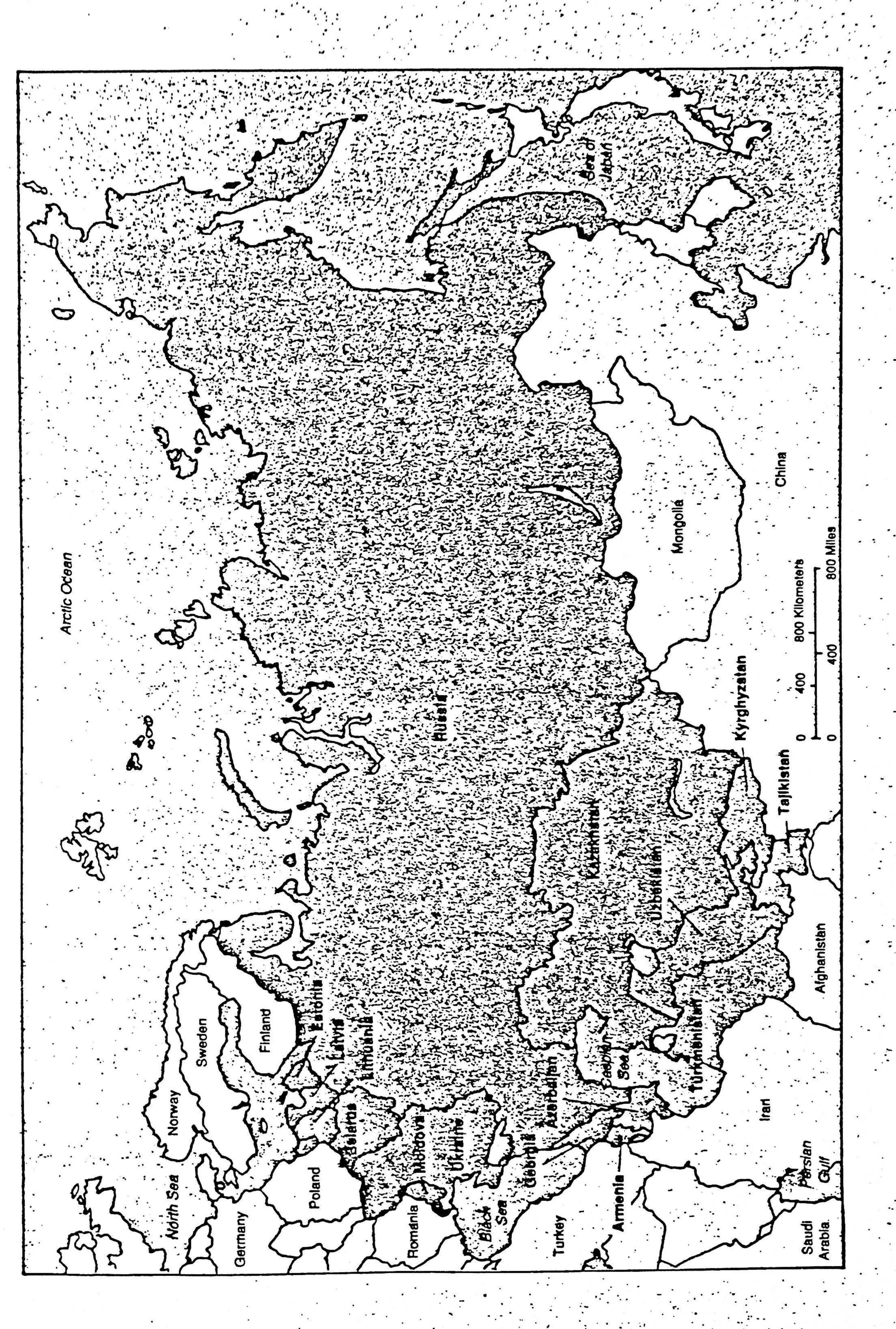
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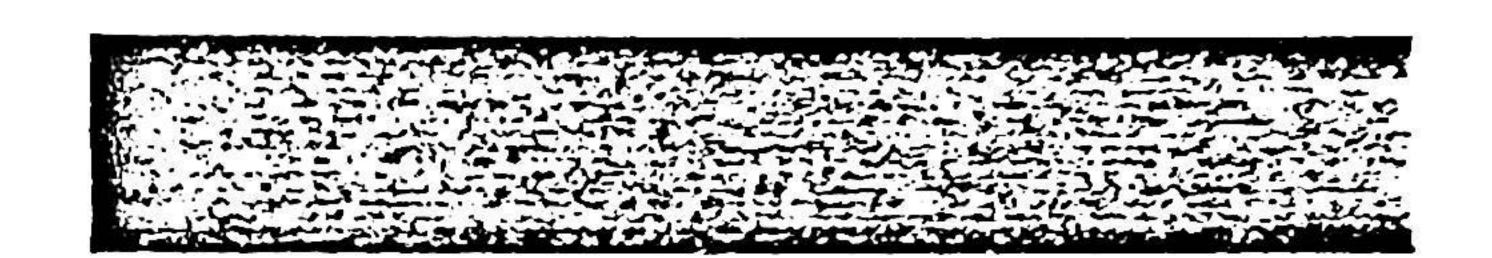


International Monetary Fund Washington, D.C.





KAZAKHSTAN



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Preface

Between September 1991 and March 1992 all the states of the former U.S.S.R. applied for membership in the International Monetary Fund. During this period, staff members of the IMF visited each of these countries to hold discussions with the various national authorities, review the domestic procedural and legal steps required for membership, collect economic data to process these applications, and provide policy advice. Following these visits, pre-membership reports were prepared on the countries' economies. Two companion reports were also prepared, the first reviewing the economy of the former U.S.S.R. in 1991 and the second providing an overview of common policy issues and major interrepublican economic relationships. The reports were prepared in the European II Department of the IMF, under the direction of John Odling-Smee. They also draw on the expertise of other IMF departments, as well as the staff of the World Bank.

Because of the importance of and widespread interest in the subject matter, these economic reviews are being published at this time, even though they are of an interim nature and it is still too early to present a comprehensive assessment of most of the economies. The reports are based on information available in early 1992. Although the studies were prepared for the Executive Board of the IMF, the descriptions of developments and policies they contain are those of the IMF staff and should not be attributed to Executive Directors or to the authorities of any of the individual countries.

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I. Background¹

Kazakhstan formally applied for membership in the International Monetary Fund in January 1992. The application coincided with the visit of an IMF staff team to Alma-Ata to review economic and financial developments, discuss the authorities' macroeconomic policies for 1992, and undertake the preparatory work for IMF membership.

Geography, Population, Natural Resources, and Economic Structure

Kazakhstan, whose land area roughly equals that of Western Europe, stretches from the Caspian Sea to China. It is a major republic of the former Soviet Union and ranks second only to the Russian Federation in size (with 2.7 million square kilometers or 12 percent of total U.S.S.R. territory), third in output (accounting for 4 percent of net material product (NMP) of the U.S.S.R. in 1988), and fourth in population (with almost 17 million people, or about 6 percent of the former U.S.S.R.'s total in 1989). The population includes roughly 40 percent ethnic Kazakhs, living mostly in the south; 40 percent Slavs (mainly ethnic Russians), living mostly in the north; and about 100 other ethnic and national groups. (See the basic social and demographic indicators included in Table 7.)

With about one fifth of the combined arable land of the former Soviet Union, Kazakhstan is a significant producer, and exporter, of agricultural products, which represented around 37 percent of NMP in 1991; the most important agricultural products include grain, wool, and meat. Kazakhstan also possesses substantial mineral resources and has developed large-scale mining and processing activities. As of 1990, the country's proven mineral reserves represented over 90 percent of total U.S.S.R. reserves of chrome and close to 50 percent of the U.S.S.R. reserves of lead, wolfram, copper, and zinc; it accounted for 19 percent of U.S.S.R. coal production and 7 percent of oil production. Furthermore, there is substantial mining of nonferrous metals (copper, zinc, lead, and gold) and iron ore.

In addition, the country has a well-developed industrial base geared mainly toward metallurgy, heavy machinery and machine tools, petrochemicals, agro-processing, and textiles. The extent of specialization is such that about one half of the finished goods consumed in the country are imported, while almost three fourths of total exports (including interrepublican trade) are intermediate goods and raw materials. The main means of freight transportation is the railway network (with some 14 thousand kilometers of track), while passenger traffic is conducted primarily by road and air transport. Kazakhstan has an adequate infrastructure and well-developed cultural and public health facilities, as well as several major institutions of secondary and higher education. Two important facilities located in Kazakhstan, both of which have considerable economic and political significance, are the Baikonur space center—which was the primary location for the Soviet Union's space program—and the Semiplatinsk nuclear-weapons testing facility.

Not surprisingly, the public sector dominates all economic activity. Out of an estimated stock of fixed assets worth over 200 billion rubles (rub) in 1991, about 90 percent was state owned, while the rest was equally divided between cooperatives and the private sector. State enterprises accounted for about 80 percent of output. A privatization program was started in 1991, however, and some progress has been achieved so far in the sale of enterprises in the services sector.

Political Setting

Kazakhstan's national Parliament enacted the law declaring independence on December 16, 1991. President Nursultan Nazarbayev, who was elected in the first presidential elections in December, has publicly endorsed economic reforms aimed at a rapid transformation to a market-based economic system and has stressed the importance of maintaining the stable multi-ethnic character of the country. The Government has expressed adherence to the principle of maintaining a common economic space with other republics of the former U.S.S.R.; accordingly, it played a key role in expanding the Commonwealth of Independent States (CIS) to include the eastern republics. Kazakhstan was also a signatory to the Memorandum of Understanding on Debt with the Group of Seven industrial countries and has recently signed agreements with both Russia and Belarus on free trade, labor, and capital movements. The Government has applied for membership in the World Bank Group and, in January 1992, announced its intention to seek participation in the General Agreement on Tariffs and Trade (GATT).

