Programmatic Cooperation Framework for
Armenia, Azerbaijan, Georgia, Republic of Moldova, Ukraine and Belarus

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STRENGTHENING INSTITUTIONAL FRAMEWORKS FOR LOCAL GOVERNANCE PROGRAMME
2015-2017

STUDY
Finance Benchmarks: areas and options for assessing local financial resources and financial management in Georgia

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Country Study for Preparing Local Finance Benchmarks

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Political and administrative structure

Forms and types of elected local governments

Apart from occupied territories (Abkhazia and South Ossetia) there are 76 self-government units in Georgia, out of which 12 are self-governing cities and 64 are municipalities. Local governments are elected every 4 years in Georgia, latest one organized in 2014. Elections are conducted throughout the country simultaneously, in autumn.

Local administrative units of the state

Ministries and state agencies do not have representation at the municipal level. Territorial branches of the state are established at the (historical) regional level. Eight out of 18 line ministries (education, agriculture, environmental protection, healthcare, refugees and accommodation, internal affairs and finance) have regional representation. Provision of services is administered from the center, however regional branches do monitoring activities.

Local government tiers, administrative structure

From 2006, there is a single tier of local self-governments in Georgia. Municipalities consist of villages, boroughs and towns. Self governing cities are divided into districts. Local governments' independence is guaranteed by the Constitution.

Local self-government has two branches. The representative organ-Sakrebulo is formed through direct elections (both from majoritarian and proportional voting system). In LSGs that have more than 70 thousand inhabitants 15 members of representative body are elected through proportional votes and 10 members through majoritarian vote. In smaller LSGs Sakrebulo consist of 15 members (10 elected through proportional and 5 through majoritarian vote). Sakrebulo is headed by the chairman and deputy chairman(s)[1] that are elected from its members. Not more than five committees shall be established within the representative organ. Temporary commissions can be formed with the period of 3 month. Political parties form fractions.

The executive branch of LSG is headed by Mayor in self governing cities and by "Gamgebeli" in municipalities. Mayor/Gamgebeli is elected directly from 2014. Even though Mayor/Gamgebeli is elected, he/she represents the head of the local administration. The Mayor/Gamgebeli is free to form the executive organ, by nominating deputy Mayors and defining the administrative structure of the office. The Mayor/Gamgebeli appoints representatives in LSG districts.

Population size of elected local government units

[1]In LSG with the size of population above 100 000, municipality Sakrebulo chairman has two deputy chairmen.

According to 2015 census, the population of Georgia has decreased by 700 thousand compared to 2004 and amounts 3.7 million persons. The average number of inhabitants per municipality is 49 thousand. If exclude the capital, Tbilisi that has 1.12 ml. population, the average number will amount only 34 thousand. There are only 7 LSG that have more than 100 thousand citizens.

Table 1: Local Self Governments according to size of population[2]

	Number of local governments	Population number (1,000)
1,000-4,999	2	8
5,000-19,999	13	182
20,000-49,999	30	942
50,000	18	1,480
capital city	1	1,118
Total	64 (76)	3,730

Central government agencies, responsible for local governments

There are two entities established at state level in charge of local government affairs.

The Ministry of Regional Development and Infrastructure (MRDI) was formed in 2010. The ministry is responsible for providing legal and administrative support to LSG units. It also manages the regional development fund-the budget line in the State Budget that finances projects in regions/municipalities. Another entity, Municipal Development Fund, is under MRDI's supervision and implements infrastructure projects, which is financed from external investment credits and grants.

The unit for communication with the regional and local authorities is established under the Prime Minister's office. The unit does mostly coordination and analytical activities.

Status, size, significance of the autonomous entities within the territory of the country

There are two autonomous republics-Abkhazia and Adjara, established by the Constitution. Georgian authorities are exercising control only in Adjara autonomous republic, Abkazia is occupied by Russia. Five local-self governments are established within Adjara, including self-governing city of Batumi that is the third largest in the Country. The competences of autonomous republic are set in the areas of education, culture and sport, agriculture, economy, environment. Competences of LSG units functioning in Adjara are identical to those of the rest of Georgia. The only exclusion from the rule is construction and maintenance of local roads that is organized at the autonomous republic's level.

[2]Source: Statistics Service of Georgia-Geostat

There are five LSG that exist de-jure: one LSG under the Abkhazia Autonomous republic and four under the temporary administration of South Ossetia. These LSG receive transfers from the state but do not poses revenues as do not exercise control in "Occupied Territories".

Local government functions

Locally provided public services:

Services provided to local population by LSG are two types i) exclusive, that fall in the competence according to the law and ii) delegated from state.

a) *state functions delegated to local units of administration*

Legislation does not define spheres to be delegated to LSG units. However, state organs can delegate functions in two ways: 1) by making amendments to the legislation (requiring approval by the Parliament) 2) by signing contracts with LSGs.

Legislation obliges the state to allocate respective financing to LSGs for executing delegated responsibilities.

