

# Analysis and Recommendations on 2013 year Draft Budget of Georgia

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# ABOUT THE PROJECT

The present project was prepared by Economic Policy Research Centre (EPRC) with the support of Open Society Georgia Foundation. The present report about "Analysis and recommendations on 2013 year draft budget of Georgia", provides analysis, how economic challenges of the state are reflected in the major financial documents of the country by the recently elected government of Georgia; in addition Economic policy Research Centre suggest possible ways of solution of the above challenges.

## INTRODUCTION

2012 elections resulted in the first precedent of peaceful replacement of power in the history of independent Georgia. The results of the above replacement also had its impact on the budget of 2012 and draft budget of 2013. It should be mentioned here, that during October elections both competing political forces made main focus on improvement of social and economic condition of the population. Obviously, economic growth was also on the political agenda, though 2012 emphasize made on the latter was much weaker compared to that made on the social equality.

Preferences of a political force winning the elections are already reflected in the draft budget, presented for year 2013, which is largely oriented on social expenditures. We assume, that in case of victory of the previous authorities there would have been a very similar situation, but still it is rather difficult to judge about possible structure of distribution of expenses according to main budget trends.

It should be mentioned here, that the present ruling team has no experience of being in the government and the budget presented gives the feeling of intention to promptly overcome inequalities and gaps, existing on the economy, which, in certain cases, is rather unrealistic. In general, state budget, despite of its size, has rather limited resources in means of influencing economy, and we believe that its role should imply support of economic development.

Unfortunately, draft budget of 2013 already reveals certain collision between the ask of economic growth and that of social equality. We believe that the above collision should be solved in favour of the former, since task of social equality can never be achieved without economic growth. After analyzing the budget, we get an impression, that the new government will have to become more realistic already during next budget cycle and to admit, that rapid fulfilment of major part of pre-election promises is not feasible. We believe, that it would be much more rational rather than throwing billions of GEL in unreasonable expenses.

The present document assesses 2013 budget according to size and degree of funding priority lines; it also provides brief analysis of the budget in general context of macroeconomic development. A number of recommendations and findings are made as a result of analysis priority fields. While working on the analysis we have used the 2012 draft budget, materials on 2011 and 2012 budgets and BDD. Since we have used the above materials for compiling graphs and diagrams, and while they contain certain shared information, graphs and diagrams do not indicate the sources except for the cases when they are based on sources other than the above mentioned documents.

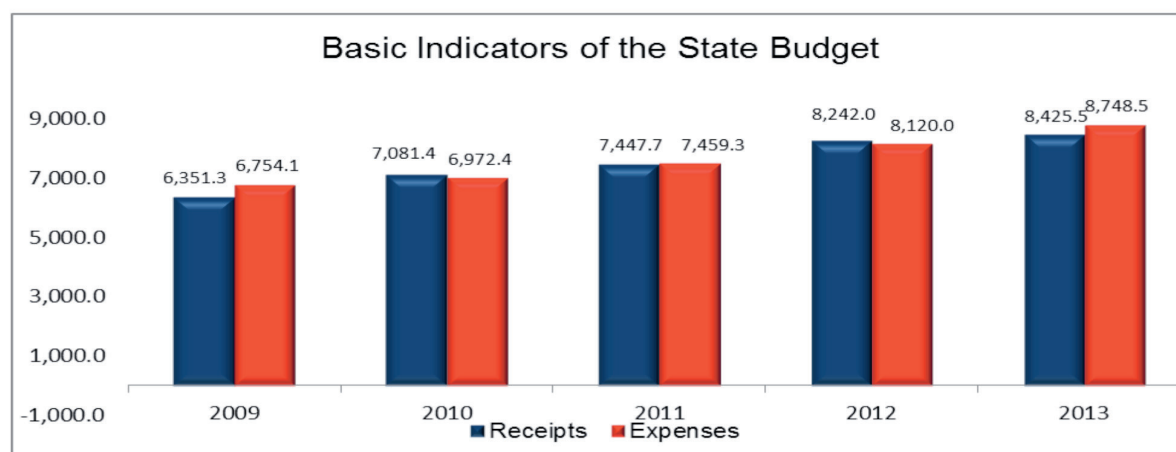
## MAIN TRENDS

The state budget continues to grow similarly to the recent years. According to the 2013 draft state budget, financial resources of the state budget is 8 748,5 million GEL, which exceeds the corresponding indicators of the 2012 year by 628.5 million GEL. In financial resources 8 425.5million GEL falls on means, mobilized from receipts and the rest is available deposits. Unlike two previous years, share of use of free balance existing on the accounts in the state budget has substantially increased and equals to 323.0 million GEL. Based on the budget expenditure, in the previous years money was mostly accumulated on the budget accounts, (109 million GEL- in 2010, 122 million GEL – in 2012 ), or their use was insignificant (11.5 million GEL - in 2011). Draft budget for the coming year plans to spend 323.0 million GEL from the amounts existing on the budget accounts. It is well known, that the budget is an important tool for stability of the macro economy of the state and its impact on the economy can be easily felt. Such scale of use of amounts from the budget accounts is rather risky from the point of view of managing inflation processes (within the goals set), Though attention should also be paid to expenses part of the budget. Namely, 189.4million GEL was implied for covering liabilities from state budget, in 2013 the corresponding indicator is increased to 539.8 million GEL. The above indicates, that compared to 2012 out of the budget which is increased by 628.5 million GEL, 305.5 million GEL will not stay on the domestic market and therefore, its influence on the inflation will be rather insignificant. Though the above threat is not completely removed. Namely, it is clear that at the beginning of the year budget revenues are much lower that at the end of the year, whereas the procurement procedures are carried out by the spending organizations from the very beginning of the year. Therefore balancing of state budget receipts and expenses on the quarterly basis will be connected to use of such available deposits, which eventually will trigger inflation processes.

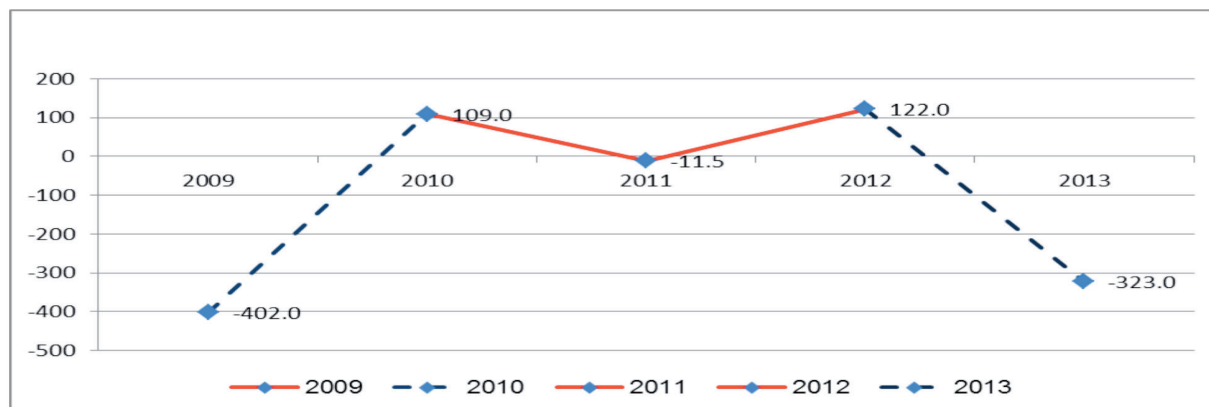
**Table #1** Financial resources of the state budget

	2011	2012	2013
I. Total Receipts	7,447.7	8,242.0	8,425.5
Revenues	6,442.3	7,053.6	7,422.5
Decrease of nonfinancial assets	189.8	70.0	100.0
Decrease of financial assets(excluding change in deposits)	80.7	60.0	35.0
Increase of liabilities	734.9	1,058.4	868.0
II. change in deposits +use /-accumulation	11.5	-122.0	323.0
Financial resources	<b>7,459.2</b>	<b>8,120.0</b>	<b>8,748.5</b>
% GDP	30.8	30.7	29.9

**Diagram 1:** Basic indicators of the state budget



**Diagram 2:** Change in Deposits



**Revenues** are defined by 2013 state budget as 7 422.5 million GEL which exceeds 2012 value by 368.9 thousand GEL.

**Table #2.** Revenues of the state budget

	2011	2012	2013	+/-change
Total receipts	6,442.3	7,053.6	7,422.5	368.9
Taxes revenues	5,802.0	6,300.0	6,920.0	620.0
Grants	223.1	333.6	202.5	-131.1
Other revenues	417.2	420.0	300.0	-120.0

Revenues growth are related to increase of tax revenues, which is increased by 620 million GEL compared to 2012. But taking into consideration that financial means received from grants and other revenues is reduced as compared to 2012, in total budget revenues are only increased by 368.9 million GEL.