II. Recent Economic Developments

In general, economic developments in Kazakhstan during the past few years were in line with events in the U.S.S.R. as a whole.² The Kazakh authorities pursued similar policies to those pursued by the other republics of the former U.S.S.R., particularly the various reforms introduced in 1991. There were, however, some factors that specifically influenced developments in Kazakhstan—notably in the second half of 1991—which are briefly described below.

Output, Inflation, and Employment

Following a period of moderate but sustained growth during 1985-88, aggregate output, as measured by net material product (NMP), contracted slightly in 1989, by close to 2 percent in 1990, and by an estimated 10 percent in 1991 (Table 1).3 A severe drought, coupled with problems in the distribution of fertilizers, affected major crop-producing areas, while disruptions in trade and budgetary constraints slowed economic activity in general, notably construction, in 1991; industrial production roughly maintained its 1990 level, with performance varying widely across subsectors.

The disruption in output, coupled with lax financial policies in the U.S.S.R. as a whole, helped fuel inflation. Following a long period of stable (and centrally fixed) prices, average retail prices rose by 84 percent in 1991; on an end-of-year basis, retail prices increased by 149 percent. The partial price-liberalization effort of April 1991 brought about large discrete increases in retail prices, including one of close to 60 percent in April alone. The reform called for a two- to threefold increase in most of the prices that remained under control and introduced free or negotiated price setting for some 15 percent of non-agricultural consumer goods, 30 percent of heavy industrial goods. 20 percent of agricultural goods, and about 70 percent of household services. Retail prices rose only half as fast as wholesale prices.

Notwithstanding adverse developments in output and prices, employment remained fairly stable in 1991 owing to a deliberate policy of protecting the work forces of government and state enterprises. Wages declined in real terms as workers were only partially compensated for the April price adjustments. Subsequently, as prices increased rapidly during the remainder of the year, and in anticipation of another round of price liberalization in January 1992, the statutory minimum wage and public sector wages were raised by 90 percent in mid-December 1991. Nevertheless, real wages declined by about one fifth during the course of the year.

During 1991, the authorities began a privatization program⁴ and sold 380 enterprises, mainly in the services sector, with gross assets valued at about rub 1 billion.⁵ Most of the sales were to the workers of the respective enterprises and were conducted at a discount from book value with facilities for payments on credit; some other enterprises were sold at auction or by direct tender, and only a few were offered as joint stock operations. At this initial stage, no foreign participation was allowed, except for nationals of other states of the former Union.

Fiscal Policies

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Kazakhstan's fiscal accounts were broadly in balance through 1991, but only after substantial transfers from the Union (Table 2). Net transfers from the Union increased from 4 percent of gross

domestic product (GDP) in 1985 to 10 percent of GDP in 1990, as Kazakhstan's underlying fiscal position deteriorated throughout the period. With Kazakhstan's ratio of budgetary outlays to GDP falling between 1985 and 1990, the deterioration in the fiscal position reflected a sharp fall in revenues (Table 3).

To deal with the deteriorating economic situation, and in the context of a likely loss of transfers from the Union later in the year, the authorities attempted to reinforce their financial policies during 1991. Thus, the budget passed in February 1991 was substantially revised in June to reflect the effects of the partial liberalization of prices in April and the need to reduce outlays. As in other republics of the former U.S.S.R., the authorities implemented a broad-ranging tax reform; most enterprises were subjected to a proportional flat-rate income tax of 35 percent and individuals to a progressive income tax, and a 5 percent sales tax was enacted. While corporate income and turnover taxes represented the bulk of siscal receipts, a sizable proportion of outlays in 1991 were for social6 and cultural expenditures, subsidies to the population, and transfers to enterprises. The wage bill in 1991 is roughly estimated at rub 6.7 billion, or about 18 percent of total budgetary outlays. No other data on the economic classification of expenditures is available for 1991. Despite attempts to reduce expenditures, the overall fiscal deficit reached the equivalent of about 8 percent of GDP in 1991. This deterioration reflected a reduction in net transfers from the Union by 4.5 percent of GDP, to less than half their previous level, and the earmarking of social security contributions for an extrabudgetary fund, which resulted in a revenue loss equivalent to 3.5 percent of GDP. In contrast to the past, in 1991 the Kazakhstan Government had to resort to domestic borrowing (albeit at very low interest rates), mostly from the National Bank of Kazakhstan.

Monetary Policies

Until 1991, monetary developments were largely determined by the policies in effect for the U.S.S.R. as a whole. Targets for total credit growth in each republic, including Kazakhstan, were in effect throughout each year, although they were modified as circumstances required. Thus, following the April 1991 price liberalization, and in the context of a generally rapid growth of the U.S.S.R's money supply, credit extended by financial institutions in Kazakhstan almost doubled in 1991, with most of the increase directed to enterprises (Table 4). The authorities attempted to discourage credit growth by raising the refinance rate of the National Bank from 8 percent to 12 percent in July and by introducing reserve requirements on deposits at commercial banks. However, the National Bank's refinancing of banks continued to increase, which contributed to more than a doubling of the stock of currency issued during the year (Table 5). Interest rates on deposits held in commercial banks were increased by about 2 percentage points in the second half of 1991 to a range of 4-10 percent per annum by year-end. However, interest rates remained strongly negative in real terms, and consequently, monetary aggregates declined in real terms in 1991.

Balance of Payments and External Debt

In general, the product specialization which characterized the economies of the former Soviet republics led to high ratios of external trade to GDP. Kazakhstan had the largest interrepublican trade deficit among the republics of the former U.S.S.R., with a ratio of this deficit to GDP of 12 percent in 1989; the foreign (convertible-currency) trade deficit is estimated to have been equivalent to 1 percent of GDP in the same year. Between 1989 and 1991, the direction of trade appears to have shifted toward interrepublican trade as foreign imports feil, reflecting the general shortage of foreign exchange in the Union and the impact of the depreciation of the exchange rate from an

average of rub 0.6 per U.S. dollar in 1990 to an average of rub 1.8 per U.S. dollar in 1991. Foreign exports also faltered, as shipments to the international market were virtually halted in the last two months of 1991, mainly owing to disruptions in output and in the payments mechanism. The interrepublican capital account surplus—largely the result of transfers to the National Bank from the Union's central bank—was more than sufficient to cover the interrepublican current account deficit and, as a result, the domestic banking system is estimated to have improved its net external position. Thus, the current account deficit of the balance of payments narrowed in relation to GDP in 1991 as a sharp contraction in imports outweighed moderately reduced exports and net transfers from the Union to the republican budget (Table 6).

After the signing of the external debt agreement among eight former Soviet republics, Kazakhstan's share of the former U.S.S.R's external debt was set at about \$2.5 billion, with scheduled debt-service payments on medium- and long-term debt estimated at \$511 million (with \$209 million in estimated interest payments) in 1992. Following the signing of the agreement with the Group of Seven industrial countries, Kazakhstan benefitted from the deferral of principal payments; so far, no payments have been made on interest due. The authorities contend that this delay has arisen because of uncertainties regarding the legal and financial status of U.S.S.R. Vneshekonombank (formally the recipient of such payments) and the early state of negotiations regarding the level and distribution of gold holdings and other external assets of the former U.S.S.R.

Kazakhstan maintained the same exchange and trade system as the rest of the Union during 1991. However, despite its participation in the common currency union of the ruble area, the changes in the system introduced by Russia in early 1992, including the introduction of a dual exchange rate mechanism, had not been fully implemented in Kazakhstan by January 1992. Although there are indications that several enterprises are buying and selling foreign exchange between themselves at the free-market rate, the banking system as a whole and the Government were applying the previous commercial exchange rate of rub 1.8 to the U.S. dollar instead of the depreciated rates of either rub 55 or rub 110 to the U.S. dollar prevailing in Russia in January 1992 for its sales of convertible currencies to budget organizations and selected enterprises.

With a view to attracting foreign capital, a new foreign investment code was enacted in 1991 and free economic areas were established. As a result, foreign investment is now allowed in any sphere of economic activity, except the manufacturing of products used for military purposes. The main incentives provided under the law include duty-free imports and accelerated depreciation. The law also grants a 100 percent income tax exemption for the first five years of operation and a 50 percent exemption for the subsequent five years for enterprises involved in the production of consumer goods, agricultural goods, and electronic and medical equipment. Imported equipment parts, raw materials, and other components intended for production and processing on the territory of free economic areas, as well as exports from such areas, are exempt from customs duties. In its early stages, foreign investment has been carried out mainly in the context of joint ventures, of which about 100 had been registered by the end of 1991. These involved more than 50 foreign firms, including 12 from Germany, 10 from the United States, 8 each from China and Turkey, and 4 from Italy.

The Institutional Framework for Economic Policymaking

Until 1991, the function of the Kazakhstan Government, as was the case in all other republics of the former U.S.S.R, was largely to implement the policy decisions made at the Union level. Kazakhstan's institutional framework was a replica of that prevailing at the center but virtually without administrative structures to formulate policies or even to analyze the significant amount of statistical information being routinely collected in Kazakhstan. Moreover, a substantial part of economic activity (including defense industries, transport, communications, and major industrial units) was in the domain of the Union and was reported directly to the center.