The most common practice used for delegating competences is putting respective article in the annual state budget. The same document defines the amount allocated for delegated functions by each municipality. According to 2015 State budget, State delegated functions related to public health, compulsory military recall, provision of certain communal services to internally displaced persons, commemoration of heroes fallen in war. Financial data demonstrate that delegated responsibilities do not put burden on LSG, having limited number of beneficiaries. The total amount of transfer for all LSGs is around 11 million Gel, approximately 0,01% of the state budget (not more than 5% per LSG budget).

b) *services devolved to elected municipalities (exclusive)*

The law defines the following exclusive competences for LSG units:

-Spatial and urban planning
- Taking care of municipal amenities (cleaning parks and roads, planting greenery, street lighting)
- Garbage collection,
- Provision of water (including technical); Development of local melioration system
- Establishment of pre-school education centers and their maintenance
- Construction and maintenance of municipal roads; regulating local traffic and parking
- Organization and provision of local public transport service
- Organization of markets, exhibitions and trading
- Establishing cemeteries and their maintenance
- Preservation and promotion of local folklore and heritage
- Providing of social housing to homeless and their registration

Municipalities spend 85%-90% of their budget for financing exclusive competences

c) *Voluntary responsibilities*

Local self governments have the right to provide services to the local population that are not defined by the legislation as the competence of the State. Under "voluntary" responsibilities, LSGs provide discrete cash transfers to vulnerable groups of population. Financially strong municipalities also provide SME support services.

LSG spend from 15% to 10% of their budget on financing voluntary services.

In 2014, local governments spend approximately 17% of the consolidated budget expenses that amounts around 5.4% of Gross Domestic Product.

Main forms of local service management

Services are provided to citizens through 1) outsourcing- shall follow public procurement procedures (tendering and/or single source procurement), 2) LSG owned Noncommercial Legal Entities (NLE) or 3) LSG owned Commercial Entities.

Spatial and urban planning: In almost all LSGs, there is no practice of spatial planning and development. Taking into consideration inadequate capacity of local public servants in this area, the service has to be outsourced when LSG start developing spatial plans.

The table below shows the service delivery practices in Local Self Governments in Georgia

Table 2: Service delivery practices across LSGs in Georgia

Type of Service	Outsourcing	LSG owned non-commercial Legal Entities	LSG owned Commercial Legal Entities
Cleaning parks and roads	X (mostly developed in self governing cities)		
Planting greenery	X (mostly developed in self governing cities)		
Street lighting	X (mostly developed in self governing cities)		
Garbage collection			X
Water provision	In municipalities Tariff ceilings are set by the (state) commission for electricity, gas and water		In self governing entities Tariff ceilings are set by the (state) commission for electricity, gas and water
Pre-school education		X	

Municipal roads construction and maintenance	X		
Local public transport	X (mostly in large self governing cities)		
Organization of markets and trading	X		
Cemeteries			X
Local folklore and heritage		X	
Social Housing		X (only in Tbilisi and Batumi)	

Local government own and shared revenues

1) Scope and types of local own source revenues: taxes, user charges, fees

According to legislation, LSGs are entitled to the following revenues:

"Own" revenues

- Property tax (taxation objects are land and property)
- Local fees (Gambling fee, construction, garbage collection, urban development, rehabilitation of cultural heritage area)
- Income for property (including from shares)
- Administrative fines

"Shared" revenues

- Fee for using natural resources (100%), eg. mining, mineral waters, forestry
- Fee for postponement of military service (10%)
- Fines (Traffic police fines (40%), breaching construction rules, pollution fines)

Capital revenues (from selling municipal property, in Vienna you also mentioned dividends)

Table 3: consolidated LSG revenues by revenue types (2014 data)

	ml GEL	%
"Own" revenues	**534.77**	**33.4**
· **Property tax**	**245.87**	**15.3**
· **Local fees**	**129.88**	**8.1**
Gambling fee	64.91	4.1
Construction permission fee	4.18	0.3
Garbage collection fee	47.36	3.0
Urban Development	9.52	0.6
Other fees	3.91	0.2
· **Income for property (including from shares)**	**42.63**	**2.7**
· **Municipal Administrative fines**	**21.87**	**1.4**
"Shared" revenues	**64.66**	**4.0**
· Fee for using natural resources (100%), eg. mining, mineral waters, forestry	32.93	2.1
· Fee for postponement of military service (10%)	0.13	0.0
· Fines (Traffic police fines (60%), breaching construction rules, pollution fines)	31.6	2.0
Capital revenues (from selling municipal property)	**29.86**	1.9
Transfers from State	**1067.80**	**66.6**
Total	**1602.57**	**100.0**

2) *Local autonomy in tax policy design: setting base, rate, exemptions*

Property tax

Property tax is defined a local tax by the Tax Code. Georgia has a liberal tax legislation having only 6 types of taxes (VAT, excise, personal income tax, profit tax, tax on import and property tax).

Property tax is set on property (buildings) and land (that is separated from property). Land is divided between agriculture and non-agriculture types.