**Table #3** State budget tax revenues

	2011	2012	2013	+/-change
Total Tax Revenues	5,802.0	6,300.0	6,920.0	620.0
Income tax	1,439.5	1,597.0	1,813.0	216.0
Profit tax	832.2	900.0	924.0	24.0
VAT	2,784.4	3,014.0	3,384.0	370.0
Axcise	615.1	644.0	665.0	21.0
Import tax	93.2	100.0	104.0	4.0
Other taxes	37.6	45.0	30.0	-15.0

While reviewing **revenue** indicators we need to consider certain legislative amendments related to income tax rates, particularly:

- The plan was to reduce income tax from 20 % to 18 %, which was part of the tax rate liberalization policy. According to the draft presented to the Parliament, income tax rate will not be reduced in the coming year and 20 % will be retained;
- 5 % minimum not subject to tax presently applied to dividends and interest will not be revoked from 2013;
- Untaxable minimum will be introduced from 2013; namely 1800 GEL of income of natural persons, with income not exceeding 6000 GEL will not be subject to taxation;
- Income received from royalty will be subject to 20 % tax, rather than 15 % implied by the law, from 2013.

**Suspension of the process of liberalization of tax rates probably is related to extreme necessity of mobilizing additional budget revenues. Namely, based on BDD priorities, due to dramatic growth of social expenditures the state will need additional budget means. In case of reduction of income tax rate state budget will have shortage of over 200 million GEL and it will make seeking sources for funding social expenses even more difficult.**

Introduction of untaxable minimum makes clear that the state policy is to re-distribute revenues and reduce social inequality. Explanatory note of the state draft budget defines, that after enactment of the above exemption, the beneficiaries will be given back 170 million GEL as an allowance in 2014. It means that up to 472 000 employees whose monthly wages do not exceed 500 GEL will receive back 360 GEL annually from the budget. If we calculate the volume of the allowance per days, it is clear that up to 472 000 employees will pay 98 Tetri less taxes per day into the state budget.

In case income tax rate were reduced from 20 % to 18 % for everybody, and untaxable minimum were not introduced, the above 472 000 persons would only save 10 Tetri per day.

If we consider the outcome of this amendment in means of the amount, it can be said that 98 Tetri per day is definitely savings for people of that category, but it can be further argued how effective the suggested allowance can be. It may be better if the above 170 million GEL could be used for funding e.g. healthcare programs or covered by any insurance packages.

It also should be considered that the above category of the population will personally get the impact of this exemption only from 2014. According to amendments presented in the Tax Code, an accounting year shall be completed for revealing beneficiaries of the exemption, to confirm that persons of the above category have definitely not received more than 6000 GEL of annual income. Only after the above the state will ensure returning of 360 GEL to these persons. Taking into consideration all the above, the effect of the legislative amendment will be even weaker by 2014, considering inflation and decrease of buying power of 98 Tetri.

In the context of other **revenues**, we see decrease in draft budget of 2013. Particularly, its volume is decreased by 120 million GEL and equals 300 million GEL. As we can see from table # 4, means mobilized from dividends, fines and other non-classified revenues play important role in other revenues. It should also be mentioned that budget presented to the Parliament of Georgia in the beginning of November significantly differs from the last wording of the existing budget in this section.

Namely, revenues projected from dividends were to increase almost by 200 % (from 51.5 million GEL to 151.0million GEL). The above dividend simply amounts to be transferred to the state budget from profit received from enterprises under state ownership. As it is known, in the current year mobilization and disposal of the above financial means was carried out by the state partnership fund, which is responsible for management of enterprises under state ownership and investments of the profit

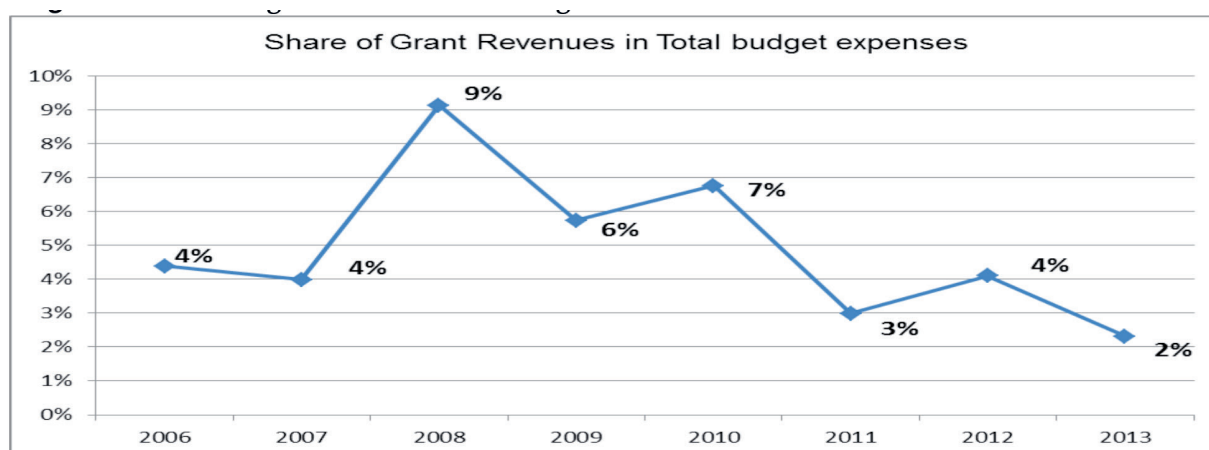
received. Therefore, such large scale transfers to the state budget raised significant questions in relation to the future activities of the partnership funds; though, according to the final wording of the budget, amounts to be received from the dividends are going to be similar to those of 2012. Such a significant difference indicates the change in the approaching relation to the partnership fund.

**Table #4.** other revenues of the state budget

	2011	2012	2013	+/-change
Total other revenues	<b>417,221.7</b>	<b>420,000.0</b>	<b>300,000.0</b>	<b>-120,000.0</b>
Interest	19,375.6	17,000.0	11,000.0	-6,000.0
Dividend	34,257.1	51,500.0	51,000.0	-500.0
rent	111,105.5	120,500.0	10,000.0	-110,500.0
Realization of goods and services	62,302.8	63,790.0	61,350.0	-2,440.0
Fines and penalties	121,319.3	100,000.0	100,000.0	0.0
Voluntary transfers excluding grants	1,982.6	1,650.0	1,650.0	0.0
Other nonclassified revenues	66,878.8	65,560.0	65,000.0	-560.0

Similarly, according to the previous wording of the budget, in 2013 revenues projected from fines and penalties are to be reduced by almost 50 % from 100 million GEL to 50 million GEL. The above might have been perceived as a sign of state policy liberalization, in this direction, though no legislative amendments in conjunction with budge package has been presented to the society. Similarly, according to the updated wording of the budget, 100 million GEL will be mobilized from fines and equals to the indicator of 2012. Such a difference in projected volume implied by this item also indicates significant change in the approach.

**Diagram #3** Share of grants in the state budget



Revenues to be received from grant items are reduced for 2013 by 49 % and equals to 202.5 GEL. According to the statistics reflected on the diagram payments to the budget from the means mobilized under grants' item has decreasing trend. The above demonstrates increasing trend of autonomy of the budget. On one hand, this is a positive moment, though on the other hand, if we take into consideration that major part of grants (52 % in 2012, and 68 % in 2013) falls on earmarked or investment grants, it indicates decreasing trend on behalf of donors to fund such projects.