Following its declaration of independence, Kazakhstan was faced with the need to design and implement economic (and other) policies that had been previously handled at the center and for which limited institutional capability existed in the country. In the circumstances, economic management appears to be in a state of flux—with, for example, direct state orders to enterprises coexisting with the liberalization of prices.

Since December 1991, the Government has undertaken steps to reinforce the President's authority to direct the reform process; important personnel changes have been made at the top levels of key agencies and departments; consideration is being given to a rationalization of the structure of economic ministries; and the coordination of economic and financial policies is being concentrated in the President's office. Close relations have been developed with key committees in Parliament, including the committee that oversees the National Bank.

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IV. Economic Policies for 1992

The severe dislocation in economic activity that began during the second half of last year is likely to continue in 1992. The prospects for real output will essentially depend on three factors: (1) a normal agricultural harvest following a drought-induced decline in 1991, (2) the extent to which further disruptions in interrepublican trade can be avoided and foreign trade increased, and (3) the speed of the positive supply response to the liberalization of prices and the privatization of key sectors of the economy. Barring unforeseen developments, however, real output will continue to decline in 1992, in part as a result of short-term losses from the stabilization efforts. The outlook for inflation will, of course, depend critically upon developments in Russia—and in other countries in the ruble area—but, on the basis of the large increases already recorded after price liberalization, a several-fold rise in prices is likely.

The strategy being pursued by the Kazakh authorities in the transformation to a market economy is based on five key principles: (1) to allow price liberalization to play an essential role in the allocation of resources and the generation of a supply response; (2) to promote the development of a private sector through an extensive privatization program and liberal investment conditions; (3) to aim at price stability through tight financial policies within the context of a common monetary and exchange rate policy with other members of the ruble area; (4) to endeavor to maintain free trade, in part through coordinated efforts with other republics of the former U.S.S.R.; and (5) to contain the impact of the transition upon selected groups of the population through the creation of an adequate social safety net.

Price and Structural Reforms

Along the lines of the price liberalization in Russia, on January 6, 1992, Kazakhstan's authorities allowed the prices of most goods and services to be set freely according to market conditions. At the retail level, only rents for housing remained unchanged; the prices of about 20 percent of the goods in the basket for the consumer price index (mostly basic food and essential services) remained controlled, although even these increased between three and five times; the largest increases mainly affected kerosene, coal, and fuel oil, and smaller increases were applied, inter alia, to cereals, bread, milk, gasoline, natural gas, and passenger transportation by road and air. At the wholesale level, prices that remained administered were increased between three to eight times, with the lowest increases being applicable to communications, electricity, and road freight, and the highest ones to certain types of coal, agricultural electric power, and interrepublican railway freight.

Social tensions built up quickly in the aftermath of the price reform, and, as a result, in January the Government partially rolled back the increases in the retail prices of some basic food items (milk and bread) and brought a few others under regulation. Despite these reversals, the direct impact of the increase in controlled prices on the retail price index in January 1992 is estimated to have been around 75 percentage points above the underlying rate of inflation; the authorities estimated that the overall increase in prices following price liberalization was of the order of three to five times.9

The original privatization program for 1992 called for the sale of enterprises with assets valued at only rub 3 billion. However, the authorities have recently announced their intention to accelerate the privatization program, and the plan likely to be approved for 1992 calls for the privatization of

up to 50 percent of assets in industry, 40 percent of assets in agriculture, all assets in housing, and the continuation of the program in the services sector. Moreover, foreign participation in the program is being given serious consideration. The modalities for privatization will continue to consist of auctions as well as direct sales to workers. Further privatization of the retail and wholesale trade, and distribution networks, would help accelerate the economy's supply response and reduce shortages.

Regarding the housing sector, the Government intends to introduce a system of investment coupons. The coupons, which would not be transferable, would be allocated directly to the population. The total amount to be distributed (approximately rub 26 billion at 1991 prices) would correspond to the total value of assets of the State Housing Fund. Recipients of the coupons, however, do not have to use them to buy their homes but can instead purchase other assets offered for sale in the privatization program. The Kazakh authorities viewed this program as compensating for previous restrictions and as a way to foster private ownership.

The privatization program does not cover a few sectors—such as the defense complex, some of the state monopolies such as the railways, and those activities which may create ecological risks; however, a conversion program is being implemented in parts of the defense sector although details are not available. The authorities have indicated that the communications, electricity, and airline services will be converted into joint ventures as soon as possible; negotiations are already in progress with several major multinational companies to that end.

Regarding land reform, the authorities have indicated that private ownership of land is not under consideration for the time being. They recognize the critical role that land reform could play in the development of a market economy in general, and of agriculture in particular, but point out that ownership restrictions may be overcome by means of existing provisions in the privatization law which allow for the purchase of long-term leases, with inheritance rights, on land use.

Fiscal Policy

In the wake of the January 1992 price reform, the Government adopted a budget which targeted an overall deficit of rub 10.7 billion, which is to be entirely financed from domestic sources. The authorities experienced considerable difficulties in preparing the 1992 budget, largely because of the uncertainties surrounding key parameters, such as inflation, the exchange rate, possible transfers to and from Russia to cover common expenditures, and external financing.

On the revenue side, the 1992 budget was based on important changes in the tax system, including the introduction of new taxes and increases in certain tax rates, and reflected an expected positive impact of the price liberalization on indirect taxes; total budgetary revenue was estimated at rub 84 billion. In the area of indirect taxes, a large increase in receipts was expected as a result of the replacement of the turnover tax and the sales tax with a combination of excise taxes and a value-added tax (VAT).¹⁰ The introduction of the VAT at a rate of 28 percent represents a major reform—one also undertaken by other former republics of the U.S.S.R. In the area of direct taxation, the decline in the ratio of income tax revenues to GDP reflects the impact of measures taken last year to reduce certain corporate and individual income tax rates. Moreover, a new tax on the operating costs of enterprises has been introduced, although revenues from the tax have been earmarked for an investment fund. Finally, sizable receipts are anticipated from some profit-making budgetary transactions in foreign exchange (consisting mainly of intermediation of imported consumer goods).¹¹

On the expenditure side, the budget allocations amount to almost rub 95 billion. Compared with preliminary estimates of the 1991 outcome, total expenditure declined in relation to GDP; this was largely the result of lower budgetary subsidies following the liberalization of prices. Although expenditures to cover price subsidies were expected to fall by nearly 50 percent, the share of

allocations to the social and cultural sectors (education, health, and social security) in GDP were expected to be maintained.

The lack of an economic classification of expenditure precludes a detailed analysis of the 1992 budget. Based on partial information, however, the wage bill (including stipends, scholarships, and allocations for wage indexation) is estimated to fall in relation to GDP, even after account is taken of the 90 percent wage increase of December 1991 and the Government's intention to freeze hiring in 1992. Open-ended price subsidies (for bread, flour, milk, and coal) are expected to account for only a small proportion of budgetary allocations for transfers and subsidies (including social security benefits); however, enterprises that have been unable to pass the full impact of price reform through to their retail prices—in the pharmaceutical, public housing management, transportation, and energy sectors—will require large financial support. The only identified capital expenditure is that of the investment fund; however, this underestimates the extent of investment, since it does not include, for example, expenditure by local governments financed through extrabudgetary funds.

The authorities' budget reflected the operations carried out by the Republican Hard Currency Fund, which was established under the direct control of the Council of Ministers, to accumulate foreign exchange reserves and finance specific import needs; the fund's foreign exchange receipts result from the surrender requirements imposed on exporting enterprises. The authorities intend to use the fund to accumulate the foreign exchange needed to make interest payments on external debt (\$209 million in 1992), pay for the import of selected consumer goods that are to be sold at a profit on the local market, meet the Government's own foreign exchange needs, and sell foreign exchange to enterprises.

As a consequence of the uncertainties prevailing at the time the 1992 budget was prepared, it did not fully reflect the economic and financial realities in the country. As adopted, the budget was based on a notional exchange rate for all foreign exchange transactions (including payments of interest on external debt) which recent developments have rendered unrealistic; it excluded allocations for Kazakhstan's share of CIS expenditures for defense, as well as for space exploration and other common projects; in addition, the rollback of the January 1992 price increases for a few basic foodstuffs could add to outlays. In view of the difficult fiscal situation, the Government intends to consider several revenue-enhancing and expenditure-reducing measures during the year.

Monetary and Credit Policy

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The authorities are formulating their financial policies for 1992 on the assumption that Kazakhstan will remain part of the ruble area for the foreseeable future and, therefore, that there will be a need for close coordination with other members of the ruble area, in particular the Central Bank of Russia. The authorities expressed concern, however, at the lack of adequate consultation and coordination within the monetary union; they are also worried about the risks involved in being part of the ruble area in the absence of clearly defined rules that would encourage all members to exercise fiscal prudence and monetary restraint. Close coordination of monetary and credit policies is important, and considerable benefits, at least in the short run, could be derived from common efforts to strengthen the ruble area.

As part of common efforts to achieve monetary stability in the ruble area, the authorities plan to implement financial policies limiting the amount of currency the National Bank of Kazakhstan would need to obtain from the Central Bank of Russia. In line with appropriate policies in the rest of the ruble area, and on the assumption that the inflation target for the second half of the year should imply a sharp deceleration following the large price increases in early 1992, overall domestic bank financing should be limited. However, a significant reduction in the fiscal deficit would permit a greater availability of credit to the remainder of the economy and thereby forestall further

disruptions in output and trade. In any case, under a scenario of restrained credit expansion, the supply of broad money would decline in real terms, and velocity would increase sharply, during the year.

