



BUDGETARY PRIORITIES IN GEORGIA

Expenditure Dynamics since the Rose Revolution

Since the “Rose Revolution” one of the most significant changes in the fiscal field has been the continued expansion of the Georgian state budget. This has undeniably shown the increase of the state’s capacity, in this case illustrated by the state’s increased revenue-collecting capacity. This expansion has been coupled with significantly lowered taxes that took effect after the adoption of the new tax code in 2004. Since 2003 state revenues¹ (including grants) have tripled, increasing from 933,055,000 GEL² to 2,948,747,000 GEL in 2006. This comes as a significant reverse of the previous tradition of almost annual sequestering of the budget under President Shevardnadze.

Although Georgia has not traditionally had any comprehensive strategic document formulating the policy priorities of the government, the real, de facto priorities are best reflected in the state budget expenditures. The practice of operating without a ‘master plan’ was reversed in 2006 with the adoption of the Basic Data and Directions (BDD) document. The document provides not only the data analyzing the previous year’s fiscal performance and the contours of the next year’s financial plans, but the government’s medium-term strategy and priorities for action for 2007-2010 along with the expected results and outcomes for that period.

This medium-term planning is based on the Medium-Term Expenditure Framework (MTEF) process, which was imported into Georgia as a best practice in the fiscal sphere. The practice has not yet taken its final shape in Georgia, however, and individual ministries that are to formulate their medium-term priorities are largely falling behind. Ministries, according to the form provided in the BDD, of which MTEF is a part, are to provide not only their priorities and amount of funds requested. They are expected to also include the needs assessment and justification for their actions and priorities as well as expected outcomes and criteria for judging success and effectiveness. To date the ministries have been having difficulties in providing quality information about needs assessment, anticipated results, and assessment criteria. The idea of MTEF is to increase efficiency and transparency and provide for more coherent and result-oriented policies. For this the planning process needs to be firmly systematized and internalized. The ministries need to build capacity and refine their performance in this regard if the process is to yield significant outcomes.

But even without firmly framed expenditure policies the priorities of the Georgian state are quite easy to distinguish by looking at the approved budgets, later amendments to them, and the budget fulfillment reports since the Rose Revolution. Below, we have isolated the top five priority spending areas according to their share of the budget along with their dynamics since 2004. We believe that basing our discussion only on the nominal amounts allocated for the spheres could be misleading, since the state budget has significantly expanded over the last years. Hence, sorting spheres in terms of their share (percentages) of the budget can be more helpful in judging their priority. The spheres are grouped according to the Government Finance Statistics Manual 2001 (GFS 2001) methodology of the International Monetary Fund. Adoption of this methodology was one of the commitments Georgia made to NATO through the Individual Partnership Action Plan (IPAP) and the EU through the European Neighbourhood Policy

¹ The data used in the report is based on the official budgetary reports provided by the budgetary department of the Ministry of Finance.

² The exchange rate has fallen since 2004 from 1 USD=1.8 GEL to the current 1USD=1.73 GEL rate.



Action Plan (ENP AP). This was set as a measure to increase the transparency and reliability of statistics in the fiscal sphere.

Traditionally, social protection spending tops the list of priorities. Spending on this sphere rose from 7% of the entire budget in 2004 (107,333,794 GEL) to 20% in 2005 (529,081,300 GEL), then fell to 16% in 2006 (643,653,279 GEL), and then increased to 19% (736,282,300 GEL) for 2007. It must be noted, however, that these figures do not include healthcare spending, which is featured as a separate category. Rather, social protection here denotes any pensions – for old age, veterans, survivors, sickness, or disability – as well as benefits for refugees and Internally Displaced Persons (IDPs), unemployment, families with many children, and others.

Second on the list is the defense sector, which has been steadily increasing throughout this period, except for next year's planned budget. It was allocated 10% of the budget in 2004 (158,749,045 GEL), which rose to 15% in 2005 and 16% in 2006 (389,292,600 GEL and 646,060,019 GEL respectively). Next year defense spending will be decreased to 10% (397,996,600 GEL).

Public order and security, mostly funds allocated for the police, stood at 16% of the budget in 2004 (239,573,852 GEL), then dropped to 10% in 2005 (267,563,900 GEL) and 9% in 2006 (363,396,500 GEL) and is to rise to 11% in 2007 (421,940,500 GEL).