## OVERVIEW OF PRIORITY FIELDS

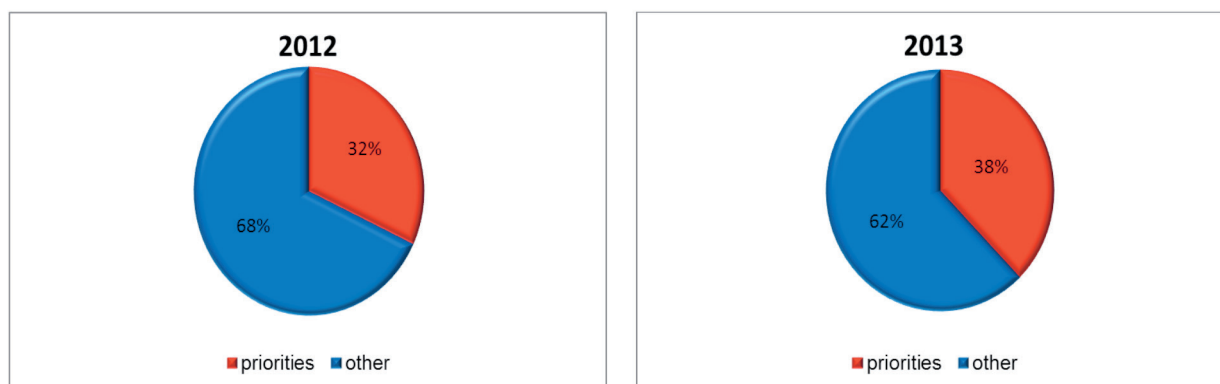
As it is known, state budget is the basic document to guarantee financial provisioning of liabilities taken by the government. Therefore, it is important to have available analysis of the above document and the analyses of budget parameters implied by the above document.

On its part, annual budget law is based on BDD (basic Data and Directions) document, which is implied by the Constitution of Georgia and Budget Code of Georgia, which reflects priorities of the ruling political team and activities planned for their achievement within certain period of time.

According to BDD for 2013-2016 main priorities of the government of Georgia are sectors of healthcare, social protection, education and agriculture. The above document also implies other important priorities, such as human rights protection, reform of prosecutor's office and the judiciary. Though, the above four main directions represent the fields, improvement of which is directly connected to budget funding.

As we have already mentioned, financial resource of the state budget is increased in 2013 by 628.5 million GEL compared to 2012. The above increment will be fully used on increase of funding of declared priority directions, which is confirmed by figures, reflected on the diagram ( diagram 3).

**Diagram #4.** Priority trends % to total state budget, 2012-13 years

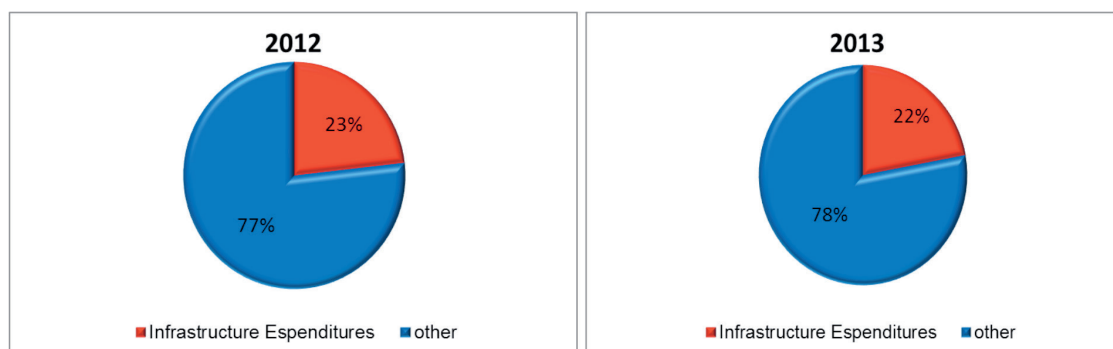


In absolute figures funding of the priority areas in 2013 is increased by 706.4 million GEL compared to 2012 and equals 3 304.0 million GEL.

## INFRASTRUCTURE AND CAPITAL EXPENDITURES

Means allocated for funding infrastructure projects is one of the main directions supporting long term economic growth. In this direction financial means are mainly allocated for The Ministry of Infrastructure and Regional Development of Georgia, for establishing Funds, of projects to be implemented in the regions of Georgia, implied in the section of appropriations of national importance, as well as for funding infrastructure projects to be implemented in various ministries. Infrastructural projects also imply projects funded by credits and grants allocated by various international organizations.

**Diagram #5.** Dynamics of infrastructure expenditures 2012-13 years



According to budget indicators described in the diagram means allocated for infrastructural projects for 2013 are decreased by 1 per cent in relation to the total budget, though in absolute value it is increased by 43.8 million GEL. Though it should be mentioned here that by the previous wording of the draft budget 2013 funding of infrastructural projects was meant to dramatically decrease and had to be 1.4 million GEL in 2013 compared to 1.9 million GEL in 2012.

Reduction of appropriations allocated for infrastructural projects in favour of social sector, on one hand can have positive impact on increasing the level of life of socially vulnerable strata of the population; on the other hand we need to take into consideration that wage related costs make large part of costs incurred during implementation of infrastructural projects. Therefore, reduction of such costs are also related to reduction of number of jobs. We shall also consider, how effectively private sector will be able to provide employment in short term period. Now that it has been just few weeks since the government has been replaced, when the business sector has no trust to the new authorities, it will be rather difficult for it to make long term decisions and therefore to balance number of the unemployed increased as a result of reduction of projects with newly created jobs.

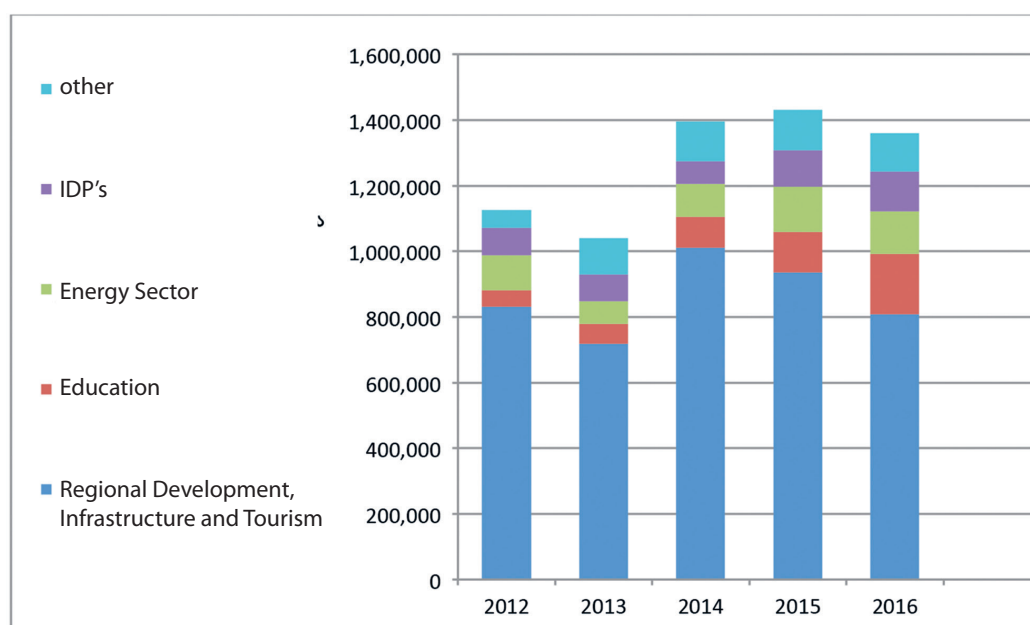
**Table # 5.** Volume of infrastructural expenditures 2012-2103 years

	2012			2013		
	total	Donor Funds	Budget FUNds	total	Donor Funds	Budget FUNds
Infrastructure	1,884.0	1,033.0	851.0	1,925.0	777.0	1,148.0
The Ministry of Regional Development and Infrastructure	982.0	628.0	354.0	901.0	559.0	342.0
Fund of the projects to be implemented in the regions of Georgia	358.0	-	358.0	450.0	-	450.0
Rural support program	50.0	-	50.0	50.0	-	50.0
Rehabilitation of educational institutions	45.0	-	45.0	60.0	-	60.0
Rehabilitation of health institutions	25.0	-	25.0	15.0	-	15.0
Construction of Houses of Justice		-		25.0	-	25.0
Energo projects	282.0	282.0		109.0	109.0	
Infrastructural projects of national importance	45.0	37.0	8.0	38.0	36.0	2.0
Infrastructural projects of the Ministry of Economic development	56.0	55.0	1.0	57.0	52.0	5.0
Development of agro sector	11.0	10.0	1.0	181.0	16.0	165.0
Establishment of Protected area system	16.0	7.0	9.0	10.0	5.0	5.0
Infrastructural improvement of penitentiary system				29.0	-	29.0
Other	14.0	14.0				

Viewing infrastructural expenses in conjunction with capital expenditures and their functional distribution gives us rather interesting picture. We have used the document displayed on the internet page of the Ministry of Finance "Information on capital projects implied by 2013 state budget" for analyzing dynamics of capital expenditure. Expenses reflected in the above document are analyzed through presenting annual volumes of appropriations (allocations) allocated for capital projects to be implemented in fields of regional development, energy, tourism, education, in support of IDPs and other capital projects. In addition the expenses are analysed according to the sources. In case any of the projects has indication of being funded by a foreign donor, we conventionally consider such an item as a project, funded by "donor's means". In case when the title of a donor is not clearly indicated in the project, budget of the state of Georgia or "own resources" are considered to be source of funding. (See diagram # 6)

In capital projects absolute excess of infrastructural components in relation to other expenses is obvious, in 2013 draft, as well as during the whole cycle of 2013-2016. In 2013 these expenses represent 69 % of total capital projects, for coming years it fluctuates between the range of 60-70 %.