In order for the Government to conduct an effective credit policy, monetary management by the National Bank is being improved. On the institutional side, accounting practices are to be revised, regulatory and supervisory mechanisms strengthened, especially given the recent proliferation of banking institutions—from 8 in 1990 to 73 at the end of 1991.¹² Moreover, organizational changes are being introduced to facilitate the carrying out of new functions that will be required of an independent central bank. The authorities are also considering possible actions to tighten credit and improve the effectiveness of monetary control. Since banks are structurally dependent on credit from the National Bank, the amount of refinancing made available could be strictly limited and, in conjunction with other members of the ruble area, the refinance rate raised significantly in line with the expected inflation rate for 1992. One option being considered is to establish quarterly ceilings on the amount of refinancing, consistent with an overall domestic credit target.

External Sector

There are considerable uncertainties in the external outlook for 1992—in particular, the extent to which interrepublican trade will be further disrupted and the possibilities for engaging in direct trade with the rest of the world. The Kazakh authorities are projecting a substantial increase in exports to be paid for in convertible currencies in 1992 on the basis of contracts already undertaken and possible diversion of raw material exports from interrepublican trade to foreign trade. However, due to a sizable increase in imports over the previous year, the convertible-currency trade balance is expected to continue to record a deficit. At the same time, Kazakhstan is expected to be favored by the shift in the interrepublican terms of trade following the January 1992 price reform; moreover, the authorities anticipate that the latest round of bilateral trade agreements among republics of the former U.S.S.R. will favor Kazakhstan's trade balance.

As in the case of monetary policy, Kazakhstan and some of the other members of the ruble area are committed to maintaining a common exchange rate policy and exchange and trade system. As noted above, there were delays in implementing the new exchange system introduced in Russia and other republics of the former Union in early 1992; in January 1992, the new commercial exchange rate and the modified surrender requirements were not yet being applied in Kazakhstan. The system in place consists of a dual legal market and an incipient black market. Compulsory surrender of a portion of the export proceeds at an appreciated exchange rate serves to ensure that foreign exchange is available to the Government for servicing external debt and subsidizing imports. The system of surrender requirements is highly complex, since it imposes differential surrender coefficients by industry and production levels. Simplification is expected soon in line with measures recently applied in other republics—especially Russia—including the adoption of a more depreciated commercial rate.¹³

Social Safety Net

As part of its economic reform program, the Government of Kazakhstan is committed to strengthening its social security and welfare systems and to protecting certain groups of the population from the adverse impact of the transition to a market economy. In pursuit of these objectives, in 1991 the authorities created an Employment Fund, embarked on the reform of the Social Security Funds, maintained a comprehensive system of cash allowances, and separated the Pension Fund from the budget.

The 1992 program aims at consolidating these reforms while maintaining the financial viability of the social safety net they provide. In particular, new legislation is being considered to revise the indexation of pensions, as well as to reassess pensions, allowances, and wages in the enterprise and civil service sectors. In addition, a special short-term program has been urgently designed for the agricultural sector to alleviate shortages of fodder, grain, and selected food products created by the drought in 1991. The shortages will be compensated for by the import of \$400-500 million of these products for sale at cost on the local market; a portion of these products will be sold at subsidized prices. Concerning the evolution of consumer subsidies in the aftermath of the January price liberalization, the authorities have tried to strike a balance between efficiency and social objectives. In addition to the subsidization of a few selected consumer goods, the budget provides for direct transfers to cover the losses of energy, transportation, pharmaceutical, and housing management companies. Clearly, in the present, difficult fiscal situation, all aspects of the social safety net would be carefully evaluated, and, to the extent possible, generalized subsidies replaced by expenditures targeted on the highest-priority areas.

V. Technical Assistance

The IMF has received a number of requests for technical assistance from the authorities in Kazakhstan. IMF technical assistance missions have already visited Alma-Ata to provide advice on tax administration, expenditure control, issues related to central banking, and multi-topic seminars on economic statistics. The IMF will provide additional technical assistance in fiscal operations, central banking, and statistics during 1992.

The future provision of technical assistance should (1) help to meet Kazakhstan's immediate need to effectively design, implement, and monitor macroeconomic stabilization policies; and (2) focus on basic operational aspects of the day-to-day economic and financial management of the economic reform program, including development of appropriate institutions. Although the need for technical assistance is apparent in almost every area of economic management, the authorities are conscious of their limited ability to absorb and implement massive technical assistance simultaneously in several areas. Furthermore, the present state of institutional capabilities and skills requires that any technical assistance, in order to be effective, needs to be rigorously based on a nuts-and-bolts approach.

Notes

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1. Data contained in this report are indicative and subject to a high margin of error.

2. An overview of developments in the U.S.S.R. in 1991 is presented in the companion Economic Review

on The Economy of the U.S.S.R. in 1991 (Washington: IMF, 1992).

3. The Kazakhstan Statistical Department (Goskomstat) does not as yet produce national accounts according to the international standards set out in the United Nations System of National Accounts (SNA). The gross domestic product (GDP) figures referred to in this report were constructed by applying to Kazakhstan's NMP the U.S.S.R. adjustment coefficients calculated in International Monetary Fund, World Bank, Organization for Economic Cooperation and Development, and European Bank for Reconstruction and Development, A Study of the Soviet Economy, Vol. 1 (Washington: IMF, 1991), p. 166.

- 4. The State Committee on State Property was created in August 1991. (It had previously been called the Ministry of State Property.) In the first stage of the privatization program (1991–92), the Supreme Soviet and Government developed jointly a comprehensive body of legislation on the regulations concerning privatization, on foreign investment, on the creation of enterprises, on joint stock companies, and on the setting up of a stock exchange. The Presidential Program of Privatization identified the sectors in which state assets would be privatized and the value, or proportion, of assets to be sold, as well as defining the modalities which would be adopted for the sales.
- 5. Kazakhstan has about 34,400 enterprises with gross assets whose value is estimated at some rub 200 billion. Over 90 percent of these enterprises belong to the state, although not all these enterprises are managed directly by the central republican government; a significant number have been leased by the ministries in charge of various sectors.
- 6. Although heavily dependent on transfers, virtually all social security programs were administered by extrabudgetary funds, such as the Pension Fund, the Social Insurance Fund, and the Employment Fund.
- 7. Reserve requirements of 5 percent were introduced for all commercial bank deposits, except those of the Savings Bank, at the beginning of 1991. In July 1991, reserve requirements were increased to 15 percent for demand deposits, 12 percent for time deposits up to 1 year, and 10 percent for time deposits of 1-3 years.
 - 8. Only partial information is available on the foreign and interrepublican transactions of Kazakhstan.
- 9. Even though the price increases were quite large, they were not sufficient to close the wide deviations with respect to either border prices or long-run incremental costs of production. This is notable in the pre-tax wholesale price of crude oil which, despite a fivefold increase to rub 350 per ton, still remains well below the current world price for comparable crudes. Similarly, electricity prices which, after the authorized increases, reached a level of rub 12 per 100 kwh (kilowatt-hours) are also significantly below the typical long-run incremental cost of production in industrial economies.
- 10. Excise taxes are levied on alcohol, tobacco, tea, and other selected products at ad valorem rates, and at specific rates on gasoline, tires, and caviar.
- 11. In addition to the profit-making sale of imported consumer goods, the budget includes the sale at-cost of imported grain, fodder, and foodstuffs.
- 12. So far, no commercial bank has engaged in direct foreign borrowing from outside the ruble area, but those institutions authorized to deal in foreign exchange are actively setting up correspondent accounts and seeking foreign financing.
- 13. The foreign exchange retained by exporters feeds an interbank market where residents can transact business at a freely determined rate. Prior to the introduction of the dual exchange market in Russia, the interbank rate in Kazakhstan was about rub 30 per U.S. dollar, since then it has been below the rate arising from the foreign exchange auctions held by the Central Bank of Russia. At the National Bank of Kazakhstan, the Republican Currency Exchange, where financial institutions will be entitled to buy and sell foreign exchange at weekly auctions, is being set up.

Table 1. Output and Price Indicators

			7	
	1988	1989	1990	1991
		(Percentage c	hange)	
Real net material product (NMP)			_ 2	-10
Real national income	• • •		2	-10
Oil output	5	5	-7	7
Electricity consumed	2	2	1	
Industry	3	1	-1	• • •
Agriculture	. 3	4	11	
Transport	5	2	2	
		(Shares in N	IMP)	1 6
Industry	32	30	28	31
Agriculture	33	35	40	37
Construction	17	19	15	15
Transport and communication	9	9	9	10
Trade and catering	5	5	5	5
Other	4	4	3	. 3
		(Percentage ch	nange)	
			15. X265	
NMP deflator		9	12	101
Retail prices (average)			4	84
Wholesale prices (average)		• • •	4 - 4	172
Nominal household incomes	9	77	17	65
Average wages	8	9	14	51
		(Billion ruble	es)	
National income	27	27	33	61
NMP	28	30	35	64
Gross domestic product (GDP)	39	42	51	92

Sources: Kazakh authorities; and IMF staff estimates.

