17.6	22.6	23.0	22.7	22.4
Income tax	2.1	2.7	2.9	2.8	2.8	3.5	3.1	3.1	3.7	5.2	5.8
VAT	4.6	5.7	6.4	6.6	7.2	7.0	8.0	9.0	8.8	6.9	6.5
Excises	2.3	1.5	1.4	1.4	1.3		1.1	1.0	0.8	0.8	1.0
Customs	0.4	0.4	0.6	0.5	0.5	1.6	2.5	2.7	2.5	2.1	2.1
Land tax	0.3	0.3	0.4	0.4	0.4		0.4	0.4	0.4	0.5	0.4
Road & Emer. Tax	1.6	1.3	1.4	1.3	1.3		1.3	1.3	1.5	0.2	0.0
Retail sales tax	0.4	0.4	0.5	0.6	0.6		0.7	0.8	0.8	0.0	0.0
New turnover tax	...	...	...	...	...	...	...	...	...	2.0	2.0
Social Fund (excl.)					3.5	3.8	3.8	3.8	3.9	4.4	4.2
Other	0.1	0.1	0.3	0.6	0.7		0.5	0.5	0.6	0.7	0.5
2. Non-Tax revenues *	2.4	3.7	4.1	4.0	3.9	3.6	4.2	5.4	5.0	4.9	6.2

Notes: * Includes Capital Revenue and foreign grants. 2010f refers to a forecast.

2008-2010 data from Kyrgyz Republic: Request for Disbursement under the Rapid Credit Facility, IMF, October 2010.

2007 data from "Kyrgyz Republic: 2009 Article IV Consultation". IMF, July 2009.

2006 data from "Kyrgyz Republic: Request for an 18-Month Arrangement under the Exogenous Shocks Facility-Staff Report". IMF, December 2008.

2005 data from "Kyrgyz Republic: Sixth Review under the Three-Year Arrangement under the Poverty Reduction and Growth Facility". IMF, June 2008.

2004 data from "Kyrgyz Republic: 2006 Article IV Consultation, Third Review under the Poverty Reduction and Growth Facility" IMF, March 2007.

2002-2003 data from "Kyrgyz Republic: First Review under the Three-Year Arrangement under the Poverty Reduction and Growth Facility". November 2005.

2001 data from "Kyrgyz Republic: Sixth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for New Three-Year PRGF Arrangement". March 2005.

2000 data from "Kyrgyz Republic: Article IV Statistical Appendix". February 2005.

2.40 ***Timeline of revenue policy.*** In 1996 the Kyrgyz Republic passed a tax code that put in place the elements of a typical modern tax system—a credit-invoice VAT, a personal and corporate income tax system, a variety of excise taxes, and a payroll tax (“social tax”) on labor income. The latter goes into the Social Fund to finance public pensions and health care; an employee’s payments are only loosely linked with expected future social benefits. Tax revenues were under 12 percent of GDP. This was low by international standards (see Table 1) and too low to balance the budget and sustainably service the debt, which was 96 percent of GDP at the end of 1998. Sixteen local taxes and charges generated little revenue in most cases and were a nuisance to business. Regulations and the administration of customs and domestic taxation were not well coordinated or consistent. Imports were not adequately documented for inclusion under the VAT system; not only was there widespread smuggling, but many importers paid customs based only weight, without identifying the goods or their value. These problems remain.

2.41 Tax provisions were frequently amended from 1996-2008, resulting in some improvements but also expanding some inefficient special regimes and creating confusion and uncertainty for both taxpayers and administrators. Since 2000 the legal setting has stabilized to some extent, but uncertainty and frequent changes remain a pervasive problem. Implementation of the law according to interviews, was also plagued by weak tax administration and severe problems of corruption. Until 2008, the Kyrgyz Republic had limited success in implementing revenue policy reform, although revenue performance improved substantially, due to better enforcement. One can see this in the text of various CASs: “Notwithstanding the efforts during the last three years to improve the tax system, much remains to be done to simplify tax structures, to further rationalize tax rates, and to improve tax collection and compliance.” and “... further work is needed to identify specific actions to improve tax administration” (World Bank CAS 2003, p. 9, 14). “Tax regulations are numerous, inconsistent, and are constantly being amended. Inconsistencies in the tax code create opportunities for rent-seeking behavior by tax inspectors, auditors, and tax police (World Bank CAS 2007).” When the number of amendments reached unmanageable proportions in 2008, the government felt obliged to pass a new Tax Code, which was implemented gradually, starting in January 2009. The new code addresses some of problems of the previous tax system, including some of those identified in the Bank report in 2000, but it also left other problems untouched and created a few new ones. Coordination between customs and domestic taxation may be declining due to the shift of tax policy responsibility from the Ministry of Finance to the Ministry of Economic Regulation. Each segment of the tax regime has its own story.

2.42 ***Value-added and transactions taxes.*** The VAT brings in the most revenue, almost half of the total in 2008. The 2008 reform reduced the VAT rate from 20 to 12 percent starting in 2009, so that the Kyrgyz Republic would have the lowest VAT rate in the region. The 2008 law also removed turnover taxes for road and emergency funds, which had cascaded (accumulated on sales between firms) and thus imposed high effective tax rates on those sectors with many inter-firm transactions in the production process; this also created a tax bias toward vertical integration designed to avoid such taxes. These taxes and some others that were specified outside the tax code, led to additional tax burdens and inefficiencies and made compliance and enforcement difficult. While the low uniform

VAT rate in the 2008 law sounds attractive, it did not raise adequate revenue, and to fill the gap the government introduced a new gross receipts tax of 4 to 6 percent (depending on the sector) to make up for the revenue loss from reducing the VAT rate. The sales tax is on all turnover and cascades from one stage of processing to another, which is highly inefficient compared to going back to a slightly higher VAT rate.

2.43 The 2008 code also allowed the continuation of severely outdated weight-based rather than value-based customs charges for many categories of imports. Such imports fall outside of the VAT system and thus erode its base to the extent the imports are consumer goods. They also are ineligible for legitimate re-export into the new customs union formed in 2010 by Kazakhstan, Russia and Belarus because they lack the requisite documentation. This is creating pressure for reform.

2.44 In 2000, the *corporate income (profits) tax* was complex, unclearly specified, and poorly administered. Reforms prior to 2008 clarified somewhat the rules and reduced the rate from 20 to 10 percent. Although this rate seems modest, its implementation in combination with turnover taxes led to total tax rate on capital income of 59 percent, according to calculations in Doing Business 2009.⁸ Even with the 2008 law, there are no general investment tax credits that mitigate the effects of the turnover taxes or measures that integrate the corporate tax with the personal income tax, although the low nominal corporate rate makes this less critical. Depreciation is based on unindexed historic costs, whose real value would quickly erode in the presence of significant inflation.

2.45 In 2000 the *personal income tax* rates were progressive, ranging from 5 percent for incomes less than 5 minimum wages up to 33 percent for incomes above 100 times the minimum wage. 80 percent of revenue was withheld by employers in the formal sector, and the progressivity of the income tax made accurate withholding and compliance in general difficult. Many exemptions and deductions narrowed the tax base. In addition to income taxes, wages were heavily taxed for employees of firms in the regular tax system, but not for employees who worked for firms under the patent regime or the alternative simplified turnover tax available to some SMEs. Additional social taxes on the payroll, theoretically for health and pensions, were assessed at a rate of 39 percent, without a cap on wages subject to the tax and without a close linkage to benefits. With a top personal income tax rate of 33 percent, the combined tax on labor income was up to 72 percent. From 2000 to 2007 various measures unified the PIT at 10%, where it remained in the new 2008 code. The Social Tax for employees in the formal sector was not unified with the PIT, in contrast to Georgia; although rate has come down from 39 to 27 percent, it is still higher than other FSU countries.

2.46 *SME tax regimes.* The Kyrgyz Republic has two regimes for SMEs, with significantly different structures, although both have the same legal threshold of 4 Kg Som million (\$116,000), beyond which firms become subject to the VAT, PIT for employees, and the regular corporate income tax. While this threshold is only slightly above the US\$50-100,000 threshold recommended by the IMF (IMF 2011, p. 41), the effective rates

⁸ This is not a precise indicator of the corporate tax burden, as noted in the Independent Evaluation Group (IEG) evaluation of Doing Business (IEG 2008), but the figure for Kyrgyz contrasts clearly with the 36 percent burden calculated for Kazakhstan in 2009 and the 15 percent in Georgia.

are very low compared to the regular regime, which distorts incentives against firms that would grow as formal sector businesses. The small enterprise regime requires that firms record their turnover or gross receipts and pay a fixed percentage of this amount in tax. Few enterprises choose this regime, however, because the reporting costs and effective tax rates are higher than under the alternative patent regime. Under the patent regime, supposedly sole entrepreneurs pay a flat fee on a monthly or quarterly basis, with the fee dependent on the line of business, and then they owe no further profit, income or sales/turnover taxes, and have no financial reporting requirements. Patent holders are supposed to pay the social payroll taxes, although at a lower rate than in the regular regime, and many do so in order to be eligible for pension benefits and health care. Many enterprises stay in the patent regime even as they grow relatively large and exceed the legal threshold, by using bribes and subterfuges—like having relatives or employees take out additional patents—to avoid the regular tax system. Such firms have become entrenched politically as well as economically, as many politicians own or are financially linked with patent-holding enterprises in the transport (minibus, taxi) and trade sectors (e.g., in Bishkek’s Dordoy bazaar, the largest in central Asia, conducting international wholesale business as well as domestic and retail sales). In 2010 the government reinstated a long list of categories of firms eligible for the patent regime, after temporarily reducing the list and increasing rates in early 2010; they also reversed an increase in tax rates under the patent regime back to their low pre-2008 levels. (IFC 2010 gives details.)

2.47 Although there seems to be little domestic political incentive to reform the SME regime and a lot of opposition to reform, international developments—namely the creation of the customs union of Russia, Kazakhstan and Belarus—may create incentives that will direct more of the trade sector toward the regular regime. The customs union, which is the ultimate destination for a substantial share of the goods coming through the Dordoy bazaar, requires proper documentation of the origin of goods. Getting such documentation would require firms to move away from the weight-based customs duties that are applied to the majority of Dordoy goods. Going to value-based customs duties and full documentation of the origin of goods processed at customs would also put the many of the importing firms into the regular tax net for the VAT, the corporate income tax, etc., and out of the patent regime, since the true value of their imports is above the threshold. (Trading firms in the Bishkek FTZ are already in the regular system, so they presumably can sell to the customs union.) Trading enterprises at Dordoy trying to make such a transition, say by starting a parallel company to handle trade with the customs union, now face a daunting array of additional tax payments and reporting requirements – especially when compared to their current situation within the patent regime, where most enterprises seem to want to stay as long as they can.

2.48 There is also another special *contract-based regime* under which firms (that have been operating for at least three years in the regular tax regime) agree voluntarily to pay an amount equal to 125 percent their highest total annual payment for profit, VAT and sales taxes in the past 3 years. This payment settles their obligation for those three taxes. Firms must sign up for this in one tax year before the end of the previous year. In 2009, over 1300 firms signed up for 2010. Authorities do not see this as a major program for the medium term, however, as most firms will not want to see their tax obligation grow at a compounded 25 percent annually—more than doubling every three years.

2.49 **Free Economic Zones** were too extensive in 2000 and lacked secure customs borders with the rest of the economy, creating significant opportunities for tax avoidance and evasion in the customs and domestic tax system. Businesses in the FEZs were exempt from VAT, import duties, and income (profit) taxes, while international best practice is to relieve them only from customs duties on imports used as inputs for export and from VAT on exports (as is typically done in any case under a destination-based VAT). Reforms in 2000-01 made the customs borders more secure, as part of the prior actions for the Consolidation SAC. Since then the FEZ outside of Bishkek have closed, making it easier to enforce the taxes due in the Bishkek FEZ. The 2008 tax code clarified that only the firms that had been in the FEZ before 2000 (which was a minority of the firms by 2010) would be exempt from regular corporate taxes and that this exemption would expire by 2020.

2.50 **Land tax** rates in 2000 were low relative to international standards, since the rates were reduced by half in 1998. Rates were set by the national government and varied widely according to location and usage—ranging from about US\$1 per hectare of pasture land in one location up to over \$100 per hectare of irrigated land in another location. The 2008 code left the revenue from the rural land tax low in real terms but did introduce a tax on real property for urban local governments. It replaced several small local fees and taxes and raises roughly the same amount of revenue in a less distorting and simpler way.

2.51 **Excise taxes**—on alcohol, tobacco, jewelry, petroleum products, coffee, etc—were low by international standards, raising less than half (as a percent of GDP) of revenues raised in most transition economies. The 2008 reform reduced the number of taxes, eliminating many nuisance taxes that generated little revenue at high administrative cost.

2.52 **Energy Pricing.** Before 2000 and since, tariffs for electricity, gas and district heating have been too low to cover operating costs, much less needed maintenance and investment. There was no metering or pricing based on volume of service in many areas, encouraging over-consumption. Privileged groups enjoyed extensive price discounts, creating large inequities that were not targeted to helping to relieve poverty. Since 2000, utility company deficits have persisted, efforts to raise tariffs were inadequate, and some earlier tariff increases were reversed. The Kyrgyz Republic gets most of its energy from hydroelectric power, which is abundant in the country. Operating costs with hydroelectric are low, compared to thermal, which requires continual purchase of fuel. Nonetheless, hydroelectric needs substantial investment and maintenance over the medium term, and energy prices in the Kyrgyz Republic have been too low to finance such expenditures. The Bank (in its 2000 Fiscal Sustainability Study and in subsequent policy dialogue) recommended simplifying the price structure and raising prices gradually in combination with a cash compensation scheme for low income groups. The CSAC loan agreement in 2000 promised action in this area, but it never occurred. In the mid-2000s, energy prices were unified for each class of user and industrial prices were raised; in addition, the electric company was split into separate companies—one for generation, one transmission and four for distribution. In early 2010 the household price and the small business price were abruptly doubled in conjunction with the beginning of the privatization of the industry. The main distribution company was destined to go to the son of the president, however, and this measure along with sudden energy price increases and other issues led to a revolution. The new government stopped the privatization process and reversed the price increases in mid-

2010. Compensation measures for vulnerable groups had also been implemented and these were left in place, despite the reversal of the energy price increases, leaving unjustified subsidies that will only further increase deficits in this sector. The Energy Regulatory Department hopes that the new government will implement its plan for gradual price increases.

2.53 Tax enforcement, compliance and corruption. Of the three countries studied, the Kyrgyz Republic has the weakest tax administration capacity and the least vigorous culture of enforcement, although the situation has improved to a limited extent over the past decade. USAID and the Asian Development Bank are providing technical support to the effort to improve tax administration and enforcement. Businesses do not seem particularly afraid of the tax inspectors, and corruption remains a substantial problem. “Recent BEEPS (2008) data suggests that the business environment is not improving when it comes to actual implementation of regulatory, administrative and taxation systems.” (CAS CR 2010, p. 16)

2.54 Whether the post-2010-revolution government in the Kyrgyz Republic will continue implementation of the 2008 tax reform and perhaps even strengthen it remains to be seen. The legal complexity and the new cascading gross receipts tax are serious problems under the regular tax regime. The SME regimes seem to expand and worsen as the informal sector—the shadow economy—grows, further delaying the entry of successful enterprises into the regular tax system while increasing their political power.

Summary and Potential lessons for Tax Reformers

2.55 By the end of the 1990s all three countries had legislated the rudiments of modern tax systems, but they were performing poorly, with excessively high rates, far too many exemptions, many distortionary special regimes and taxes, and weak and corrupt administration. In the 2000s, to varying degrees the countries implemented revenue policy reforms, with different types of WBG support, with objectives of both raising more revenue and improving the investment environment. Table 7 summarizes the extent of improvements made by each country along the dimensions discussed above.

Table 7. Revenue Policy Progress in the Kyrgyz Republic, Georgia and Kazakhstan, 2000-2010

<i>Dimension</i>	<i>The Kyrgyz Republic</i>	<i>Georgia</i>	<i>Kazakhstan</i>
Increasing tax revenue as a share of GDP	++	+++	+
Number of taxes and rate structure	++/-	+++	++
Clarity of tax laws	+	+	-
(Anti)Corruption	0	+++	+
Enforcement	+	+++	++
Tax environment for business (formal sector)	+	++/-	+/-
SME agenda (encouraging move to formal sector)	--	tbd	-
Energy tariffs and collection	--	+	0

Note: IEG summary. The +s and –s refer to the extent of positive or negative changes during 2000-2010.

2.56 From these three cases, three lessons for revenue policy design stand out: the benefits and limits of the flat-tax agenda, the importance and difficulty of getting a good policy for treating micro to medium-sized enterprises, and the need for tax administration and enforcement that balances goals of revenue and client service, especially in terms of a clear definition of obligations, fair enforcement, and expeditious appeals. The benefits from the agenda depend on reduced corruption. In terms of reducing the frequency of bribery and petty corruption in connection with tax administration, Georgia has made the most progress, Kazakhstan substantial progress, and the Kyrgyz Republic the least. In all three countries, some anecdotal evidence from interviews suggested that for cases involving large tax payers, personal political connections were helpful, but the team did not have the resources to verify this fully.

2.57 *Flat Tax.* Going to a single flat rate for the PIT, as all three countries here and some others in ECA have done, is not the same as going to an integrated flat tax system, which would involve the taxation at single rate of all income for all persons and corporations. What is often cited as a flat tax in the three countries is a personal income tax at a single rate, rather than a progressive rate structure, that is assessed primarily on employees of enterprises in the regular tax regime. This change, while not a flat tax, has some benefits of simplification, but also a few drawbacks. The single PIT rate is still somewhat progressive in that there is a substantial threshold before individuals must start paying tax—which is desirable on equity grounds. Going to a single rate for the PIT simplifies compliance, because it allows firms to withhold tax on wages at a flat rate subject to taking into account the tax threshold).⁹ This benefit should not be overstated, to the extent that it reduces the likelihood of comprehensive personal income taxation. Unless the CIT system fully captures income from capital (which it does not in these cases, given the prevalence of lightly taxed non-corporate firms and exemptions from the corporate tax), a focus on wage withholding moves the system farther from the (possible) objective of taxing individuals at equal rates on their whole income. (Taxing all capital income at the same rate at the individual level might be a desirable goal, but it would be achieved only if it were thorough, which it is not the case in most countries, including these three.)

2.58 Even more important for reducing distortions is the single rate for the corporate profit tax and for the VAT, both of which have benefited from a unification of rates and the elimination of many exemptions under the regular tax regime. The biggest remaining divergences from a true flat-tax regime in all three countries are the special regimes for SMEs, which exempt these enterprises and their employees from the regular tax system. The special regimes, especially the patent regimes in Kazakhstan and the Kyrgyz Republic, have effective rates that are much lower than under the regular regime and that vary inversely with the size of the business that is under the patent regime, since they are based approximately on a flat annual fee.

⁹ The elimination of the taxation of personal income from capital gains, interest or dividends would result in a true Hall-Rabushka flat consumption-based tax at the individual level. If business income were only taxed at the firm level, expensing rather than deductions for depreciation were allowed, and interest deductions were disallowed, then there would be a flat consumption-based tax at the corporate level.

2.59 ***SME taxation.*** Simpler reporting requirements for small firms are desirable to reduce their burden of compliance. But allowing them to stay totally outside the tax net or to pay only a nominal flat fee annually is the wrong way to achieve this goal. It gives firms a strong incentive to stay outside the formal system, an incentive that increases as firms grow in size, since the flat fee implies a decreasing effective tax rate. The latest ESW in Kazakhstan on the SME taxation demonstrates this clearly. Success in broadening the tax-paying culture, bringing SMEs into the tax system, and creating incentives for them to move up to the regular regime (VAT, profit and income taxes, and social insurance for workers financed with payroll taxes) depends on how micro enterprises are treated and on incentives against corruption in the revenue service. The World Bank and some policy makers have turned their attention to this issue recently. If the regime for micro enterprises is too favorable and its limits are not well policed, then so many operations may get into that regime and grow that it becomes politically difficult to pressure firms to move to the SME regime, and then to encourage SME firms to move to the regular regime. That has happened in the Kyrgyz Republic and it seems to be a danger in Kazakhstan. Indeed, it may be desirable to set the tax rate on turnover under the special regimes sufficiently high so that moving to the regular tax system would lower the effective income tax rate for most firms.

2.60 ***Balancing enforcement, reducing corruption, and creating a business friendly tax service.*** Strengthening enforcement of the law, especially with large tax payer units in the administration, reducing corruption, and facilitating compliance contributed substantially to the revenue increases experienced in all three countries. This started in the 1990s and accelerated since 2000, with Georgia being the most successful, Kazakhstan ranking second, and the Kyrgyz Republic coming in third but still showing progress. Carving out special regimes for small enterprises, with low or zero effective tax rates and low costs of compliance and administration, has allowed the authorities to focus on the large taxpayers that bring in the bulk of the revenue, but it has also limited the reach of the regular tax system and encouraged expansion of the informal sector.

2.61 Tax administrations in all three countries have had trouble balancing the objectives of raising revenue and treating individuals and businesses fairly and in a way that minimizes unnecessary costs of participating in the tax system. Georgia has gone the farthest in achieving its revenue objectives and reducing corruption, and that is probably a good way to start. Now the agenda seems to be turning to the objectives of equal treatment for taxpayers in similar situations, transparency and predictability in applying rules, low costs of compliance, and penalties for violations that are effective in deterring noncompliance but nevertheless proportional to the seriousness of the infraction. The 2010 tax code, entering into effect in 2011, has potential to bring improvements on these issues. Kazakhstan has similar problems and a similar agenda, although it has not progressed as far yet. The Kyrgyz Republic is still at the stage of facing major challenges with corruption and weak enforcement. The new law there seems more business friendly in giving the taxpayers the benefit of the doubt in disputes, but it remains to be seen how this will be implemented and whether such a strategy can avoid excessive weakening of a system that still suffers from corruption and poor general administration.

3. World Bank Support for Tax Reform, 2000-10: Common Experiences and Potential lessons

3.1 *Historical overview of tax policy work at the World Bank:* Since at least the early 1980s, when the Bank began supporting fiscal adjustment programs in the borrowing countries, the Bank has supported revenue policy reforms, although the degree and type of attention has changed over time.

