Increased use of the National Fund and monetary emission of the National Bank will exacerbate the imbalances of economic policy

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Nowadays the State budget approved by the Parliament, is incomplete and do not conform to the international standards of accounting and reporting. In accordance with them, the consolidated State budget must include all revenues and expenses. In particular, it should include the receipt and expenditure of funds of National fund, as well as public and quasi public expenditures to be financed by the National Bank, national holdings "Baiterek", Samruk-Kazyna, ENPF, GFSS, and other State funds. In terms of consolidated budget, we tried to assess how recent initiatives to increase public spending would affect the economy in General, as well as the economic, fiscal, and monetary policies carried out by the Government and The National Bank.

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Kazakhstan's economy is highly dependent on exports of natural resources, therefore one of the key objectives of economic policy is to reduce dependency of the State budget on the situation in world commodity markets to maintain long-term fiscal sustainability. From this point of view, according to the International Monetary Fund and the World Bank, it is very important for Kazakhstan to move to a sustained level of non-oil deficit of the consolidated budget in the range of 5-6% of GDP.

To conserve financial resources of the National Fund by making provisions for future generations and to reduce dependency of State budget on situation in world commodity markets at the end of 2016 by the Decree of the President, the Concept on the formation and use of funds of the National Fund (hereinafter concept) was approved. In our view, this document contains very important budget rules, which allow to support the long-term fiscal sustainability of Kazakhstan, which, in turn, strengthens the investment attractiveness of the country and enhances the credibility of the economic policy of authorities.

One of the key fiscal rules of the Concepts is – “in order to ensure a balanced budget and a National Fund, reducing dependency of the Republican budget from oil revenues, fiscal policy should be formed on the basis of gradual decrease of non-oil deficit relative to GDP”.

Concrete plans for every year starting from 2017 was planned by the concept, the level of non-oil deficit of the Republican budget was lowered to 7.0% of GDP in 2020 and up to 6.0% of GDP by 2025. At the same time, during the 2017-2019 these plans on the basis of the consolidated budget have not been met.

Significant deviations from the previously approved policy of lowering the national budget dependency from oil revenues demonstrate low execution discipline of non-oil deficit reduction plans, established in the concept on the formation and use of funds of the National Fund. It should be noted that the financial authorities are in no hurry to compile the country's financial report (consolidated budget) in accordance with international standards on statistics of public finances (IMF methodology), as a result, the financial transactions of the National Bank, ENPF and quasi-public sector are not fully accounted for. At the same time, starting from 2017 to fund additional government spending instead of funds of the National Fund and increase of State debt, the printing press of the National Bank, was increasingly used.

In particular, in February 2017, the Government made huge adjustments to the Republican budget, its expenses were increased immediately by 31%, or by T2.6 tn. Of this amount, T2.1 tn were aimed at reviving the banking sector (Kazkommertsbank). In turn, such help for the financial sector was by T1.1 tn financed by the National Fund and the remainder is due to the growth of public debt.

However, in addition, the National Bank in February 2017 increased capitalization of its “Non-performing loans Fund"(hereinafter referred to as the NPLF) by the sum worth T470 bn, then transferred it to the Government. NPLF was then used to assist “Kazkommertsbank”. Also, in 2017, within the framework of the rehabilitation of the financial sector, the National Bank has provided support for banks in the amount of T654 bn on conditions of subordinated debt with a maturity of 15 years and an interest rate of 4% per annum. In accordance with best international practice, these amounts financed by the National Bank (1.1 trillion tenge), should have been included in the consolidated State budget as Government costs and taken into account in the calculation of the non-oil deficit. However, this has not been done and has not done so far.

The situation with the sharp increase in government spending in 2017, largely repeated in 2019.

At the last congregation of the "Nur Otan" party at the end of February new initiatives to improve the well-being and quality of life of the population, affordability of housing for low-income citizens, improvement of education and health care, as well as regional development were announced. For the implementation of the announced measures T2.350 trillion will be spent, which will be distributed for three years until 2021. T1.35 trillion are planned to allocate from the National Fund and T1 trillion from additional State budget incomes generated by the economic impact of previously expended and due to improved customs revenue administration.