The tax is paid by legal persons (both residents and non-residents) and by individuals.

Tax code sets maximum and minimum thresholds for property tax (from 0 to 1% of the value). LSG have the right to introduce the tax within the given limits.

Tax on property (buildings and land) for legal persons is set for not more than 1% of the value

Individuals pay tax on property based on their annual income:

-Persons whose family members earn not more than 100 000 Gel (appr 45 000 USD) should pay minimum 0.05% and max 0.2% of the property value.

-Persons whose family members earn more than 100 000 Gel should pay minimum 0.8% and max 1% of the property value.

The tax code also sets fix tax rate (in Gel) for agriculture land across municipalities. The minimum amount of tax is 5 Gel (for mountainous regions) and maximum is 1000 Gel per hectare.

There are significant exemptions set by the tax code to land owners. This shrinks the tax base significantly. Namely,

- Individuals, whose family earns less than 40 000 GEL (17 000 USD four times more than GDP per capita) annually are exempted from paying the property tax.
- Individuals who own less than 5 hectares of land before 1.01.2005 are exempt for property tax. Taking into consideration the land fragmentation in Georgia, most of the individuals holding the land are exempted from paying tax.

Local self-governments introduce tax rates with the consultation of the Ministry of Finance. Usually they set the maximum rates.

Local fees

There following activities are taxed by local fees: gambling, construction, garbage collection.

The law on Local Fees defines fee types and sets maximum rates.

- Gambling fee: levied on casinos, gambling machines, lotteries. This source of revenue is mainly generated by large self-governing cities (Tbilisi, Batumi, Rustavi, Kutaisi). The fee rates shall be set by LSGs within the following limits:

On each table in casino	from 15000 to 30 000 Gel
On each gaming machine	From 1500 to 3000 Gel
On lotteries	20% of profit
On each table for gaming clubs	From 3000 to 10000 Gel

- Construction permit? fee: maximum rate established by the legislation: 1 Lari per sqm. in urban areas, 5 lari per sqm. in resorts.
- Garbage collection fee: maximum rate per physical person 3 Lari, for legal person 25 Lari.

- Urban Development fee: maximum rate per sqm. is 400 Lari
- Fee for rehabilitation of cultural heritage area: 1.5 Lari per sqm.

Representative organ of the LSG introduces local fees by its statute. Factors that determine the amount of the fee are: level of urbanization, local economic potential (for tourism, industry), quality of infrastructure. Fees are higher in self-governing cities (Tbilisi, Batumi) than in municipalities.

Income from property

Income from property renting is significant source of revenue, especially for self-governing cities. The 100% of revenues from renting municipal property go to the LSG budget.
Large municipalities and self-governing cities also benefit from income generated by LSG established commercial entities.

Another important source of revenue for LSGs is the interest earned on the current account held in commercial banks.

Administrative Fines

Law on administrative fines defines the state and local fines and sets fixed amounts for each type.
Fines that generate local revenues are as follows:

Type	Amount
Illegal occupation of land	2000 Gel, repetitive action 3500 Gel
Not taking after for pets	20 – 50 Gel
Illegal organization of local transport routes	100 Gel
For dropping out construction materials	200 Gel for individuals; 1000 Gel for legal persons
Illegal reconstruction of buildings, facades	From 1000 to 5000 Gel
Damaging greenery	From 500 to 1000 Gel
Illegal trading	From 20 to 100 Gel

In addition to local fees, 60% of traffic police fines go to local budgets.Amount of fine depends on the type of offense and is set by the legislation.

It should be noted that fines are insignificant in rural municipalities because most of the fines address infringement of the urban style of living.

3) Capital revenues (assets sale)
   Selling property is the source of capital revenues for local-self government units. Public property can be owned by the State, by Autonomous Republic or by Municipality. LSG get 65% of the price municipality owned property that is sold and 35% of the price of the state owned property that is sold.

4) Tax sharing: origin or formula based; set ratio or arbitrary allocation rules
Currently, there is no practice of sharing taxes with the LSGs. The mechanism for sharing personal and corporate income taxes was abolished in 2006.

The fee on using of natural resources is state fee by its nature, but is channeled to local budgets by 100%. The following resources are subject to the fee:

- Oil and gas
- Minerals and metals
- Construction materials
- Mineral water
- Wood
- Animals (hunting)
- Fishery

There are few local self governments (Bolnisi-gold, Borjomi-mineral waters) in Georgia that benefit from the fee on usage of natural resources. This source of revenue for Bolnisi municipality amounts up to 70% of its budget revenue.

Apart fee from natural resources, State shares 10% of the fee for postponement of the Military Service: 2000 Gel for one year

5) Tax and tariff collection, payment systems, managing arrears, enforcement, administrative capacity

Property tax, like all taxes are administered by the State. Revenue Service of the Ministry of Finance is in charge of this matter. LSGs have almost no competence to interact with the tax-payers.

In addition to property tax, the national tax authorities administer gambling and natural resource usage fees.

The rest of local fees and fines are collected by local self-government units.