3.2 During the decade of structural adjustment in the 1980s, raising tax revenue was an important part of countries efforts to close their fiscal gaps. The Bank's SALs supported many of these efforts. By the late 1980s, expertise on tax policy was centered in the Public Economics Division in the Development Economics Department (DEC), including both consultants and regular staff. The adjustment programs usually succeeded in reducing fiscal deficits, by raising revenues as well as reducing spending as a share of GDP. The spending cuts, however, were often done in ways that had longer term negative effects on development, growth and poverty reduction (World Bank 1992). In the early 1990s, when faced with internal budget pressures to focus their efforts, the DEC management decided to focus the work in the public economics division on expenditure issues and to redeploy the staff that had been working on tax policy. Although soon thereafter there was strong demand for work on taxes in the former communist countries, this was left mostly to the IMF, which had stronger staffing on taxes. This division of labor was not set in stone or in writing, but the tendency has persisted.

3.3 The Bank's operational units in the 2000s have worked on tax policy as the need arose. Besides the ECA countries, demand for tax work by the Bank continued in Latin America and the Caribbean and increased in Africa, where successful reforms of trade regimes had reduced revenues from import duties and from direct and indirect taxes on exports, e.g. via commodity marketing boards. The prospect of declining aid flows as high income countries reduce overall spending is likely to increase further the need for Bank work on taxation issues in IDA countries. In Georgia, Kazakhstan, and the Kyrgyz Republic, the IMF was very active on tax issues in the 1990s, and the WBG has taken the lead in the 2000s.

3.4 Public sector group in the Poverty Reduction and Economic Management (PREM) group has maintained a revenue policy in its portfolio, and since 2010 it has increase attention there, with support from the Spanish Trust Fund. At the IFC, the Advisory Services Group has a Global Tax Simplification Program has grown to be larger than the tax program within the Bank. It has provided detailed policy advice and studies in a number of countries, including Georgia, Kazakhstan and the Kyrgyz Republic, and in 2009 they published a handbook for tax simplification.¹⁰ The Bank has not published a similar handbook in recent years, but it did commission a series of policy

¹⁰ [http://www.ifc.org/ifcext/fias.nsf/AttachmentsByTitle/PublicationMT_TaxSimplification/\\$FILE/FIAS-HTSfinal.pdf](http://www.ifc.org/ifcext/fias.nsf/AttachmentsByTitle/PublicationMT_TaxSimplification/$FILE/FIAS-HTSfinal.pdf)

notes on different taxes—VAT, corporate profits, and others.¹¹ The PREM-PS tax team, along with the IFC tax group, has increased activity of the Revenue Administration and Policy Thematic Group (RAPTG), with seminars and an intranet web share-point.

3.5 *Bank-Fund cooperation and division of labor on taxes.* Usually the Bank has worked on revenue policy in close collaboration with other external players (IMF, United States Agency for international Development, British Department for International Development, and Canadian International Development Agency). In the 1998 update of the Concordat between the Bank and the Fund, tax policy and administration are designated as areas of shared responsibility.¹² Usually, the IMF takes the lead in making the diagnosis and recommendations, and often the Bank supports implementation with development policy and technical assistance lending, as in Tanzania, Bulgaria, the Kyrgyz Republic, and Russia. In a few cases, the Bank took the lead for the policy dialogue on taxes (e.g., Georgia, Colombia and Mexico), and the IMF played a smaller role, although it was consulted and its consent was sought. Only in rare cases has there been a significant disagreement about the substance of tax policy.¹³ The origin of the disagreements was usually that the Fund was more concerned about a short-term reform-induced fall in revenues, whereas the Bank focused more on tax reforms promoting longer term growth, equity and efficiency.

3.6 Fund conditionality has often included some tax measures, designed primarily to raise more revenue within the time frame of the IMF program. Some of these measures would qualify as reforms from the viewpoint of improving equity and efficiency, and encouraging medium-term growth, but at other times the IMF conditionality encouraged (or tolerated) excessively high tax rates and the use of inefficient taxes (such as on financial transactions) primarily for the purpose of improving fiscal balances to meet Fund targets in the short term. By contrast, the Bank’s policy-reform lending is more likely to include budget support to finance the fiscal cost of undertaking reforms (lowering rates, broadening bases, etc.) designed to be more conducive to efficient growth and that do not increase revenue until the medium term. This institutional difference in the relative emphasis placed on tax disincentives could justify the increased involvement of the Bank in revenue policy issues, and highlights the need for close coordination between the two institutions.¹⁴

¹¹<http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTDEBTDEPT/0,,contentMDK:21387064~menuPK:64166739~pagePK:64166689~piPK:64166646~theSitePK:469043~isCURL:Y,00.html>

¹² “In the public sector, primary responsibility in public enterprise reform, public expenditure (composition and efficiency), and administrative and civil service reform resides with the Bank. The Fund has primary responsibility for the aggregate aspects of public sector spending and revenues. Tax policy and administration is an area of overlap.” (World Bank 1998, p. 4)

¹³ Disagreement arose probably less than 5 percent of the time. (Interview with Shanta Devarajan, former head of Public Economics Division and now Regional Chief Economist for SS Africa.)

¹⁴ Revenue administration reforms supported by the Bank and Fund are usually more similar in purpose, since more efficient administration both raises more revenue and allows lower rates and more judicious choice of tax instruments. The typical difference is that the Fund provides more of the TA expertise in outlining the program, while a Bank project may fund the consultants, training and IT to implement the program of improving revenue administration. (IEG Public Sector Reform Evaluation [2008] discusses this issue.)

3.7 The Bank has been a partner with the IMF and the OECD in the International Tax Dialogue, started in 2005, but its participation has been limited. Partly this has been the result of insufficient funding to finance a tax expert in the PREM anchor to participate fully in meetings, a situation that was recently remedied, with the help of the Spanish Trust Fund. Also, over the last 15 years the Bank's involvement in tax issues, especially the formulation of tax policy, has arisen in an ad hoc way from country demands, and the country economists (who are generally not tax specialists) responding to that demand have not usually known about ITD and therefore not drawn on its resources.¹⁵

Concepts for Evaluating WBG Support for Revenue Policy Reform

3.8 The revenue policy objectives enumerated at the beginning of the previous section are immediately relevant to a substantial share of the WBG's overall objectives in its country programs: strengthen and stabilize public finances, improve public sector capacity, encourage private sector development, reduce environmentally negative externalities, reduce inequalities in disposable income, decentralize government activities in an appropriate and fiscally sustainable way, and enhance governmental accountability to citizens. This might suggest the need for a pervasive and extensive involvement in revenue policy issues, but for practical reasons, WBG engagement usually needs to be narrowly focused. Nonetheless, even in a focused ESW it is useful to mention the broader revenue agenda and explain how a particular piece of analysis or loan conditionality relates to it. As described below, the Bank's work on tax policy has sometimes lacked this breadth of vision, which should be a comparative advantage of the WBG. As mentioned earlier, the IFC has taken an increasing role in the WBG support for tax reform as part of its investment climate work. It emphasizes simplifying procedures to reduce compliance costs and improve efficiency in raising revenue. This is seen not so much a division of labor as a shared labor within the WBG. This effort is shared among units in WBG—economic policy, public sector, private sector development, and IFC. Some other dimensions of tax issues, like equity and environmental protection, seem to get less systematic attention.

3.9 Revenue policy reform requires not only that a government change some laws, which the World Bank can encourage with various mixes of incentives, but a recognition that the reform will have its desired effect only if the government institutes and persists with a program of administrative reform. This requires that the authorities and to some extent the whole society buy into the concept of tax reform, facilitating both better compliance and enforcement. The Bank can support the capacity and implementation of such an effort with investment loans for tax administration, as it has done in 2010 in Georgia and Kazakhstan.

3.10 So, when one sees revenue-policy reform, or its failure, how much should be attributed to WBG efforts? No mechanistic formula can answer this question. Now that the Bank's strategy for support to countries is developed more or less jointly in Country Partnership Strategies, even the source of the idea to address revenue policy is less clear than ever. Nonetheless, examination of the Bank's AAA and lending for tax improvement and discussion with the authorities can shed light on the value-added of the

¹⁵ IEG survey of country economists concerning the knowledge and use of the ITD (2008, unpublished).

Bank's contributions. Did the diagnosis in ESW and other AAA and in the preparation of projects identify the most important tax policy problems and recommend appropriate policy measures? Did the Bank and authorities choose the appropriate instruments of Bank support? Were reform agendas carried out effectively and did they succeed in addressing the problems?

GEORGIA

3.11 The WBG dialogue on revenue policy with Georgia has gone through three distinct phases since 2000. In the years immediately preceding the Rose Revolution of 2003, there was mainly a technical level dialogue due to the country's governance problems and authorities' lack of interest in reform. The PER of 2002 identified tax policy as an area in serious need of reform, and the recommendations made that context were relatively cautious. (See Annex 1 for an evaluation of this report.) Revenue got up-front attention because its low level and unpredictability were seen as critical constraints to better public expenditure management and to providing adequate levels of public services, especially in social sectors. The PER stated that "Proposals for reform need to take account of these highly constrained initial conditions." (p. iii) Tax policy and administration in the PER was emphasized for raising revenue and not primarily as part of a strategy for improving the climate for private-sector investment and development, as it would be seen in 2004 and thereafter. With a non-reformist government in power in 2002, however, the proposals for tax policy reform were expected to yield only modest increases of revenue. Key recommendations for tax policy were to eliminate most exemptions from VAT, personal and corporate income tax, to simplify the tax regime for small businesses by implementing presumptive taxes, and to increase excise tax collections from large petroleum importers and domestic cigarette producers.

3.12 The PER was prescient in two important senses: First, the four areas of reform and most of the specific reforms it recommended were taken up by the post-Rose Revolution government. Second, the PER was right in identifying improved revenue mobilization as a key condition for improving expenditure management and carrying out effective poverty reduction programs.

3.13 After the Rose Revolution, mostly without WBG input, the government developed a tax reform agenda that was more radical than the Bank and other IFIs and donors had contemplated, i.e. more radical than the recommendations of the PER, particularly in terms of reducing rates. The Bank recognized that there was a risk of revenue shortfalls but played an important role at the time by supporting this agenda with a DPL (PRSO-1) and by getting other IFIs, especially the IMF, to go along with the agenda. The government's own reform agenda for taxes (as well as anticorruption and regulation) turned out to be very successful both in raising revenue and attracting investment in the mid 2000s, and the Bank need only to support it, mainly with financing. Tax revenue rose from 15 percent of GDP in 2003 to 26 percent in 2007, and foreign investment increased rapidly until mid 2008, when there was military conflict with Russia and the world economy turned down. Since 2008, the environment, both global and local, has become less favorable to Georgia, making the government more receptive to active WBG support on policy substance.

3.14 The World Bank lending supported revenue reforms (among others) in Georgia with the PRSO series, especially PRSO-1 (2005) which provided technical and budget support, and with preparation of a Tax Administration TA loan, in process for FY11. See Table 8. Although there has not been formal ESW on taxation issues since 2002, the Bank group (including IFC) provided other AAA for developing the tax code reform in 2010.

Table 8. Bank loans and AAA supporting tax reform in Georgia

<i>Year Appr. or Delivery</i>	<i>DPL with Rev Policy Conditionality (Prior Action or Benchmark)</i>	<i>Amount, US\$ million</i>	<i>IEG Project Outcome Rating</i>
Lending			
2005	Poverty Reduction Support Operation (PRSO)	20.0	Satisfactory
2006	PRSO 2	20.0	Satisfactory
2007	PRSO 3	20.0	Satisfactory
2008	PRSO 4	62.7	Satisfactory
2009	Development Policy Operation (DPO) -1	85.0	-
2010	DPO-2	50.0	-
2010	Tax Administration Reform Project Loan	17.0	
Analytic and Advisory Activities			
2002	PER (Ch 2: Revenue Policy and Administration)		
2010	Diagnostics and Needs Assessment of the Revenue Administration (unpublished)		

3.15 The Bank's earlier ESW, mainly the PER in 2002, identified in mild terms the problems that the reforms of 2005-07 subsequently addressed, but the report downplayed the severity of these problems with cautious optimism—things aren't as bad as they used to be—and recommended a cautious phased strategy of reform. This was probably an appropriate stance for the situation in 2002, given the lack of enthusiasm for reform in the pre-revolution government, and with no CAS since 1997 and no policy-based lending since 1999.¹⁶

3.16 The DPO-2 (FY11) addresses some of the problems with tax administration for business, as one of the Prior actions introduced a risk-based tax audit system, with at least half of planned on-site tax audits selected by the system. The WBG prepared a Diagnostics and Needs Assessment of the Revenue Administration in 2009-10, which served as a background for this DPO and for the revision of the tax code in 2010. With the support of DPO-3, the tax payment system would be streamlined further by issuing comprehensive procedural guidelines for use by tax officers in providing the entire menu

¹⁶ The Implementation Completion and Results Report (ICR) for the PRSOs paints a much bleaker picture of the pre-Rose Revolution policy dialogue than does the PER.

of necessary services to taxpayers. The objective would be to further improve interaction between taxpayers and tax authorities, so that a uniform set of guidelines is in place for all cases. Furthermore, the risk-based tax audit system would be enhanced, with the objective of selecting all planned on-site tax audits using the system, increasing the number of planned on-site audits by at least 50 percent, and reducing the share of control checks to less than 40 percent of the total (of planned on-site audits plus control checks). A Tax Administration investment loan is also planned as a complement to DPO 3. As in the Kyrgyz Republic and Kazakhstan, the IFC worked closely with authorities in Georgia in drafting the sections of the 2010 law pertaining to the SME regime and in preparing the implementing regulations.

3.17 The two main objectives of Georgia's tax reforms since 2004 have been to raise revenue and to improve the business investment climate. The revenue objective was achieved by 2007, but the business climate objective has taken more time. While the 2002 PER emphasized taxes mainly for their revenue effect, the WBG support on tax policy since 2005 has given more attention to the objective of improving business climate, first in terms of simplifying the rate structures and more recently in changes of the code that should make compliance and enforcement less onerous. Judging by survey evidence and interviews in the mission, reforms since 2004 have made the tax environment better for business, but it still has much room for improvement, as taxes seem to be the part of the business environment generating the most complaints. The WBG's non-lending TA contributed substantially to the latest reforms of the tax code, effective January 2011, especially on administration issues. One will be able to judge the success of these latest reforms only after we see how the new code is working.

3.18 In summary, we can look at the Bank's tax policy support in light of the three evaluation questions posed above. The diagnosis of tax issues in the PER was correct but only moderately useful, since the subsequent government started afresh with their tax reform agenda, but the later AAA, especially in 2009-10 leading up to the latest tax code revision was clearly useful. The DPO series, starting in 2005, was an appropriate lending instrument to support Georgia's tax policy reform, and the agenda has succeeded in both raising revenue and, along with other measures, in improving the investment climate. WBG support has gone more to tax administration than to pure tax policy reform, which was beneficial, since the improvements on the administrative side have been crucial for giving the government the fiscal space to move strongly on the policy side.

KAZAKHSTAN

3.19 In Kazakhstan the Bank has supported tax policy reform mainly through AAA, particularly through the Joint Economic Research Program (JERP), discussed in Box 1. The WBG's products related to tax issues are listed in Table 9.

Box 1. Kazakhstan's Joint Economic Research Program

In 2002 the Bank and GoKz agreed to form a Joint Economic Research Program that would cover all the AAA in the country. The first agreement was for three years, and two additional three-year agreements have followed. GoKz and the Bank agree on the AAA program and fund it jointly. In the first three years the cost shares were 50-50; in the next two programs the government has paid about two-thirds, with the Bank covering its own staff costs, amounting to about one-third. The JERP focuses the Bank's investigation on topics that the government wants to pursue, and it has been effective in getting the government to take the recommendations seriously and to act upon many of them. A drawback has been that, at least on tax issues, the discussions of the reports and their policy recommendations have not included much participation from the independent business sector and NGOs, who may receive and discuss the reports only after the government has decided what actions it wishes to take.

Table 9. Kazakhstan: World Bank activities related to taxation

<i>Approval/Delivery year</i>	<i>Project or AAA</i>	<i>amount</i>
Lending		
2010	Tax Administration Reform Project	\$17.0 mill.
Economic and Sector Work		
2002	Strategic Review of the Mining and Metallurgy Sector	
2008	Tax Strategy Paper	
2011	Small and Medium Enterprise Taxation Study	

3.20 In 2002 the Bank did a study of the mining and metallurgy sector, which included a chapter on taxation. Its main conclusion was that the sector differed in important ways from both the petroleum industry and the non-extractive sectors. Therefore the report argued it should have a tax regime that matched its risk characteristics, took into account its typical payback periods, and was consistent with international standards of mining taxation. Also, since mining mainly entails selling abroad the mineral wealth of the nation it, along with petroleum, should bear a heavier tax burden than the non-extractive sectors, reflecting a payment to the government for the use of the nation's scarce natural resources.

3.21 In 2004 a CEM laid out an overall macro-fiscal framework. Based on analysis of past and projected trends, it proposed a plan for a national fiscal fund, with important implications for revenue policy. In that framework, non-oil and non-mineral taxes would collect a substantial share on average of necessary revenues, but these taxes would maintain steady rates in order to be attractive for private investment. All oil revenue would go to or through the national stabilization fund, with net withdrawals sufficing to keep a steady fiscal flow to pay for efficient spending. While the oil revenues have recently been more volatile than this scheme could handle completely, it did allow the tax policymakers to give most of their attention to improving the business environment.

3.22 The main analysis on taxes was in the Tax Strategy Paper for the non-extractive sectors, through the JERP. The report on tax policy (volume 1) was prepared in 2005-06 and intensively discussed with the government in 2006; the chapters on tax policy were ready in 2006 and were used in preparing the tax reform package for 2007 (See Annex 2 for an evaluation of this report). The government requested more work on tax administration, turning what had been planned as a chapter into a full second volume. By the time of publishing this report in 2008, the government had already enacted the 2007 reform, and the report (in its grey cover version) takes that reform as given and focuses its recommendations on further improvements. A subsequent tax reform in 2009 incorporated many recommendations from the 2008 report, particularly reducing the CIT and VAT rates.

3.23 Key recommendations for tax policy in the Tax Strategy Paper included broadening of the base for the Corporate Income Tax (CIT) by phasing-out exemptions in exchange for a lower rate, replacing the highly discretionary system of Investment Tax Preferences by a general investment tax credit, extending the period for carry-loss forward, indexing depreciation allowances for inflation, aligning depreciation schedules with economic depreciation, enlarging the domestic base of the VAT by eliminating most exemptions, improving the refund mechanism, preserving the single VAT rate, integrating the personal income tax (PIT) and the social tax (ST) into a single PIT with a flat rate, simplify rate structure of excises and increasing rates to reflect the social costs of smoking, drinking and polluting. Most of these were done in 2007 or 2009, but the recommended merger of the PIT and social tax for pensions was not done, and plans for further reductions in the CIT rate were postponed because the global crisis reduced the fiscal space available to do rate reductions.

3.24 The tax administration volume had even more recommendations, which were grouped in eight areas: Planning, Organization, and Staffing; Anti-Corruption; Taxpayer Service and Education; Large Taxpayer Operations; Audit System; Collection System; Information Systems; and Judiciary and Appeals issues.

3.25 The government was not asking for any DPLs in 2006-09, so there was not an expectation of lending support for implementing the recommendations of the report for changes to the tax code. There was a DPL in spring 2010, but it did not have any prior actions on tax policy. On the other hand, the Tax Administration Reform Project Loan (investment) in 2010 was based largely on the recommendations in Vol. 2 of the Tax Strategy Paper.

3.26 The Tax Administration Loan focuses on strengthening the internal organization and back-office operations of the Tax Committee (the revenue administrative arm) of the Ministry of Finance. This dual approach, working on both tax policy and the administration of the tax system, seems to be a sound one for which the government has expressed strong appreciation. The tax administration part of the 2008 study and the Tax Administration Loan also give some attention to the front office operations of the tax authority -- how it interacts with taxpayers, including rules for audits -- which is where private-sector interviewees saw the most problems. A report on SME taxation was prepared in 2010 with IFC Advisory Services and was still under discussion with the government at the time of the mission. It identifies the problems with the patent and

simplified regimes, showing how they erode the tax base and create strong disincentives for firms to get out of the shadow economy. The recommendations to reduce the discrepancy of tax burdens between the regular tax system and the SME regimes face opposition from those who would have to pay more and might have to move into a compliance regime more commensurate with the true scale of their businesses.

3.27 Improving the investment environment has been the primary objective of the WBG support on tax policy and administration, and in this it has achieved satisfactory results in attracting foreign investment. Revenue was a secondary consideration, and was explicitly subordinated for a time during the oil boom. The majority of WBG support to Kazakhstan on tax policy was via AAA; it has been well designed and of high technical quality and was delivered in a timely manner to the government. Initially it focused on the major taxpayers and covered most important parts of policy related to the front-office policy of tax administration. More recently it has turned attention to the tax regime for small and micro enterprises and the challenges of linking that with the rest of the tax system. Situating this tax work within the context of the Joint Economic Research Program has helped to garner appropriate attention by the authorities. It would have been and in the future will be useful to put more effort into disseminating the AAA on taxes to a wider audience beyond the government.

3.28 In summary, in light of the three evaluation questions posed earlier, the Bank's tax policy support in Kazakhstan provided accurate and useful diagnosis of the main issues with revenue policy for the non-oil sectors, although a more integrated economy-wide vision might have made it more useful. The choice of mainly AAA instruments and only one investment TA loan was appropriate for the Kazakh situation. The JERP has been a convenient, if not perfect, way to arrange this, so that the financing for AAA does not depend on the size of the lending program and the government has substantial ownership of the AAA products. The tax reform agenda has achieved important improvements.

KYRGYZ REPUBLIC

3.29 The World Bank Group has been supporting tax reform in the Kyrgyz Republic throughout the 2000s, although the priority attached to this effort seems to have declined. Table 10 gives a summary of loans and AAA. The Fiscal Sustainability Study and the Consolidation SAC in 2000 gave the most attention to tax issues, but this dialogue was discontinued with the change of government in 2001, and interest by the Bank or the government on tax issues never returned to the level of 2000 until around 2008, when the IFC Investment Advisory Service started the SME study, which included a chapter on taxation.