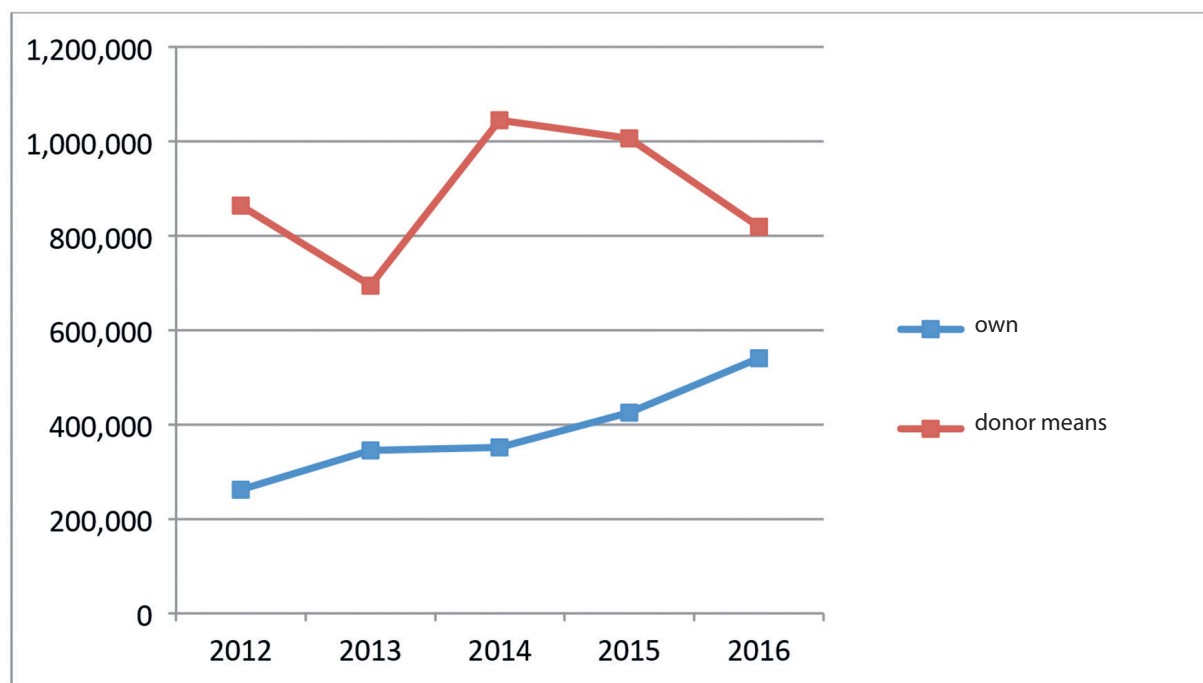
**Diagram #6.** Functional distribution of capital expenses 2012-16 years



Other important components of capital projects are current projects in support of IDPs, as well as projects in the field of education, energy, implementation of which will enter the decisive phase in second half of 2013-2016. Similar to general infrastructural projects, 2013 draft budget can be seen as certain intermediary, provisional point, in means that more obviously declared priorities of the new government shall be only expected after 2014. Capital expenses' part of the draft budget presented is a certain reflection of the structure of the expenditures of the budget, in means that capacity for implementation of radical changes here (in the context of absolute volume and structure of appropriations) was extremely restricted for two reasons: 1). Big majority of projects have already been launched; 2). In the conditions of obvious deficit of resources the government has to retain the presently declared priorities almost with no changes, especially that need for their implementation and urgency of the problems, that they serve, leaves no doubts. This is especially true for current projects in support of IDPs.

The rest of expenses from the above graph falls on healthcare, infrastructure of local importance (Batumi utility infrastructure, Kakheti development fund), Cultural Heritage Protection and houses of justice. The dynamics of expenses to be incurred in education and healthcare field in the future will depend on fiscal capacities sought in future fiscal cycles and on volume and quality of implementation of activities implemented in this direction including 2012.

**Diagram #7.** Dynamics of own and donor means 2012-16 years



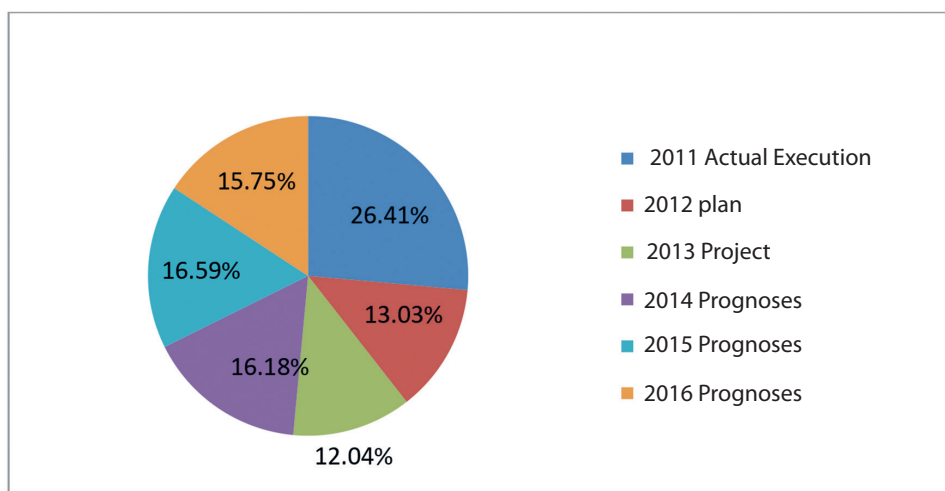
The above graph analyses structure of capital expenditures according to sources. The sources are conventionally divided as “own resources” or budget own resources, resources, mobilized through taxes collected in the country and resources provided by donors. From the above graph we can see one important circumstance, that after 2012 funding of capital projects by “own means” will pass low point of the curve and gradually increase till 2016. In the same period average volume of capital projects funded from donor resources are more or less stable, though it permanently exceeds “own resources”. In case of equality of other parameters this is a rather optimistic trend, since it is obvious, that already during previous budget cycles Georgia has developed substantial possibility to finance state importance infrastructural projects, which have paramount importance for ensuring long term economic growth of the country. At the same time it is not necessary for this trend to last unchanged, since the authorities shall be able not to increase the tax pressure and in mobilization of fiscal revenues depend on new opportunities developed through improvement of administration and economic growth. At the same time we should not be disillusioned that in the closest future major projects can be funded with no involvement of donors.

Starting from 2014 for meeting priority liabilities the government will have to find optimal balance between retaining dependence on donors within rational confines on one hand and on the other hand, such increase of own resources, which will not create additional tax burden for the economy.

The draft budget of 2013 year implies spending of about 1 billion GEL on capital projects, which are planned to be completed by 2016. Cumulative cost of these projects is more than 8.6 billion GEL.

It should be understood, that out of these capital projects only 40 million GEL worth works will be started in year 2013. Approximately 40% of capital works were implemented either in year 2011 or they are implied in 2012 budget plan.

**Diagram #8. Dynamics of budget capital expenses 2011-16 years**



The remaining 60 % of capital works are more or less evenly distributed throughout remaining 4 years of the budget cycle (years 2013-2016). It is rather difficult to talk about potential growth of the volume of capital works, as the government would not have actual time to present well-formulated action plan in this direction with time line and amount detailization. In the coming years, presumably while drafting budget for year 2014 it will be important to analyse whether total volume of capital expenditures - already incurred and current - will be sufficient for retaining and subsequent increase of rate of economic growth. In case of operating of entrepreneurship and agricultural funds, mentioned in the pre election program of Georgian Dream, there will be need for funding additional capital works from the budget, since even gradual commissioning of new enterprises will presumably require strengthening of the infrastructure and energy system of the state.

## **SOCIAL FIELD AND HEALTHCARE**

According to the draft budget 2 345.0 million GEL will be allocated to the Ministry of Labour, Health and Social Protection, which exceeds plan for year 2012 by 540 million GEL.