LSG units are not entitled to conduct enforcement activities by themselves. The decisions are enforced on voluntary bases or through Law Enforcement Bureau (LEB). The latter is the subordinated agency of the Ministry of Justice.

If person does not fulfill decision on administrative fine, the executive body of the Local Self Government sends a letter to the Law Enforcement Bureau. LEB has the right to take the hold on property (bank account) of the person who has conducted administrative infringement. After LEB enforces the decision, it transfers amount of fine to LSG account (keeps 7% of the amount as a service fee).

Information on tax collection targets (plans) and rates is available on a quarterly bases in MoF's reports. However, the data are consolidated for all LSGs.

Property tax (in ml. Gel)

	2012	2013	2014
Target	232	232	275,0
Actual	230	230.9	245,8
Difference	-2.0	-1.1	29,1

As we can see from the table, tax collection rate was almost 100% during 2012-2013, however, decreased to 89% in 2014. In 1st quarter of 2015 tax authorities mobilized only 85% of the target. One of the reasons for decline of the tax collection ratio could be over-optimistic planning of the Property Tax base. Due to economic crises in Georgia/region the value of property has not increased (declined in certain areas).

6) Local property management

Legislation defines two types of LSG property: indispensable –that is vital for functioning for LSG and dispensable- that can be sold.

There is a special unit established in the executive branch of the LSG dealing with property management. Property management units are usually dealing with property registration and then renting or selling. Majority of LSG units do not apply modern methods of property management, the database is also incomplete or inexistent.

The Local Self Government code grants the right to the state government to define the rules for municipal property management.

According to the government statute, the property can be rented or sold in two ways:

1. through electronic E-auctioning on the designated website www.e-auction.ge. Access to the website that is bilingual (Georgian and English) is free of charge for all.

2. through direct negotiation with the thirds party. In case of direct negotiations, the representative body of LSG should grant the rights to the executive.

The second option is not competitive and is subject to criticism from NGOs. Defensive argument coming from the LSG is the opportunity to attract investors in a prompt way. The fact that representative body makes decision on direct negotiation should prevent the possibility of corruption. The watchdog organizations however claim that representative body of the LSG often does not have the capacity and competence to properly oversight the process.

7) Information sources, public and available databases on collected local and shared taxes

Main source of information is the Ministry of Finance and the Statistics Office of Georgia. The cumulative financial data are available in Georgian at the websites: www.mof.ge, www.treasury.gov.ge and www.geostat.ge. Some of the general information is in English too.

Some of the LSG units run their own websites that are updated regularly (Tbilisi, Batumi). The annual budget laws and execution reports are uploaded on the websites too.

LFB topics/areas (Annex 1.)

Vertical fiscal balance

Changes in service standards are compensated by higher local revenues-can be used example of 2012 when LSGs have been obliged to provide pre-school education service for all, for free

Horizontal fiscal balance

Ratio of per capita municipal expenditure in the richest and poorest municipalities – interesting to measure difference between the self-governing cities and municipalities (costs vs quality of service)

Own revenue raising capacity

- Ratio of own source revenues in the total revenue
- Autonomy in setting local own source revenue base and rate
- Right to collect taxes and fees
- stability,\ and continuity in local tax revenues

Tax sharing

- Types and significance of taxes shared
- Methods of sharing

Intergovernmental transfers, fiscal equalization

1) Size and forms of intergovernmental transfers:

There are four types of inter-governmental transfers that State allocates to local budgets:
Equalization transfer: formula based, general purpose, unconditional
Transfer for delegated responsibilities: discretionary, matching, earmarked
Special transfer: discretionary, earmarked
Capital transfer: discretionary, earmarked

Transfers are reflected in the State budget and calculated during the budget preparation phase in August-September, each year.

Below table summarizes the types of transfers and number of local self governments that receive financial assistance in 2015.

Transfer type	Equalization	Delegated responsibilities	Special	Capital
Number of LSGs receiving the transfer	74	70	0??	Not defined
% of total	98.5%, 835 ml. Gel	1.5%, 1.6 ml. Gel	0	

Transfer (total)	Equalization	Delegated responsibilities	Special	Capital
1065.38	776.14	11.25	6.65	271.3
%	72.85	1.0	0.5	25.65

Equalization transfer.

According to the Budget Code, the objective of the equalization transfer is to converge socio-economic development among local-self-governments.

The equalization procedure and formula is defined by the decree of the Ministry of Finance that is usually amended every year.

During the initial stage of the equalization formula calculation, the Ministry of Finance defines the consolidated amount of municipal expenses that should not be less than 4% of GDP[3]. The MoF also defines the ratio for self-governing cities and municipalities. The usual practise is around 2/3 for cities and 1/3 for municipalities. For 2015, the total amount of expenses for self-governing cities (12, including capital) is 69%, for municipalities only 31%. Pre-determination of shares of expenses in the total amount for cities and municipalities undermines the objective of the transfer- that is the equalization of socio-economic conditions.