Table 10. World Bank support for tax strengthening in the Kyrgyz Republic

<i>Appr/Del FY</i>	<i>DPL with Rev Policy Conditionality (prior action or benchmark) or Loan with TA on taxes</i>	<i>Amount, US\$ million</i>	<i>IEG Project Outcome Rating</i>
Lending			
2000	Consolidation Structural Adjustment Credit	35.0	Unsatisfactory
2003	Governance Structural Adjustment Credit	20.0	Moderately Unsatisfactory
2003	Governance TA Loan	7.8	-
2008	Second Land & Real Estate Registration	5.9	-
2008	Capacity Bldg Econ Mgt	3.0	-
2010	Emergency Recovery Project	70.0	-
Economic and Sector Work			
2000	Fiscal Sustainability (Ch 4: Tax System)*		
2002	Mining Sector Study		
2004	PER		
2010	SME Investment Climate Study (IFC)		

3.30 The Fiscal Sustainability Study (2000), assessed in Annex 3, was thorough in its analysis of debt and fiscal sustainability; its analytical work on taxes was less innovative, but yielded good policy prescriptions. It discussed the VAT, labor taxation (mainly personal income tax and the social tax), corporate profit taxes, a presumptive minimum assets tax, turnover taxes, tax administration and coordination with customs. It had some discussion of the regime for SMEs, but developments since then suggest that the topic deserved more attention earlier.

3.31 The study included some analysis on the revenue effects of the suggested reforms, which was useful in the tight fiscal situation of the Kyrgyz Republic in 2000. The proposed reforms were widely discussed and had the support of the government at the time of the report. However, this political support did not survive to the end of 2000, and 2001 brought in a new and less reform-oriented government. Changes of the government (the change of government in late 2000 and the revolutions in 2005 and 2010) weakened political support for revenue reforms—including reform of energy policy as well as tax policy. Soon after its completion, the 2000 study was no longer included in policy discussions, although many of the issues it raised remained relevant throughout the decade.

3.32 One problem identified in the Fiscal Sustainability Study was that firms operating in the Free Enterprise Zones (FEZ) were given broad exemption from taxes. In July 1998, the Government enacted a resolution requiring that customs duties be collected on the foreign component of goods produced in the FEZ and that customs duties and VAT be collected on imports that pass through the FEZ. But problems persisted in the enforcement of these provisions. In the mid 2000s the government closed all but one of

the FEZ, and it now has better border security and most of firms based there are subject to regular income and VAT taxation (except for a few with grandfather provisions).

3.33 Leading up to the CSAC in 2000, the Government made several efforts to improve tax administration. For example, it maintained a steady record of reducing the magnitudes of offsets used to pay tax liabilities, and it placed tax inspectors in firms that had large outstanding tax arrears. Cooperation between government agencies was also enhanced (e.g., the government developed a taxpayer identification system that allows the State Tax Inspectorate (STI), State Customs Committee (SCC), and Social Fund to use each others' records to analyze taxpayer compliance with the various taxes).

3.34 Compared to the comprehensive revenue reform agenda identified in the 2000 Fiscal Sustainability study, the conditionality in the CSAC supported only minor improvements in the revenue system and did not address its major problems. Legal and administrative changes to the revenue system since 2003 have addressed some of these problems, particularly with the profit (corporate income) tax and the VAT, which together now produce the majority of tax revenue. These apply to medium and large scale businesses. Reporting requirements remain unnecessarily complex under the VAT, discouraging small businesses from moving out of the patent regime (IFC 2010).

3.35 Recently the IFC within the World Bank Group has taken up tax issues as part of its program to improve the environment for SMEs. The IFC report, *Investment Climate in the Kyrgyz Republic as Seen by Small and Medium Enterprises* (2010), has a whole chapter on taxation that presents survey evidence, interviews, and comparisons with other countries. It gives a list of recommendations for short and medium term actions. They are modest in scope and would be technically feasible to implement; it remains to be seen whether the new coalition government (still being formed at the time of the mission) will implement them. Other donors, especially USAID, also played a prominent role in encouraging improvements in the revenue system in the Kyrgyz Republic.

3.36 The objective of increasing tax revenue was partly achieved during the 2000s, as shown in Table 6, although not sufficiently to bring the fiscal gap down to a sustainable level, assuming that high levels of donor assistance are not permanent. The objective of increasing revenue for utilities and improving their efficiency was not achieved. The failure to achieve revenue objectives in the Kyrgyz Republic, in contrast to the Georgia and Kazakhstan, has not only distorted the rest of public finances but has also diverted policy makers from other objectives of tax policy.

3.37 The objective of making the tax regime more attractive to private investment was only partially achieved, with many delays and reversals in some aspects. Overshooting in reducing some tax rates necessitated introduction or retention of other more dictionary taxes. Despite the recent efforts of IFC, the tax regime for micro and small enterprises remains a gap in the tax structure that costs the government revenue, discourages firms from growing into the formal sector, and provides a way for many middle and upper income individuals to avoid paying taxes comparable to what salary earners at the same level pay in retained taxes.

3.38 The problems with revenue policy in the Kyrgyz Republic derive mainly from the political instability, over which the WBG and the policy technocrats have little influence. Perhaps the Bank team could have pushed more on the revenue issue, for instance based on the analysis in the 2000 report, but it is not clear if this would have made any real difference.

3.39 To summarize, the Bank's tax policy support to the Kyrgyz Republic offered potentially useful diagnosis and recommendations, such as in the PER and the IFC's report on SME investment environment, but the problem has been with political disruptions that repeatedly derailed their implementation. The AAA instruments were appropriate for the country situation, although more could have been done in the late 2000s to link the investment-climate side of tax analysis with the country's need for fiscal revenue. It is difficult to discern whether budget-support lending had a sustained impact in improving revenue policy, because the three major political turnovers in the decade of the 2000s disrupted the policy trajectory and led to some reversals.

Summary and Potential Lessons for World Bank Tax Work

3.40 The three cases analyzed in this report show how the economic and political context dominates the prospects for progress on tax policy, with corresponding implications for the limits of World Bank influence. Nonetheless, the Bank can play an important facilitating role and should be ready to do so when the opportunity arises. The case of Kazakhstan shows the value of good advice and that financial assistance is not always necessary for the Bank to have a positive impact on policy. The case of Georgia after 2004 shows that financial assistance with continued AAA can help create the fiscal space needed to allow a reformist government to survive and accomplish its agenda. The difference between this experience and Georgia pre-2004 and the Kyrgyz Republic in 2000 or 2010 is subtle *ex ante*, however, as ministers may overstate their reform intentions or may underestimate the political difficulties involved in carrying through their sincere reform intentions. So, in a difficult political situation, even if AAA sometimes has no immediate traction with the government, it can at least set a policy agenda that can later be revived when the political climate becomes more favorable.

3.41 In the three cases, the progress on tax policy came when the governments were ready politically. The advice of the WBG helped to guide the design of the policy reforms, but the reforms were not directly motivated by policy based lending. Financial instruments like policy based lending and grants sometimes (along with stronger tax collection and enforcement) helped provide the fiscal space for policy reforms that might reduce revenue in the short term, but the main value added of the Bank was in helping to identify the details of reform that would be consistent with sound public finance principles, an improved overall investment climate, and what the government already wanted.

3.42 In Georgia the government since the Rose Revolution in 2003 has made major progress in raising more revenue by streamlining the tax system, strengthening administration, and improving the finances of energy utilities. The World Bank has supported this agenda with DPOs and recently with an investment loan for tax administration. The Georgian case in the mid 2000s shows how a strong government

with a clear idea of where it wants to go with policy can move faster and even farther than the Bank has advised. Much of that movement was in the right direction, but more time and deliberation might have avoided some of the confusing signals that tax policy has given to private investors. Since the 2002 PER, the WBG support on taxes focused on administration rather than pure policy; the 2010 paper had a good chapter on the registration, client services, and enforcement issues, which constitute important aspects of policy from the taxpayers' point of view (See Annex 1).

3.43 In Kazakhstan, the Bank has worked on tax policy mainly through AAA as part of the Joint Economic Research Project, which has been of high quality. The most recent work on SME taxation addresses an important problem area. The authorities have taken little support through DPLs, and policy for taxes and energy revenues have not been on that agenda. Recent investment lending has supported the strengthening of back-office aspects of tax administration but some front-office issues, including how the administration deals with taxpayers, remain problematic, especially in terms of creating a favorable business environment (See Annex 2).

3.44 In the Kyrgyz Republic, the Fiscal Sustainability Study in 2000 and the IFC SME paper in 2010 gave sound advice on tax policy. DPLs have not, however, done much to support the enactment of this agenda. Over the decade the government has made some steps forward on tax policy and some steps back, as the shifts in the political system—one major electoral swing and two revolutions since 2000—have diverted attention away from the economic and fiscal reform agenda. The Kyrgyz case shows the limited ability of the World Bank, even with substantial financial leverage, to induce a government to undertake reforms unless the government wants and has the political stability and support to do so (See Annex 3).

3.45 In the three country cases reviewed here, the WBG has played a largely independent role and taken the lead, rather than the Fund, although they two have generally agreed on the appropriate direction for tax policy. The WBG has needed to bring its own expertise to the table, and it would have been less effective if it had had to rely completely on the lead of the Fund. Thus, these cases demonstrate the value for the WBG to maintain capacity and some core staffing for tax policy issues.

References

- Engel, Eduardo, Galetovic and Raddatz. 1999. "Taxes and income distribution in Chile: some unpleasant redistributive arithmetic." *Journal of Development Economics*, 59:155-192.
- IFC. 2007. *Designing a Tax System for Micro and Small Businesses: A Guide for Practitioners*. IFC: Washington, D.C.
- IFC. 2010. *Investment Climate in the Kyrgyz Republic as seen by Small and Medium Enterprises*. IFC: Washington, D.C.
- IFC Investment Advisory Services, 2009. *A Handbook for Tax Simplification*. IFC: Washington, D.C.
- International Monetary Fund 2000, *Tax Code of the Republic of Taxastan*. IMF: Washington, DC.
- International Monetary Fund 2011. "Revenue Mobilization in Developing Countries", prepared by the Fiscal Affairs Department. Processed, March 8.
- Saavedra, Pablo, with Anton Marcincin and Juraj Vlachy 2007. "Flat Income Tax Reforms," in Cheryl Gray, Tracey and Aristomene Varoudakis, ed., *Fiscal Policy and Economic Growth: Lessons for Eastern Europe and Central Asia*. Washington DC: World Bank.
- World Bank 1992. *Third Report on Adjustment Lending*. Washington DC: World Bank.
- World Bank and IMF. 1998. "Report of the Managing Director and the President on the Bank-Fund Collaboration." IBRD SecM98-733 (September 4).
- World Bank 2000. *Kyrgyz Republic: Fiscal Sustainability Study*.
- World Bank 2002. *Georgia: Public Expenditure Review*.
- World Bank 2002b. *Strategic Review of the Mining and Metallurgy Sector*.
- World Bank 2005. "Kazakhstan: Towards an Optimal Taxation System for Non-extractive Sectors in Kazakhstan: Concept Note: A Study under the Joint Economic and Research Program of the Government of Kazakhstan and the World Bank." December.
- World Bank Group 2007. "Designing a Tax System for Micro and Small Businesses: Guide for Practitioners." December.
- World Bank 2008. *Republic of Kazakhstan: Tax Strategy Paper*.
- World Bank 2010. "Georgia: Diagnostics and Needs Assessment of the Revenue Administration". Discussion Draft.

Annexes

Annex 1: PAR - Georgia: Public Expenditure Review, November 2002

Annex 2: PAR - Kazakhstan: Tax Strategy Paper, June 2008

Annex 3: PAR - Kyrgyz Republic: Fiscal Sustainability Report, 2000

Annex 4: Criteria for Rating Economic and Sector Work

Annex 5. Persons Interviewed

Annex 1: PAR - Georgia: Public Expenditure Review, November 2002

Principal Ratings

<i>Results</i>	<i>Strategic Relevance and Ownership</i>	<i>Quality</i>	<i>Dissemination and Sustained Dialogue</i>
Moderately Satisfactory	Moderately Unsatisfactory	Satisfactory	Unsatisfactory

Key Staff Responsible

<i>Task Manager</i>	<i>Sector Director</i>	<i>Sector Manager</i>	<i>Country Director</i>
Rocio Castro	Cheryl W. Gray	Samuel Otoo	Donna Dowsett-Coirolo

Background

1. Georgia suffered a serious economic collapse in the immediate post-independence years of the early 1990s. After 1996 growth restarted, but from a per capita-income base that was only about a third of what it had been in the late 1980s. The fiscal situation stabilized by 2001, as the deficit was down to about 2 percent of GDP, but it was not economically or socially sustainable. Real spending cuts, mostly via inflation, had brought the public spending share down to 18.5 percent of (reduced) GDP, the lowest share among the post Soviet (CIS) countries. Provision of social and economic services (e.g., utilities) had fallen to unsustainably low levels, for example with electric power on for a few hours a day. The PER aimed to address these issues from macroeconomic, institutional and sectoral perspectives.

2. The World Bank dialogue and program were at a low point in 2002 when this PER was done, due to severe corruption and governance problems in the country, although the PER made no explicit reference to this situation. In the 2003 CAS, completed a month before the (unexpected) Rose Revolution, the base case focused on ESW with a low level of lending, and even this was seen as risky unless the government addressed key governance issues. The low expectations of reform probability and of the Bank's leverage in promoting reforms led the team to propose a modest agenda of reforms in the PER. The Rose Revolution in December 2003 brought in a completely new government, initially at the top and soon at almost all policy making levels.¹⁷ Whereas the old government had been

¹⁷ "The peaceful Rose Revolution of late November 2003 was a popular uprising against years of mismanagement and corruption in government, triggered by frustration over fraudulent abuses in parliamentary elections. Presidential elections were held in early January 2004 and the new President, Mikhail Saakashvili, obtained 97 percent of the votes in an election considered by domestic and international monitors as largely corruption-free. The election results were interpreted as a strong endorsement of the call for a deep and far-reaching fight against corruption and poor governance." (Georgia: PRSO I: PAD, 2005, p.1)

composed predominantly with former officials of the pre-independence communist government, the new government was oriented to the private-sector and was much younger in most cases.

3. The Minister of Finance had requested that the 2002 PER include a section on taxes, and he was seriously interested in the report, but he was fired shortly after the report was done and his successor showed little interest. The World Bank, rather than the IMF, took the lead on tax issues in Georgia in the 2000s.

4. The PER had chapters on Fiscal Overview, Revenue Policy and Administration, Budget Management, Inter-governmental Fiscal Relations (with subnational governments), Health Sector, Education Sector, and Social Protection (for pensioners [10 pp.], internally displaced persons [5pp.], and the poor [3 pp]). Revenue got up-front attention because its low level and unpredictability were seen as critical constraints to better public expenditure management and to providing adequate levels of public services, especially in social sectors. The PER stated, "Proposals for reform need to take account of these highly constrained initial conditions." (p. iii) Tax policy was emphasized for raising revenue and was not portrayed as part of a strategy for improving the climate for private-sector investment and development, as it would be seen in 2004 and thereafter. With a non-reformist government in power in 2002, however, the proposals for tax policy reform were expected to yield only modest increases of revenue. The PER recommendations gave a lot of attention to expenditure and financial management—cash-flow, treasury functions, and matching legally protected social expenditures with true programmatic priorities—in order to make do in a situation with serious revenue shortfalls in 2001-02. In the social sectors, misallocation of resources and poor execution exacerbated the problems of inappropriate targeting, relative to the goal of poverty reduction. The sectoral problems were traced partly back to problems with inadequate and unpredictable revenue streams and to the problems with central budget management.

5. The policy reforms supported by the Bank's First Poverty Reduction Support Operation (2005) and by other DPLs in that series, with the subsequent government (post-Rose Revolution), follow many of the recommendations of the PER concerning public financial management, fiscal decentralization, and spending for education, health, and social protection. The new government adopted the Economic Development and Poverty Reduction Strategy formulated by its predecessor in 2003, which drew substantially on the 2002 PER, but without explicit reference to it. The spending reforms in the whole PRSO program went farther than contemplated in the PER—including measures for capitation based allocation, monitoring and evaluation—because the government was more reform oriented overall and because its tax reforms were being so successful in raising revenue. The tax policy reform of 2004-5, however, which was a prior action for PRSO-1, was more extensive and successful than what was contemplated in the revenue policy chapter of the PER, and it went in some directions not identified in the PER. The PER addresses tax policy primarily as a way to raise revenue, which it certainly was. In the PRSO series with the post-Rose Revolution government, however, tax policy is addressed more as part of the strategy for improving business environment; reduced corruption and vigorous enforcement were the main ways to raise more revenue, along with closing many loopholes in the corporate tax

code. The tax reforms undertaken in 2004 were much more radical than proposed in the PER. The combination of policy and administration reforms led to strong growth of revenues after 2004.

Table A1.1: Ratings for Georgia PER (2002)

<i>Criterion</i>	<i>Rating</i>	<i>Comments</i> (see elaboration in the text)
Results	MS	Initially, with the government at the time of the report, there was no result. Eventually and without reference to the PER, the government after 2004 implemented most of the recommended measures on social service spending and intergovernmental and some them for expenditure management and taxes. The government's tax program after 2004 was more radical and successful in raising revenue than what the Bank or authorities contemplated in 2002, making unnecessary some of the second-best measures recommended in the PER for taxes and PFM. Many ideas from the PER were incorporated in the Bank program after 2004, although usually without explicit reference to the report.
Strategic relevance and ownership	MU	The PER was strategically right in identifying improved revenue mobilization as a key condition for improving expenditure management and carrying out effective poverty reduction programs. The report thus addressed key development constraints, but there was not a coherent country assistance program at the time. It was delivered at a time when it was needed by the country, but not when the government was ready to act on it. There was no evidence of strong interest by the government, and no engagement of civil society.
Quality	S	The report is solid in its analysis, bringing in a lot of comparative information for Georgia and other FSU countries, and collecting new data on health spending in Georgia and using it for pilots to analyze the institutions and flow of funds for spending on health. It made recommendations in all the policy areas covered; they were especially clear and actionable on taxes, financial management and intergovernmental fiscal relations. The peer reviewer was good, although there was only one.
Dissemination and sustained dialogue	U	The report had limited dissemination within the government and none with the private sector and civil society. Dialogue was not sustained when the Minister of Finance changed, even in the pre-revolution government.

Results

6. The policy dimensions on which one would look for results were laid out in the PER; the criteria for success were largely implicit in the comparisons of Georgia's performance with other CIS countries—giving approval when Georgia was doing better than the sub-regional average and noting shortfalls. Since the authorities in Georgia and the other countries of the region seemed to measure their progress mainly relative to each other, this was an appropriate way to present the findings recommendations.

7. In the country program, the potential results of the PER were both direct with the government in place in 2002 and indirect with the government that came to power after the Rose Revolution. See Table A1.2, below, showing the recommendations of the PER and the related policies that were implemented in Georgia. Direct results from the PER were minimal—the pre-revolution government undertook few if any reforms in 2002-3, indeed policy was deteriorating on most fronts addressed in the PER. The PER was intended as input to the Economic Development and Poverty Reduction Program of 2003, although this PRSP seems to have been mostly a Bank exercise with little involvement of the government at that time and the document made no direct reference to the PER. Results came with the post-Rose Revolution government, although they were indirect both in the sense of delayed timing and in the sense that the ambitious policy reforms after 2004 were designed with little or no explicit reference to the PER. The PRSP in 2004 made no direct reference to the PER. Particularly in the area of tax policy, most of the reforms starting in 2004 were more radical than anything proposed in the PER. The subsequent government followed some of the report's recommendations in the areas of social spending and intergovernmental finances, and there were notable achievements, like more students per teacher. None of the officials interviewed in 2010 remembered the report, however; so its direct impact is unclear.

8. There were no discernable effects of the PER in the wider Georgian society. The audience was mainly the government itself, and even the reformist government after the Rose Revolution took the measures that it thought appropriate, without much direct input from domestic stakeholders or information to them. The PER was done by the Bank staff and external international consultants, with little input from local counterparts within or outside the government, so it did not have any effect in developing local capacity. There was some involvement of the donor community, as a US Treasury advisor provided comments on the expenditure management chapter.