Table 2. Government Financial Operations¹

(In millions of rubles)

	1988	1989	1990	1991	1992 Budget	
Total revenue and grants	13,796	15,391	17,686	25,391	83,806	7 4
Total revenue	10,064	10,789	11,633	19,388	1 5 8	
Current revenue	10,064	10,789	11,633	19,385	202 WARD 202 WARD 200	, ,
Tax revenue	9,812	10,497	11,187	16,997	272 SAN	
Tax on income, profits, and			37.54 S.	300000 000 0 gg 3000 0000 0000		
capital gains	4,123	4,393	4,238	9,873	19,208	6 9
Social security contributions	1,467	1,573	1,805			
Domestic taxes on goods and	50 - 00					i di
services	4,142	4,438	4,925	6,268	33,610	
Taxes on international trade					85	0 4
Other taxes	80	93	219	857	12,179	7 2
Non-tax revenue	252	292	446	2,388	18,489	691 N 1996 I
Capital revenue				3		2 2
Grants (transfers from the Union						
budget)	3,732	4,602	6,053	6,003	235	Ę,
Total expenditure	13,499	15,371	17,044	32,758	07. 511	1 9
Financing of the economy	7,323	800	8	S	94,511	
Financing of social and cultural	1,525	0,090	5,005	10,924	30,074	5 . 4
programs, including: Public education and	5,385	5,830	6,498	14,156	51,013	
professional training	2,635	2,768	3,001	6,252	21,464	
Health care	1,108	1,283	1,473	2,987	10,829	
Social security	1,635	1,769	2,013	4,289	16,474	
Other	7	10	11	628	2,246	
Other expenses	276	367	541	5,836	13,423	
Transfers to the Union budget	515	479	995	1,842	23	
Overall balance	297	19	642	-7,367	-10,705	

Source: Kazakh authorities.

¹Consolidates the central government and local governments.

Table 3. Government Financial Operations¹
(In percent of GDP)

	1988	1989	1990	1991
Total revenue and grants	35.4	36.6	34.7	27.6
Total revenue	25.8	25.7	22.8	21.1
Current revenue	25.8	25.7	22.8	21.1
Tax revenue	25.2	25.0	21.9	18.5
Tax on income, profits, and				
capital gains	10.6	10.5	8.3	10.7
Social security contributions	3.8	3.7	3.5	
Domestic taxes on goods and services	10.6	10.6	9.7	6.8
Taxes on international trade			p 1 (45)	
Other taxes	0.2	0.2	0.4	0.9
Non-tax revenue	0.6		0.9	2.6
Capital revenue				
Grants (Transfers from the Union budget)	9.6	11.0	11.9	6.5
Total expenditure	34.6	36.6	33.4	35.6
Financing of the economy Financing of social and cultural programs,	18.8	20.7	17.7	11.9
including:	13.8	13.9	12.7	15.4
Public education and professional training		6.6	5.9	6.8
Health care	2.8	3.1	2.9	3.2
Social security	4.2	4.2	3.9	4.7
Other	• •	-		0.7
Other expenses	0.8	0.8	1.1	6.3
Transfers to the Union budget	1.3	1.1	2.0	2.0
Overall balance	0.8		1.3	-8.0
Memorandum item:				
Net public transfers from Union	8.2	9.8	9.9	4.5

Source: Kazakh authorities; and IMF staff estimates.

¹Consolidates the central government and local governments.

Table 4. Banking System Accounts¹ (End-of-period stocks, in millions of rubles)

	1988	1989	1990	1991
Net external claims ²			1,942	6,555
Net domestic assets		• • •	25,871	55,274
Credit to government (net)			6,304	13,670
Credit to the economy	27,619	27,935	25,570	55,690
Credit to enterprises	22,389	22,361	20,763	50,177
Credit to cooperatives	2,442	2,179	1,100	1,726
Credit to households	2,788	3,395	3,708	3,787
Other items net		• •	-6,003	-14,087
Broad money (M2)			27,814	61,828
Currency ³			6,580	13,865
Deposits ⁴	15,033	17,004		47,963

Sources: National Bank of Kazakhstan; and IMF staff estimates.

¹Data are as of December 31 in each year shown.

²Includes foreign exchange held by the Government. This item also includes certain ruble claims and liabilities of Kazakhstan vis-à-vis other republics of the former U.S.S.R. Figures for ruble and convertible-currency assets are not available separately for 1990 or 1991. It has been assumed that convertible-currency assets were zero prior to 1992.

³Assumed to be equivalent to the stock of currency issued to the National Bank of Kazakhstan.

fincludes deposits of public enterprises.

Table 5. Monetary Authorities' Accounts1

(End-of-period stocks, in millions of rubles)

	1990	1991 Est.
Net foreign claims ²	1,942	6,555
Net domestic assets	19,081	45,522
Credit to government (net) Credit to the economy Credit to banks Other items net	4,181 0 810 14,090	17,340 48 27,043 1,090
Total liabilities	21,023	52,076
Currency ³ Required reserves Savings bank deposits Other bank deposits Other deposit liabilities	6,580 0 14,158 265 21	13,865 3,800 20,211 13,000 1,200

Sources: National Bank of Kazakhstan; and IMF staff estimates.

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¹Estimates are as of December 31 in each year shown. Final figures for the National Bank's balance sheet are not yet available, and it is possible that the year-end estimates will have to be revised substantially.

²Includes foreign exchange held by the Government. This item also includes certain ruble claims and liabilities of Kazakhstan vis-à-vis other republics of the former U.S.S.R. Figures for ruble and convertible-currency assets are not available separately for 1990 or 1991. It has been assumed that convertible-currency assets were zero prior to 1992.

³Assumed to be equivalent to the stock of currency issued to the National Bank of Kazakhstan.

Table 6. Balance of Payments

		For	reign			Interr	epublican	
	1988	1989	1990	1991	1988	1989	1990	1991
	Est.	Est.	Est.	Est.	Est.	Est.	Est.	Est.
		(In millions	of U.S. dolla	75)		(In million	s of rubles)	
Current account			-666	-417			-1,733	2,511
Trade balance	-1,064	-850	-215	-102	-4.118	-5,058	-4,583	-4,155
Exports	1,600	1,700	1,800	1,254	8,337	8,201	8,443	13,208
Imports	-2,664	-2,550	-2,015			MCD40 (MALDIO) - MCD40 4 (MD 1104	-13,026	Section 1980 Section 1980 Section 1980
Services, net			-451	-316			-2,209	-2,517
Transport and insurance1			-199	-134			-1,288	-1,717
Travel ²			-116	-34			-920	-800
Interest ³		•	-135	-147				
Net public sector transfers							5,058	4,161
Capital account ⁴				19				7,285
								7,200
Errors and omissions			• • •	417				-162
Overall balance				19			• •	4,612
Financing				-19				-4,612
Banking system's net								
foreign assets			• 1017149				· ·	-4,612
Exceptional financing ³				-19		3.	• • •	
Memorandum items:								
Current account								
(in percent of GDP) ⁵ Trade balance			-0.8	-0.8			-3.4	-2.7
(in percent of GDF)5	-1.7	-1.3	-0.3	-0.2	-10.5	-12.1	-9.1	-4.5
External debt service (in percent of exports								1 44 1
cf goods)				49.7				

Sources: Kazakh authorities; and IMF staff estimates.

Assumed to represent 9 percent of the c.i.f. import value.

²Gosplan estimates.

³Calculated by applying Kazakhstan's share (3.87 percent) to the total debt operations of the former U.S.S.R. Exceptional financing includes changes in arrears.

⁴Disbursements in domestic currencies were calculated by applying Kazahkstan's share in the interrepublican balance of payments (3.87 percent) to the total disbursements to the former U.S.S.R.

⁵Foreign transactions were converted to rubles using nominal exchange rates. Rates (in rubles per U.S. dollar) used were 0.608 in 1988, 0.627 in 1989, 0.6 in 1990, and 1.75 in 1991.

Table 7. Basic Data

Social and Demographic Indicators (1990)

Area	2,717,000 sq. km.
Population density	6.1 per sq. km.
Population	16.691 million
Rate of population growth	0.94 percent
Life expectancy at birth	68.7 years
Infant mortality rate	25.9 per thousand
Population per hospital bed	73.5

Economic Indicators (1988-91)

	1988	1989	1990	1991
Origin of NMP		(Percent	•)	
Industry	31.7	29.9	27.6	30.7
Agriculture	33.0	34.5	39.9	36.5
Construction	17.4	18.6	15.3	15.4
Transport and communication	9.3	8.7	9.3	9.6
Trade and catering	4.8	4.9	4.6	4.5
Other	3.8	3.5	3.4	3.4
Ratios to GDP				
Exports				
Foreign ¹	2.5	2.5	2.1	2.4
Interrepublican	21.4	19.5	16.6	14.4
Imports				
Foreign ¹	4.2	3.8	2.4	2.6
Interrepublican	31.9	31.6	25.5	18.9
Current account2				
Foreign ¹			-0.8	-0.8
Interrepublican			-3.4	-2.7
Government revenue and grants ³	35.4	36.6	34.7	27.6
Government expenditure ³	34.6	36.6	33.4	35.6
Net public transfers from the Union Public sector overall surplus	8.2	9.8	9.9	4.5
or deficit (-)	0.8		1.3	-8.0
Money and quasi-money (end of year)3			54.5	67.2
Change in money and quasi-money ³				37.0
Annual changes in selected indicators				
Real NMP ⁴		-0.4	-1.5	-9.6
NMP at current prices ⁴		8.5	15.5	82.0
			1. 2	ο /. Ο
Retail prices (annual averages) Government revenue and grants ³	10.3	11.6	14.9	84.0 43.6

Table 7 (concluded)

	1988	1989	1990	1991
Government expenditure ³	8.0	13.9	10.9	92.2
Broad money (M2)4				122.3
Broad money (M2) ⁴ Money (M1) ⁴	• •			120.7
Quasi-money ⁴				125.9
Net domestic assets of the banking	system ⁴			113.7
Credit to the government (net)4		• • •	• • •	116.8
Credit to the economy ⁴	• • •	• • •		117.8
General government operations			s of rubles)	
Revenues ³	13.8	15.4	17.7	25.4
Expenditures ³	13.5	15.4	17.0	32.8
Overall surplus or deficit (-)	0.3		0.6	-7.4
External trade		(In billions o	of U.S. dollars	;)
Foreign balance	-1.1	-0.9	-0.2	-0.1
Merchandise exports	1.6	1.7	1.8	1.3
Merchandise imports	2.7	2.6	2.0	1.4
		(In billion	ns of rubles)	
Interrepublican balance	-4.1	-5.1	-4.6	-4.2
Merchandise exports	8.3	8.2	8.4	13.2
Merchandise imports	-12.5	-1.3.3	-13.0	-17.4
GDP ⁵	39.0	42.0	51.0	91.0

¹Foreign trade was converted to rubles using nominal exchange rates. Rates (in rubles per U.S. dollar) were 0.608 in 1988, 0.627 in 1989, 0.6 in 1990, and 1.75 in 1991.

