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FISCAL DECENTRALIZATION: A REVIEW OF INTERGOVERNMENTAL RELATIONS IN KAZAKHSTAN

Abstract. Fiscal decentralization has become one of the most important reforms for countries with transitional economies, facilitating effective resource allocation and local decision-making. Kazakhstan has implemented decentralization reforms as part of its economic policies to strengthen the prosperity of regional economies. This dissertation provides a comprehensive review of fiscal decentralization in Kazakhstan, analyzing the evolution, challenges, and prospects of intergovernmental relations in light of the recent reform that started in 2020, which involves delivering SME corporate tax revenue to local budgets.

Key words: fiscal decentralization, effective resource allocation, corporate tax decentralization, local decision-making.

1. Introduction

Many developing countries are undertaking various economic, including fiscal, reforms to improve the efficiency of government structures and thereby the well-being of their citizens by improving public services effectively.

Many studies have not reached a definitive conclusion regarding the impact of fiscal decentralization on regional economic development and their efficiency. This is because many countries simultaneously implement other political reforms alongside fiscal decentralization, which affect the assessment of fiscal decentralization implementation.

One way to improve the effectiveness and responsiveness of public service delivery is to shift decision-making and budgetary authority from the federal government to subnational institutions (Fatoni, 2020).

However, as the articles in this special issue demonstrate, the dynamics and implications of fiscal decentralization are complicated.

Since local governments are better able to customize public goods and services to the unique requirements and preferences of their residents, proponents of fiscal decentralization frequently contend that this can result in a more efficient allocation of resources (Garello, 2003).

According to a review of the research, fiscal decentralization affects local revenue collection in two ways. Decentralization has the potential to improve

revenue performance by enabling local governments to better establish tax policies and enforcement tactics that take into account the unique needs and features of their small and medium-sized enterprises (SMEs) (Din et al., 2022).

1.1. Background of the study

With the law "On Local Representative and Executive Bodies of the Republic of Kazakhstan" (1993) in all regions of the country were established maslikhats (councils), elected by the residents. It was first steps toward decentralization reforms.

Later President Nazarbayev stressed the need for decentralization of power and the transfer of authority from higher levels of government to lower levels, as well as the transfer of public functions from the state to local authorities and the private sector, when he announced the strategy for Kazakhstan's development until 2030 in 1997.

Adopted were the new Budget Code of the Republic of Kazakhstan (2008) and the "Law on Amendments and Additions to Certain Legislative Acts of the Republic of Kazakhstan on the Issues of Delimitation of Powers between Levels of Government" (2006). These actions made it easier to understand the roles, finances, and sources of income for municipal government. Local budgets received the transfer of personal income tax, property tax, land tax, and alcohol excise taxes.

Subsequent reforms took place in 2020, when corporate taxes of small and medium-sized enterprises (SME) were allocated to regions. The approaches developed by the Government to transfer Corporate Income Tax (CIT) revenues from small and medium-sized businesses (SMEs) to local budgets aim to increase the interest of local authorities in expanding the tax base and enhancing financial independence. This initiative is intended to motivate local governments to develop their economic base by giving them a more significant stake in the revenues generated within their jurisdictions, thus promoting local financial autonomy and responsibility.

1.2 Problem statement of the study

In initial phase of development centralized tax collection mechanism is believed that more efficiently collect tax from regions and it will be redistributed among regions based on needs. Existing evidence shows that economic development of regions could not bring to parallel growth of local tax revenue. The allocation of budget funds from the central budget to local budgets not only creates transaction costs but also delays the transfer of funds to local budgets due to bureaucratic procedures. As region getting stronger economically, they need more incentives to manage local budget from tax revenue. It would be prudent to redirect the system of intergovernmental relations to stimulate regions to increase their own revenue base. We hypothesis that transition from centralized

into decentralized fiscal management incentivizing the generation of own revenues by efficiency tax collection.

1.3 Objective of the study

Corporate tax decentralization poses a significant fiscal policy change, raising questions about its implications for regional revenue collection rates. This study aims to investigate the relationship between corporate tax decentralization and revenue collection rates in various regions, exploring the potential impact of this decentralization on regional fiscal capacities and government finances.