Table A1.2: Recommendations of the Georgia PER (2002) and Implementation of related reforms

Recommendation	Implementation of related reforms
<i>Expenditure Management</i>	
<i>Improving cash-flow management.</i> Setting more conservative quarterly allocations during the first half of the year using within year borrowing to smooth expenditure.	Specific measures to deal with revenue shortfalls were not implemented before 2004 and became unneeded thereafter.
<i>Improving the match between protected items and priority programs.</i> Earmarking of 'protected items' should be phased out.	Objectives achieved with strong revenue growth starting in 2003, as tax revenue grew from under 10% of GDP to over 19% by 2006. ^b
<i>Building incentives for budget rationalization.</i> Programs restructured to be consistent with budget ceilings should get adequate financing assured.	Achieved in 2005-07. ^b
<i>Strengthening treasury functions</i> (ongoing). Bringing revenue accounts into the treasury, introducing comprehensive commitment control.	Achieved in 2005 -08. Budget exercise now begins with Basic Data and Directions document and builds to an MTEF. ^{a, b}
<i>Develop bottom up sector programs, using MTEF.</i>	
<i>Horizon of the budget framework</i> should be extended to the medium term, e.g., three years, with increasing depth of sectoral analysis.	
<i>Put a phase of budget strategy formulation within the budget cycle.</i>	
<i>Link Budget with the Poverty Reduction Strategy Paper.</i>	

Recommendation	Implementation of related reforms
Revenue Mobilization	Tax revenues grew quickly in the mid 2000s, from 15% of GDP in 2003 to 26% in 2007/
<i>Limit tax policy changes</i> , by making changes only with each annual budget and with estimates of revenue impact.	Not achieved, until perhaps with 2010 revision of tax code, as frequent revisions to tax code continued to create confusion and uncertainty at least thru 2010.
<i>Strengthen VAT performance</i> by (a) raising the VAT threshold to about US\$50,000), while limiting voluntary registration of businesses below the threshold; (b) reducing exemptions, and (c) begin implementing VAT refunds for exports. <i>Simplify the tax regime for small businesses</i> , by implementing the proposed simplified and presumptive taxes. <i>Eliminate most exemptions from personal and corporate income tax.*</i>	Achieved, mostly in 2004-5. ^b The reforms in 2004-05 went farther than what was recommended.
<i>Eliminate nuisance taxes.</i> <i>Increase excise tax collections</i> from petroleum products and cigarettes by enforcing payments from large petroleum importers and domestic cigarette producers.	Achieved, mostly in 2004-5. ^b Fiscal surpluses starting in 2004.
<i>Introduce a broader range of criteria to measure administrative performance</i> , e.g., number of audits, recovery rate of tax arrears, and number of registered tax payers.	Introduced 2004-05. ^b
<i>Eliminate the practice of advance payments</i> , by transferring all revenue accounts from the National Bank of Georgia.	Achieved by 2006. ^b
<i>Implement phased customs reform</i> , improving the coordination between the tax department and customs, and establishing a customs manual.	Achieved by 2008. ^b
Adopt a functional organization of the tax department that separates the collection, audit, and enforcement functions. Increase coverage and performance of the large-taxpayer unit. <i>Increase tax payers' registration</i> , with emphasis on quality tax payers. Harmonize (strengthen) enforcement powers of the tax administration with current practice in OECD.	Achieved by 2008 ^b
Prompt actions to recover tax arrears. Realign fees and penalties (to reduce their share in arrears). [*] Switch to administrative tax enforcement, without court involvement [*]	Achieved by 2006, 2008 ^b
Intergovernmental Fiscal Relations	
Put income tax revenues all into the central fund (along with VAT, customs, etc) and Adopt a transparent formula-based mechanism for transfers from the central fund to the local level.	Achieved with Law on Local Self Government Budgets, 2006. ^a
<i>boost the local tax effort:</i> - re-assign land and property taxes as local taxes; - assigning a flat PIT tax rate to the local level; - reassign the progressive PIT and the CIT to the equalization fund; - transferring public utilities to local governments; - allow local governments to set fees, taxes and local tariffs within an established range.	All of PIT was moved to a flat rate in 2004. Effective Tax powers remain relatively centralized, although local governments can collect some local fees. Most utilities remain at the national level.
<i>Clarify expenditure responsibilities/competences</i> - distribute functions/competences between rayons and self-government units according to organic law; - reassigning to the central government the financing of primary education	Achieved with Law on Local Self Government Budgets, 2006. ^a

Recommendation	Implementation of related reforms
Phase out the criteria of 'protected items' on delegated responsibilities.	Achieved 2004, as revenue growth meant that there was no more need for special protected items.
Use conditional grants for specified programs	Local Self Government Budgets, 2006. ^a
Social Services	
-Allocate (limited) public funds for a Basic Benefits Package for health -promote private sources of financing for other medical services -downsize and restructure the health system. Increase public financing of health services to 4 percent of GDP by 2005.	Objectives Achieved by 2006-07, as revenue growth allowed a more generous Basic Benefits Package than envisioned in the PER. ^b
In education sector, strategically restructure to shift resources from tertiary to general (primary and secondary) levels. * increase the student/teacher ratio (many teachers were reaching retirement age soon) and consolidate school facilities	Achieved by 2006 ^b
Assure the access of the poor to education. include provision of: (i) free of charge basic education materials (e.g., textbooks); (ii) education and training subsidies for poor students (e.g., scholarships for higher education).*	Achieved by 2006 ^b
Pay pensions on a timely basis and reduce arrears*	Achieved by 2006 ^{b, a}
Improve administration and monitoring of cash- transfer programs to improve their actual targeting.	Achieved by 2006 ^b

Sources: ^a Georgia Public Expenditure Review and PEFA Assessment (World Bank 2008)

^b Georgia PAD for PRSO IV (2008)

* Implicit recommendation in the text.

9. The PER also had potential for results within the World Bank, but these were mostly indirect and later, after the Rose Revolution, when the Government carried out many of the reforms recommended in the PER. The Bank encouraged and endorsed these reforms, but by-in-large the dialogue went forward without reference to the PER. It was not mentioned in the CAS of 2003 or 2005 nor in the PADs of the PRSO series starting in 2005.

10. The PER was prescient in two important senses: First, the four areas of reform and most of the specific reforms it recommended were taken up by the post-Rose Revolution government. Second, the PER was right in identifying improved revenue mobilization as a key condition for improving expenditure management and carrying out effective poverty reduction programs.

Strategic Relevance and Ownership

11. The conditions for policy dialogue were difficult in 2002, for reasons beyond the control of the task team and the country team. Since the government was not in a reform mode in the years before the PER, it did not come at a time to affect relevant government policy, although according to the 2003 CAS there was the expectation that annual process-based Public Expenditure Reviews would provide the underpinnings for systemic changes in expenditure management. As an input to the PRSP in 2003, it did affect Bank decisions. The previous Georgia CAS for FY98-00 had expired and no update had been done as of 2002. Other than the Minister of Finance, who departed shortly after the report was delivered, there was essentially little ownership of the report by the government of the time.

12. The PER addressed problems that had been identified in previous Bank reports. The previous CAS in 1997 had identified underfunded and poorly managed social sector programs as hindrances to achieving the MDGs, and the PER addressed these issues. The CPAR and CFAA in 2002 had identified financial management problems that were covered in the PER. The PAD for the Structural Reform Support Project (FY 1999) had tried to strengthen the treasury function, but that project had stalled by the time of the PER, and it was revived after 2004.

13. The report made long term and short term recommendations. These were based on analysis comparing Georgia and other CIS countries on various dimensions, which was a relevant argumentation tactic, since all the countries of the region were intensely interested in how they compared with each other. The recommendations were not followed by the pre-Rose Revolution government, however; actions of its successor were in line with many of the recommendations on the revenue policy, financial management and social sector topics.

14. The report did not have much ownership from the government of 2002, which had not in advance agreed at a significant level to a program of AAA that included the report. The previous approved CAS was for 1998-2000, approved in 1997. Local institutions or government agencies were not involved in producing the report.

15. Later governments, whose policies were consistent with some of the recommendations, did not seem to have been consciously following the recommendations. It was written for a Bank audience to some extent, in order to stay informed, and with the hope that its findings would guide future policy dialogue, which they did to some extent, but not until after the Rose Revolution at the end of 2003.

16. There was a workshop presentation of the results of the PER in September 2002 in Tbilisi, at which representatives of the Ministry of Finance, Ministry of Economy, State Chancellery, National Bank of Georgia, Ministry of Health, and Ministry of Defense attended and commented. External participants included the IMF, USAID, the US Treasury, and Barents. According to the BTOR, the discussions focused on the implications for the budget formulation process.

Quality

17. The technical quality was fully *satisfactory*, especially considering the limited client interest at the time. To some extent the PER summarized previous work, using a variety of good sources. On many issues it put together relevant international comparisons—total spending and revenue, tax structure and collection, health expenditures and outcomes, education expenditures and outcomes, and teacher-student ratios. It brought out a lot of detailed data on potential and actual tax revenues, budget execution rates, geographic allocation of decentralized transfers and spending, health spending by program, pension contributions and disbursements, and poverty benefits to recipients.

18. After the Executive Summary and Overview of Fiscal Development, there follow six chapters on particular topics: Revenue Policy and Administration, Budget Management, Intergovernmental Fiscal Relations, Health Sector, Education Sector, and Social Protection.

A common theme is the problems with revenue, contributing to problems with budget management, which contributes to problems with service delivery. The report was well organized to bring out these linkages. Presumably there was some political economy behind this configuration, but the report does not get into that.

19. *Revenue.* This chapter lays out the main problem with taxation in Georgia, relative to the standard prescriptions—a simple tax structure, with a minimum of exemptions, and a strong and honest tax administration. Several international comparisons, especially with other FSU countries, show that Georgia lagged behind in revenue collection and, at the same time, had some relatively high tax rates, especially on formal sector labor, and many exemptions in the law and shortcomings in administration and enforcement. Lack of coordination between tax and customs authorities and rampant corruption in tax collection were identified as major problems. The strong rise in revenue that took place as these problems were addressed after 2004 shows that the diagnosis was correct.

20. *Budget management.* The report documented the negative effects of various ad hoc cash management devices that had been introduced to try to deal with the uncertainty and shortfalls of revenue. Several of the recommendations aimed at interim improvements in these devices, since at the time of the report a direct remedy on the revenue side was not envisioned for the short term. It was thus a fortuitous and, for some, unexpected outcome when revenues grew strongly after 2004. This allowed the government to start relatively quickly on the medium terms parts of the agenda—building a multi-step budgeting process, based on a rolling medium-term expenditure framework.

21. *Intergovernmental Fiscal Relations.* This section describes the legal system in 2002 for subnational governments and analyzes how the actual practice diverged from the law. A lot of the divergence resulted from the same problems with revenue that were plaguing national-level budget management. The report identified as problematic the practice of having “priority items” in the national budget carried through to the local levels, which created even greater distortions there. The section also shows the very large disparities in the fiscal resources per capita going to different regional governments.

22. *Health Sector.* This was perhaps the strongest section of the report. The PER did fresh data gathering and analysis, such as a pilot public expenditure tracking survey in the health sector. Although the sample was small, facilities that received the majority of their funds from public sources were selected, and some variety as assured by comparing Tbilisi—the capital and one of the richest municipalities—and the Imereti Region, which is the poorest region, according to the 1999 poverty assessment. The PER identified a number of financial management problems in the sector that obstructed the flow of funds and hindered adequate service provision. It showed how the lack of transparent rules regarding budget execution hurt poorer regions and hindered some potentially cost-effective and poverty targeted programs for health services. Other parts of the chapter also brought evidence on the problem of underfunding for health programs in poorer regions.

23. *Education Sector.* The chapter documented the extent to which enrollments had fallen in various areas of the country, as result of demographic changes and of failures in

service provision. This resulted in low student to teacher ratios, which in a situation of severe under-funding, like that of Georgia, implied low levels of efficiency. The PER shows how private education payments had replaced falling public funding, which was less than half of total education funding by 2000, and how this tilted education opportunities away from low income households. The report shows that, despite the high share of teacher salaries in the total education budget (compared to other FSU countries), real teacher salaries had declined sharply, and even that pay came on an irregular basis, due to the revenue and financial management problems mentioned above. This had led to serious teacher absentee problems, with many taking other jobs in order to make a living.

24. *Social Protection.* The chapter discusses the three main social protection programs: (i) pensions, (ii) cash transfers to internally displaced persons (IDPs); and (iii) a limited poverty benefit program. The pension issue gets the most attention, showing that the financial management problems, such as arrears, had made the program much less effective than it could have been in alleviating poverty.

Dissemination and Sustained Dialogue

25. The main counterpart of the report was the Ministry of Finance. There was some dialogue until the person of the minister changed, shortly after the report was done. After that there was no further dialogue based on the report, although the topics of the report remained relevant. During report preparation, there was also some dialogue with the Ministry of Health, for which sector the study included a pilot expenditure tracking survey. There was a 2-day workshop to discuss the report; it was attended by some ministries, the IMF and USAID. The PER was not disseminated outside the government, at the request of the Minister of Finance, who was concerned that making known the idea for tax reform would stimulate opposition to the tax reform measures recommended.

Overall Assessment

26. This PER had little impact with the government at the time it was written, but it presented analysis and recommendations that were appropriate for the situation, with a non-reform oriented government. In 2002 there was no reason to predict the ultra-reformist attitude of the new government starting in 2004. When the new government came in, it carried out many of the recommendations of the PER for budget management and social spending, so that part of the report had a positive impact, although delayed and indirect. In the revenue policy and administration area, the new government moved in directions not contemplated in the revenue chapter of the PER, so it had negligible impact there.

Lessons

27. Despite the low state of country dialogue at the time of preparation, a basic diagnostic report like a PER can have a long-term value in guiding reforms for a subsequent government. In hindsight, the PER was overly modest in its recommendations; if the authors had had an inkling of the big increase in reform readiness under the next government, they would probably have put forward recommendations that were closer to the best international practice, but no one predicted the large change (for the better) of the government's attitude toward reform.

IEG PAR									
Georgia: Public Expenditure Review, November 2002									
Product Data									
Vice President	Country Director	Sector Manager	Task Manager	Project ID/ Type/ Report No./Cost	Number of: Volumes/ Pages	Languages	Document Type	Topics	Unit
Johannes Linn	Donna Dowsett-Coirolo	Samuel Otoo	Rocio Castro	P076270/ PER/Report No. 22913-GE \$372,098	1 Vol. 136 pp	English	ESW	Fiscal Overview, Revenue Policy and Admin., Budget Management, Intergovernmental Fiscal Relations, Expenditures for Education, Health, and Social Protection	ECA/PREM
Ratings Summary									
Criterion	Rating	Comments (elaborated in the text of the annex)							
Results	MS	Initially, with the government at the time of the report, there was no result. Eventually and without reference to the PER, the government after 2004 implemented most of the recommended measures on social service spending and intergovernmental and some them for expenditure management and taxes. The government's tax program after 2004 was more radical and successful in raising revenue than what the Bank or authorities contemplated in 2002, making unnecessary some of the second-best measures recommended in the PER for taxes and PFM. Many ideas from the PER were incorporated in the Bank program after 2004, although usually without explicit reference to the report.							
Strategic relevance and ownership	MU	The PER was strategically right in identifying improved revenue mobilization as a key condition for improving expenditure management and carrying out effective poverty reduction programs. The report thus addressed key development constraints, but there was not a coherent country assistance program at the time. It was delivered at a time when it was needed by the country, but not when the government was ready to act on it. Ownership in the government was minimal. There was no evidence of strong interest by the government, and no engagement of civil society.							
Quality	S	The report is solid in its analysis, bringing in a lot of comparative information for Georgia and other FSU countries, and collecting new data on health spending in Georgia and using it for pilots to analyze the institutions and flow of funds for spending on health. It made recommendations in all the policy areas covered; they were especially clear and actionable on taxes, financial management and intergovernmental fiscal relations. The peer reviewer was good, although there was only one.							
Dissemination and sustained dialogue	U	The report had limited dissemination within the government and none with the private sector and civil society. Dialogue was not sustained when the Minister of Finance changed, even in the pre-revolution government.							
Criterion	Evidence of Results								
RESULTS INDICATORS:									
..results objectives defined at inception?	Yes. The concept note stated that the objective of the PER was to analyze why the level of public services had fallen so low and to provide a menu of recommendations with which to address the problems. Low and uncertain revenue was hypothesized as a key constraint to provision of adequate services in utilities and the main social sectors.								
..indicators defined at inception?	No. There were not specific indicators for monitoring the implementation of the recommendations, although the tables of international comparisons provided implicit indicators with which to judge results.								

IEG PAR Georgia: Public Expenditure Review, November 2002	
..strategy to achieve results?	Yes. Improving the predictability of fiscal resources was identified as a key revenue reform that would allow better spending practices, both in terms of overall budget management and in social sector programs.
RESULTS ACHIEVED: Did country use findings:	Indirectly, The subsequent government followed some of the recommendations, but none of the officials interviewed in 2010 remembered the report. So, its direct impact is unclear.
..in policy law, regulation, or implementation?	The main change of law related to the report was the new national budget law in 2004 and the 2006 law for local government budgets. Other important changes were in the implementation of the budget and financial management law.
..in design of public expenditure?	Indirectly, The subsequent government followed some of the recommendations, but none of the officials interviewed in 2010 remembered the report. So, its direct impact is unclear.
..to raise stakeholder awareness?	Not particularly. The audience was mainly the government itself, and even the reformist government after the Rose Revolution took the measures that it thought appropriate, without much direct input from domestic stakeholders. The counterpart at the Ministry of Finance requested that the report not be disseminated locally due to concern in 2002 that making known the ideas for tax reform would mobilize business interests to lobby against reform.
..to build a coalition for change?	No. The coalition for change came later, without any apparent link with the PER.
..to build in-country capacity?	The PER was done by the Bank staff and consultants, with little involvement in report preparation by local counterparts within or outside the government.
..to influence the donor community?	To a limited extent, as a US Treasury advisor provided comments on the expenditure management chapter.
..to change institutions	Not in the period of the report.
Did the Bank use the findings in:	
..the design of development policy lending?	Yes, indirectly, in that the measures supported in the PRSO series of 2005-07 includes implementation of PER recommendations in the areas of public expenditure management and social spending, although not much on revenue policy.
..Bank strategy formulation?	In its discussion of the reform program for public expenditure management and social spending, the 2003 CAS refers to the PER's recommendations on these topics.
..future knowledge products?	Yes. A CFAA (2003) built on the results of the PER; in May 2002 there was a joint mission of the two task teams.
..informing the country's strategy?	Yes. The PER was an input to the country's Economic Development and Poverty Reductions Strategy of 2003.
Is there evidence that results are sustainable?	Reforms since the Rose Revolution of late 2003 have been sustained in the areas of budgeting and financial management. The question is the extent to which these results can be attributed to the PER, given the gap in time and the major change of government.
MONITORING OF RESULTS IMPACT: Did the Bank or client assess the product's impact on results?	Neither the Bank nor the client assessed the results of the PER.
<p>Discussion of Results: Initially, with the government at the time of the report, there was no result. Eventually, the government of 2004 and after implemented many financial management and spending measures recommended in the PER, but not to the revenue policy recommendations.</p> <p>Many ideas from the PER were incorporated in the Bank program, but usually without explicit reference to the report.</p> <p>The rating on this dimension is thus Moderately Satisfactory, since there was modest impact on the programs of both the country and the Bank.</p>	

IEG PAR Georgia: Public Expenditure Review, November 2002	
Criterion	Evidence of Strategic Relevance
STRATEGIC RELEVANCE	
Did delivery of product come in time to affect relevant government policy or Bank decisions?	The government was not in a reform mode in the years before the Rose Revolution when the report was done. It made some indirect contribution to reforms by the subsequent government.
Was topic identified as "development constraint or opportunity in:	
.. the relevant CAS/CSP?	Yes, The CAS in 2003 identified underfunded and poorly managed social sector programs as hindrances to achieving the MDGs.
..previous AAA?	CPAR and CFAA in 2002 provided detail on some financial management problems that were flagged in the PER.
..particular projects (specify)?	In part. The Structural Reform Support Project (FY 99) tried to strengthen the treasury function, but progress on that had stalled by the time of the PER.
..particular evaluations?	No.
..policy dialogue with clients?	Yes. In the 2003 CAS and PRSP.
..donor coordination fora?	To some extent, especially with USAID, but there was not a lot of donor activity in Georgia around the time of the report, before the Rose Revolution.
Under conditions of difficult dialogue, did the product?	Dialogue conditions were difficult at the time of the PER, for reasons well beyond the control of the task team.
..focus on long-term issues for better receptivity to Bank input	The PER separated the recommendations for the short and longer term. The government at the time did not seem to pay much attention to either.
.. address sector issues in areas where there is more receptivity to Bank input	The sector ministries were receptive to the message that problems with budget and financial management were causing problems with service delivery. The Minister of Finance was receptive to ideas on strengthening tax policy. But these interests did not coalesce into a
..address country issues in a regional or global context?	Yes. The PER made frequent comparisons between Georgia and other CIS countries on the relevant dimensions of expenditure and revenue policy and practice.
Evidence of Ownership	
Is product part of overall AAA program to which the authorities have contributed or agreed?	No. There was not an active CAS at the time the report was done.
Did the client request or commission the specific product?	The PER responded to the Minister of Finance's request for work on taxes, and to interest of social sector ministries in clarifying some origins of their problems.
Did the client cover some or all of the costs?	No. All costs were paid from BB.
Did the key decision makers (as distinct from technical specialists) collaborate with, discuss or provide feedback on the product?	The Minister of Finance reviewed in some detail an early draft of the PER>

IEG PAR Georgia: Public Expenditure Review, November 2002	
Did a local institute, academy, consulting firm or government agency help to:	
..define the scope of the work?	No
..plan and design the work?	No
..carry out the work?	No
.. analyze the results and write the report?	No
.. formulate conclusions and recommendations?	No
..provide peer review or comments on the draft report?	No
..organize workshops or discussions about the findings?	No
Discussion of Strategic relevance and ownership: Thus the overall rating is Moderately Unsatisfactory. The report addressed key development constraints with some key insights, but there was not a coherent country assistance program at the time. The PER was delivered at a time when it was needed by the country, but not when the government was ready to act on it. There was no evidence of strong interest by the government, and no engagement of civil society. Thus there were moderate shortcomings in all three dimensions.	
Criterion	Evidence of Quality
QUALITY OF CONTENT	
Did the product...	
...include appropriate knowledge (i.e. make use of current and relevant knowledge from both inside and outside of the Bank)?	Revenue policy and administration – the PER gives summary descriptions of the key issues and cites relevant analysis done in other studies and shows how this is relevant for the expenditure issues. On budget management and intergovernmental fiscal issues, the document gives detailed diagnosis of the problems created by ad hoc measures to deal with revenue uncertainty and short falls. In the chapters on social sector spending the report used up to date information and techniques of analysis, especially in the health sector, where the team did a pilot expenditure tracking survey.
...cite relevant examples of practice or research from other countries in the region?	Yes, there were many regional comparisons on key variables of interest. This was appropriate, in light of the sense of competition among the FSU countries.
...cite relevant examples of practice or research from other regions?	The examples and references were mainly to practice in the ECA region (plus a few to Western Europe), which had the most relevance to policy makers in Georgia.
...discuss the specific institutional and policy context for the issue in this country?	Yes, the policy context was the low level and great uncertainty of revenue flow, and their poor management, which led to poor social service delivery.
...collect and analyze existing local data?	Yes. Local data were collected and presented.
...generate new evidence?	It provided an adequate summary of evidence in a variety of other sources. New data were collected and analyzed in a pilot expenditure tracking survey, in the health sector.
...include recommendations?	Yes. The recommendations, though modest, were probably as much as could be hoped from the government at that time.
Do the recommendations include specified actions to be taken by specified actors (incl. non-Bank)?	Yes, there were actions for the country authorities to take on issue of sectoral spending, budget management and revenue collection. In each area the PER lists the main policy results that its recommendations would support.