[3]According to the law on Economic Freedom, the total amount of consolidated budget (state, autonomous republics and local governments) should not exceed 30% of the Gross Domestic Product.

During the second stage, the total amount of expenses is calculated per LSG. There are two coefficients used for calculations: i) statistical coefficient and ii) equalization coefficient. Combination of these coefficients per LSG defines the share of expenses in the total LSG expenses.

Statistical coefficient is calculated based on population density, as well as number of population below age 6, number of population between 6-18 years and the total length of municipal roads.

The equalization coefficient is the sum of status coefficient and equalization scores.

Status coefficient for Tbilisi and Batumi is high: 2.8. For mountainous municipalities status coefficient is 1.1. For the rest of local self governments it is 1.0[4].

Equalization scores are defined per LSG as sum of arithmetic average and equalization score. Equalization score is calculates based on LSG revenue. LSG revenues are calculated based on the analysis of the current and previous three years data. Analysis uses the Microsoft excel function "Trend".

The equalization transfer is defined per LSG as the difference between total expenses (calculated total LSG expenses multipled by status and equalization coefficients) and LSG revenues (estimated with inflation rate and/or estimated GDP growth rate)

s. Almost all LSG units receive the equalization grant that is 30-70% of their budget.

Exception is for those municipalities that have high revenue from fee on usage of natural resources. For calculating equalization transfer for 2015, the MoF decided not to decrease the absolute amount of equalization transfer compared to previous year for each municipality.

Equalization transfer is unconditional and is used for financing of exclusive and "voluntary" responsibilities.

Transfer for delegated responsibilities

As already noted above, State is allocating transfer to LSGs for delegated responsibilities, annually. During the initial phase of transfer design, Ministry of Finance notifies local self governing units regarding the amount of transfer. This should be done before the 5th of October, each year, which gives LSGs 40 days to identify service beneficiaries and reflect the amount in the draft budget. Draft municipal budget is submitted to the representative body before the 15th of November.

Transfer for delegated responsibilities is conditional and can be used only for pre-defined services (public health, compulsory military recall, provision of certain communal services to internally displaced persons, commemoration of heroes fallen in war).

Special transfer

It is worth noting that the scope of the transfer was completely changed after 2014. According to the Budget Code of Georgia, special transfer currently can be allocated to LSGs for mitigating damage caused by natural disasters, wars, pandemics and other emergency cases. The special transfer can still be used for "other", not specified purposes. As the starting point,

[4]As a temporary measure for five newly established self-governing cities status coefficient is 0.5. LSGs that exist de jure (occupied territories) status coefficient is 1.5.

the local self government unit should request the State allocation of the special transfer. The request should contain the amount and justification. There is no time defined for sending request, therefore the request can be submitted during budget preparation as well as during budget execution periods.

Capital Transfer

Capital transfer was introduced in 2014, after the new Code on Local Self Government was enacted. The capital transfer is allocated to local self governments for capital/infrastructure projects. The mechanism for transfer allocation is similar to that one of the special transfer; the LSG should submit the request, indicating the required amount and justification. It is again assumed that the request can be submitted during budget preparation and execution phases.

Special funds of the State budget

There are three funds in the budget, that may allocate funding to local-self governments during the budget execution period: i) reserve fund of the President, ii) reserve fund of the government, iii) fund for implementation of projects in regions

Reserve fund of the Government and the President together should not exceed 2% of the State budget. Total amount of the fund for implementation of projects in regions is formed during the budget preparation period. It varies from 5 to 8% depending on the macroeconomic performance of the country and the election cycle.

Allocation of funding from special funds is done by the decision of the President and the Government. If the amount is less than 100 000 Gel, Prime Minister can authorize the allocation by consulting the Ministry of Finance.

It has to be highlighted that funds allocated to LSGs from special funds, during the year are added to initial amount of "special" and "capital" transfers.

2) Disparity among self-governing cities and municipalities in terms of financial resourses

   The main purpose of all type of transfers that exist in Georgia is to match the spending needs of LSGs. Studies, conducted by NGOs and think-tanks, have shown that more funding and services are available for inhabitants in self governing cities than in municipalities. The reason for positive discrimination of cities are twofold.
   Firstly, the majority (more than 57%) of population leaves in cities, therefore government wants to target the larger group of persons. Thus, constructing and maintenance of infrastructure in urban areas is more costly and demand of the population is higher.
   Second argument often quoted, is promotion of economic “enclaves”. Fostering targeted cities and settlements, that has touristic or other potential for development, requires heavy investments from the State. The targeted investment and economic revival shall trigger the neighbouring settlements and municipalities in future. This approach was used for developing Batumi, as a touristic destination, during 2009-2012. This increased Georgia’s touristic capacities significantly and promoted foreign direct investments and touristic inflows in the country.

3) Capital investment: local responsibilities, sources of financing, planning and managing investments
   Capital investment projects in regions are managed directly by the State (through municipal development fund) or by LSG. In almost all of the cases financing is coming from the state budget (even though in some cases the initial source is external donor).
   LSG units are involved in the planning process and their voice is not neglected. However, modern practices of capital budgeting and investment project management are not introduced in Georgia.