²Includes transport and insurance (assumed 9 percent of the c.i.f. import value), travel, and interest payments (calculated by applying Kazakhstan's share of 3.87 percent to the total of interest payments made by the former U.S.S.R.).

³includes the republican and local budgets.

⁴Figures for 1991 are estimates.

⁵GDP was obtained by multiplying Kazakhstan's NMP by the average GDP/NMP adjustment factor of the former U.S.S.R.

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Annex 1. Fiscal Structure of the Government¹

The general government includes the central (or republican) government and 21 local governments, including those of 19 regions (oblasts) and two cities. The central government budget is subject to approval by the republic's Supreme Soviet, whereas those of the local governments require approval by the local assemblies. The budgets are established on a calendar-year basis.

The state budget consolidates the budgets of the central and local governments. Its coverage excludes several extrabudgetary funds—such as the Social Security Fund and the Pension Fund—at the republican level, as well as many investment funds at the local level.

The general government of Kazakhstan is highly decentralized. In 1991, local governments accounted for an estimated 46 percent of total revenue and 62 percent of total expenditure (Table A1). On the revenue side, following the 1991 reform of the tax system, local governments have been sharing most tax revenue with the central government. Tax revenue is mainly self-assessed and is withheld at the source. Local governments did not receive direct transfers from the Union in 1991. On the expenditure side, local governments are the main executors of expenditure on the national economy (65 percent of total) and on sociocultural sectors (87 percent of total). Expenditures on the national economy cover transfers and subsidies, as well as operational expenditures of ministries linked to operations of the public enterprises within their purview. Expenditures on the sociocultural sectors cover education, health, social security (transfers), and cultural activities.

Under the system of fiscal federalism adopted by Kazakhstan, the central government can exercise some control over local government budgets using a number of mechanisms. On the revenue side, sharing schemes have been established by the republican budget law, while local taxes are restricted to a limited list and have a minor revenue impact. On the expenditure side, a sizable portion of outlays are financed by transfers from the central government. An informal, non-binding agreement defines the primary responsibilities of central and local governments expenditures. For example, local governments are responsible for primary and secondary education, and primary health care, while the central government is responsible for higher education and public transfers in general. On the financing side, pressure has been exerted on local governments running a deficit to refrain from borrowing from the banking system. However, there is no equivalent mechanism to persuade local governments running surpluses not to increase their expenditures.

The above-mentioned elements enable the republic's Parliament to exercise some degree of control over the size and the composition of the state budget, and to allocate responsibilities between the central government and the local governments. However, fiscal flexibility is evident mostly at the central government level, since local government operations cannot be materially altered until a revised state budget is considered by Parliament.

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Annex 2. Main Funds for Social Protection

The social security and welfare system developed under the Soviet regime has been an important element of the sociopolitical environment of Kazakhstan. The system was a pay-as-you-go scheme financed through earmarked and general revenues of the budget. Benefits were extensive, including old-age disability pensions, various family allowances, sick leave and maternity support, and a socialized health-care system.

The social security system was reformed in 1991. A Pension Fund was created to handle old-age and disability pensions, and family allowances, and a State Insurance Fund was set up to provide benefits, such as sick leave and maternity leave, at the enterprise level. These funds are financed by social security fees levied on employers and employees—and, in addition, the Pension Fund receives transfers from the state budget on a pay-as-you-go basis. Social security fees on employers were raised from 28 percent to 37 percent of each enterprise's wage bill in January 1992. Employees pay an additional 1 percent of their salaries.² The Social Security Fund transfers 80.5 percent of its receipts to the Pension Fund, with the remainder (19.5 percent) going to the state insurance fund. Also, as part of ongoing reforms, an Employment Fund was introduced in 1991 in light of the expected emergence of unemployment in the move to a market economy. It finances unemployment benefits, retraining, and job-placement facilities.

The structural and financial reform of the social security and welfare system is due to be completed in 1992 by an indexation of pensions and family allowances. It is expected that the reform would be affected by labor market reforms, including changes in the minimum wage. While new policies may change the benefits offered by the social security system and affect its financial viability, the overall structure of the system is not expected to change. The authorities intend to protect certain groups of the population—particularly the unemployed, low-income pensioners, and single-parent families—during the transition period to a market economy.

The Pension Fund

The Pension Fund was created in January 1991 as an extrabudgetary fund to operate the oldage and disability pensions, and the family cash-allowances systems. It was previously part of the republican budget and was financed by contributions varying between 5 percent and 20 percent of wages according to the particular economic sector. Under the new structure, the fund receives 80.5 percent of social security contributions to cover its pension liabilities, as explained above, and additional transfers from the republican budget to pay for the family allowances. Disbursements of the Pension Fund were budgeted at rub 35 billion in 1992, of which rub 16 billion are for family cash allowances (matched by equivalent transfers from the republican budget). There are currently about 2.5 million pensioners, but a greater number is expected as a result of ecological problems in the Aral Sea and nuclear-testing areas.

Pension benefits are not linked to contributions and provide retirement income for about 1.7 million people. Benefits are paid at 60 percent of the highest average pay earned over a five-year period of consecutive employment. Although the official retirement age is 60 years for men and 55 for women, early retirement has been highly prevalent. As a result of the low average retirement age, the low level of pension benefits, and the legal right of pensioners to work without experiencing a reduction in their pension benefits, many pensioners have stayed in the labor force to complement

their pension income. In January 1992, the average monthly pension was rub 543 per retiree, with many pensioners receiving the minimum pension, which was equal to the minimum monthly salary of rub 342; the authorities estimate that the latter amount of monthly income would put pensioners below the poverty line. Although pensions are not formally indexed, they are likely to be adjusted by the increase in wages or in line with price developments to the extent resources are available. In addition, following the reclassification of some positions, pensions for recent retirees may be revised to take into account the higher salaries which resulted from the job regrading. A new draft pension indexation law is under consideration; if approved, pensions above the minimum level would be increased once a year by an amount equivalent to at least 10 percent of the minimum wage. A supplementary funded-pension system, financed by employees' contributions, is also under consideration.

In addition to the provision of disability pensions for workers, a program started in 1991 targeted the handicapped from birth. This program was the first of its type in a former Soviet republic, but its implementation was jeopardized by financial and budgetary constraints. Employers are responsible for supplementary allowances to workers who are permanently handicapped as a result of work-related illnesses or injuries; the employer's liability is determined by investigative commissions. The program introduced in 1991 also targeted individuals reaching retirement without having been in the labor force; the eligibility age was 63 years for men and 58 for women.

Family cash allowances provided by the pension fund include various monthly allowances for children and for single mothers; benefits are not means-tested, are not subject to wage or income indexation, and are taxable. Allowances were budgeted at about rub 1.9 billion in 1991, and additional payments of rub 1.9 billion were planned for special allowances to compensate for price increases in children's goods and school uniforms. Budgetary transfers to the Pension Fund cover the payment of allowances and account for nearly half of the expected disbursements of the Pension Fund in 1992. The allowance system was streamlined in 1991 by eliminating numerous special payments and increasing the general family allowance. Family allowances represent an important share of incomes for poor families.

The State Insurance Fund

The purpose of the State Insurance Fund is to provide a number of social security and welfare benefits at the enterprise level. It has been financed since 1991 from part of the proceeds of the Social Security Fund, which obtains its revenues from fees on employers and employees. The receipts of the fund are estimated at rub 4.4 billion in 1992.

The State Insurance Fund is controlled at the enterprise level by trade unions. Most of its benefits are regulated by law and include sick leave, maternity leave, lump-sum grants for newly born children, burial benefits, and sanatorium care. In addition to these regulated benefits, each trade union has discretionary power to spend any remaining resources on other benefits, such as sports facilities, medical facilities, and summer camps for children.

As a result of the decentralized management of these benefits, there has been a formal lack of monitoring of the fund; no historical time series on its finances are available.

The Employment Fund

In July 1991, the Kazakh Supreme Soviet enacted the Law on Employment creating the State Service for Employment to provide job placement, retraining, and unemployment benefits. The service included employment boards in all regions and major cities; its total staff of 2,700 implies a ratio of about 16 staff members for every 100,000 members of the population.