Here it must be noted that these were not the only resources allocated for the so called 'power ministries,' in particular the Ministry of Defense. Besides the budgetary sums, two non-budgetary funds were established in 2004 for targeted donations: the Georgian Army Development Fund (GADF) and the Law Enforcement Development Fund (LEDF). Administration of these funds caused much controversy: critics from the opposition and civil society questioned the funds' transparency and accountability and voiced concerns about the secrecy of both the amounts accumulated in the funds and the spending scheme. To date no official data has been disclosed regarding the donors, but anecdotal evidence suggests donations were made by patriotic businessmen. It still remains unclear whether these contributions were entirely voluntary or not. Since the funds themselves were legal entities of public law, the respective ministries were not responsible for releasing information and the funds did not respond to such requests. The activities of the funds were discussed only at the National Security Council meetings and with a small 'confidence group'³ of selected MPs, all of them from the National Movement party. This effectively blocked both civil society and opposition parties from receiving any information.

All such funds have been closed since the middle of 2006 though and for the year 2007 the budgetary allocations will be the only resources for these spheres. Although there has been no official public report published on these funds, the report delivered by Minister of Defense Okruashvili to the 'confidence group' of the parliament in April 2006 states that throughout its existence the GADF spent 52.5 million GEL⁴. No figures have been reported regarding the LEDF.

Education currently occupies fourth place. In 2004 it secured 4% of the budget (65,291,960 GEL), dropped slightly to 3% in 2005 (77,694,300 GEL), then expanded to 9% in 2006 (345,530,831 GEL), and is still to rise to 10% in 2007 (369,422,600 GEL). It must be noted, however that the budgetary figures and shares for the years 2004 and 2005 do not constitute all of the funding sources for the educational sector. Before adopting the law on General Education in 2005 education was partly financed from local budgets.

³ The confidence group was set up within the frames of the parliamentary committee for defense and security for ensuring parliamentary oversight on classified issues, including the military's budget.

⁴ No actual report has been made available to date. This figure has been reported by the media, based on interviews with the Minister himself and members of the confidence group. Information from these two sources has not always proven compatible, as illustrated by the confusion regarding the sources of funding for the GADF.



According to the new law, funding for public educational facilities is completely the obligation of the central government.

The most significant increase within the present time-period has been recorded in the transportation and communications sphere. While in 2004 it accounted for less than 1% of the budget (1,039,655 GEL), its share has risen to 5% in 2005 and 2006 (GEL 125,689,100 and 189,597,500 respectively) and is to further rise to 11% in 2007 (440,516,000 GEL). This significant share is the result of the extensive road renovation and highway building across the country. These figures reflect only the national road construction projects, while a big part of all construction projects was of local significance and thus funded from the local governance budgets. Next year's allotment is most probably⁵ to finance the ongoing construction of the highway from Tbilisi to western Georgia.