Specific objective as follow:

1. To examine intergovernmental relations in terms of the impact of reforms of decentralized corporate tax on SMEs and revenue collection in regions

2. Literature Review

Fiscal decentralization - that is, the turning over of fiscal responsibilities and competences from the central government to the local level - has herself been a focal point of an increasing body of literature in public finance. This debate has one important dimension the effect of fiscal decentralization on the revenue collection rates of the region. The literature reveals that the effect of fiscal decentralization on which level of government finances certain types of regional revenue appears complex and context-dependent. Fiscal decentralization has been found to improve the quality of public services, and indirectly benefit economic activity at the local level, through increased public consumption, and as a result, higher tax revenue (Ahmad, 2003). Whereas, the Critics argue that fiscal decentralization can decrease the fiscal capacity of local governments that can result in lower revenue generation. (Stone, 2015)

Fiscal decentralization could also have a different effect on revenue collection in differing contexts and across differing levels of decentralization. This can lead to a race to the bottom in local tax rates as businesses and investment drift away from higher taxed regions towards the lower taxed ones in a highly decentralized tax structure. Research suggests that the decentralization of corporate tax can impact revenue collection rates in regions. Pechenskaya-Polishchuk (2021) found that decentralizing tax revenues can increase regional tax potential, leading to better budget figures. However, Libman (2007) noted that regional authorities may manipulate tax auditing and collection, potentially affecting revenue collection amounts. This is further supported by Güth (2005), who found that centralization can lead to lower tax morale and less efficient outcomes. Lewis (2003) also highlighted the potential or regional governments to create new taxes and charges, which could further impact revenue collection rates.

3. Methodology

3.1 Data collection

Our study will use official statistic dates from Ministry of Finance of Kazakhstan. Official data from 2017 to 2023 on the revenues of each region were collected. Additionally, data on gross regional products, per capita income, population, and unemployment were collected from Bureau of National Statistics. In the process of data collection, we encountered a number of problems. According to the official data from the Department of State Revenues, until 2020, there were two types of corporate income tax. The first type was corporate income tax from legal entities in the oil sector, which went to the National Fund.

The second type was corporate income tax from legal entities in large enterprises, excluding revenues from oil sector organizations. After the 2020 reforms, another type of corporate income tax was introduced, specifically from small and medium-sized businesses, excluding revenues from large enterprises and oil sector organizations. Since there was no such type of corporate income tax before 2020, the data did not separately show revenues from large enterprises and small and medium-sized businesses.

To address this problem, we determined the proportion of corporate income tax revenue from large enterprises and SMEs, and used these proportions to estimate the presumed tax amounts from 2017 to 2020.

3.2 Estimation technique

We will apply fixed and random effect panel regression analysis to address our research question. In our case, regression analysis is suitable because we are investigating the relationship between revenue collection by local governments and the fiscal decentralization of corporate tax from SMEs. For our regression analysis, we determine the revenue collection amount of Corporate tax from SMEs in regions as the dependent variable. The independent variable will be corporate tax decentralization. We will also use control variables such as the size of the regional economy (GRDP), population, GRDP per capita, unemployment rate, and other factors that might influence the revenue collection amount in regions. This study employs both fixed-effects (FE) and random-effects (RE) panel models to analyze the data. The fixed-effects model is particularly useful for controlling for unobserved heterogeneity when this heterogeneity is constant over time and correlated with the independent variables.

1. Null Hypothesis (H0): There is no significant relationship between the degree of fiscal decentralization of corporate tax policies and the revenue collection rate of regions.

2. Alternative Hypothesis (H1): There is a significant positive relationship between the degree of fiscal decentralization of corporate tax policies and the revenue collection rate of regions, indicating that regions with greater fiscal decentralization of corporate tax policies experience higher revenue collection rates.

4. Result and result Analysis

4.1. Regression analysis: Overall performance

This study examines how various factors, particularly CIT decentralization reforms, affect SME Corporate Income Tax (CIT) across different models. The findings from the five models highlight the influence of decentralization and other economic indicators on SME taxation.

Model 1 uses only CIT decentralization reform as a predictor, showing a significant positive effect (26,916, $p<0.001$), explaining 12.4% of the variability in SME CIT ($R^2=0.124$).

Model 2 adds transfers as a variable. The positive impact of CIT decentralization reform persists (27,433, $p<0.001$), but transfers are negative and insignificant (-0.003), with no change in explanatory power ($R^2=0.124$).

Model 3 includes Gross Regional Domestic Product (GRDP) per capita. Both CIT decentralization reform and GRDP per capita have significant positive effects, but the former's significance decreases (13,670). Transfers remain negative and insignificant (-0.033), while the model's explanatory power increases to 26.7% ($R^2=0.267$).

Model 4 incorporates population, showing that CIT decentralization reform's effect becomes insignificant (3,610). GRDP per capita and population have significant positive effects, while transfers become significantly negative (-0.095, $p<0.001$). The model explains 65% of the variability in SME CIT ($R^2=0.650$).

Model 5 includes the unemployment rate. CIT decentralization reform regains significance (15,089, $p<0.05$). Transfers remain significantly negative (-0.122, $p<0.001$), GRDP per capita has a smaller positive effect (3,462, $p<0.05$), and population maintains its significant impact (0.469, $p<0.001$). Unemployment is insignificant (-96.164), with the model explaining 69.3% of the variability in SME CIT ($R^2=0.693$).