According to the BDD activities to be implemented in the social field, comprises the following important directions:

- Work pension shall be equalled to subsistence minimum;
- Pensions for persons with special needs of category I and II, for persons who have lost breadwinners and persons for the politrepressed shall be equalled to subsistence minimum;
- Social aid for the extremely impoverished will be doubled;

Social programs in the appropriations of the ministry of Health of Georgia is funded from the program " Social protection and pension provisioning". Funding of the above item for 2012 was 1.384.8 million GEL. The above program finances: pension package; social package. State compensations; social subsidies; subsistence allowances; aid for pregnancy, child delivery, child care, fostering a newborn, IDP allowances;

In October, 2012 the following resources were allocated for each of these programs (source: Social Service Agency):

- Pensions package - 83.2 million GEL (682.2 thousand beneficiaries);
- Social package - 11.9 million GEL (174.2 thousand beneficiaries);
- State compensations – 3 million GEL (18 thousand beneficiaries);
- Social subsidies 729.0 thousand GEL (39 thousand beneficiaries);
- Subsistence allowances 12.5 million GEL (472 thousand beneficiaries);
- aid for pregnancy, child delivery, child care, fostering a newborn – 442 thousand GEL;
- IDP allowances – 6.2 million GEL (228 thousand beneficiaries).

The above statistics enables us to assess approximate value of priorities for 2013 implied by BDD, particularly:

- According to priority one of the government increase of minimum pension up to 150 GEL requires approximately 1 228.0 GEL;
- According to priority two pension of for persons with special needs of category I and II, for persons who have lost breadwinners and persons for the politrepressed shall also
- be increased to 150 GEL. equalled to subsistence minimum

**Table # 6.** Means allocated for Persons on social aid

	Persons on social aid	Person who have lost a bread winner	The politrepressed	Receiving state compensation	Receiving utility allowance	other	total
Beneficiaries	121 846	28 089	1 614	9 491	12 872	245	174 157
Total amount (thousand GEL)	8 606.0	1 596.8	103.9	250.6	294.2	19.7	11 871.1

Expenses for October, 2012 source: Social service agency:


Number of beneficiaries with special needs of category I and II among total number of persons with special needs is about 80 %. Consequently, if we take into consideration the above number, as well as persons who have lost breadwinners and persons for the politrepressed, in case number of all the rest categories remain unchanged, the total cost of the priority will approximately equal to 256.0 million GEL.

- Approximate cost priority three, which implies doubling of subsistence allowance (472 thousand beneficiaries as of October 2012) equals to 3000 million GEL.;
- For funding all the above directions, provided policy in relation to them and beneficiaries remain the same 130.5 million GEL will be required;

Considering the above assumptions tentative amount needed for funding the program “ Social protection and pension provisioning “ is 1 910.0 million GEL.

In addition BDD implies providing basic universal package of health insurance for every citizen of Georgia through non profitable financial institution. Apart from it it is planned to use private insurance funds in the services above basic package.

According to the data of the National Statistics Agency of Georgia by January 1, 2012 number of the population in the country was 4.5 million. Since such data are published once a year, we will be applying available official data. Therefore if the state provides basic health insurance package to every citizen of Georgia, cost of which according to the “health insurance program” is 12-15 GEL per month per person on average, the approximate cost of the program is 650-810 million GEL.



According to the above approach it should be mentioned that instead of providing basic health insurance to every citizen of Georgia it should be more appropriate to carry out accurate identification of exact number of beneficiaries according to needs. For certain category of the population with income several times exceeding subsistence minimum, paying for health insurance out of the pocket shall be mandatory, for the remaining category, who have very low income and/or who belong to socially vulnerable strata of the population, the state shall ensure buying health insurance package. The above will ensure efficient spending of resources allocated by the state.

In addition to the above mentioned there is a category of diseases, which are not covered by the health insurance package. The state permanently finances costs of treatment of the above diseases, though in the conditions of the existing resources, the above programs frequently experience deficit and in order to approximate to realistic demand on them it will be appropriate to increase funding of such programs at least by 50 %.

The above mentioned assumptions are reflected in table # 7 and diagram # 10. Namely, in order all declared provisions to be enabled from January 1, 2013, appropriations of the Ministry of Labour, Health and Social Protection should be increased in the budget of 2013 by 625 million GEL compared to appropriations presented by the ministry (2 345.0 million GEL), which requires attracting additional resources. **In case of absence of additional resources it is impossible to meet all declared liabilities from January 1, 2013 though they can be implemented gradually during 2013.** As for future years, according to the information reflected on the same diagram, it will be possible to take additional liabilities in addition to completely financing already declared liabilities.

The latest draft state budget for year 2013, presented to the Parliament also confirms gradual implementation of declared liabilities, namely:

From 2013 draft budget implies increase of pension rate for age pension. At the first stage starting from April 1, 2013 pension of age pensioners up to 67 years, which presently is 110 GEL, will become 125 GEL. At the second stage, from September 1, 2013 pensions of all age pensioners will reach current subsistence minimum (150 GEL).

We see the same situation in relation to increase of pensions of persons with special needs. Namely, from April 1, 2013 pension of persons with special needs of Category I will become 125 GEL, instead of current 100 GEL, and from September 1, 2013 it will become 150 GEL. As for pensions of persons with special needs of category II, of persons, who have lost breadwinners, and the politreprressed, which presently is correspondingly 70 and 55 GEL, they will become 100 GEL from September 1, 2013.

We can also see growth trend in regard to subsistence allowance. According to declared priorities, amount of allowance shall be doubled. According to the acting legislation presently all persons in Georgia, whose scores, based on evaluation of the households, are less than 57 001, receive subsistence allowance in cash. According to the explanatory note of the state draft budget " first member of the household with less than 57 000 points, will receive 60 GEL instead of 30 GEL, and all next members will receive 48 GEL instead of 24 GEL. Additional cost of doubling of social aids exceeds 70.0 million GEL". The above provision definitely corresponds to the promise, made by the government of Georgia, though timeline of its implementation is not specified. If we take into consideration that 12.5 million GEL was spent in October, 2012, which makes approximately 150 million GEL annually, and in 2013 budget 70 million GEL is allocated in this direction, we can assume that increase in should be expected from the second half of 2013.

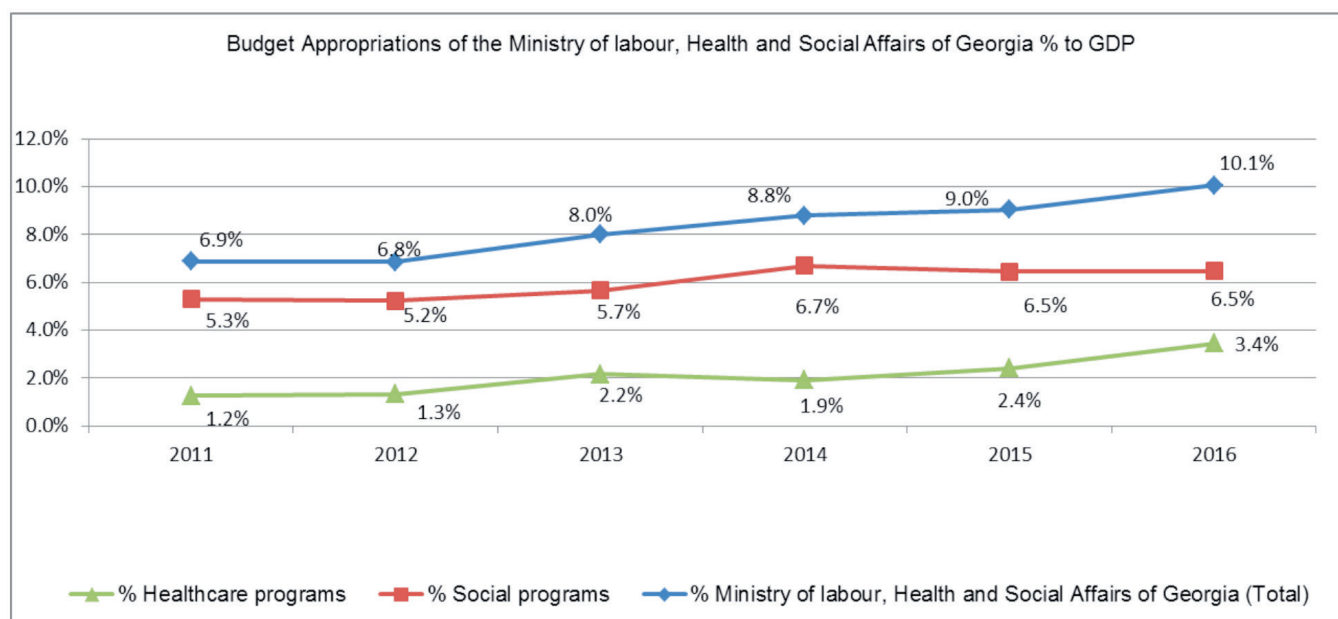
Funding is also increased in the framework of healthcare program. The volume of the above funding in 2012 was 174 million GEL; in 2013 funding will be increased to 505 million GEL. According to the explanatory note of the draft budget health insurance of the population not covered by the insurance will be gradually enabled in 2013 and universal insurance will be enabled from July 1.