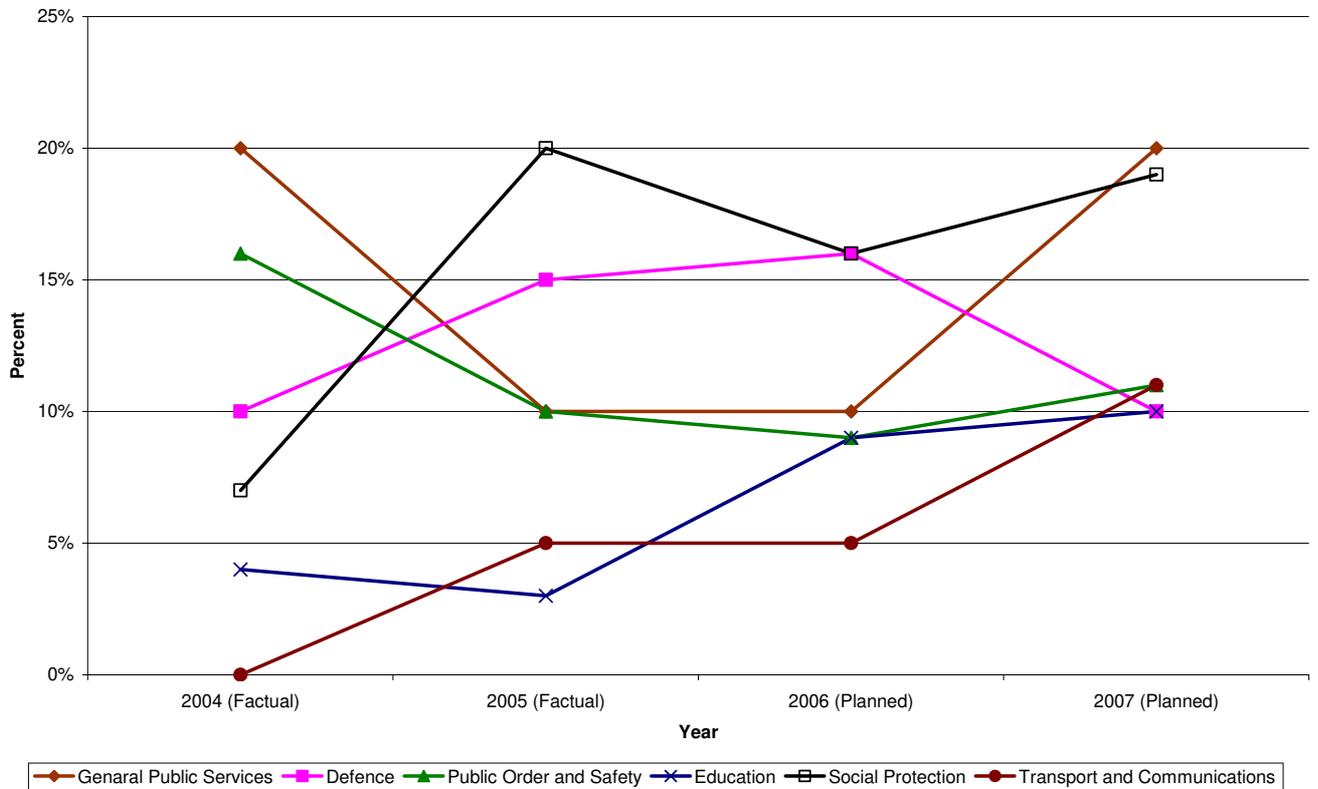
Yet, besides this sphere-specific spending, the most significant share of the state budget for the next year, 20% (790,135,100 GEL) is to be spent on general public services, meaning mostly administrative expenses of the executive, parliament, and foreign representation. This part of the budget has been quite volatile in recent years. Its share was 20% of the budget in 2004 (302,188,410 GEL), then plunged to 10% for the years 2005 and 2006 (264,037,000 GEL and 380,230,606 GEL respectively), only to regain the position of the single most significant segment of the budget in 2007 at one-fifth of the total. One explanation for the plunge could be the existence of the Development and Reform Fund, set up in early 2004. The fund was supported by international donors, mainly the United Nations Development Program (UNDP) and Open Society Institute (OSI) and aimed at providing adequate salaries to public servants. Thus, besides their official salaries paid by the state, public officials received supplements from the Fund that were usually more than the actual salary. The arrangement was set up as an anti-corruption measure, to diminish corruption incentives through providing adequate remuneration and to attract better qualified professionals to the civil service. According to the data provided on the Fund's web page a total of two million USD was donated. Initially the supplements were paid to the highest officials, including the president, ministers, and parliamentary speaker, but later the focus was shifted towards senior and mid-level officials within the ministries. The fund was set up as a temporary measure, providing a cushion for the problem-ridden country in paying decent salaries to its civil service. It was agreed that the supplements would gradually reduce, with the state replacing it with own resources, and finally to be completely removed. As initially agreed, no supplements were paid in 2006 and the burden was placed on the state.

The BDD and MTEF adopted in 2006 were to provide a broad picture of the state's development priorities, and that is indeed what they do provide. What the strategic part of the BDD – chapter 6 devoted to Sectoral Aims – spells out is not much different from the current trends. The most prominently featured categories include: army, security, and border protection; reform of the justice system, including the penitentiary; transportation and infrastructure; social protection; education; and healthcare. These trends are to persist at least until 2010 and since the BDD of 2006 is the first effort for strategic planning on the national scale it will undoubtedly evolve over the coming years and provide an even clearer picture of the country's development plans.

⁵ There is no concrete indication in the budget regarding the destination of the funds, but the highway is the only major road construction project currently underway.



Chart: Expenditure Dynamics 2004-2007



Figures for the year 2006 are not yet finalised, since the Ministry of Finance publishes end of the year financial reports in early spring. Hence, the data for 2006 is featured as 'planned'.

January, 2007