IEG PAR Georgia: Public Expenditure Review, November 2002	
Was the product team staffed with the appropriate expertise (incl. consultants)?	Yes. There were good staff and consultants with experience and good reputations.
Did the product receive appropriate managerial attention?	Yes, IRIS records indicate that senior and middle managers participated in planning and monitoring the task. They participated in the review meetings at the concept paper and Bank-wide review stages.
Did the product receive sufficient budget?	Yes. \$372K seems sufficient.
REVIEW OF CONTENT	
Was the draft peer-reviewed by appropriate experts?	There was one peer reviewer, who was a top expert in the Bank on the topic.
Were the peer-review comments taken into account as appropriate?	Yes. . His comments at the final review said that he had already commented on two earlier versions and that "most, if not all" of his earlier comments had been incorporated.
Was the feedback from the client about the product incorporated into the final version?	The report was discussed with authorities on two occasions, but there does not seem to have been much dialogue with the client during the report preparation.
Discussion of Technical quality: Technical quality was satisfactory, especially considering the low level of client interest at the time. This was not a best-practice report. To a substantial extent it summarized previous work, from a good variety of sources, and it did some fresh analysis and data gathering.	
Criterion	Evidence of Dissemination and Sustained Dialogue
INITIAL DISSEMINATION	
Was the product...	
...made available in the local language?	No. Only English.
...made available on a website?	It is on the Bank's website now. There was not a Georgia Program website at the time, and the Government did not put it on its website.
...discussed with senior policy-makers?	Yes, there was a discussion of a draft with the Ministry of Finance and then a two-day workshop with ministers from most of the ministries whose programs were covered in the PER.
...presented at a workshop, conference, seminar or on-line discussion?	There was one workshop with government officials and other donors.
...covered in the general or specialized media?	No. No dissemination in the media.
SUSTAINED DIALOGUE	
Did the product serve as an input to a sustained engagement with the client through	
...policy dialogue?	To a limited extent directly. It contributed to the CFAA.
...sustained workshops/discussions with stakeholders beyond initial dissemination?	No. There was only one dissemination workshop.
...lending products (Bank and non-Bank)?	Not directly, although its ideas fed indirectly into the PRSO series starting 3 years later.
...technical assistance (formal or informal)?	This was formal TA. It also contributed to the CFAA.
...programmatic instruments?	It fed indirectly into the PRSO series starting in 2005.
...other means (please discuss below)?	

IEG PAR

Georgia: Public Expenditure Review, November 2002

Discussion of Dissemination and sustained dialogue:

Dissemination of the report was Unsatisfactory. It was disseminated some within the government, but not at all in wider society. With the government there was no sustained dialogue after the report, as the Minister of Finance who had requested the work departed shortly after it was completed.

Annex 2: PAR - Kazakhstan: Tax Strategy Paper

Volume I: A Strategic Plan for Increasing the Neutrality of the Tax System in Non-Extractive Sectors

Volume II: Tax Administration Reform and Modernization, June 2008

Principal ratings

<i>Results</i>	<i>Strategic Relevance and Ownership</i>	<i>Quality</i>	<i>Dissemination and Sustained Dialogue</i>
Satisfactory	Satisfactory	Highly Satisfactory	Satisfactory

Key Staff Responsible

<i>Task Manager/Leader</i>	<i>Division Chief/ Sector Director</i>	<i>Sector Manager</i>	<i>Country Director</i>
Pedro L. Rodriguez Munawer S. Khwaja	Luca Barbone	Kazi Abdul-Matin	Annette Dixon

Background

28. In the 1990s Kazakhstan rebuilt its post-independence economy and built from scratch a modern tax system, reflected in the Tax Code of 1995. Although not exemplary, having various distortions and unnecessary complexities, it had the basic standard taxes on imports, value-added, personal and corporate income, as well as on oil and mineral production (and export). Oil is Kazakhstan's most important export. Minerals are also important, and in 2002 the Bank did a study of the mining and mineral sector, which included a chapter on taxation. In the early 2000s the tax regime deteriorated, as exemptions and special regimes proliferated. With the oil boom from 2004 onward, GoK did not have urgent needs for revenue from non-mineral taxation, and the government looked to tax reform as a way to improve the business environment, even if it cost the treasury some revenue in the short term.

29. In 2005 they agreed with the Bank to do the Tax Strategy Paper as part of the Joint Economic Research Programs, for which the government provided over half of the funding. The chapters on tax policy were ready in 2006 and were used in preparing the tax reform package for 2007. The government requested more work on tax administration, turning what had been planned as a chapter into a full second volume. By the time of publishing this report in 2008, the government had already done the 2007 reform, and the report (in its grey cover version) takes that reform as given and focuses its recommendations on further improvements.

30. A subsequent tax reform in 2009 incorporated many recommendations from the 2008 report, particularly reducing the CIT and VAT rates. The merger of the PIT and social tax

for pensions was not done, and plans for further reductions in the CIT rate were postponed because the global crisis reduced the fiscal space available to do rate reductions.

31. GoK was not asking for any DPLs in 2006-09, so there was not an expectation of lending support for implementing the recommendations of the report for changes to the tax code. There was a DPL in spring 2010, but it did not have any prior actions on tax policy. The Tax Administration Reform Loan (investment) in 2010 was based largely on the recommendations in Vol. 2 of the Tax Strategy Paper.

32. Kazakhstan, like many former Soviet Union countries, has had problems with the tax administration being corrupt and at times too heavy handed with enforcement and penalties, to the point of becoming major complaints of private firms. The volume II of the report raises these issues, and the 2010 Tax Administration TA loan addresses some of them.

Overall Assessment

33. Overall, the report is high quality and had substantial impact on tax policy and probably will have an important impact on tax administration. The government had strong ownership and participation in preparing the report. Dissemination was good within government circles. There was little dissemination to wider circles of stakeholders, which is a weakness, although not a fatal one for reform prospects in a society where most policy decisions are made at top and sustained from there, with little recourse to wider circles.

Table A2.1. Ratings

Results	S	The report brought positive results in tax policy, with some but not all of the recommended reforms being implemented. The Tax Administration TA loan, approved in FY10, was designed to support implementation of most of the report's recommendations for tax administration, and it seems on track to do that. The report has had a highly positive result in the Bank program, with a central place in the JERP and follow-on ESW and lending, for tax administration reform.
Strategic relevance and ownership	S	It was timely to do this report while the oil revenues were high and the country could focus on improving the efficiency of the tax system and its effects on the business environment. While focusing on four major taxes and how they work in the non-oil sectors, it was a strategic limitation not to give some consideration to the overall fiscal setting (as initially proposed in the concept note), including the oil and mineral sector and the way that the VAT and income taxes operated there. The government ownership of the study was strong. It financed over half of the study through the JERP.
Quality	HS	The high technical quality of the tax policy analysis makes this report valuable not only for Kazakhstan, but also as an example and possible template for tax work in other countries. The chapters on capital taxation and the VAT were especially strong. The capital tax chapter showed how marginal effective tax rates differed by sector and by capital investment vehicle, demonstrating the extent of distortions created by the old tax policy. The VAT chapter showed how the emphasis in raising revenue had shifted from domestic to international transactions and used the household spending survey to show the distribution of the initial incidence of the VAT across income groups.
Dissemination and sustained dialogue	S	Dialogue with the government counterparts was well supported by the study, although dissemination beyond the government and its close associates was less extensive.

Results

34. The tax study was a central part of a dialogue that led to some important improvements in tax policy—simplifying the rate structure, eliminating many exemptions, and reducing rates—and to agreement on an agenda of tax administration measures that are being supported by the Tax Administration TA loan, currently under implementation. These results pertain mainly to the medium to large end of the tax payer spectrum. The taxation of SMEs remains problematic, and this was not a major aspect of the study, although it has been treated in a subsequent study.

35. Results objectives were designed at the onset—to provide NLTA to the Government of Kazakhstan (GoK) to sustain tax policy reform and further it, and to plan for complementary improvements in tax administration. “The tax policy review will aim at assessing the current taxation regime with a view of understanding: (A) whether it meets public finance revenue requirements given the non-oil deficit target stemming from oil policy and given non-oil expenditure objectives; (B) whether it does so at reasonable efficiency costs or whether improvements can be made in general tax structure and administration; (C) how it can more effectively contribute to the economic diversification and social equity objectives of the authorities. “ (World Bank 2005, p. 8) The focus was on raising revenue, as well as improving the business environment.

36. The report brought better information and thus awareness to the relevant government counterparts and to some elements in the private sector that are closely connected to the government. Many government technocrats worked with the Bank team, especially from the Tax Committee in the Ministry of Finance. The government’s Tax Committee was strengthened by the interaction with the Bank team, and the report proposed major overhauls of the tax administration. Local academics were not involved in the study, so it was not contributing to build analytic capacity on taxes there. It was not well disseminated to the private sector and tax payers at large, and thus it did not raise awareness among those stakeholders. The essential coalition to support change is within the government, and the report was thoroughly discussed within those government circles. In the private sector, the report received less airing, although those working closely with the government in Astana had had it for some time. In Almaty, where the private business sector is centered, relevant persons got the report in preparation for the IEG visit, but it did not seem to be widely accessible in Russian, although a translation was put on the World Bank website, and is available to those who know how to access it.

37. The Tax Administration Reform Project (TARP) loan in 2010 (US\$17 million) drew heavily on the analysis and recommendations in the Volume 2 on Tax Administration. The same Bank team and country counterparts that worked on tax administration section of the report worked also on the TARP. Tax policy seems to be well established as part of the Joint Economic Research Program (JERP).¹⁸ The latest tax work, on SME taxation in FY11, not

¹⁸ In 2002 the Bank and GoKz agreed to form a Joint Economic Research Program that has since then co-financed all the AAA in the country, with a jointly agreed work plan.

yet published, was done under the JERP. USAID was a co-sponsor of the tax study, showing that the issues are relevant in Kazakhstan's wider international dialogue on economic issues. Table A2.2 elaborates on which recommendations of the report have been or are being implemented.

Table A2.2: Recommendations of the Kazakhstan Tax Strategy Paper and Implementation of related reforms

Recommendations (Volume I—tax policy)	Implementation of related reforms
<i>Broadening of the base for the Corporate Income Tax (CIT) in exchange for a lower rate</i>	Done in part. Law remains complex in its application.
Replace the various simplified regimes by a single system targeting only very small enterprises and farms, whether incorporated or not incorporated. Firms and farms would qualify for the single simplified regime on the basis of a turnover threshold, and the rate could be based on turnover.	Not done. In addition to the turnover-tax regime, the patent regime remains, with numerous enterprises staying there illegitimately.
Consider phasing-out exemptions to the CIT using one of the following options: <ul style="list-style-type: none"> – Introduce a sunset provision for all exceptions (say 2010?). – Offer voluntary switching to the full CIT regime in exchange for a one time subsidy (paid as a tax credit). – Free Economic Zones and Technoparks can be assisted through provision of infrastructure and the reduction of red tape. 	Not done.
Replace the current highly discretionary system of Investment Tax Preferences by a general investment tax credit for everyone	Not done.
Extending the period for carry-loss forward.	Loss Carry-forward was extended to 10 years. (Previously it was 3 years.)
Consider also introducing indexation of depreciation allowances and aligning depreciation schedules with economic depreciation.	Not done.
Avoid eroding the working capital of firms by allowing refunds or credits for excessive advance payments	Partially done.
Phasing out the 80 percent discount on CIT for agricultural enterprises' (gradually if necessary)	Not done.
Lower the CIT rate to 20-25% depending on the extent of base broadening, and to bring it more in line with neighboring countries and EU rates. The reduction should apply strictly to non-extractive industries.	Rate lowered to 20%. Further reductions once planned but deferred after economic crisis of 2008-09.
<i>Simplification of taxes on labor:</i> Fully integrate the personal income tax (PIT) and the social tax (ST) into a single PIT with a flat rate.	Not done.
<i>Enlarging the domestic base of the VAT, while also improving the refund mechanism:</i>	Broadened the VAT base, but problems with refunds remain.
Eliminate most exemptions (e.g., farmers, lawyers, the construction of infrastructure projects for government, economic zones and technoparks, and newly created residential buildings)	Done.
Preserve the single VAT rate	Done.
Review the high VAT exemption threshold	VAT threshold remains high.
<i>Simplify rate structure of excises and increase rates to reflect the costs that smoking, drinking and polluting impose on society</i>	Not done.
<i>Conduct a separate assessment of the taxation of real estate and land</i>	Not done.
Recommendations (Volume II—tax administration)	Implementation of related reforms
<i>Planning, Organization, and Staffing</i>	
The Tax Committee in the Ministry of Finance should develop a strategic plan within a medium to long-term framework (from three to seven years). The process should begin with a realistic assessment of current tax administration operations, followed by a detailed modernization plan.	Being done under the Tax Administration Reform Project, 2010 (TARP)

Recommendations (Volume I—tax policy)	Implementation of related reforms
Restructuring of the organization and redeployment of human and other resources requires a comprehensive study designed to improve incentives and concentrate on the most profitable areas. To ensure proper oversight of both the field and central offices, the span of control of the TC chair should be reduced. The authorities may consider rebalancing field and headquarters functions to separate those responsible for preparation of policies and procedures, and inspection of local offices, from those responsible for the conduct of field operations and case work which involves interactions with taxpayers. Personnel with skill levels necessary for each type of work should be reassigned or rotated to the relevant units of the organization	Being addressed with TARP.
Anti-Corruption	One objective of the TARP is to reduce the potential for corruption.
A realistic and relevant Code of Conduct must be promulgated. Units within the Tax Committee should be created to detect and combat corruption and should report directly to the Chairman or a senior official reporting directly to him/her.	Not done.
Protocols and procedures for reporting, preventing, and detecting corrupt practices must be instituted. Organizationally, investigation of such offenses should be a responsibility of the Tax Committee itself, at least in the first instance.	TARP includes components to improve reporting.
Systems should be constructed: requiring management controls and reviews that expose transactions and operations vulnerable to abuse. Risk assessments must be undertaken at all steps in case processing. Information systems must be designed to track and minimize corrupt incidents. A systemic effort to review procedures, assess human resources issues (e.g., rotations, compensation, qualifications for hiring and retention, disciplinary actions) is equally important.	TARP components include introduction of a risk management system for HR and measures for improving transparency.
Taxpayer Service and Education	
The taxpayer service structure must be a separate division with constituent distinct elements in all field offices and with its own dedicated resources. Taxpayer service strategies and plans should be prepared and implemented quickly.	Being addressed with TARP.
As a means of measuring taxpayer satisfaction all functions and capabilities need to be measured and analyzed from time to time.	TARP supports development of taxpayer surveys.
Large Taxpayer Operations	
Constituting 65 percent plus of the revenues, this sector of operations must receive highly specialized training and its entire effort should be reorganized. Greater expertise in specific industry and business operations must be acquired, documented and internalized.	Being addressed with TARP.
Computer-assisted auditing and other specialties must be constituent elements of audit teams, and team audit, package audit, and integrated audit concepts must be improved or employed	Being addressed with TARP.
Audit System	
Inspections should only be conducted in the field and the TC Headquarters should not have responsibility for tax cases. It should focus exclusively on prescribing policies and procedures for audit and monitoring audit in the field.	Being addressed with TARP.
The qualifications for recruitment of new inspectors need to be revised. Extensive training should be undertaken to improve the quality of audits.	Being addressed with TARP.
An objective methodology for the risk-based selection of audit cases must be instituted for non-cameral control. An Annual Audit Plan should be created	Being addressed with TARP.
The Tax Code needs to be rationalized with respect to the frequency and duration of audits to ensure that integrated audits are conducted to minimize repetitive visits to taxpayers. The integrated audit should be a coordinated examination of the taxpayer and all related entities or principals. It should also be a one-stop audit, covering all taxes-- payroll, PIT or CIT, VAT, Excise in one visit. An Audit Manual needs to be compiled for the use of all inspectors to guide them in the conduct of audits	Being addressed with TARP.

Recommendations (Volume I—tax policy)	Implementation of related reforms
Collection System	
The Tax Code should be amended and procedures promulgated to enable write-off of uncollectible accounts.	Not done.
The Code also should be clarified and appropriate procedures put in place to permit automatic offset of any tax refund due to a taxpayer against indebtedness for any tax owed.	Not done.
Creation of a specialist position for tax collection separate from Inspection/Audit functions	Could be addressed with TARP, but not explicit in the PAD.
An enforcement mechanism should also be modeled on most modern tax administrations by which certain tax obligations survive the liquidation of an entity, and can be applied against responsible officers of the taxpayer entity who were responsible for paying such taxes to the government but failed to do so.	Could be addressed with TARP, but not explicit in the PAD.
An analysis of the age of all arrears should be undertaken to assess the quality and nature of collection efforts and the currency and worth of accrued indebtedness.	Could be addressed with TARP, but not explicit in the PAD.
The advisability and relative advantages to be enjoyed by freeing the TC from the responsibility of collecting local taxes, obligatory payments and state duties should also be considered	Could be addressed with TARP, but not explicit in the PAD.
Information Systems	
E-systems for taxpayer interface and inputs must be expanded and made more user-friendly. The capacity of hardware and equipments need to be enhanced and upgraded.	Being addressed with TARP.
Management reporting and information systems must be expanded to permit monitoring at all critical junctures within the “pipelines” of all processes so as to keep management apprised of system efficiency.	Being addressed with TARP.
Technology management, technology development and technology support should be segregated for better specialization.	Being addressed with TARP.
Registration requirements and procedures need to be streamlined and simplified. Better cross referencing of files and matching with databases of other ministries should be effectuated.	Being addressed with TARP.
Judiciary and Appeals	
The Appeals structure should be placed outside the normal chain of command and subordinated directly to the Appeals Division in the Central Office. This division should report directly to the Tax Committee Chairman or a Deputy.	Could be addressed with TARP, but not explicit in the PAD.
The Appeals Committee in the Central Office should be abolished. The decision of the Tax Appeals Division should be the final step in the administrative appeals process.	Could be addressed with TARP, but not explicit in the PAD.
The position of “Appeals Officer” should be created. Appeals Officers should be permitted to negotiate with the appellants taking into account the risks of litigation	Could be addressed with TARP, but not explicit in the PAD.
Appropriate government authorities should consider the establishment of a branch of the judiciary to be dedicated to adjudicating tax cases	Being addressed with TARP.

38. The tax policy reforms encouraged by the study have not all been implemented, but those that were done have been sustained. The tax policy changes since the report have remained in place, and the 2010 Tax Administration Loan shows the government’s commitment to continue progress with the tax agenda. Taxes remain one of the main themes in the JERP, and the 2008 report is the centerpiece. Building on the 2008 study, the Bank did a report on SME taxation, with publication expected in 2011. Thus the Result in the Bank program is highly satisfactory, and the overall result is *satisfactory*.

Strategic Relevance and Ownership

39. The study was strategically timely, while the oil revenues were high and the country could focus on improving the efficiency of the tax system and its effects on the business environment. The report could focus on longer term issues because of the strong revenue position of the government at the time of the report, due to high oil prices. Subsequently they have had to go slower than initially planned on tax rate reductions and have put more pressure on enforcement, to accommodate shortfalls from expected oil revenues. The task was started in 2005 and the chapters on specific taxes were delivered in time to have a substantial impact on revisions to the tax code. Delivery of the final product was delayed, however, because the government asked that the work on tax administration be expanded from a single chapter to a full second volume. Thus, some of the tax policy reforms had already been done by the time of publication, but the process of doing the report was no less valuable for that.

40. One shortcoming is that the report did not cover aspects of the regular taxes (labor and personal income, corporate income, VAT, excises) that pertained to the petroleum and mining sectors. This issue had been raised in the 2002 report on the mineral and mining sectors.¹⁹ Also, it did not give the reader a sense of the relative importance of these taxes and of the nonoil and non-mineral sectors. So one could not tell how much of the whole fiscal and business picture the report was addressing. Also, the report did not cover aspects of these taxes as applied in the petroleum sector—very large for public finances and the overall economy. Given the importance of those sectors, even the non-sectoral taxes on them must be important for fiscal reasons and for the incentive effects—for example on whether non-oil firms would have a tax incentive to expand into the non-oil sectors, or to avoid such an expansion. It would have been useful to have had an overview of the whole revenue side of finances, to give a context for the issues that were explored in depth. Doing the work as part of the JERP means, however, that the government can set the limits to what it wishes to have explored.

41. Ownership of the report by the government was strong. Obvious evidence is that the clients requested the study and paid for about half of it. Since then, the country counterparts still make reference to it, and many of the recommendations for strengthening tax administration were incorporated in the action plan for the Tax Administration TA Loan, approved in 2010.

Quality

42. The quality of the study was excellent for the taxes covered—labor and personal income, corporate income, VAT, excises. Volume I on policy had sophisticated analysis in the text and annexes was summarized in less technical terms for the executive summary. The four chapters are on taxation of labor (PIT and social tax), taxation of capital, VAT, and

¹⁹ In the 2002 sector study of the mineral and mining sectors, the chapter on taxes for those sectors identifies some problems in how general taxes (VAT, withholding on consultant fees, interest payments, dividends, profits tax, depreciation) apply in the mineral sector. It did not call for a broader review of these taxes, however, and the 2008 tax report did not address the problems in applying general taxes to the mineral sector.

excise taxes. The labor tax chapter shows how the PIT would affect families at different income levels. The social tax is shown to be more complex and more burdensome on lower income households than the PIT, and argues for simplifying it and making it at least proportional to income. It also points out the inequities in tax treatment between those that are wage workers in the formal sector, and paying high rates, and those that are self-employed (even well-paid professionals) or in the informal sector. The capital taxation chapter shows the inconsistencies in the way different forms of capital are taxed. It analyzes critically the different regimes for small businesses and agriculture, makes estimates how the effective tax rates differ according to the sector and to the way that a firm is legally organized. It has many international comparisons, which is appropriate, given the government's motivation to attract international investment.

43. The VAT chapter looks at three issues. First it considers how efficiently the VAT raises revenue, since it is potentially the least distorting of the major taxes and would be a good vehicle to fill revenue gaps that might arise. It looks at how the share of VAT revenue from imports has grown dramatically. It highlights the need to keep the domestic VAT base as broad as possible and to strengthen VAT administration, because the domestic VAT would have to be relied on more heavily if imports were to decline in the wake of a decrease in exports. Second, it calculates the incidence across income groups, based on the household expenditure survey, and finds that the tax is relatively progressive. It concludes therefore that proposals to lower the rate on foodstuffs is unnecessary in order to increase progressivity and would have other undesirable effects. Therefore the report recommends keeping a unified VAT rate. Third, it reviews all the exemptions and special regimes that have eroded the VAT base and recommends getting rid of them. The chapter on excise taxes finds that these are relatively low by international standards and thus do not achieve much toward the usual objectives of curbing undesirable behavior (drinking, smoking, gambling, polluting) and raising revenue. It concludes that there is scope to raise the rates, and improve enforcement, in order to both realize more revenue and to counteract negative externalities.

44. Volume II on administration had not only good discussions of the back office concerns that the Bank usually attends to, but also gave a good analysis of the over-zealous and punitive auditing and enforcement that create problems for legitimate private sector firms. World-class consultants and technically strong staff drew on their knowledge and expertise, making good use of current and relevant knowledge from both inside and outside of the Bank. Footnotes cite a wide range of publications. The report used relevant examples of practice or research from other countries in the region and in the rest of the world. Besides the numerous comparative tables in the main text, two annexes summarize the tax regimes in China and Russia.