The potentially unemployed population of working age was estimated at about 650,000 individuals in 1991, including married women with children. Nearly 40 percent of these individuals were described as "ready and able to work," although many would have preconditions for accepting a job, such as child care, or were interested only in part-time work. Around 4,500 people were registered with the employment services as unemployed, but only 600 of these received unemployment benefits. Another 55,500 who already had jobs were registered with the State Service for Employment as looking for alternative employment. A significant increase in the number of people needing support from the employment services is expected in 1992, especially training or employment in publicworks programs. The Ministry of Labor expects 350,000 applicants in 1992, and expects there will be 140,000 unemployed persons by the end of 1992.

The emphasis of the Employment Fund is on-job placement and retraining programs, which are expected to account for 50 to 75 percent of the rub 2 billion it plans to spend in 1992. A person looking for employment is only registered as unemployed if, after 7 days have elapsed since his or her initial request, the employment services have not been able to provide the person with a "suitable" position taking account of his profession, age, health, and place of residence. Entitlement to unemployment benefits is then determined as follows:

- (1) all unemployed persons can claim benefits for a basic three-month period;
- (2) after three months, someone who has rejected two "suitable" job offers is disqualified from receiving further benefits;
- (3) someone who is not disqualified under (ii) but who has not worked before must, after receiving benefits for three months, submit to a retraining program (with a stipend of not less than the minimum wage);
- (4) someone who is not disqualified under (ii) but who has worked before, is allowed to receive benefits for six months before having to go for retraining; and
- (5) exceptions are made for those "close to retirement" who can claim benefits for up to nine months in any calendar year.

Unemployment benefits are equal to 50 percent of the person's last wage during employment but be neither lower than the statutory minimum wage nor higher than the average wage in the country. The fund is financed by enterprise contributions equal to 3 percent of the "wage funds." Claims on it were modest in 1991, and its resources are likely to be sufficient for the services it is expected to provide in 1992.

Annex 3. Key Features of the January 1992 Price Reform

This annex summarizes the key seatures of the price-liberalization law that was passed on December 31, 1991, and came into essect on January 6, 1992.

Liberalized Prices

The law stated that wholesale prices would be determined by agreement between buyers and sellers. It noted that the price of a good should include the VAT and should reflect market conditions, the type of the good and its quality, the region where it is sold, and its production and selling costs. For imported goods, prices could also include import-related expenses, including any tariffs or import taxes. In cases where (1) buyers and sellers cannot agree on a price for a good, (2) the product involved is in short supply, and (3) the buyer has no alternative source, the State Committee for Materials and Technical Supply will determine the good's price. The agreed-upon price will be recorded in a "protocol of agreement." Sellers are obliged to inform buyers that the price of the goods the latter are purchasing are not subject to state control. Wholesale prices can be changed if production costs change. If producer goods are sold (wholesale) to other producers through an intermediary, the intermediary has the right to charge an intermediation markup that takes into account transportation and other relevant costs. This markup is not to exceed 25 percent of the good's wholesale price, regardless of the number of intermediaries involved.

Prices of goods produced (or purchased wholesale) prior to January 6, 1992, will be raised using a coefficient of 2.5. Previously liberalized goods, imported goods, and goods sold prior to January 6, 1992 (but which remain in warehouses) are not subject to revaluation.

Retail prices of consumer goods and services comprise the wholesale price, the applicable taxes (including the VAT and tariffs (if the good is imported)) and the intermediation markup. The markup has not yet been determined by the regional authorities; in the interim, it has been allowed to vary between 15 and 30 percent depending on the type of product and the region where it is sold. Retail prices are to be clearly visible on each product. Intermediaries should periodically provide the authorities with data on their intermediation markups. Retail prices can be changed if the relevant market conditions change.

Liberalized consumer goods that were purchased by intermediaries prior to January 6, 1992 but remain in their warehouses will be revalued according to the following rules: prices of foodstuffs will be determined using a coefficient of 3, prices of non-food products using a coefficient of 2. A list of luxury goods (including imported cigarettes and perfumes) has been exempted from maximum revaluation coefficients.

Regulated Prices

The prices of a number of producer goods are still subject to state control. On January 6, 1992, however, those prices were adjusted upward. Table A2 provides a list of those goods and the applicable adjustment coefficients. The prices of goods produced (or purchased wholesale) prior to

January 6, 1992, but remaining in the warehouses of producers (or wholesale sellers) will be revalued using the coefficients provided in Table A3. Goods sold prior to January 6, 1992, but not yet delivered are not subject to revaluation.

The prices of a number of consumer goods and services are still subject to state control. On January 6, 1992, however, their prices were adjusted upward. Table A3 provides a list of those goods and of the applicable adjustment coefficients. If the price of a locally produced good differs from the price of a similar imported good, then the price of the latter should be made identical to the price of the former.

The prices of goods purchased by a retail seller prior to January 6, 1992 but not sold yet, should be revalued according to the coefficients in Table A3. Revaluation is not applicable to goods sold prior to January 6 but which remain in their sellers' warehouses. Revenue from revaluation is divided as follows: 50 percent is retained by the seller and used for his working capital, and 50 percent is divided evenly between the Government and the regional funds for the protection of the population.

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Annex 4. Structure of the Financial System

The banking system of Kazakhstan has experienced major changes since 1987-88, when a two-tier banking system was established in the former Soviet Union. Legislation enacted in December 1990 modified the nature of the banking system, which under central planning was an integral part of the central allocation system. The new laws changed the charter of the Alma-Ata branch of the (Soviet) Gosbank to make it a full-fledged central bank (independent of the Gosbank) and authorized the establishment of private and public financial institutions. Sixty-six banks were licensed in 1991, some with very small capital bases. By the end of 1991, the banking system consisted of the National Bank of Kazakhstan (NBK—the central bank), the Kazvnesheconombank (KazVEB), and 72 other commercial and cooperative banks, five of which were privately owned.

Sectoral specialization is an important feature of the Kazakhstan banking system, especially for the long-established banks. For example, the three largest banks—the Kazakhstan Bank, Turanbank, and Kredsotsbank—lend almost exclusively to industry and agriculture, construction organizations, and organizations involved in housing management and municipal facilities, respectively. (See Table A4 for data on total lending by Kazakh financial institutions during 1988–91.) Moreover, KazVEB extends credit primarily to enterprises responsible for foreign trade, and the Savings Bank's quasi-monopoly on household deposits has been maintained; the latter's deposit liabilities amount to over 95 percent of household deposits, with all deposits guaranteed by the Government. The Savings Bank provides small loans to individuals, but the bulk of its funds are placed at the National Bank. In December 1991, however, a new banking law abolished the sectoral specializations of banks, allowing them to lend to, and collect deposits from, the public and enterprises in all sectors.

Under Kazakhstan's central banking law and its banking law, the National Bank is responsible for money and credit policy, the licensing of commercial banks, prudential regulation and supervision, and foreign exchange and exchange rate management. However, it has not yet asserted its independence by exercising any of these functions. For example, prudential regulations imposed by the National Bank are those previously established by the former U.S.S.R. Gosbank. These include a minimum initial capital requirement (50,000 rubles for private commercial banks, 5 million rubles for other commercial banks, and 500,000 rubles for cooperative banks), limits on the leverage ratio (1:20 for commercial banks and 1:12 for cooperative banks), and exposure limits (50 percent of capital per borrower for commercial banks). Moreover, the National Bank has not yet played a role in foreign exchange management and control; the official foreign exchange reserves Kazakhstan accumulated prior to September 1991 are still held by Russia, and those accumulated since then are held by KazVEB. It is anticipated that the National Bank will assume an increasing role in these operations as its capacity to perform these functions is strengthened.

The reforms of 1987 and 1988 also introduced new instruments of monetary control. The National Bank currently relies on reserve requirements, the refinancing of commercial banks, and lending to the Government, although, in practice, it has made little use of the latter two instruments. There are no regulations on interest rates except for the ceiling of 3 percentage points on the average spread between the cost of funds and the lending rates charged by commercial banks.

Annex 5. Foreign Exchange System

In principle, the exchange arrangements used by Kazakhstan should be similar to the arrangements prevailing in the ruble area as a whole. The key elements of the system in force in Kazakhstan in January 1992 are described below. In several respects, they differ from those in effect in Russia at that time.

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Exchange Arrangements

The foreign exchange system of Kazakhstan is regulated by a currency law approved by the Kazakh Supreme Soviet on June 13, 1991. Foreign exchange may be bought and sold by residents at a market-based interbank rate through KazVEB and commercial banks licensed to deal in foreign exchange. Prior to the changes made in the exchange system of Russia in early 1992, the interbank rate in Kazakhstan was about 30 rubles per U.S. dollar; since then, it has been a few points below the rate arising from the foreign exchange auctions held by the Central Bank of Russia. The Republican Currency Exchange is being set up at the National Bank of Kazakhstan. It will make it possible for KazVEB, commercial banks, and other financial institutions to buy and sell foreign exchange in weekly auctions; the modalities of the auctions, and their relationship to the auctions conducted in Russia, are still unclear. The exchange is expected to start operations in February 1992.

Administration and Control

KazVEB handles the foreign exchange operations of the Government and enforces the rules regulating foreign exchange transactions that are issued by the Republican Currency Committee, which is headed by the Prime Minister and includes representatives from regions, the Ministry of Finance, the Ministry of Foreign Economic Relations, and KazVEB. Licenses allowing commercial banks to deal in foreign exchange are issued by the National Bank. Presently, ten banks are authorized to participate in foreign exchange transactions.