*It should be mentioned in general that practice of tying social policy to the parameter of subsistence minimum shall be revised. The above parameter from our point of view is not an objective economic category and is only a matter of permanent political speculations. As an option in the future it will be needed to obtain more quality information about the population regarding the income and to determine social programs based on this information.*

**Table #7.** Health and social expenses 2012-13

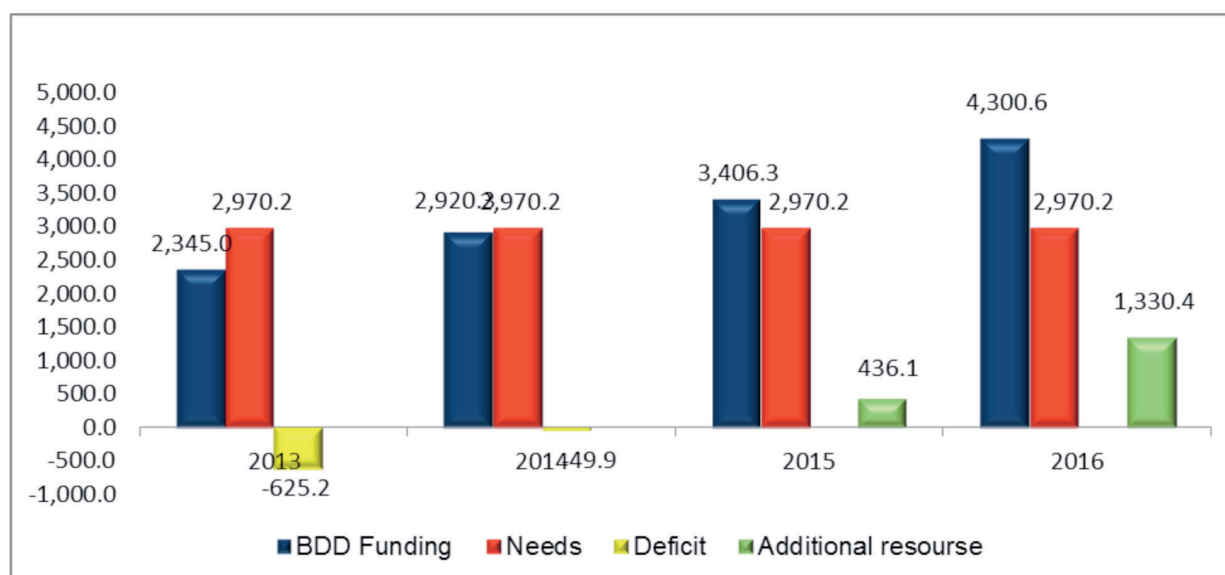
	2012 year	2013 year (presented)	Tentative value of the priority
<b>The Ministry of Labour, Health and Social Protection</b>	<b>1,805.5</b>	<b>2,345.0</b>	<b>2,970.2</b>
Social protection and pension provisioning	1,384.8	1,654.7	1,914.0
Health insurance	174.0	505.8	810.0
Other health programs	172.5	127.9	189.6
Other activities	74.2	56.6	56.6

**Diagram #9.** Health and social expenses and GDP 2011-16





**Diagram #10.** Budge Appropriations of the Ministry of labour, Health and Social Affairs of Georgia



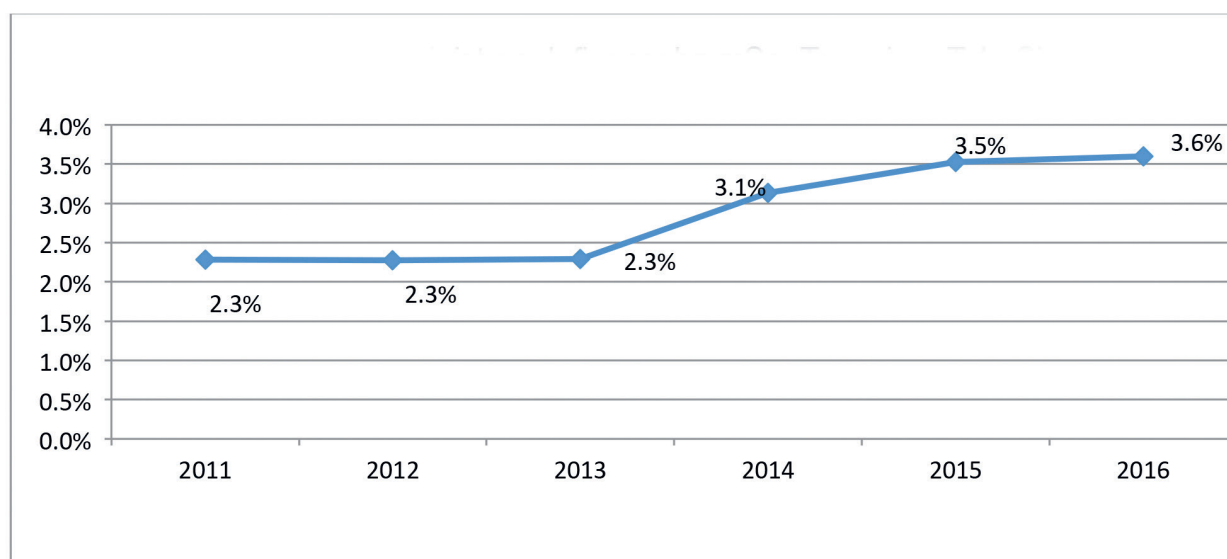
## EDUCATION

Funding of education field, which is the second main direction according to the BDD is increased by 70 million GEL, out of which increase of 52.1 million GEL falls on the general education. According to the BDD funding of education system should be increased both in absolute figures, as well as in relation to GDP. According to statistical data reflected on the diagram funding of the education sector will be only increased in relation to GDP starting from 2014. As for increase of funding by 70 million GEL, it definitely will not be sufficient for significant increase of the voucher value within the confines of the general education and subsequently for growth of wages of the employed in the general education system; it will be also impossible to ensure increase of number of students of higher education institutions receiving grants awarded by the state.

**Table #8.** Funding of education 2012-13

	2012	2013	Difference
Funding of the Ministry of education and Science	600.7	670.0	69.3
General education	373.0	425.1	52.1
Higher education and research program	124.0	129.3	5.3
Vocational education	15.0	19.8	4.8
Development of infrastructure of educational institutions	76.7	83.5	6.8
Other programs	12.0	12.3	0.3

**Diagram #11.** Budget Appropriations of the Ministry of Education and Science of Georgia % to GDP



Substantial increase of means allocated for the education sector from 2014 shall be considered as an optimistic trend, provided it is realizable. There is no doubt in need to increase appropriations of education sector for sustaining present rate of economic development of Georgia. In spite of this, it should also be considered, that in this case we only speak about increase of planned indicators of funding and its practical implementation will require substantial revision of budget parameters in the future and reallocation of funds from other sectors to the education. Another thing is that increase of expenditures on education can not be the only key for success, especially that means invested in education usually give the return in a very long term. In this regard especial attention shall be paid to increase of the quality of the education, particularly school education. Presently in Georgia there is a popular practice of providing additional tutoring to school students by private teachers. Which means that presently in Georgia more money is spent on education, that it is registered by the official statistics. Private tutoring of school students take place already from middle classes, which means that social expenditures of state education system significantly exceeds those officially declared, since students of public schools are not adequately prepared for higher education. Therefore, we believe that concurrently with increasing appropriations on education, efforts should be made for improving the quality of the education, otherwise, increase of appropriations planned for the future cannot become the guarantee for growth of qualitative indicators of education.

## AGRICULTURE

2013 budget focuses on significant increase of means allocated for the ministry of agriculture. This is rather an encouraging trend, since agriculture has been experiencing serious shortage of tangible resources, as well as suffering from lack of well formulated, long term state policy for several years.