Dissemination and Sustained Dialogue

45. The dissemination and dialogue within the government were excellent. Preparation and finalization was done in close collaboration with authorities. The Tax Committee in the Ministry of Finance created a special unit to coordinate the technical work with the World Bank. The Bank team held workshops with the government counterparts and key stakeholders in the business community-- Association of Tax Payers, Forum of Entrepreneurs, and Association of Entrepreneurs. Outreach to broader spectrums of society

seems to have been limited, although there was a press conference in Almaty (the main center of business) and media coverage of the report in 2008.

46. The report was translated into Russian and is available on the WB external and internal websites, in Russian as well as English. Some private sector counterparts had gotten copies prior to the mission's arrival, but it did not seem to be well known in the private sector in Almaty.

Lessons

47. This report shows what positive results can come from AAA that is agreed on and strongly supported by the client. The usefulness of ESW seems enhanced when it responds to government demand for knowledge not linked with an urgent need for funding and when the government helps to pay the cost of the report. Agreeing with the government on a whole program of AAA, to be co-financed, appears to be an attractive model for upper income countries—superior, for instance to ad hoc tasks on a fee for service basis. It also shows a limitation, although less important, in that the report only deals with the specific issues requested by the client and does not touch on some related issues—like oil and mineral revenues—that would seem relevant to the country situation and the Bank's dialogue on revenue policy and administration.

48. The report brought out the close linkage of tax policy and administration, and the joint reforms of the two sides of revenue policy have been mutually supportive.

49. As the country contemplates widening opportunities political participation (see OpEd by President [Nursultan Nazarbayev](#) in Washington Post, 12 April 2011), it may want to disseminate reports like this more widely within society. The Bank should support such efforts.

50. Good ESW on one country like this should be disseminated to enhance the policy dialogue in other countries where it is relevant, such as the other FSU countries.

IEG PAR Kazakhstan: Tax Strategy Paper, June 2008									
Product Data									
Vice President	Country Director	Sector Manager	Task Manager	Project ID/ Type/ Report No./Cost	Number of: Volumes/ Pages	Languages	Document Type	Topics	Unit
Shigeo Katsu	Annette Dixon	Kazi Abdul-Matin	Pedro Rodriguez & Munawer Khwaja	P096940/Report No. 36494-KZ \$308,964	2 Vols. 116 & xx pp.	English, Russian	ESW	Tax Policy and Administration for Non-extractive sectors	ECA/PREM
Ratings Summary									
Criterion	Rating	Comments							
Results	S	<p>The report brought positive results in tax policy, with some but not all of the recommended reforms being implemented. The Tax Administration TA loan, approved in FY10, was designed to support implementation of most of the report's recommendations for tax administration, and it seems on track to do that.</p> <p>The report has had a highly positive result in the Bank program, with a central place in the JERP and follow-on ESW on SME taxation and lending for tax administration reform.</p>							
Strategic relevance and ownership	S	<p>It was timely to do this report while the oil revenues were high and the country could focus on improving the efficiency of the tax system and its effects on the business environment.</p> <p>While focusing on four major taxes and how they work in the non-oil sectors, it was a strategic limitation not to give some consideration to the overall fiscal setting (as initially proposed in the concept note), including the oil and mineral sector and the way that the VAT and income taxes operated there.</p> <p>The government ownership of the study was strong. It financed over half of the study through the JERP.</p>							
Quality	HS	<p>The high technical quality of the tax policy analysis makes this report valuable not only for Kazakhstan, but also as an example and possible template for tax work in other countries. The chapters on capital taxation and the VAT were especially strong. The capital tax chapter showed how marginal effective tax rates differed by sector and by capital investment vehicle, demonstrating the extent of distortions created by the old tax policy. The VAT chapter showed how the emphasis in raising revenue had shifted from domestic to international transactions and used the household spending survey to show the distribution of the initial incidence of the VAT across income groups.</p>							
Dissemination and sustained dialogue	S	<p>Dialogue with the government counterparts was strongly supported by the study, although dissemination beyond the government and its close associates was less extensive.</p>							
Criterion	Evidence of Results								
RESULTS INDICATORS:									
..results objectives defined at inception?	<p>When Kazakhstan asked the Bank to undertake the Tax Study, its petroleum revenues were booming. The government wanted to get more private sector investment, including from foreign direct investors, and they were willing to sacrifice some revenue in order to make the tax environment more attractive to major investors—those in the formal sector.</p> <p>The Bank's strategy was to provide ESW and other NLTA to GoK to sustain tax policy reform and further it, and to plan for complementary improvements in tax administration.</p>								

IEG PAR Kazakhstan: Tax Strategy Paper, June 2008	
..indicators defined at inception?	Implicitly, the indicators of progress on tax reform were to improve the investment climate, for instance, as in the Doing Business ratings. Longer-term and more direct indicators of success included increasing the amount of FDI, while not sacrificing too much in tax revenue.
..strategy to achieve results?	In the near term, the Kazakh government has had relatively few political constraints in implementing what it decides to do, but it still had to pay some attention to the revenue side. The initially announced pace of lowering the corporate tax rate was deferred in the wake of the world economic recession and fall of oil prices in late 2008.
RESULTS ACHIEVED: Did country use findings:	Yes, as a guide to reform of tax policy and administration. Some recommendations made in the course of preparing volume 1 of the report had already been implemented by the time volume 2 was completed and the report was published in 2008. Volume 1 was revised for publication, to reflect progress already made and to revise the list of recommendations for further reform.
..in policy law, regulation, or implementation?	Yes the government used the recommendations in revising the tax code and in preparing the Tax Administration TA loan.
..in design of public expenditure?	No. Focus was on raising revenue, as well as improving the business environment.
..to raise stakeholder awareness?	It brought better information and thus awareness to the relevant government counterparts and to some elements in the private sector that are closely connected to the government. It was not well disseminated to the private sector and tax payers at large, and thus it did not raise awareness among those stakeholders.
..to build a coalition for change?	The essential coalition to support change is within the government, and the report was thoroughly discussed within those government circles. In the private sector, the report received less airing, although those working closely with the government in Astana have had it for some time. In Almaty, where the private business sector is centered, relevant persons got the report in preparation for the IEG visit, but it did not seem to be widely accessible in Russian, although a translation was put on the World Bank website, and is available to those who know how to request it.
..to build in-country capacity?	Many government technocrats worked with the Bank team, especially from the Tax Committee in the Ministry of Finance. Local academics were not involved in the study, so it was not contributing to build analytic capacity on taxes there.
..to influence the donor community?	Not directly an issue, since Kazakhstan is not a donor recipient. USAID has however been a partner in supporting the AAA on tax.
..to change institutions	The government's Tax Committee was strengthened by the interaction with the Bank team, and the report proposed major overhauls of the tax administration.
Did the Bank use the findings in:	
..the design of development policy lending?	There were no DPLs envisioned at the time of the study. The FY2010 DPL did not have tax policy prior actions, because the government was not ready then to take or commit to further tax policy changes.
..the design of Bank lending products	There was a tax administration loan in 2010 that drew heavily on the analysis and recommendations in the Vol 2 on Tax Administration. The same Bank team and country counterparts that worked on tax administration loan
..Bank strategy formulation?	Tax policy seems to be well established as part of the JERP. Tax administration is an issue for which GOK also asked for investment lending support.
..future knowledge products?	Yes. Building on the 2008 study, the Bank had done a report on SME taxation, which is now with the government awaiting their comment and approval for public discussion.
..informing the country's strategy?	Yes. Taxes remain one of the main themes in the JERP, and the 2008 report is the centerpiece of the AAA on taxes.

IEG PAR Kazakhstan: Tax Strategy Paper, June 2008	
Is there evidence that results are sustainable?	Yes. The tax policy changes since the report have remained in place, and the 2010 Tax Administration Loan shows the government's commitment to continue progress with the tax agenda.
MONITORING OF RESULTS IMPACT: Did the Bank or client assess the product's impact on results?	Yes, although not in a focused impact assessment. The CPS Progress Report in 2008 told of how the AAA on tax policy had supported reforms.
Discussion of results: Based on the evidence above, and taking into account any self evaluation of the product's results, assess how and to what extent the AAA product affected Bank or client actions.	
<p>The tax study was a central part of a dialogue that led to some important improvements in tax policy for the objective of improving the investment climate—simplifying the rate structure, eliminating many exemptions, and reducing rates—and to agreement on an agenda of tax administration measures that are being supported by the Tax Administration TA loan. These results pertain mainly to the medium to large end of the tax payer spectrum. The bottom end—SMEs—remain problematic, and this was not a major aspect of the study.</p> <p>The revenue from taxes was not an immediately pressing issue at the time the study was launched, although keeping them from falling too much was a secondary concern. It grew in importance around the time that the report was completed, due to the fall of oil prices in 2008, and now revenues are being watched more closely.</p>	
Criterion	Evidence of Strategic Relevance
STRATEGIC RELEVANCE	
Did delivery of product come in time to affect relevant government policy or Bank decisions?	The study was strategically timely, while the oil revenues were high and the country could focus on improving the efficiency of the tax system and its effects on the business environment. Some of the needed reforms had already been done. One shortcoming is that the report did not cover aspects of the regular taxes (labor and personal income, corporate income, VAT, excises) that had been raised in the 2002 report on the mineral and mining sectors. Also, it did not give the reader a sense of the relative importance of these taxes and of the nonoil and non-mineral sectors. So one could not tell how much of the whole fiscal and business picture the report was addressing.
Was topic identified as "development constraint or opportunity in:	
.. the relevant CAS/CSP?	The 2004 CSP did not have the Tax Study included in plans for the Joint Economic Research Program. It was added later to the JERP, when the government decided it would revise the tax code with help from the WBG.
..previous AAA?	In the 2002 sector study of mineral and mining sectors, the chapter on taxes for those sectors identifies some problems in how general taxes (VAT, withholding on consultant fees, interest payments, dividends, profits tax, depreciation) apply in the mineral sector. It did not call for a broader review of these taxes, however, and the 2008 tax report did not address the problems in applying general taxes to the mineral sector.
..particular projects (specify)?	No.
..particular evaluations?	No. The report made no reference to prior IEG evaluations.
..policy dialogue with clients?	Yes. Obvious evidence is that the clients requested the study. Since then, the country counterparts still make reference to it, and many of the recommendations for strengthening tax administration were incorporated in the action plan for the Tax Administration TA Loan, approved in 2010.
..donor coordination fora?	Partially. USAID was a co-sponsor of the tax study.
Under conditions of difficult dialogue, did the product?	NA. Not difficult conditions.

IEG PAR Kazakhstan: Tax Strategy Paper, June 2008	
..focus on long-term issues for better receptivity to Bank input	The report could focus on longer term issues because of the strong revenue position of the government at the time of the report, due to high oil prices. Subsequently they have had to go slower than initially planned on rate reductions and have put more (perhaps too much) pressure in enforcement, to accommodate shortfalls from expected oil revenues.
.. address sector issues in areas where there is more receptivity to Bank input	Yes. The report only focused on the taxes that the government was ready to revise. It did not deal at all with taxation in the mineral resource sectors, even for the VAT and corporate income taxes.
..address country issues in a regional or global context?	The study had many tables with international comparisons, especially with the other FSU countries of the region.
Evidence of Ownership	
Is product part of overall AAA program to which the authorities have contributed or agreed?	Yes. The JERP that the WB has with GOK is exemplary in building ownership into the design of the ESW program. This arrangement could be a good model for AAA programs with other middle-income countries.
Did the client request or commission the specific product?	Yes. It was part of the program agreed in JERP.
Did the client cover some or all of the costs?	Yes. They covered about half of the cost.
Did the key decision makers (as distinct from technical specialists) collaborate with, discuss or provide feedback on the product?	Yes. The PM, Dep PM, Min of Finance, Min of Economy, and chairs for Budget and for Tax Committees in Parliament participated in seminars and workshops on the report.
Did a local institute, academy, consulting firm or government agency help to:	
..define the scope of the work?	The Tax Committee in the Ministry of Finance participated actively in defining the scope of work.
..plan and design the work?	The Tax Committee reviewed the design, but the Bank team did most of the planning.
..carry out the work?	No
.. analyze the results and write the report?	No.
.. formulate conclusions and recommendations?	No, although the conclusions and recommendations were discussed with the Tax Committee before being finalized.
..provide peer review or comments on the draft report?	Yes. Association of Tax Payers, Forum of Entrepreneurs, and Association of Entrepreneurs.
..organize workshops or discussions about the findings?	Yes. Association of Tax Payers, Forum of Entrepreneurs, and Association of Entrepreneurs.
Discussion of Strategic relevance and ownership: The government participated actively, through the Joint Economic Research Program, in deciding on the study as part of a broader strategy for public finance. They provided the majority of funding, through the JERP.	
On balance this is rated : Satisfactory .	

IEG PAR Kazakhstan: Tax Strategy Paper, June 2008	
Criterion	Evidence of Technical Quality
QUALITY OF CONTENT	
Did the product...	
...include appropriate knowledge (i.e. make use of current and relevant knowledge from both inside and outside of the Bank)?	Yes. World-class consultants and technically strong staff drew on their knowledge and expertise. Footnotes cite a wider range of publications
...cite relevant examples of practice or research from other countries in the region?	Yes. Two Annexes summarize the tax regimes in China and Russia. Evidence on other OECD is presented in tables and the main text.
...cite relevant examples of practice or research from other regions?	Yes. Six tables and various places in the text show international comparisons of tax regimes.
...discuss the specific institutional and policy context for the issue in this country?	Yes. The favorable revenue situation from the petroleum exports was explicitly described as a reason why Kazakhstan could focus tax reform on improving the investment environment for private business, even at the cost of some revenue in the short term.
...collect and analyze existing local data?	Yes. 24 tables and 9 graphs showed relevant Kazakh data and calculations, but material in annexes.
...generate new evidence?	Yes. Team calculated marginal effective tax rates, effects on incentives of inflation and exemption, and distributional effects of taxes.
...include recommendations?	Yes. Up front there was a 2 page list of key recommendations, and these were discussed fully in the executive summary. For some recommendations, there were simulations/estimations of the effects.
Do the recommendations include specified actions to be taken by specified actors (incl. non-Bank)?	Recommendations were mainly for the authorities.
Was the product team staffed with the appropriate expertise (incl. consultants)?	The team had strong technical competence. World-class experts participated in the study—McLure and van Wijnbergen.
Did the product receive appropriate managerial attention?	Yes. The sector manager followed the task closely.
Did the product receive sufficient budget?	Yes. It was well resourced--\$309K.
REVIEW OF CONTENT	
Was the draft peer-reviewed by appropriate experts?	OK. Peer reviewers were staff with some public finance background, although not at the level of the team consultants.
Were the peer-review comments taken into account as appropriate?	Yes .
Was the feedback from the client about the product incorporated into the final version?	Yes. The tax policy part (volume I) was discussed in draft in 2006 and taken into account in tax code changes. Then, as the volume II on administration was finished, the report was updated in the first part to acknowledge the progress of the policy dialogue.

IEG PAR

Kazakhstan: Tax Strategy Paper, June 2008

Discussion of Technical quality:

The technical quality was superb for the taxes covered—labor and personal income, corporate income, VAT, excises. Volume I on policy had sophisticated analysis in the text and annexes was summarized in less technical terms for the executive summary. Volume II on administration had not only good discussions of the back office concerns that the Bank usually attends to, but also gave a good analysis of the over-zealous and punitive auditing and enforcement that create problems for legitimate private sector firms.

One shortcoming is that the report did not cover aspects of the regular taxes (labor and personal income, corporate income, VAT, excises) that had been raised in the 2002 report on the mineral and mining sectors. Also, there are probably aspects of these taxes as applied in the petroleum sector—very large for public finances and the overall economy—that the report did not cover. Given the importance of those sectors, even the non-sectoral taxes on them must be important for fiscal reasons and for the incentive effects—for example on whether non-oil firms would have a tax incentive to expand into the non-oil sectors, or to avoid such an expansion.

Criterion	Evidence of Dissemination and Sustained Dialogue
INITIAL DISSEMINATION	
Was the product...	
...made available in the local language?	Yes, The report has been translated into Russian, and some private sector counterparts got copies when the mission was to meet with them, but the Russian version was not distributed widely..
...made available on a website?	Yes, The report is available on the WB external and internal websites, in Russian as well as English.
...discussed with senior policy-makers?	Yes. Preparation and finalization was done in close collaboration with senior authorities, who were enthusiastic about it.
...presented at a workshop, conference, seminar or on-line discussion?	Yes. The team held workshops with the government counterparts and key stakeholders in the business community-- Association of Tax Payers, Forum of Entrepreneurs, and Association of Entrepreneurs. Outreach to broader spectrums of society seems limited, however.
...covered in the general or specialized media?	No, the mission did not find evidence of this.
SUSTAINED DIALOGUE	
Did the product serve as an input to a sustained engagement with the client through	
...policy dialogue?	Yes. Dialogue on taxes by WBG has been intense and sustained, for instance with the 2010 Tax Administration loan and the FY11 study of SME taxation issues.
...sustained workshops/discussions with stakeholders beyond initial dissemination?	Yes, dialogue has continued with the government counterparts and close associates of the government in the private sector.
...lending products (Bank and non-Bank)?	The tax administration discussion (vol. 2) was an input to a tax administration loan (2009). The tax policy discussion in volume 1 does not, however, seem to have been the basis for actions supported by a DPL, such as the one in FY10, which did not have prior actions related to tax policy.
...technical assistance (formal or informal)?	This was formal TA. And it has been followed by formal TA (TARP loan) and informal (SME tax study).
...programmatic instruments?	Yes, it was part of the JERP, which has been at the core of the CSP since 2005. There were follow-on studies of tax administration and taxation of SMEs.

IEG PAR

Kazakhstan: Tax Strategy Paper, June 2008

Discussion of Dissemination and sustained dialogue

Dissemination and Dialogue is rated **Moderately Satisfactory**. Dialogue and dissemination within the government was HS, as the Ministry of Finance and especially its Tax Committee were fully involved in planning and discussing the Report. Some private sector representatives with close ties to the government were drawn into these discussions, but they did not extend to a public discussion with stakeholders outside the Government's inner circle.

Annex 3: PAR - Kyrgyz Republic: Fiscal Sustainability Report, 2000

Principal Ratings

<i>Results</i>	<i>Strategic Relevance and Ownership</i>	<i>Quality</i>	<i>Dialogue and Dissemination</i>
Moderately Unsatisfactory	Moderately Satisfactory	Satisfactory	Moderately Unsatisfactory

Key Staff Responsible

<i>Task Manager/ Leader</i>	<i>Sector Director</i>	<i>Sector Manager</i>	<i>Country Director</i>
Ritu Anand	Kiyoshi Kodera	Samuel Otoo	Pradeep Mitra

Background

51. By the mid 1990s Kyrgyz got growth restarted after economic set-backs from the Soviet Union break-up and got the fiscal deficit down to 9 percent of GDP, which it covering with external concessional lending. They passed a new tax code in the 1996, which put in place the main elements of a modern tax system—VAT, personal and corporate income taxes, a variety of excise taxes, and a payroll tax (“social tax”) on labor income. 1998 brought three new crises, however, that halted growth and raised the debt ratios to potentially unsustainable levels: debt and economic crisis in Russia (largest trading partner), massive floods, and a toxic waste spill in the lake that is the largest tourist attraction. One aspect of the fiscal crisis was revenue shortfalls in the state-owned electric utility, which exported power (to neighbors also hit by the Russian crisis) as well as providing domestic users. About half of the population was below the poverty line in 2000, making the needs of the poor a high political as well as humanitarian priority. The challenge was thus to raise more tax and utility revenue and cut expenses while protecting anti-poverty programs and shielding the poor from the effects of the pending (but never implemented) electricity rate increases. This showed that the team was aware of the institutional, political and social constraints on making sufficient fiscal adjustment to achieve sustainability.

52. The objective of the study was to “...arrive at a sustainable or ‘financeable’ deficit consistent with macroeconomic targets for growth, inflation, and sustainable external debt accumulation. The study will then estimate the actual deficit taking a broader coverage of the public sector. ... The required fiscal adjustment will need to be made by raising revenues and decreasing expenditures. The second part of the study will therefore look at the potential for raising revenues and the third part of the study will look at the scope for reducing and rationalizing expenditures.” (Aide Memoire of Kyrgyz Republic Fiscal Sustainability Study Identification Mission, June 15-25, 1998).

53. Part I of the report covers fiscal and debt sustainability, with chapters giving a macro overview, and analyses of fiscal sustainability and debt sustainability. Part II is on structural issues, with chapters covering the tax system, the (new proposed) role of the state in infrastructure and utilities, and the provision of utility services (and subsidies) to the poor. The TTL was a well-known anti-poverty specialist, and she put together a team of excellent consultants and staff.

54. The Fiscal report was widely discussed in the government and with stakeholders, and it seemed to have a favorable reception. A DPL in 2000, the Consolidation SAC, aimed to support some of the measures recommended in the Fiscal report, namely energy price increases, social protection measures, and a few reforms to the tax code, mainly to close large loopholes in the tax net, via exemptions for the free-trade zones.

55. Political events brought the reform momentum to a halt, however. Clashes with the opposition in 2001 left 6 dead and led to a change in the Prime Minister and cabinet. This brought a radically different government to power; some former officials (including major supporters of the report and the CSAC) had to leave the country. The new government of 2001 was in turn put out by a revolution in 2005. And its successor was put out by another revolution in 2010.

56. Since 2001 policy measures relevant to the problems identified in the report have been a mix of good, bad, and ugly in implementation. Tax revenues have gone up, but a large fiscal gap persists, which is mostly funded by donors, for now. Since 2002, Kyrgyz has become a key logistics point for the US-led NATO activity in Afghanistan, which brings in some direct revenue and export sales, plus aid motivated by international sympathy and competition. (Both Russia and the US have air bases there now.) So the short-term fiscal situation has not broken down, but the longer term problems of fiscal sustainability remain. Tax policy has improved in some ways since 2001, closing most loopholes for free-trade zones and following the regional trend toward the appearance of a flat tax, but this was done in a sloppy way that created some new problems, discussed below. The AAA work on taxes, started with the Fiscal Sustainability Study, has been picked up by IFC, which did a report in 2009 on SME taxation and has continued actively in the tax dialogue, including with technical experts in summer and fall 2010 while a new government was being organized.