4) Information sources, available and public databases on intergovernmental transfers

The information on intergovernmental transfers are available on annual state budget law and in quarterly budget execution reports. The budget documents and execution reports are published online at the website www.mof.ge, in Georgian, in PDF format). The information on transfers are available in disaggregated form.

Areas/topics for benchmarking (Annex 2)

Fiscal equalization

- Objectives of equalization-factors of inequalities taken into consideration
- Share of equalization grant in total amount of transfers
- Local spending autonomy in service areas eligible for transfers
-

Stability and predictability of equalization transfer amount, equalization formula

Quality of data: local government information vs State statistics

State policy towards non-equalization grants

- Transparency of decision making
- Bargaining power
- Institutions involved in grants design process

Local borrowing

1) significance of raising debt

There is a limited practise of LSG borrowing. As the financial market is underdeveloped in Georgia, the only source of borrowing is from commercial banks. Only large self governing cities occasionally use the practise of borrowing from banks. Most of the loans are short term (within year). During last three years, there has been no case of taking the loan from commercial banks (with one year or more maturity period)[5].

Multi-year borrowing is possible if it is related to investment projects. Investment projects funded from the international donor sources (World Bank, Asian Development Bank investment credits, European Union Neighbourhood Investment Facility) is reflected in State or LSG budgets. Donor funded investment projects are managed through the MoF and debt service is reflected in intergovernmental transfers.

2) autonomy in borrowing: debt limits and national regulations

According to the law on Public Debt, local self government units are not allowed to borrow without the consent of the Ministry of Finance. Having the opportunity to apply for special or capital transfers LSGs are reluctant to apply for lending to the banks. Lending became also more difficult after 2013, when the Law on Economic Liberty entered into force. The law sets limits to the national public debt that should not be more than 60% of GDP.

3) information sources, datasets on local borrowing, debt stock, debt service

The Ministry of Finance maintains the information only on State debt Ministry updates the database on a monthly basis that is also available at the website (www.mof.ge) in English and Georgian. The data on LSG debt is not available publicly. The National Bank of Georgia publishes information on total public debt on its website (www.nbgf.gov.ge). However, the data contain info on debt of State, LSG and State owned enterprises;

The investment projects that are financed through donors do not pass through the Treasury Single Account. Therefore, Treasury and MoF do not possess up-to-date database on local-self government debt. Information on LSG debt however is available on municipal budget documents (approved budgets and budget execution reports). Budget format, that is universal for all levels of the government, requires the reference on total debt as well as annual targets. For example, the annual budget of self-governing city- Tbilisi (the capital) projects the total debt by the end of 2015 as 2009.8 ml. Gel. The debt consist of:

- 95.1 ml Gel-as World Bank loan for municipal development
- 808.7 ml Gel –as Japanese project loan
- 1106 ml Gel as Kuwait fund investment credit

To collect the data on local-self government debt, one should read annual budgets and quarterly execution reports for all 76 entities. The information could be available in the Budget Department of the MoF that collects and analyses the LSG financial data regularly.

Areas/topics for benchmarking (Annex 3)

Freedom to borrow

Forms of loans available to LSGs

[5]Source: State Treasury

Availability of Central government guarantees

Local financial management

Budget classification

1) Separation of current and capital budget, balancing local budgets

IMF's Government Financial Statistics Manual 2001 (GFSM 2001) is applied in Georgia from 2009. The information on current and capital budgets are available since 2010. The budget revenues are grouped and presented under four headings:

Income: taxes, non-tax revenues and grants.

Decrease of financial assets: leftovers from bank account

Decrease of non-financial assets: selling the municipal property and shares

Increase of liabilities: loans mostly investment credits from the WB, ADB, etc.

Budget outlays are grouped under four headings:

Expenditures: salaries, procurement of goods and services, subsidies, subventions, taxes, interest payments on loans

Increase of financial assets: providing loans to business (only large self governing cities run SME development programmes)

Increase of non-financial assets: investing in infrastructure that can be considered as the capital budget

Decrease of liabilities: repaying investment credits

The Budget Code sets the requirements that the budgets shall be balanced. LSG government units have the limited source of deficit financing. In order to camouflage the deficit, usually they do optimistic projection of the revenue item "decrease of non-financial assets".

The legislation requires two type of information presented in the budget: i) financial and ii) programme.

Financial information is presented according to economic, functional and organizational classification. Economic classification groups expenses according to cost types (salaries, procurement of goods and services, etc). Functional classification groups expenses according to functions (general government expenses, economic activities, agriculture, healthcare, environment, etc.) Organizational classification groups expenses according to entities that are under the LSG (Mayor's office, representative body, other municipal entities).