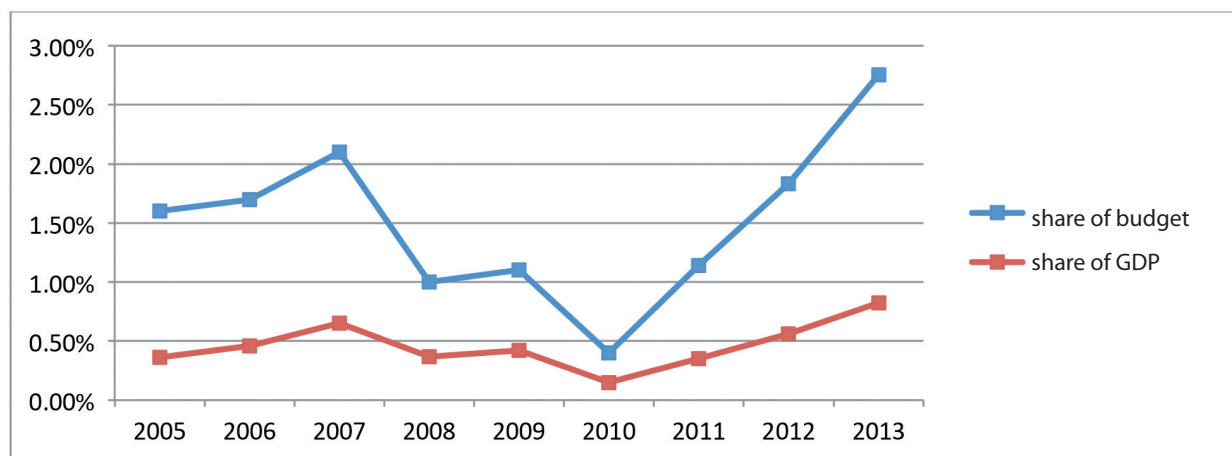
In indicators of 2013 year budget presented we can see increased attention to agriculture, as a sector somewhat ignored during years and vision how this sector, extremely important for the state, should be developed.

It should be noted that need to regulate tenure and land use issues is properly considered to be one of the important pre-requisites of agriculture development. Unfortunately despite of large scale activities and donor aids, implemented in the land reform field since 90-ies of the last century, tenure of big majority of agricultural lands is still unregulated and it is impossible to

understand, which part of land fund is owned by the state and which part – by the private sector. It should be mentioned that in the conditions, where ownership right is not fully guaranteed, an investor and generally, capital, would never direct large financial means in this sector. Obviously, solving of tenure issues might not be sufficient to start market oriented relations in the rural areas, but it is definitely an important pre requisite for major development of the sector.

In addition, the Ministry of Agriculture has planned important activities for supporting of inflow of capital in the agricultural sector. There are also plans for providing financial means for small size farmers, for purchase of agricultural equipment, renewal of technologies, rehabilitation of irrigation system. Organizing pilot/demonstration land plots, organizing green houses, intensification of grain crops, as well as working in the direction of food safety issues.

**Diagram #12** Share of funding of agriculture in consolidated budget and GDP



**Source:** Geostat, BDD

It is surprising that understanding the need of and interest towards increase of funding of agricultural sector appeared during the previous authorities; after absolute minimum of funding in 2010 significant increase of appropriations in this sector was witnessed. It is presumably conditioned by two factors: 1). Global interest towards agricultural sector as a result of global food crisis; 2). Understanding importance of agriculture, as one of the most important sector for economy of Georgia.

Priorities of the new authorities imply further increase of funding of agriculture next year and in the coming fiscal years. Despite of this, we think that there is still ambiguity regarding possible structure and size of the increase of the funding and clear concept is still not been presented. Taking into consideration all the above and the fact, that it is planned to establish 1 billion GEL fund for the purpose of supporting agricultural sector, we believe that at this stage analysis of possible trend of appropriations for agriculture for 2014-2016 is not appropriate, since it is not clear, what will be the form of the above fund, how it will be related to the state budget and whether there will be any fields shared or interchanged between the fund and the state.

Absolute volume of funding of the agriculture for 2011-2013 is the following:

**Table #9.** Funding of agriculture in functional context 2011-13

	2011	2012	2013
The Ministry of agriculture	85,1	148.9	218.9
Agriculture development program	20.0	111.2	197.0
Food safety, plant protection Epizootic reliability	5.3	6.0	15.7
Viniculture-winery development	10.4	31.8	28.4

We can see increase of expenditures in the direction of agriculture development program and development of viniculture and wine producing. It should be mentioned that despite of growth of absolute value of donor funding in 2013, their share in total expenses is not large and majority of appropriations are switched onto the agricultural sector through regrouping of other budget directions.

Taking into consideration all the above need to achieve rational management of additional financial resources allocated in agriculture and high level of efficiency of tasks set by program aims. It is also important to achieve long term effect received as a result of work conducted with their help.

Renewal of agricultural equipment equalled to approximately 3 million GEL in 2011; in 2012 it was 15 million GEL and for 2013 it is planned to reach 86 million GEL. In 2011 no funds have been directed to intensification of agricultural production, in 2012 and 2013 correspondingly 41 and 12 million GEL were directed. Increase of combined expenses focused on these two areas, indicating rapid growth of expenses for renewal of equipment and reduction of expenses for intensification of production, makes us think that the new ruling team will attempt to carry out large scale agricultural works for farmers with small land plots. It is still not clear what kind of activities will be carried out, but mass purchase of equipment implies at least conducting tilling and sowing activities free or at subsidised costs.

We consider that large scale tilling and sowing activities mostly have political connotation and can not support long term task of development of agricultural sector. Presently it is a well known fact that large part of rural population is involved in primary production by inertia. Their majority requires social aid rather than conducting of agricultural activities with the means mobilized through tax resources. We believe, that conduction of large scale agricultural activities for farmers is not appropriate also for the reason, that major increase of social expenses is planned for the 2013 budget. It means, that the rural population, however poor it should be considered, will receive double social aid at the expense of the poor urban population.

In case such service of small size producers works out in practice and more area will be cultivated compared to the previous years, the question is how the excess product will be realized? Though facilities for special storing exist and there are plans to construct more of them for this purpose, but it might happen that there is no demand on additional products on the domestic market, which means that they will be wasted.

In addition, large scale tilling and sowing activities create enormous pressure in means of adequate administration of the program, it requires lots of time and human resources, and we doubt that the Ministry of Agriculture, considering number of its personnel, has these resources available. Therefore, in case these activities are still carried out, they need to be maximally approximated to the market principles and issuing that they will not take place in the next year. Generally it can be said that this subsidy scheme is conceptually quite primitive but may turned out to be rather disastrous in means of destroying market economy leaders in rural area and growth of dependence of uncompetitive producers on external help. We consider it essential, that the Ministry of Agriculture is released fro the above mentioned activities and that it fully concentrates on creating

appropriate climate for development of the agricultural sector and on seeking and penetrating both domestic and foreign markets for sales of the product. Presently there definitely is a realistic chance for the above.

We also believe it inappropriate to throw 25 million GEL to vine harvesting activities. In Independent Georgia wine producing sector and generally viticulture enjoys advantages compared to other sectors of agriculture in means of attracting budget resources due to certain sentiments, existing in the country. In the conditions of the previous government this trend had sporadic and inconsistent character, though still rather substantial means were directed in this field.

We consider, that satisfying certain individual groups of interest through such irrational sentiments should be brought to the end. Wine production is the most developed area in the agricultural field with large markets for realization, infrastructure and technologies. Present subsidy scheme prevents competitive producer to care about quality improvement.

It should also be mentioned that besides to general lack of efficiency, subsidy schemes in Georgia are practically useless in Georgia, because of huge number of potential beneficiaries. According to the official statistics, 52 % of the total labour force is involved in agriculture, which means that the remaining 48 % of the employed have to share their scarce income with the former. Subsidy schemes work in practice only for the reason that beneficiaries and financers ration does not exceed one %.