Rating Summary:

Criterion	Rating	Comments
Results	MU	<p>On government programs there was modest impact over the long term. Although the government at the time was receptive to the ideas in the study, it did not stay in power, and thus little was done in direct response to the report. Over the next decade the government took some reforms recommended in the report, but without reference to the report, and there was some backtracking. Most of the basic problems identified in the report have persisted, however, especially fiscal imbalances (before grants), distorting taxes, and energy prices too low to cover costs.</p> <p>The most important positive result was probably the rescheduling and partial reduction of Kyrgyz's official debt—a major recommendation of the report. Initially the government showed strong interest, but this ended with a change of government.</p> <p>On the Bank's program, the study was a major input to the design of the Consolidation SAC (2000), although this result was short-lived, as the loan was set aside when the government changed and eventually cancelled (half disbursed). Over the medium term, there was modest impact in that many of the ideas from the fiscal study showed up in the next CAS, but there was no attribution to the study.</p>
Strategic relevance and ownership	MS	<p>The report was timely in identifying key development constraints and was delivered at what seemed to be an appropriate time. It had government ownership when it was prepared, but within less than a year that government was out and the successor governments did not give it much regard. Report preparation was done by Bank staff and international consultants. Government and local experts did not participate actively in the actual preparation of the report.</p>
Quality	S	<p>The fiscal sustainability section was of high technical quality, using state of the art analytical techniques and making good use of local data.</p> <p>The tax policy analysis was satisfactory—describing the tax system and its problems. The discussion of infrastructure and utility enterprises was satisfactory on the main sectors, energy and water.</p> <p>The chapter on safety nets dealt well with the problem of assuring affordable access by the poor to essential infrastructure services. This and other discussions of the limits of feasible fiscal adjustment show that the team understood the local context and institutions.</p> <p>Recommendations were clear and actionable. The report had good peer reviewers and made use of client feedback.</p>
Dissemination and sustained dialogue	MU	<p>The initially good dialogue—reaching the right audiences with the government and private sector— was not sustained after the change of government, less than a year after completing the report. The report was not revised or kept alive for use with subsequent governments.</p>

Results

57. The report generated a number of policy recommendations, listed in table A3.1, along with the indications of what related reforms were made or not made in 2000-2010.

Table A1.3: Recommendations of the Kyrgyz Fiscal Sustainability and Implementation of related reforms

Recommendation	Implementation of related reforms
<p>A three-fold strategy was proposed to deal with difficulties identified.</p> <p>First, consolidate macroeconomic stability – most fundamentally, a significant fiscal adjustment is required. The deficit needs to be cut by at least 5.5 percent of GDP</p>	<p>Fiscal deficit (cash basis) was 9% of GDP in 1999; it came down to 5.2% of GDP by 2005 and achieved a small surplus (0.3 %) by 2008. Kyrgyz has needed substantial donor grants to achieve this, which leaves a problem for sustainability.</p>
<p>Second, start considering some form of debt relief, given the large debt burden and the need to preserve social expenditures</p> <p>[Third –structural reforms, as follows.]</p>	<p>Got debt relief from the Paris Club in 2002 and 2004.</p>
<p>Transformation of Public Infrastructure and Utilities</p> <p><i>Raising tariffs</i> to ensure the financial viability of the companies, attract the private sector and improve services. Raise tariffs to reflect costs and rely on the price system to reflect demand.</p>	<p>Not done. Attempted clumsily in 2010 and then reversed.</p>
<p><i>Compensation for the poor affected by the raising tariffs.</i> In the short run, a transparent cross-subsidy scheme may be required which must be built in the design of the commitments made by the Government in compensation for service obligations to be requested from private operators. Privileges in the form of utility price discounts should be phased out and replaced by budgetary support for the few that may be retained. Discounts to pensioners should also be replaced by a more appropriate pension policy (such as a well-designed base pension).</p>	<p>In 2010 a relatively targeted compensation scheme was introduced at the time of the attempted tariff increase. The increase was rescinded, but not the compensations.</p>
<p><i>Tariff, metering and disconnection policy.</i> This should cover all relevant sectors, starting with gas, and should not be restricted to end-user meters.</p>	<p>Metering has been done partially, but after a decade many customers still do not have meters.</p>
<p><i>Reform the competition and regulatory frameworks.</i> Dismantling legal barriers to entry of new firms and, where necessary, restructuring the companies, horizontally or vertically, to ensure effective competition.</p> <p><i>Bring in new sources of finance.</i> Privatization can remove from public sector responsibility the need to undertake expensive modernization programs in areas such as telecommunications.</p>	<p>The regulatory environment for most business is relatively liberal, but not in the utilities sector. In 2010 utilities still lacked funds for essential investment. Privatization was attempted in 2010 (with corruption, to the president's son) but then reversed after a revolution.</p>
<p>Consider establishing multi-sector regulatory agencies, which many small and resource-constrained countries have done.</p> <p>Fund and strengthen the SEA, improve transparency of NCA operations, and arrange some form of arbitration or complaint handling system for both sectors</p>	<p>Regulatory agency is still under Dept of Energy and thus not independent. Inadequate funding of the agency has necessitated staff cuts.</p>
<p>Improvements in the Tax System</p> <p><i>Tax exemptions for firms in the FEZ should be eliminated.</i> Until regulatory burdens are reduced across the country, there may be an interim need for a FEZ, but the Tax Code should apply to all firms irrespective of their location.</p>	<p>Tax revenue increased from about 12% of GDP in 2000, to 20% in 2005 and to 22% in 2010. Partly done with the 2008 reform. Only firms that were in the FTZ before 2000 (a minority of the total) were exempt from income taxation. VAT is now owed on sales from FTZs to the domestic market.</p>

Recommendation	Implementation of related reforms
<p>A three-fold strategy was proposed to deal with difficulties identified.</p> <p><i>A Minimum Assets Tax (MAT) should be considered as part of the profits tax.</i> The tax, levied as a percentage of assets, would be creditable against the profits tax.</p>	Not done.
<p>Presumptive taxes should be strengthened and there should be greater reliance on the Land Tax.</p>	Not done.
<p>Stop using tax holidays in attempting to stimulate foreign investment, because it is ineffective and results in revenue loss. Instead, have more liberal loss carry-forward provisions</p>	<p>Not done in spirit. The basic corporate income tax rate was lowered to 10% by 2008, reducing the importance of any holidays, but other taxes, including a revived turnover tax, have made the marginal effective tax rate on capital 59% (Doing Business 2009). Other structural problems remain with corporate taxation.</p>
<p><i>Small firms.</i> Avoid creating a new tax structure for small firms; rather, improve and simplify the administration of the corporate profits tax</p>	Not done. Special regimes for small firms have become more problematic.
<p>The turnover taxes for the road and emergency funds should be eliminated and replaced by revenue-neutral sources. Fuel and automobile taxes and any broad based tax (such as a slightly higher VAT rate or higher land taxes) could replace the road and emergency fund taxes, respectively.</p>	Those turnover taxes were eliminated, but a new un-earmarked turnover tax renews the same problems.
<p>The numerous fees and local taxes should be carefully evaluated and the number reduced, to lessen the costs of compliance and administration.</p>	Partly done. In urban areas, a property tax replaced some small taxes, via the 2008 reform.
<p>The VAT should be fully on a destination basis and rebates must be given to exporters in compliance with the Tax Code</p>	Not done fully. And many firms are exempt from the VAT, via special regimes,
<p><i>Contraband Under-reporting.</i> The under-reporting of quantity could be addressed by putting in place "flying squads" of specially trained and equipped officers to spot check shipments at Customs points of entry and at unmanned border crossings.</p> <p><i>Under-declaring.</i> The Government could consider contracting the function of determining the customs value (by pre-shipment inspections) out to an internationally recognized company specializing in customs valuation.</p>	Not done. Coordination between tax and customs has become more difficult as the
<p>Tax administration needs to be improved with a view to reducing compliance costs, improving taxpayer services, increasing collection efficiency, and enhancing taxpayers' rights to appeal, prevent corruption and reduce harassment</p>	Tax administration has strengthened the large payer unit, thus raising collections. Corruption remains problematic—37% of firms report request for bribes (Enterprise Surveys 2007-2010)

58. A key theme of the report was that debt relief would be needed in order to protect social spending, which would have to be cut if there were no debt relief. During the early 2000s, Kyrgyz got some debt relief with Paris Club rescheduling in 2002 and 2004 and strengthened fiscal balances. The fiscal progress was partly due to the NATO use of Bishkek as a logistics hub for Afghanistan operations, which was not anticipated at the time of the report, but was sustainable for the medium term although perhaps not for the long-term.

59. Quantifying projections of the need for fiscal adjustment set the stage for the second half of the report, which looked at several areas of needed structural reforms with fiscal benefits. Tax policy and administration was one area of potential reform, and the report evaluated potential reforms to all the major direct and indirect taxes and estimated their revenue effects. It also looked at the connections between the newly introduced corporate financial standards and the tax code. Kyrgyz reformed its tax code considerably in the 2000s—simplifying the rate structure of the personal income tax and VAT and lowering the rates, and closing loopholes (literally) in the system of special economic zones. It did not

address some revenue policy problems, such as the social tax on wages in addition to the income tax and particularly the inadequate energy tariffs. The taxation of small and microenterprises remains problematic, has gotten more complex in the code (with three options of regimes for firms to choose among), and has become a growing avenue for firms to avoid the higher rates and the more rigorous enforcement of the regular tax code. The rules for enforcing the tax code have contributed to a suboptimal private investment climate due to corruption and uneven rigor in enforcement, although this has improved somewhat. Revision to the tax code in the past decade have also introduced some new distortions, especially a turnover tax in 2009 that seemed necessary to compensate for the reduction of the VAT rate but that creates new distortions and administrative problems. Overall the tax policy and administration, especially for large taxpayers, has improved some in the decade since the report, but not as much as was recommended.

60. Utility reform was another area of badly needed reform, not only for reasons of fiscal sustainability, but also to support growth, which depends on reliable provision of power to the private sector. The report analyzed the performance of all the major utility companies (all publically owned then) in terms of financial measures and quality and coverage of services. The report documented the most obvious problems of poor service, frequent interruptions and operating deficits—requiring government transfers to continue operations. The report highlighted the lack of maintenance, inefficiency of the operations and weak management as underlying causes of the problems with service delivery and fiscal sustainability of the enterprises. Restructuring and various modes of privatization were considered among the recommended solutions, along with the possibility of raising rates to cover costs. The results in this area have been especially disappointing. Mismanagement and enterprise deficits continue to burden the electricity company, which was split up but not fully privatized.

61. The prospect of raising utility rates to improve fiscal balances led logically to the third area of structural issues considered in the report, namely how to protect the poor from the impact of increased utility rates. This social protection was seen as essential for electricity, district heating, gas and water, which in a central Asian location are essential for the poor. Results in this area are hard to assess, since the government never sustained the plan to raise rates. In 2010 when the government raised electricity rates it ignored the plan from the energy rate department to raise the rates gradually, and instead raised them abruptly. This led to protests and contributed to the revolution that overthrew the government, again, and the new government quickly rescinded rate rises. Before reversing itself, however, the government started a policy of extra compensatory income supplements to the poor, and these stayed in place even after the rate was brought back down, with negative implications for fiscal balances. Presumably the poor are a little better off, but this was not systematically assessed.

62. The study had results in the Bank's program, as it was a major input to the design of the Consolidation SAC (2000). This result was short-lived, however, because the loan was set aside when the government changed and eventually cancelled (half disbursed). Over the medium term, there was modest impact in that many of the ideas from the fiscal study showed up in the 2003 CAS, although it made no attribution to the Fiscal study.

Strategic Relevance and Ownership

63. The topics of the Fiscal Sustainability report were highly relevant to Kyrgyz, at the time and since then, because the problems have by in large persisted. The issues were identified in the 1998 CAS. Fiscal and debt sustainability were problems that debt forgiveness temporarily ameliorated, but without the underlying problems did not go away in the absence of fundamental reforms. The 2003 CAS did not mention the report, but the CAS did have a substantial section on fiscal sustainability, which followed the lines of analysis and arguments of the earlier report. The report fell between two CASs. Although the report was listed as a routine ESW in the (early) 1998 CAS, it was not seen as urgent until after the crises of 1998 pushed the fiscal and debt situation to the brink and worsened the situation of the electric company and the poor. The April 1998 CAS was delivered before the crises of that year and did not identify fiscal sustainability as an immediate problem, only a long term one. “The Kyrgyz Republic is not a high risk country for the Bank Group, in view of its continued strong policy performance and the fact that the economy appears to be growing.” (p. ii) “Fiscal developments were also favorable during 1996-97, although considerable further strengthening is required before the Government achieves fiscal sustainability. The most notable achievement has been a reduction in expenditure levels from 39 percent of GDP in 1993 to 26 percent of GDP in 1997.” (p. 5) The report did address energy sector issues that previous ESW report had identified as essential: planned on Fiscal Sustainability and Growth. on electricity sector issues: Private Sector Review (1999), Energy Sector Review (1995) and Energy Sector Policy Note (2000) Private Sector Review (1999), Energy Sector Review (1995) and Energy Sector Policy Note (2000).

64. Ownership by the authorities of the ideas was reasonably good at the time of preparing and delivering the report. The Ministry of Finance and the Central Bank had asked the Bank to do the study, to help them devise a strategy to deal with for immanent debt servicing problems. Ownership continued after the study was delivered, as evidenced by their endorsement of reforms in the Consolidation SAC and of measures in an IMF program. The CSAC supported measures to reform utility companies and improve income support for the poor who would be affected by utility rate increases (including better targeting), along the lines recommended in the Fiscal Report. Privatization, proposed by the report, was not carried out except in telecoms. Electricity generation was briefly privatized in 2010, but it was done along with a sudden increase in electric tariffs and in a way that appeared corrupt. Consequently, it was quickly reversed (renationalized) after a revolution (partly resulting from the electric company flap) brought in a new government. The ownership on the tax issues started out strong, as the Ministry of Finance requested help to design a tax reform, but it weakened in 2000, as the measures in the CSAC only involved closing loopholes associated with the free trade zones and did not tackle the issues with the main domestic taxes—VAT and income taxes.

65. The government that favorably received the Fiscal report was out of office within less than a year, and the subsequent government brought in a new finance team that largely ignored the previous AAA and did not fulfill the remaining conditions of the CSAC, which therefore closed without fully disbursing. Ownership was thus not sustained long enough for the report to have much immediate impact on policy.

Quality

66. The quality of the study was *satisfactory*, and highly satisfactory in some areas. The fiscal and debt sustainability chapters—part I—were first rate. They used rigorous analytical tools and brought new results to light. In part II, the analysis was satisfactory but more routine.

67. In Part I, a team of excellent consultants and staff brought the latest methods of analysis to the issues of fiscal and sustainability. After a fiscal overview, chapter 2 is on fiscal sustainability and chapter 3 is on debt sustainability. Chapter 2 shows how varying degrees of improvement in fiscal balances would correspond to various targets for inflation and real depreciation of the domestic currency. Lower inflation targets correspond to more required deficit reduction, and these implicitly defined indicators of progress on fiscal sustainability. Various simulations showed which scenarios were sustainable and which were not, since the inflation tax eventually erodes the real value of the money base that it is taxing. Chapter 3 starts with a detailed description of the origins of the debt—international and domestic. It calculates the net present value of the debt, which was lower than the nominal face-value, since a lot of the debt was on concessional terms. Since the Kyrgyz economy was projected to grow in real terms, an efficient debt repayment strategy would have had the service payments rising gradually over time, but the actual repayment schedule was high in the initial period and then declining. So debt rescheduling was shown to be warranted, but even with debt rescheduling to achieve a more efficient profile of debt service, the debt would grow explosively with any plausible fiscal policy. Comparisons are made with Mexico, Mozambique, Guyana and Cote d'Ivoire in the 1990s. The analysis shows the orders of magnitude of the fiscal adjustment and debt relief that Kyrgyz needed in order for the debt stock to be sustainable. The chapter shows the trade-offs between fiscal adjustment, debt rescheduling, and debt relief (reduction of NPV)—a large share of the debt was official external— and how a mix of the three would probably be necessary. This presentation effectively allowed the government to pick its performance targets, with an understanding their fiscal implications. It also provided a basis for potential debt negotiations with creditors.

68. The part II on Structural Reforms concerns three aspects of policy that would be crucial for achieving the aggregate fiscal adjustments that part I identified as necessary, though not in themselves sufficient to achieve fiscal and debt sustainability. Chapter 4 is on tax policy and administration, which is motivated both by the need to raise revenue for the fiscal adjustment discussed in part I and by the government's desire to increase the attractiveness for investment. After an overview of the tax system, the chapter discusses the main features and problems of the main taxes—VAT, excises, business turnover taxes, profit tax, personal income tax, social tax. The chapter concludes with a summary of major proposals (and some actions already taken) and estimated revenue effects. There is some discussion of the political economy of the options.

69. Chapter 5 is titled A New Role for the State in Infrastructure and Utilities. It describes the fiscal position of the major state enterprises—electricity, district heating, gas, telecom, aviation, urban transport and water—and shows how their deficits are a major part of the public sector's fiscal problem. It proposes privatization and revision of the tariff

structure to make the enterprises fiscally independent. Electricity and gas pose the heaviest fiscal burden and are the most difficult, so they get the most attention.

70. Chapter 6 is on Public Utility Services for the Poor, and follows up on implications of chapter 5, because privatizing utilities and raising electricity and gas tariffs would put additional pressure on those with low incomes. The study explains the concept of Universal Service Obligations (USOs). “A key aspect of the general definition of USOs for potential private operators is that the rights created through USO are not *to free access* but rather to *paid access*. This does not guarantee, however, that the price will cover cost. The challenge resulting from the idea that access to an infrastructure service met through USO is a *paying yet affordable* right implies essentially that USO's coverage, quality, pricing and financing mechanisms have to be decided jointly.” (p. 73)

71. There are some international comparisons of how similar countries have tried to handle similar problems, in the Debt Sustainability chapter and in the utilities chapter, but more of such comparisons would have been useful.

72. There were detailed recommendations on all issues. The recommendations on fiscal and debt sustainability included a range of options, depending on how much inflation and real depreciation the authorities were willing to tolerate and how much fiscal adjustment they thought they could make. On taxes, the recommendations were more generic, arising from commentary on the existing system and on proposals by the government for revisions. In the chapter on utilities, there were some calculations of SOE profits, from 1997-98. Recommendations were mainly for the authorities. The recommendations for infrastructure and utilities also included some directed to the management of state-owned enterprises.

Dissemination and Sustained Dialogue

73. Preparation and finalization of the report was done in collaboration with authorities. It was discussed several times with authorities in several ministries and with the donor community. It was not discussed with the civil society. Long-time private sector tax experts, for example, had never heard of it. In the Imagebank there is not a version of the report in Russian or other local language. In a place like Kyrgyz, disseminating it in English would have had little impact.

74. The political upheaval in 2001, as well as 2005 and 2010, cut short any chance for sustained dialogue and dissemination with the government with which the Fiscal Report was prepared. Although some discussion of the report's topics has continued, the report and its specific findings seem to have dropped out.

Overall Assessment

75. The Fiscal Sustainability report was a good product for its time—good analysis on especially Part I, and well used in the dialogue with the government then. The times and the government changed quickly, however, before the report could have much direct effect. Some of its recommendations have remained part of the policy dialogue and some have been implemented, although not to the extent recommended. The report *per se* seems largely

forgotten, however, since the original counterparts and their immediate successors are long gone.

Lessons

76. It is important to link the fiscal issues with those of public enterprises and of access by the poor to services. The fiscal issues get the attention of policy makers and, in a context like Kyrgyz's, provide a motivation to address some other issues, like policies for taxation, utilities, and social safety nets. Calling for international debt rescheduling and relief in a context like Kyrgyz's is appropriate and can help provide the technical basis for carrying out such measures.

77. It is worthwhile to do a good piece of ESW, even if the longevity of the counterpart government is uncertain. The problems identified in the report did not go away. When there is a good report and the problems it addresses persist, the Bank staff should keep the analysis alive, with repackaging and updates if needed, which was not done for the most part in the Kyrgyz case.