The consistent significance of CIT decentralization reforms across models highlights their crucial role in influencing SME CIT. The positive coefficients suggest these reforms boost SME tax revenue, likely due to more localized and efficient tax administration. The inclusion of GRDP per capita as a significant positive predictor shows that higher regional economic performance increases SME tax revenues, supporting the idea that economic growth expands the tax base. The negative effect of transfers, especially in

Models 4 and 5, suggests that higher fiscal transfers may reduce the need for local governments to generate revenue through SME taxation, indicating a possible substitution effect.

The significant positive impact of population underscores the role of demographic factors, as larger populations may correlate with higher economic activity and, consequently, higher SME tax contributions. The insignificance of unemployment in Model 5 suggests that SME tax revenues are less sensitive to labor market conditions than to other economic and demographic factors. The high R-squared values in the later models demonstrate the importance of a comprehensive approach, incorporating economic, demographic, and policy-related variables to fully understand the determinants of SME CIT.

Table 4. Regression analysis relations between collection of SME CIT and CIT decentralization Reform.

VARIABLES	Dependant variable SME CIT				
	Model 1	Model 2	Model 3	Model 4	Model 5
CIT Decentralization Reform	26 916***	27 433***	13 670	3 610	15 089**
	(7 139)	(10 319)	(10 072)	(7 058)	(7 376)
Transfers		-0.003	-0.033	-0.095***	-0.122***
		(0.046)	(0.045)	(0.032)	(0.031)
GRDP per capita			11 540***	6 109***	3 462*
			(2 668)	(1 926)	(1 958)
Population				0.489***	0.469***
				(0.048)	(0.045)
Unemployment					-96.164
					(26 658)
Constant	23 438***	23 978**	-12.584	-502.585	-4.581
	(5 418)	(9 478)	(12 220)	(48 482)	(145 427)
Observations	118	118	117	117	117
R-squared	0.124	0.124	0.267	0.650	0.693

Number of oblast	17	17	17	17	17

Standard errors in parentheses *** $p<0.01$, ** $p<0.05$, * $p<0.1$

5. Conclusions and Policy Recommendation

The findings of this study highlight the importance of decentralization reforms, economic performance, and demographic factors in shaping SME tax revenues in Kazakhstan. The results suggest that policymakers should consider these variables when designing tax policies to enhance SME contributions to public finances. The insights gained from this analysis provide a robust foundation for future research and policy formulation in the context of SME taxation and fiscal decentralization. Based on the results of our regression analysis, we will draw conclusions regarding the impact of corporate tax decentralization on revenue collection rates in different regions. We will discuss the implications of our findings and any policy recommendations that may arise.

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ФИСКАЛДЫҚ ДЕКЕНТРАЛИЗАЦИЯ: ҚАЗАҚСТАНДАҒЫ ҮКІМЕТАРАЛЫҚ ҚАТЫНАСТАРҒА ШОЛУ

Аңдатпа. Фискалдық декентрализация өтпелі экономикасы бар елдер үшін ең маңызды реформалардың бірі болып табылады, ресурстарды тиімді бөлу мен жергілікті деңгейде шешім қабылдауды жеңілдетеді. Қазақстан экономикалық саясаттың бір бөлігі ретінде декентрализация реформаларын жүзеге асыруда, бұл өңірлік экономикалардың гүлденуін күшейту мақсатында. Бұл диссертация Қазақстандағы фискалдық декентрализацияны жан-жақты қарастырады, 2020 жылдан бастап басталған соңғы реформаны, шағын және орта кәсіпорындардың корпоративтік табыс салығын жергілікті бюджеттерге беру процесін талдайды.

Түйін сөздер: фискалдық декентрализация, тиімді ресурс бөлу, корпоративтік салық декентрализациясы, жергілікті шешім қабылдау.

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ФИСКАЛЬНАЯ ДЕЦЕНТРАЛИЗАЦИЯ: ОБЗОР МЕЖПРАВИТЕЛЬСТВЕННЫХ ОТНОШЕНИЙ В КАЗАХСТАНЕ

Аннотация. Фискальная децентрализация стала одной из важнейших реформ для стран с переходными экономиками, способствуя эффективному распределению ресурсов и принятию решений на местном уровне. Казахстан реализует реформы децентрализации в рамках своей экономической политики, чтобы укрепить процветание региональных экономик. Эта диссертация представляет собой всесторонний обзор фискальной децентрализации в Казахстане, анализируя эволюцию, вызовы и перспективы межправительственных отношений в свете недавней реформы, начавшейся в 2020 году, которая включает передачу доходов от

корпоративного налога на малые и средние предприятия в местные бюджеты.

Ключевые слова: фискальная децентрализация, эффективное распределение ресурсов, децентрализация корпоративного налога, местное принятие решений.