The programme information, that is introduced from 2013,requires the local self governments to develop the programme budget format. Even though the programme budgeting is in its initial phase of development in Georgia, LSGs have to design four types of programmes:

- Administrative programmes: related to management of the municipality
- Service programmes: related to service provision
- Subsidiary programmes: related to financing of municipality owned non-commercial entities
- Infrastructure programmes: related to capital investment

Each programme should have defined objective, expected results and measurement indicators as well as costed activities that are linked to financial part of the budget. Even though, most of the LSG programmes follow the required structure, objectives, expected results and indicators are of a poor quality. Infrastructure programmes not often contain full information on projected constructions, costs per activity and per unit.

Planning and budgeting

2) Strategic planning, multiyear budgeting

Strategic planning and medium term budgeting is introduced in LSGs from 2013. The planning horizon is four years. The multi-year planning has two stages.

During the first stage, LSG units are required to elaborate Priorities Document (PD). PD should have number of sections. In the first part of the document, LSGs should outline main figures on income, expenditure, financial and non financial assets and liabilities for current, past and future four years. The source of the information is usually the Ministry of Finance of Georgia. Fiscal targets for future years are very tentative due to weak macro-fiscal forecasting and fragility of Georgia's economy.

In the second part of the document LSGs should analyse financial trends of the last and the current year. This information is usually taken from the budget execution reports that are prepared on a quarterly bases.

In the third section medium-term priorities should be indicated. Priorities shall be derived from the needs of the local population and be inline with the mandate of the LSG. It is worth noting that needs are almost identical in each of the municipality. These are mostly infrastructure (roads, water, savage), pre-school education, health and social issues, cultural heritage, etc. Priorities document should also contain preliminary information on budget programmes, their objectives, expected outcomes and indicators.

Annual budget document is the second stage of budgeting. It is developed based on the Priorities Document. During budget preparation an update on macro-fiscal targets is done and more precise projections are made on programme objectives, activities, outputs, results as well as activity costs.

Programmes (objectives, results, indicators) should be projected for next four years. The municipalities should design the programmes that derive from their mandate and have a permanent nature. Activities under the programme can be grouped into sub-programmes. Similar to programmes, sub-programmes have objectives, results and indicators. However, duration of sub-programmes shall be designed for shorter periods than programmes (around 1 year).

The Priorities Document and the annual budget are considered as a one package that should be consistent with each other.

3) Annual fiscal planning, budgeting: responsibilities, methods, timing, planning municipal subsidiaries, openness and publicity

Management of the whole budget cycle is the responsibility of the LSGs. The executive organ Mayor's office/Gamgebeli is responsible for budget planning, submission, execution and reporting. The representative body –Sakrebulo is in charge of budget approval and financial oversight.

The budget planning starts in March, each year and takes 9 month. The financial unit of the executive is coordinating the preparation of the Priorities Document. All structural units of the executive, as well as subordinated agencies should be involved in the document preparation process. Most of the LSGs conduct public consultations in order to identify the needs. The consultations are organized in April-May through public meetings, interviews and opinion surveys.

During May-July, LSGs get the preliminary data from the Ministry of Finance regarding macro-fiscal projections and the functions that will be delegated from the State. As most valuable sources of LSG finances are collected or allocated by the MoF (taxes and fees and transfers) LSGs depend on the information coming from the centre. During August-September, local budgets are prepared with informal consultations with the MoF. The latter notifies LSGs regarding state transfers before the 5th of October. After that date, municipalities have 40 days to make final changes to the draft budget and submit to the representative body no later that 15th of November.

As macro-fiscal planning is still weak incremental budgeting is the most common method to project the revenues. Taxes and fees are projected based on inflation and GDP growth expectation. Selling of assets is projected case by case.

Expenditures are projected based on inflation. Any major increase in expenditure items is consulted with the MoF. Major increase of the budget can be caused by investment loan coming from donor funding or by the decision of the State to allocate funding to specific subject (infrastructure, pre-school education, etc). The major increase of expenses is usually reflected in state transfers. The last example of this was decision by the state to increase pre-school education coverage for all.

The budget (both revenue and expenditure side) covers only partial information regarding subsidiaries. The resources transferred to commercial and non-commercial entities are reflected in the expenditure item "subsidies", without farther breakdown of expenditure types (salaries, goods and services, etc). Revenues generated by subsidiaries are not consolidated in the LSG budget too. Similar type of practice exist at the state level too. During current year, the MoF initiated number of actions for integrating the subsidiaries in the respective budgets. However, opponents of the reform argue that integration of semi-governmental institutions into the budget limits their revenue generation independence directly linked with service efficiency.

The representative body of the LSG has 45 days for budget scrutiny and approval. Sakrebulo should provide its comments to the executive regarding the draft within 10 days that is relatively short period. The Budget Code requires that the draft budget is published as well.

The executive body has another 10 days to accommodate comments issued by the representative. The budget discussion process should be public and be completed before the end of the year.

The approved budget is published in the local newspaper and uploaded on the website of the LSG. LSGs do not prepare Citizen's budgets and because information is technical, it does not get high attention from the public. However, the formal requirement of the legislation regarding the budget transparency and publicity is met.