Of particular concern is that on the instructions of the President huge public funds allocated to economy, but progress in economic development is lacking, hence the question about the quality of the work of performers of these orders, who focus on distribution functions of their activities, rather than constructive, though the head of State has already drawn attention to the need to improve the revenue side of the budget.

At the same time, before the last meeting of the party "Nur Otan" where social and other initiatives were announced, expenditures of the 2019 consolidated budget (IMF methodology) were already at a much higher level than indicated by the State budget approved by the Parliament. First of all, by the Decree of the President at the beginning of this year, it was decided to allocate from the National Fund T370 billion as a target transfer for the creation of the "Kazakhstan Investment Fund". At the moment, due to lack of information, it is difficult to assess why you it had to be done.

In addition, with a view of financing public spending in 2019, partly the printing press of the National Bank and the funds of ENPF will be used. So "NPLF" purchased bad loans of "Tsesna bank for the sum of T604 bn at the beginning of this year, and T533 bn envisaged in the program for improving liquidity of the banking system from the joint assets of the National Bank and of ENPF as part of an overall package of T600 bn (T300 bn from each party, T67 bn has been attracted from ENPF in 2018).

Also, instead of the State budget, various social and infrastructure projects (for example, «Saryarka» gas pipeline, the construction of facilities in the city of Turkestan, and so on) would be financed by State-owned companies and national holdings.

Total amounts of listed above items are not included in the State budget of the country and do not include the initiatives voiced at a meeting of the "Nur Otan" party, together equal T1.5 tn.

Thus, even under favourable to the State budget oil prices ($65-$70 per barrel), to finance increased government spending National fund means, issue of means of extrabudgetary funds (ENPF etc.) and quasi public structures are engaged. Additional use of National Fund in 2019 will cause that even with good oil prices the Fund will cease to grow and even decrease a little (pro-cyclical use).

Despite the declared approach aimed at reducing the dependence of budget on oil revenues and use of counter cyclical measures, the government couldn’t manage to come to a balanced public finances and the budget's dependence on oil, the National Bank emission, as well as extrabudgetary funds isn’t shrinking. All this leads to a lack of understanding among the participants of the market orientation of fiscal and economic policies of the Government.

It is very concerning that a planned sharp increase in government spending may coincide with changes in the monetary policy of the National Bank related to the change of its leadership. There are big risks of sharp inflation in response to stimulatory action from simultaneously both fiscal and monetary policies.

As we mentioned earlier, reduction of inflation in January and February this year is an artificial one due to administrative reduction of public utilities' tariffs. Excluding tariff reductions, monthly inflation would have been 0.8% in January and 0.9% in February, 2019, which is higher than the inflation rate in the same months of last year (in January 2018 - 0.6% mom in February - 0.7% mom). in General, it is unclear at the moment from what means will be offset the costs of State monopolies due to administratively set reduction of public utilities tariffs.

In conclusion, it is important to note that one must first carry out reforms in fiscal policy that do not require a serious investments, but will have an immediate impact on the effectiveness, adequacy, transparency and accountability of public finances, that in General will have a very positive effect on the entire economy. In addition to the transition to international accounting standards of the State budget and discontinuance of financing of budget expenditures by the National Bank, and quasi-public sector, ENPF, it is very important to improve the budget rules set in the concept on the formation and use of funds of the National Fund. Today they do not contain countercyclical use of funds of the National Fund that lead to unnecessarily increase of government spending in the period of favourable oil prices.

More details about the necessary reforms in the fiscal area are listed in WB report "Improving fiscal areas to support economic change" (Kazakhstan, November 2017), the OECD report "Towards a More Effective, Strategic and Accountable State in Kazakhstan» (December 2017), and each of the IMF'S annual report on Kazakhstan.

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