Imports and Import Payments

The Presidential Decree of January 25, 1992, rescinded the requirement for enterprises to obtain licenses to conduct foreign trade operations. Enterprises' access to convertible-currency funds requires approval by the Republican Currency Committee. The currency law established convertible-currency funds for the state and local authorities; these funds are accumulated either by purchasing foreign exchange at the commercial rate from exporters or by borrowing from abroad. The state and the local authorities use their convertible-currency funds independently to finance imports, to sell foreign exchange to enterprises licensed to engage in foreign trade, and to accumulate reserves.

Exports and Export Proceeds

The foreign exchange proceeds of resident corporations are compulsorily paid into their accounts with correspondent banks of domestic banks licensed by the National Bank of Kazakhstan. The Republican Currency Committee has set retention requirements for export proceeds which differ according to the exporting sector. In this context, a distinction is made between state orders and "free" output (output in excess of the state-ordered levels; broadly, about 70 percent of output in the exporting sectors is still based on state orders). The surrender requirements that apply to state orders average about 70 percent of export proceeds. Half of this foreign exchange is allocated to external debt service; of the remainder, 90 percent goes to the republican convertible-currency fund and 10 percent to the local governments' convertible-currency funds. As long as free output does not exceed 5 percent of total output, a uniform surrender requirement of 100 percent applies to the corresponding export proceeds; in this case, all of the foreign exchange surrendered goes to the republican convertible-currency fund. For free output exceeding 5 percent of total output, a 40 percent marginal surrender requirement applies; of this, 75 percent is allocated to the republican convertible-currency fund and 25 percent to the local authorities' convertible-currency fund. There is no specific time limit for the surrender of foreign exchange by exporters.

The foreign exchange retained by exporters can be held as currency or as deposits with KazVEB, its correspondents abroad, or the local commercial banks that have been licensed to operate in foreign exchange. Depositors have unrestricted access to their foreign-currency deposit accounts. They may sell foreign exchange to other enterprises licensed to engage in foreign trade, at a freely determined rate, through KazVEB or the licensed commercial banks. Trading is arranged by the bank holding the retention accounts and is conducted through an informal "auction" system. Demand for foreign exchange in the interbank market includes that of individuals, whose access to foreign exchange is restricted to a maximum of US\$200 per year for travel purposes.

Proceeds from Invisibles

Enterprises surrender to the convertible-currency funds the entire amount of interest, dividends, and profits received in convertible currency from investments in foreign assets. There are no limits on the amount of foreign exchange that can be brought into Kazakhstan, and individuals may hold foreign exchange brought from abroad in accounts with KazVEB or with commercial banks licensed to deal in foreign exchange. Foreign exchange payments to residents must be made into accounts with correspondent banks of KazVEB. Individuals may sell foreign exchange for rubles in the interbank market.

The legal framework for the export of foreign exchange by residents is being revised; the old currency law subjected Kazakhstan to the customs legislation of the former U.S.S.R. Residents traveling abroad may take along their foreign exchange balances with them and may hold foreign-currency accounts abroad during their absence from Kazakhstan. Nonresidents may freely re-export foreign exchange previously imported into Kazakhstan. In the free economic zones,6 it is possible to convert rubles into hard currencies.

Transactions in foreign exchange between resident individuals are generally prohibited. Non-residents are required to carry out all their foreign exchange transactions through KazVEB. The rubles received by nonresidents as a result of their sale of foreign currency may be sold back to KazVEB; the foreign exchange proceeds of these sales may be transferred abroad without limit.

Annex Notes

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- 1. The analysis of budgetary policy is complicated by several factors. Budget revenue and expenditure include financing items and operations which are of a monetary nature, such as the purchase of foreign exchange for the purpose of acquiring external reserves. In addition, a detailed economic classification of expenditure is not available.
- 2. The tax base used to determine contributions includes salaries and wages, dividends, and premiums and bonuses (with 14 monetary items considered in addition to wages and salaries). However, the one-time salary supplements granted in the wake of the Kazakhstan's price reform in 1991 were exempted from social security contributions.
- 3. The Kazakhstan Supreme Soviet approved an indexation law in the second half of 1991, but it has not yet been implemented.
- 4. Previously, the Social Insurance Fund was funded by contributions varying between 5 percent and 14 percent of the wage bill, according to the particular sector.
- 5. The combined loan portfolio of these three banks accounted for 79 percent of the total loans of the banking system, which amounted to 48.4 billion rubles at the end of 1991. Their individual shares were as follows: Kazakhstan Bank, 49 percent; Turanbank, 19 percent; and Kredsotsbank, 11 percent.
- 6. Free economic zones are specially allocated territories with clearly defined administrative borders and special legal arrangements established with the aim of attracting foreign investment.

Annex Tables

	General (Government	Centra	1 Government	Local	Governments	
	วแบ	olidated)					
	Budget,	Estimate	Budget.	Fstimate	Budget	Estimate	
				1			
?evenue	22,658	25,391	12,838	13,349	18,000	18,980	
Turnover tax		4		775	3,319	3,645	
Sales tax	₹.		928	927	510	551	
200	13	37		3,753	1,953	2,620	
1 income t	2,565	œ			2,565	3,088	
tax		17			154	173	
Rental payments (oil and gas)	351	7	351	170			
ked revenue for keolo	295	7	295	340			
tion fund revenues 2	3	006	•	006			
et subvention	0	, 50	6,000	3,500			
Fer of unified		. 50		2,503		1	
x and nontax revenue	1,259				1,259	1,965	
Internal transactions, (central							
nent to local gover					8,240	6,938	
Expenditure	33,785	32,758	21.192	19,904	20,833	19,792	
National economy	50	9		3,868	7,700	7.056	
3	Ξ.	٦.	3,370	1,836	12,748	12,320	
on	47	2	•	1,627	¥69°¥	4,625	
Health	8	2,987	541	161	2,939	2,826	
Social security	5	•	1,047	8 7	4,463	4.241	
Mass media	65		•		652	628	
	5	S	S	S			
Science	153	153	148	148	•	•	
Law-enforcement organs	427	428	345	345	82	83	
of state	30	37	27	27		10	
Administrative organs	248	26	253	2	295	318	
Transfers to Krazkredsotsbank	t	•	ı	•			
Transfer to the Union budget	3,448	•	3,448	1.842	1	•	16 36
Other expenditure	553	2,646		2,646			
Internal transaction, transfer		•					
Rovernment							
governments)			8,240	6,938			
Overell belance	-11.127	.7,367	-8,294	-6,555	-2.833	-812	
	11 127	36	8.294	6.555	2.833	812	nui equ
Gosbank financing	12, 133	7,367		7,367			
	-1,006	1	-3,839	8	2,833	812	

Sources: Kazakh authorites; and IMF staff estimates.

¹Follows the Kazakh presentation of budgetary data. ²Includes a portion of payroll tax retained in the budget (1.1 billion rubles) and a transfer from the depreciation fund frub 0.3 billion

Table A2. Producer Goods and Services Whose Wholesale Prices Are Still Regulated by the State and Their Adjustment Coefficients

(Not including VAT)

Type of Good or Service	Adjustment Coefficient Applied to Existing Prices and Rates	
Coal		
Power generating coal	5	
Coking coal	Q Q	
Oil	5 1	
Gas condensate, associated petroleum gas		
Natural gas including liquefied gas,		
broad fraction of light hydrocarbons	5	
Engine and boiler fuel, kerosene	4.8	
Electric power	42	
including for agricultural		
users - maximum rate	8 kopeks per	
	kilowatt-hour	
Mangyshlak power works	6.9	
Precious metals and alloys		
(including scrap and waste), raw		
diamonds, precious, semi-precious		
synthetic, and artificial stones	Set by special	
and articles made from them.	government decision	
Freight rates and services:		
freight shipment by rail: interrepublic tr	affic 8.3	
In local (intra-state) traffic	5	
Loading and unloading work	5	
Freight shipments by air	5	
Freight shipments by river, except		
foreign shipments	3.5	
Freight shipments by truck	3.6	
Basic communications services		
(sending postcards, letters, printed matte		
packages, money orders, and telegrams,		
international telephone calls, charges for		
radio and telephone use, installation of		
telephones for persons enjoying privileges	. 3 (on the	
	average)	

¹The coefficient is applied to the existing industry prices for oil (*minus* a surcharge of rub 14 per ton).

²The coefficients are applied to budget organizations and to enterprises producing goods whose prices are still regulated.

Table A3. Consumer Goods and Services Whose Retail Prices Are Still Regulated by the State and Their Adjustment Coefficients

(Including VAT)

Types of Good or Service	Adjustment Coefficie Existing Reta	
Bread and rolls made of wheat flour		
(of the first and second grades) and		
rye flours	3	
Semolina, millet		
Rye and wheat flour (of the first		
and second grades) sold to rural		
individuals in place of bread		
Whole and dried milk, evaporated and		
condensed milk without fat	3	
Nonfat and 1 percent fat kefir, nonfat		
cottage cheese, 10 percent fat sour crea	.m 3	
Baby food	3	
Table salt	4	
Sugar	3	. 5
Vegetable oil	3	
Vodka and beverage alcohol	4	5
Matches	4	
Carriage of passengers and baggage by:		
Rail		
Sea	2	
Air		
Bus (city, suburban, interurban, and		
interregional routes)		2
Communications services:		
Sending postcards, letters, printed		
material, packages, telegrams,		
intercity telephone calls, charges for		
radio and telephone use, installation	of	s
telephones for persons enjoying privil	eges 3	on the average)
Funeral services:		
Provision of hearses, preparation of cas	skets,	
casket lining, grave digging, and buri	lal	
Waste-removal services		3 1

¹Prices and rates approved by local governments.