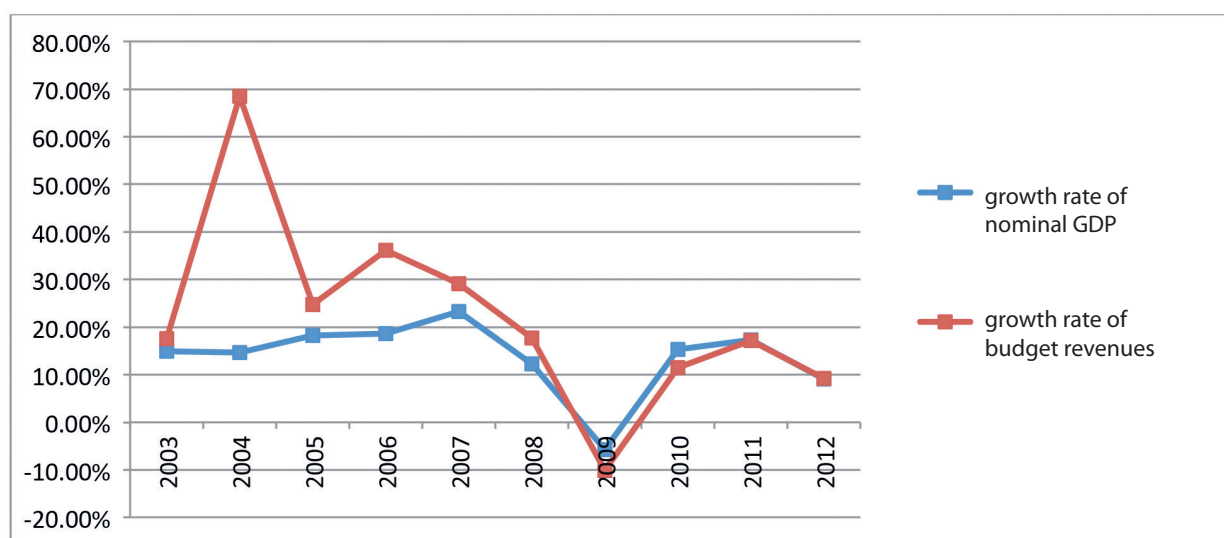
Allocation of 64 million GEL for renewal of amelioration systems and launching agriculture support program ( which will be funded by IFAD) is definitely a positive trend. We believe that renovation of agricultural and rural infrastructure should become a focus of the Ministry of Agriculture, which is obvious in increase of the above expenses. Qualitative increase of the role of the ministry as an agency disseminating and introducing technologies, is also essential. In addition, it is also rather important to start working on agricultural land registration issues and on consolidation of land parcels through market mechanisms in order to create pre requisites for capital investments in this field. Presently the state is definitely able to do this and it has trust of the population for implementation of this kind of program.

Generally it is impossible to overcome backlog of agricultural sector accumulated during several years, through single time large scale budget activities and it can harm future development of the sector. Therefore the Ministry of Agriculture should be enabled to develop a long term plan for development of the sector and prepare grounds for its implementation within realistic timeline

## **STATE BUDGET IN RELATION TO ECONOMIC DEVELOPMENT**

The state budget is the basic tool to direct economic life of the country. Despite of this we have to understand that the budget as a mechanism for accumulating and distributing economic resources, as well as facilitating economic growth is characterized with certain natural restrictions. Particularly, here we mean that actual resources existing in the budget can not permanently grow faster than general economy. In this context we need to consider that up to 2008 Georgia has already passed peak period for budget consolidation, when rate of growth of revenues and expenses achieved the maximum point. This happened at the expense of both quantitative and qualitative increase of tax administration. In addition, coverage of economy by tax purposes has increased, degree of its transparency has improved. Clear trend of state expenditure efficiency and size has somewhat strengthened positive sentiment in the society towards the authorities, which has resulted in further strengthening of the budget policy.

**Diagram #13** Rates of growth of GDP and budget revenues 2003-12



Source: Geostat


It should be mentioned that economy was rapidly developing against encouraging trend of budget consolidation. Obviously, positive outcomes of economic growth could not be evenly distributed on all social groups, which is characteristic for transitional economies at the early stage of their development, including Georgia. It should be considered as negative side effect of progress of Georgia.

After 2008 in the conditions of the was and global financial crisis there was a benchmark, when Georgia with its GDP per capita has left behind poor countries of the world and it started to rapidly catch up with intermediary group of medium development states. At the same time social inequality has further aggravated. This is important, since retaining rate of economic growth in short and mid term period is more problematic in countries with medium development, compared with relatively less developed countries. At his stage it is only possible in the context of radical improvement of healthcare, education and infrastructure. In relation to Georgia, when the state has already achieved certain stable section in means of budget consolidation, whereas social problems, and subsequently, social demand for income distribution stays in place, there is a threat of collision between the task to ensure economic growth and social demand for distribution of wealth. We consider that responsible government shall not allow for slowing down economic growth for the purpose of growth of distribution, especially that outcome of such distribution is somewhat incomplete and rather doubtful. We would like to illustrate the above by dynamics of employment in Georgia, when the economic growth rate achieved the maximum point.

**Table #10.** Dynamics of employment in Georgia 2004-2011

	2004	2005	2006	2007	2008	2009	2010	2011
The employed	600	600	603	625	572	595	618	631
selfemployed	1,180	1,143	1,141	1,078	1,028	1,058	1,007	1,025

Source: Geostat



In regard to employment growth in Georgia the situation is not very good considering reduction of rate of economic growth we should not expect major positive changes in this direction, especially that the formally employed (tax payers) on the above table do not reflect total number of the employed. Actually it means that redistribution programs of paramount importance for the economy shall be implemented at the expense of less than 600 000 tax payers. We believe that the government should at least manage to retain tax climate favourable for the employment, so that more people are able to solve own social problems through employment rather than expect state assistance.

The government shall also be more responsible in relation to management of internal and external debts. Volume of debts shall in no means exceed established limit, even if they were necessary for solving important tasks in fields of education, healthcare, infrastructure and energy. Finally, already during developing 2014 budget it will be necessary to maximally optimize election promises and approximate them to the reality.

## FINDINGS AND RECOMMENDATIONS

1. According to amendments to the Tax Code presented, untaxable minimum suggested to the society is not effective. Neither by its calculation, nor by its volume. The above amendment only allows a person to save 98 Tetri a day. Taking into consideration, that this person shall have 500 GEL salary, the above exemption will not be very effective. In addition, total value of the above exemption will be 170 million GEL for the state. Therefore, it will be appropriate if the state refuses introduction of this exemption and uses the above means for financing e.g. some of the healthcare programs, costs of which are not covered by insurance packages.
2. According to BDD there is an intention to establish state insurance fund in the country. The above fund will play the role of state insurance company and will provide the population of Georgia with basic health package. The very fact that the state is going to be a manager and an owner of such fund, creates rather significant risks in relation to its efficient operations. It is well known, that state institutions are not that effective in managing such funds compared to private sector. There are also additional threats in regard to possible illegal deals. Therefore it would be appropriate if the state provides insuring the population in the private insurance company and at the same time carry out permanent monitoring over the company. The above will facilitate on one hand, development of the insurance market and on the other hand will ensure more rational selection of patients to be insured.
3. The BDD also implies the plan of the government to provide all citizens of Georgia with basic health insurance package, whereas more comprehensive coverage price should be paid by the population. The topic of effective application of financial means is also important here. Taking into consideration that part of the population with higher income can cover costs of their own insurance, it would be better if the state provides insurance socially vulnerable strata of the population and the unemployed. Also it will be more appropriate to take care of preventive measures regarding chronic child diseases, than provide universal insurance for all citizens.
4. The attention should be paid to quality aspects of school education in conjunction with increase of funding starting from 2014. We also think that in higher education system focus should be made on strengthening of autonomy and capacity building of an education institution, their ability to attract funds for their development, rather than increase of state financing.
5. The quality of information collection shall be improved, especially in relation to social programs. These programs shall become more targeted to demand of certain social groups rather than tied to obsolete subsistence minimum parameter. It is also urgent to carry out census and agricultural inventory in planned time terms. It is particularly important during planning budgetary process, which is based on 2002 census while developing many important parameters.
6. The Ministry of Finance shall calculate exact number of formally employed, both in public and private sector (income tax payers). This is absolutely essential for proper targeting of income tax. Presently information on formal employment is assessed through household business surveys, which from our point of view is inadequate.
7. The Ministry of Agriculture shall not be charged with social aid function and it should be given time and resources for working on development of the sector, focusing on establishing political and institutional climate supporting the growth in this field.
8. The government shall manage to carry out intense rationalization of pre election promises. Meeting majority of promises in short term period is not realistic. We believe that in this regard year 2014 will be the most important year, when the new ruling team will have obtained adequate governing experience.





**85/24 Paliashvili/Mosashvili street. Building I . Floor IV.**

**Tbilisi, Georgia.**

**Tel./Fax: +995 32 2 207 305**

**e-mail: [info@eprc.ge](mailto:info@eprc.ge)**

**[www.eprc.ge](http://www.eprc.ge)**