IEG PAR									
Kyrgyz Republic: Fiscal Sustainability Report, 2000									
Product Data									
Vice President	Country Director	Sector Manager	Task Manager	Project ID/ Type/ Report No./Cost	Number of: Volumes/ Pages	Languages	Document Type	Topics	Unit
Johannes Linn	Kiyoshi Kodera	Samuel Otoo	Ritu Anand	P055404/Report No. 20644-KG \$212,866 Trust fund Co-financing \$12,174	1 Volume. pp. 92	English	ESW	Fiscal Sustainability Tax Policy and Administration Social protection vis á vis utility rate increases	ECA/PREM
Ratings Summary									
Criterion	Rating	Comments							
Results	MU	<p>On government programs there was modest impact over the long term. Although the government at the time was receptive to the ideas in the study, it did not stay in power, and thus little was done in direct response to the report. Over the next decade the government took some reforms recommended in the report, but without reference to the report, and there was some backtracking. Most of the basic problems identified in the report have persisted, however, especially fiscal imbalances (before grants), distorting taxes, and energy prices too low to cover costs.</p> <p>The most important positive result was probably the rescheduling and partial reduction of Kyrgyz's official debt—a major recommendation of the report. Initially the government showed strong interest, but this ended with a change of government.</p> <p>On the Bank's program, the study was a major input to the design of the Consolidation SAC (2000), although this result was short-lived, as the loan was set aside when the government changed and eventually cancelled (half disbursed). Over the medium term, there was modest impact in that many of the ideas from the fiscal study showed up in the next CAS, but there was no attribution to the study.</p>							
Strategic relevance and ownership	MS	<p>The report was timely in identifying key development constraints and was delivered at what seemed to be an appropriate time. It had government ownership when it was prepared, but within less than a year that government was out and the successor governments did not give it much regard. Report preparation was done by Bank staff and international consultants. Government and local experts did not participate actively in the actual preparation of the report.</p>							
Quality	S	<p>The fiscal sustainability section was of high technical quality, using state of the art analytical techniques and making good use of local data.</p> <p>The tax policy analysis was satisfactory—describing the tax system and its problems. The discussion of infrastructure and utility enterprises was satisfactory on the main sectors, energy and water.</p> <p>The chapter on safety nets dealt well with the problem of assuring affordable access by the poor to essential infrastructure services. This and other discussions of the limits of feasible fiscal adjustment show that the</p>							

IEG PAR Kyrgyz Republic: Fiscal Sustainability Report, 2000		
Criterion		Evidence of Results
		team understood the local context and institutions. Recommendations were clear and actionable. The report had good peer reviewers and made use of client feedback.
Dissemination and sustained dialogue	MU	The initially good dialogue—reaching the right audiences with the government and private sector— was not sustained after the change of government, less than a year after completing the report. The report was not revised or kept alive for use with subsequent governments.
RESULTS INDICATORS:		
..results objectives defined at inception?		Yes. The Aide Memoire from the identification mission made clear that the objective of the study was to provide the authorities with analysis to understand their fiscal sustainability problem and with recommendations for dealing with it.
..indicators defined at inception?		Yes, in part. The fiscal projections were explicitly presenting indicators of sustainability. The structural reforms sections recommended changes of law and of institutional arrangements—privatizations, etc.—which could be considered intermediate indicators.
..strategy to achieve results?		Yes. The fiscal section laid out various sustainable combinations of spending reductions, revenue increases, and debt reductions. But there was not a detailed strategy to achieve these nor to implement the recommended structural reforms.
RESULTS ACHIEVED: Did country use findings:		Not soon, or completely.
..in policy law, regulation, or implementation?		No, revenue policy reforms have come, but only slowly and partially. The electric company was privatized only briefly, but reversed due to corruption and ill-timed price increases. The ideas for protecting the poor from the impact of energy price increases became irrelevant, since the prices were not adjusted.
..in design of public expenditure?		No. The government left office without implementing reforms, and the report was not utilized by the successors.
..to raise stakeholder awareness?		Only temporarily. The effect dissipated after the government changed.
..to build a coalition for change?		Only temporarily and within the government, but it did not last.
..to build in-country capacity?		No, report was done by staff and outside consultants, with minimal use of in country resources.
..to influence the donor community?		Other donors supported the work and were influenced by it, as evidenced by their support for the rescheduling and partial reducing Kyrgyz's official debt – a key recommendation of the report. Donor representatives from circa 2000 were gone by the time of the evaluation mission. The war in Afghanistan since 2002 substantially altered the character of donor interest in Kyrgyz.
..to change institutions		No. Attempts at recommended privatizations were largely unsuccessful.
Did the Bank use the findings in:		
..the design of development policy lending?		Yes, in the Consolidation SAC, which had the same TTL and sought to support implementation of many of the recommended measures. Due to the political changes, the loan closed in an unsatisfactory state, only partially disbursed.
..the design of Bank lending products		Only the CSAC.
..Bank strategy formulation?		The 2003 CAS did not mention the report, but the CAS did have a substantial section on fiscal sustainability, which followed the lines of analysis and arguments of the earlier report.
..future knowledge products?		No

IEG PAR Kyrgyz Republic: Fiscal Sustainability Report, 2000	
..informing the country's strategy?	No
Is there evidence that results are sustainable?	The country has had three major political upheavals since the report was done, which has made policy unstable. Tougher tax administration has raised revenues, but in most other dimensions addressed in the report,
MONITORING OF RESULTS IMPACT: Did the Bank or client assess the product's impact on results?	No. With the change of government less than a year after the report was completed, the dialogue was dropped.
Discussion of results: Based on the evidence above, and taking into account any self evaluation of the product's results, assess how and to what extent the AAA product affected Bank or client actions. The report fell between two CASs. Although the report was listed as a routine ESW in the (early) 1998 CAS, it was not seen as urgent until after the crises of 1998 pushed the fiscal and debt situation to the brink and worsened the situation of the electric company and the poor. So the report was done, with urgency and high quality, but then before the report could have much policy impact, political events led to a major change of government and a disowning of the actions of the previous government, including the dialogue surrounding the report.	
Criterion	Evidence of Strategic Relevance
STRATEGIC RELEVANCE	
Did delivery of product come in time to affect relevant government policy or Bank decisions?	Yes. The Fiscal report was a key part of the policy dialogue that lead to the Consolidation SAC.
Was topic identified as "development constraint or opportunity in:	
.. the relevant CAS/CSP?	In general terms, but not as an urgent constraint. The April 1998 CAS was delivered before the crises of that year and did not identify fiscal sustainability as an immediate problem, only a long term one. "The Kyrgyz Republic is not a high risk country for the Bank Group, in view of its continued strong policy performance and the fact that the economy appears to be growing." (p. ii) "Fiscal developments were also favorable during 1996-97, although considerable further strengthening is required before the Government achieves fiscal sustainability. The most notable achievement has been a reduction in expenditure levels from 39 percent of GDP in 1993 to 26 percent of GDP in 1997." (p. 5) There was an ESW report planned on Fiscal Sustainability and Growth.
..previous AAA?	Yes, on electricity sector issues: Private Sector Review (1999), Energy Sector Review (1995) and Energy Sector Policy Note (2000) Private Sector Review (1999), Energy Sector Review (1995) and Energy Sector Policy Note (2000). The fiscal sustainability and tax issues were not previously identified in AAA.
..particular projects (specify)?	No.
..particular evaluations?	No
..policy dialogue with clients?	Yes. The Central Bank and the Ministry of Finance identified debt and fiscal sustainability and tax reform as key issues for Kazakhstan.
..donor coordination fora?	The IMF and USAID were also active on fiscal issues and saw the lack of fiscal sustainability as a key constraint for the country's development..
Under conditions of difficult dialogue, did the product?	
..focus on long-term issues for better receptivity to Bank input	Yes. The product looked at long-term issues—the essence of sustainability—, but it was also practical in considering short-term issues, since they could be impediments for getting to any long-term solution.

IEG PAR Kyrgyz Republic: Fiscal Sustainability Report, 2000	
.. address sector issues in areas where there is more receptivity to Bank input	Yes. The government at the time saw the need to reform the public utility sector, which was the topic of one of the chapters.
..address country issues in a regional or global context?	Not much. Less than in the ESW for Georgia and Kazakhstan that is also reviewed here.
Evidence of Ownership	
Is product part of overall AAA program to which the authorities have contributed or agreed?	Yes. It was in the CAS, although not defined in detail there.
Did the client request or commission the specific product?	Yes. The Central Bank and the Ministry of Finance identified debt and fiscal sustainability, particularly to prepare for negotiations with external creditors, and tax reform as key issues for Kazakhstan.
Did the client cover some or all of the costs?	No. It is an IDA country.
Did the key decision makers (as distinct from technical specialists) collaborate with, discuss or provide feedback on the product?	Yes. There were a number of high level discussions with the Ministry of Finance and the National Bank.
Did a local institute, academy, consulting firm or government agency help to:	No. there is not much capacity of that sort in Kyrgyz.
..define the scope of the work?	No
..plan and design the work?	No.
..carry out the work?	No
.. analyze the results and write the report?	No
.. formulate conclusions and recommendations?	No
..provide peer review or comments on the draft report?	Yes, the authorities provided comments on the draft.
..organize workshops or discussions about the findings?	Yes, there was a workshop with government officials to discuss the report and to use it to plan for the Consolidation SAC.
Discussion of Strategic relevance and ownership: On balance this is rated Moderately Satisfactory. The report was timely and had ownership within the government when it was prepared, but within less than a year that government was out and the successor governments did not give it much regard. In 2010 at the time of the evaluation mission, however, government technocrats did not know about the report. There are now (2010) a few private-sector people and organizations that are interested in tax issues, but they did not know of the report. Bank staff and management also seem to have laid it aside; it was not mentioned in the 2003 CAS.	
Criterion	Evidence of Quality
QUALITY OF CONTENT	
Did the product...	
...include appropriate knowledge (i.e. make use of current and relevant knowledge from both inside and outside of the Bank)?	Good team of consultants and staff brought the latest methods of analysis to the issues, especially the fiscal sustainability parts. In part I There is an excellent analysis of how varying degrees of improvement in fiscal balances correspond to various inflation targets. This effectively allows the government to pick its performance targets, with an understanding their implications. The part II on Structural Reforms is more straight description of the situation, identifying problems and commenting on possible actions, but there was not analysis of the size or time profile (short vs. long term) of fiscal costs and benefits. There is some discussion of the political economy of the options.

IEG PAR Kyrgyz Republic: Fiscal Sustainability Report, 2000	
...cite relevant examples of practice or research from other countries in the region?	Neither part I nor part II makes many international comparisons or describes how similar countries have tried to handle similar problems. There was one comparative table in the utilities chapter
...cite relevant examples of practice or research from other regions?	No
...discuss the specific institutional and policy context for the issue in this country?	Yes. The weak government institutions and fragile macroeconomic situation were raised as issues..
...collect and analyze existing local data?	Yes.
...generate new evidence?	Yes.
...include recommendations?	Yes. There were detailed recommendations on all issues. The recommendations on fiscal and debt sustainability included a range of options, depending on how much inflation the authorities were willing to tolerate and how much fiscal adjustment they thought they could make. On taxes, the recommendations were more generic, arising from commentary on the existing system and on proposals by the government for revisions. In the chapter on utilities, there were some fresh calculation of SOE profits, but these were outdated.
Do the recommendations include specified actions to be taken by specified actors (incl. non-Bank)?	Recommendations were mainly for the authorities. The recommendations for infrastructure and utilities also included some directed to the management of state-owned enterprises.
Was the product team staffed with the appropriate expertise (incl. consultants)?	A consultant with great expertise on the topic—van Wijnbergen—led the analysis of fiscal and debt sustainability. Staff also showed strong technical competence. Consultants on the tax chapter were also recognized experts.
Did the product receive appropriate managerial attention?	Yes.
Did the product receive sufficient budget?	Yes. \$213K
REVIEW OF CONTENT	
Was the draft peer-reviewed by appropriate experts?	Yes. Peer reviewers were staff with some public finance background, although not at the level of the team consultants.
Were the peer-review comments taken into account as appropriate?	Yes
Was the feedback from the client about the product incorporated into the final version?	Yes.
Discussion of quality: The quality was uneven. The fiscal and debt sustainability chapters—part I—were first rate. They used rigorous analytical tools and brought new results to light. In part II, the discussion was less rigorous and brought little new evidence or analysis. Mostly it was description and commentary by experts, although the information and discussion was relevant for the structural measures that would be needed to make the fiscal situation sustainable..	
Criterion	Evidence of Dissemination and Sustained Dialogue
INITIAL DISSEMINATION	
Was the product...	
...made available in the local language?	No.
...made available on a website?	No.
...discussed with senior policy-makers?	Yes. Preparation and finalization was done in collaboration with authorities,

IEG PAR Kyrgyz Republic: Fiscal Sustainability Report, 2000	
...presented at a workshop, conference, seminar or on-line discussion?	Yes.
...covered in the general or specialized media?	No, apparently not.
SUSTAINED DIALOGUE	
Did the product serve as an input to a sustained engagement with the client through	
...policy dialogue?	The dialogue went on in 2000, but was not sustained
...sustained workshops/discussions with stakeholders beyond initial dissemination?	There were the initial discussions of the report and the CSAC, which was designed to support some of the reforms recommended in the Fiscal report. This dialogue was not sustained with the next government in 2001.
...lending products (Bank and non-Bank)?	The ESW did not lead to any lending beyond 2000.
...technical assistance (formal or informal)?	No. Not beyond 2000.
...programmatic instruments?	No.
...other means (please discuss below)?	No.
Discussion of Dissemination and sustained dialogue Moderately Unsatisfactory There was some dissemination in 2000 but it not sustained beyond that, due to political developments beyond the control of the Bank. The excellent technical work was not repackaged or re-presented to successor counterparts, although the policy issues continued to be of critical concern for the country.	

Annex 4. Criteria for Rating Economic and Sector Work

<i>Rating</i>	<i>Results</i>	<i>Strategic Relevance and Ownership</i>	<i>Quality</i>	<i>Dialogue and Dissemination</i>
HS	<p>Meets to a high extent both of the following criteria:</p> <ul style="list-style-type: none"> • Impact on government programs and/or the broader development dialogue in the country • Impact on the design of the Bank's program and/or the subsequent CAS. 	<p>Meets to a high extent all of the following three criteria:</p> <ul style="list-style-type: none"> • Addresses a key development constraint and is coherent with the country assistance program • Delivered at the right time in relation to key decisions • Evidence of strong interest by government, development partners, or civil society and/or evidence of active engagement of government agencies or local institutions in conducting the work 	<p>Meets to a high extent all of the following six criteria</p> <ul style="list-style-type: none"> • Use of appropriate knowledge and analytic techniques. • Analysis of existing and/or new local data • Effective use of cross-country comparisons and global experience^a • Evidence of clear understanding of local institutions and context. • Clear and actionable recommendations. • Subjected to adequate peer review and client feedback 	<p>Meets to a high extent all of the following three criteria:</p> <ul style="list-style-type: none"> • Evidence of appropriate dissemination • Report reaches effectively the right audiences through appropriate targeted distribution and events. • Evidence of sustained engagement
S	<ul style="list-style-type: none"> • Substantial impact on both of the criteria or substantial impact on one and high impact on the other 	<ul style="list-style-type: none"> • No more than minor shortcomings in any of the three criteria 	<ul style="list-style-type: none"> • No more than minor shortcomings in any of the six criteria. 	<ul style="list-style-type: none"> • No more than minor shortcomings in any of the above areas.
MS	<ul style="list-style-type: none"> • Substantial or higher impact on one criterion, modest or no impact on the other. 	<ul style="list-style-type: none"> • Moderate shortcomings in no more than 2 criteria and no more than minor shortcomings in the third OR major shortcomings in one criterion but no more than minor shortcomings in the other two. 	<ul style="list-style-type: none"> • Moderate shortcomings in no more than 2 criteria and no more than minor shortcomings on the remainder OR major shortcomings in one but no more than minor shortcomings in others 	<ul style="list-style-type: none"> • Moderate shortcomings in no more than two of the above criteria and no more than minor in the third OR major shortcomings in one criterion but no more than minor shortcomings in the other two
MU	<ul style="list-style-type: none"> • At least modest impact on one criterion, modest or no impact on the other 	<ul style="list-style-type: none"> • Moderate shortcomings in all 3 criteria or major shortcomings in 1-2 criteria and no worse than moderate shortcomings in the remaining criteria 	<ul style="list-style-type: none"> • Moderate shortcomings in half or more of the criteria with no more than minor shortcomings in the others OR major shortcomings in fewer than half of the criteria with no more than moderate shortcomings in the others 	<ul style="list-style-type: none"> • Moderate shortcomings in all 3 criteria or major shortcomings in 1-2 criteria and no worse than moderate shortcomings in the remaining criteria.

Rating	Results	Strategic Relevance and Ownership	Quality	Dialogue and Dissemination
U	<ul style="list-style-type: none"> No impact on either criterion. 	<ul style="list-style-type: none"> Major shortcomings in all three criteria 	<ul style="list-style-type: none"> Major shortcomings in majority of above criteria 	<ul style="list-style-type: none"> Major shortcomings in all three criteria.
HU	<ul style="list-style-type: none"> Negative impact on one or both of the criteria 	<ul style="list-style-type: none"> Severe shortcomings 2 or more of the criteria 	<ul style="list-style-type: none"> Severe shortcomings in half or more of the criteria 	<ul style="list-style-type: none"> Severe shortcomings in 2 or more of the criteria

Note: HS – Highly Satisfactory; S – Satisfactory; MS – Moderately Satisfactory; MU – Moderately Unsatisfactory; and U – Unsatisfactory, HU – Highly Unsatisfactory

- a. As appropriate, contingent on the nature of the analytic work.

Annex 5: Persons Interviewed

World Bank Group

Emil Abdykalykov, Tax Policy Consultant, IFC Investment Climate Advisory Services Project in the Kyrgyz Republic, Bishkek
Sebnem Akkaya, Country Manager for Kazakhstan, Astana
Kostya Atenasian, former Consultant/Country Economist on Kyrgyz (now IEG staff)
Rocio Castro, former Sr. Economist in TTL
Shanta Devarajan, Chief Economist for Africa and Former Division Chief for Public Economics
Mariam Dolidze, Economist for Georgia, Tbilisi
Bakyt Dubashev, Economist, World Bank Country Office in the Kyrgyz Republic
Urkaly Isaev (IFC), Former Minister of Economic Development, Kyrgyz Republic
Raul Junquera-Varela, Head of Tax Thematic Group
Faruk Khan, Sr. Economist, ECA PREM
Salamat Kussainova, WB Consultant, Astana
Tuan Minh Le, Former Head of Tax Thematic Group
Vsevolod Payevskiy, Project Manager, IFC Investment Climate Advisory Services Project in the Kyrgyz Republic, Bishkek
Rosalinda Quintanilla, Lead Economist for Georgia
Pedro Rodriquez, PREM Sector Manager for Caucus Dept (Georgia) and Former Country Economist for Kyrgyz and Kazakhstan
Ilyas Sarsenov, Economist for Kazakhstan, Astana
Afsaneh Sedgi, Country Economist for Kyrgyz, ECA
Richard Stern, IFC, Global Tax Simplification Program
Ekaterine Vashakmadze, CARO Country Sector Coordinator, Almaty

IMF staff

Stefana Fabrizio
Luc Kyrand
Geremia Palomba

Georgia

Giorgi Alasania, Head of Social Security, Audit Department, Chamber of Control
Lily Begiashvili, Deputy Head, Revenue Service
Ms. Molly Corso, American Chamber of Commerce in Georgia
Nino Ehlukidze, Deputy Minister, Ministry of Energy
George Jerenashvili, Head, Audit Department, Chamber of Control
Thea Jokhadze, Head of Debt Capital Markets, Bank of Georgia
Ms. Nicole Jordania, Acting Executive Director, American Chamber of Commerce in Georgia

Giorgi Kakauridze, Head of Budget Department, Ministry of Finance
 Otar Kakhidze, Secretary of the Council, Anticorruption Council, Ministry of Justice
 Nino Kekelidze, Senior Specialist of International Relations, Chamber of Control
 Rusudan Kemularia, Deputy Minister of Finance
 Devi Khechinashvili, Partnership for Social Initiatives
 Ms. Bella Makaridze, Member Relations Manager, American Chamber of Commerce in Georgia
 Ketu Melikadze, Partnership for Social Initiatives
 Rusudan Mikhelidze, Deputy Head of Analytical Department, Head of Strategic Policy Development Unit, Ministry of Justice
 Ms. Maia Miminoshvili, Director, National Examinations Center (Higher Education)
 Nino Mishvelia, Head of Tax Advisory Unit, Financial Directorate, Bank of Georgia
 NGOs, PSI Partnership for Social Initiatives and Transparency International, Tbilisi
 Zurab Nikashvili, Partner, Ernst & Young International
 Ms. Caitlin Ryan, Transparency International, Georgia
 Revaz Sakevarishvili, Partnership for Social Initiatives
 Nino Tchelishvili Deputy Head, Treasury Service, Ministry of Finance
 Moris Tsamalashvili, Deputy Minister, Director of Social Service Agency Ministry of Labour, Health and Social Affairs
 Samson Uridia, Head of Bureau for International Relations, Revenue Service, Ministry of Finance
 Tato Urjumelashvili, Chairman, State Procurement Agency

Kazakhstan

Mr. Ahanov, Association of Financiers of KZ, Almaty
 Mr. Richard Bregonier, Partner, PricewaterhouseCoopers, Almaty
 Ms. Alena Gerun, Head of IT Department of the Tax Committee, Ministry of Finance, Astana
 Mr. Timur Junusov, Tax Director, PricewaterhouseCoopers, Almaty
 Ms. Vera Knyukh, Expert, National Analytical Center, Astana
 Ms. Nurbike Mahambetova, Chairman Advisor, Halyk Bank, Almaty
 Ms. Ekaterina Nikitinskaya, Deputy Chairman, Atameken Union, Astana
 Mr. Baglan Sultanbek, Director, PricewaterhouseCoopers, Almaty
 Ms. Ariel Utembayeva, Director, Dept. of Financial Sector, Chamber of Commerce and Industry of Kazakhstan, Almaty
 Mr. Popelushko Anatoly Vishanovich, President, Food Manufacturing Industry Association, Almaty
 Ms. Natalya Yantsen, President of Kazakhstan Tax Standards Formation Fund, Almaty
 Mr. Daulet Yergozhin, Chairman, Tax Committee, Ministry of Finance, Astana
 Ms. Zhannat Yertlessova, Adviser to Prime-Minister and Head of Taxpayers Association, Astana
 Ms. Tatyana Zhdanova, Vice President, Chamber of Commerce and Industry of Kazakhstan, Almaty

Kyrgyz Republic

Bahodyr Akhmatov, Debt Management Department, Ministry of Finance
 Aigul Akmatjanova, Transparency International Kyrgyzstan
 Ms. Gulbarvhyn Asanova, Ministry of Economic Regulation
 Lewis Bauer, Consultant, Asian Development Bank
 Aliev Bekbolot, Department of State Revenue, Ministry of Finance
 Damir Bisembin, National Program Officer for Economic Affairs, Swiss Cooperation Office
 in the Kyrgyz Republic, Swiss Consular Agency
 Peter Bruges, Country Manager, USAID Economic Reforms to Enhance Competitiveness
 Project
 Ahmatova Gulnara, Senior Lawyer, International Business Council
 Rafkat Hasanov, Economic and Financial Expert, Secretariat of the Business Development
 and Investments Council
 Albek Ibraimov, Director, Bishkek Free Economic Zone
 Murat Ismailov, Vice Mayor, Mayor Office
 Tatiana Kim, Head of Tax Consultants, Chamber of Tax Consultants, National Alliance of
 Business Associations
 Nurdin Kumushbekov, Consultant/Lawyer
 Kubat Myrzaev, Ministry of Economic Regulation
 Niyazov Nurbek, Adviser of the General Director, Bishkek Free Economic Zone
 Toktomatov Nurmambet, Head, Aid Planning and Evaluation Division, Ministry of
 Economic Regulation
 Pragma Corporation, USAID Business Environment Improvement Project (BEI)
 Alexandr Savitskii, Counsellor of the Chamber, 2nd Class Councillor of State, Chamber of
 Commerce and Industry of Kyrgyz Republic
 Adylbek Sharshenbaev, Board Member, Transparency International Kyrgyzstan
 Ms. Mairam Sherimbekova, Ministry of Economic Regulation
 Aisuluu Sydygalieva, BEI Consultant
 Azmet Tinmebaev, Ministry of Economic Regulation
 Sultankulova Aigul Uzbekovna, Director, State Department on Tariffs and Regulation of
 Fuel Energy Complex, Ministry of Energy