Budget implementation

4) Budget implementation, local spending autonomy: supervision and control over approved budgets, carry forward leftovers, intervention rules in emergency cases

The executive branch of the LSG is responsible for budget execution and reporting. The fiscal year is similar to the calendar year. Approved budget is braked-down into quarters and executed according to public procurement plan.The procurement system is fully electronic in Georgia that obliges all procuring entities to place their requests in the system (procurement.ge). The procurement is open to national and international bidders and is bi-lingual (Georgian and English).

Executive is allowed to spend the money, strictly according to the approved budget. Deviation is allowed within the 5% margin. Thus, the Mayor/Gamgebeli has reserve fund that should not exceed 2% of the municipal budget. Even though the reserve fund is intended for unforeseen expenses it should be spend according to public procurement rules (competitive tendering). The only exemption is Tbilisi municipality that most of the LSGs find unfair.

Reallocation of costs from one programme to another (or from one budget organization to another) above 5% should be done through budget amendments. Amendments are quite frequent and happen number of times during the year, mostly in mid-year and late autumn.

Apart from weak capacity to project expenses, the reason for budget amendments are state transfers coming during the year. As noted above, special and capital transfers can be allocated during the budget execution period and its reflection and execution in the LSG budget requires the consent from the representative body.

The unspent funds that are accumulated on the LSGs accounts at the end of the year can be carried over to the next year's budget.

5) Agreement, contract with and control of service organizations

Cultural, sports and primary education services are implemented through municipality established non-commercial legal entities.

The garbage collection is managed through LSG established companies.

The rest of the services (road construction and maintenance, street lighting, greenery, look after cemeteries) is outsourced or provided through municipal companies.

The contract on service delivery is signed only in case of outsourcing. In the rest of the cases, the statute of the LSG defines the terms of service provision.

Respective departments of the LSG are are in charge of monitoring the service delivery. Monitoring is done through regular reporting from subsidiary agencies and from contractors.

Information and audit

6) Fiscal information system, accounting rules, practices, transparency of budget and reports

The cash based accounting is used during the budget execution. Certain items are also recorded through accrual. The budget execution reporting is done on a cash basis. Apart from financial data, LSGs provide some information regarding service delivery (number of beneficiaries, geographical mapping of provided services). Most of the service related information is focused on inputs (rather than on outputs).

According to the Budget Code of Georgia, all budget data and reports should be open to public. Therefore, LSGs provided financial data to interested stakeholders if requested.

7) Budget monitoring, supervision, independent and external audit

The representative branch of the LSG is responsible for budget execution monitoring. This is done through Budget and Finance Commission that is formed in all LSGs. Commission has the right to conduct hearings on budget execution and recall respective documents from executive as well as from subsidiary agencies.

The representative body should approve the annual budget execution report not later than May of the year after. If the execution report is not approved the "vote of no confidence" to executive is declared.

In addition, representative body has the right to contract an independent auditor for verification of annual financial statements produced by the Executive.

The State Audit Office, that is the supreme audit institution, independent from the government has the right to conduct audit (financial and performance) of LSGs. The audit is done usually once per 3-5 years, as the budget of LSGs are relatively small compared to State.

Line Ministries have the right to monitor the implementation of those functions/activities that is delegated from state. However, the monitoring is always coordinated with the Ministry of Regional Development and Infrastructure (MRDI) that is providing technical and methodological guidance to LSGs.

Governor's offices, established in regions have the right to monitor the compliance of legal documents issued by LSGs vis-à-vis the national legislation. They also have a function to provide inputs to the Priorities Documents that are produced by municipalities. This should allow alignment of national priorities in regions with local needs.

8) Conflict of interest regulations, transparency

The law on Civil Service defines the conflict of interest for public officials. Civil servants have the obligation to submit annual income statement/declaration to Civil Service Bureau that monitors the potential cases of misconduct.

Local financial management capacity, training of municipal administration and elected officials

Capacity of local financial managers are still week. Only large local-self governing cities have the ability to attract most qualified personnel. The knowledge of elected members of Sakrebulo regarding budget and financial oversight issues is very poor in most of the LSGs.

The Ministry of Finance is providing trainings through its financial academy related to newly adopted regulations. The target audience of MOF trainings is executive.

International donors and local NGOs provide training in municipal finance, including to elected officials but this is not done on a regular basis.

From 2015, LSGs are required to allocate 1% of their budget for capacity development of local civil servants. More systemic approach for capacity development of municipal civil servants will be coordinated by the Ministry of Regional Development and Infrastructure.

Potential areas, topics for benchmarking (Annex 4.)

Involvement of the public in budgeting (planning, execution, monitoring and evaluation)-accountability channels

Framework of budget preparation and approval

Multi-annual budget plans

Explanations of performance: quality of programme budgets

Involvement of elected bodies in the budgeting process (including the right to amend the proposal)

Rules and frequency for budget adjustments

Financial monitoring system of local budgets

Transparency of budget documents

Implementation of LFB

1) Information, datasets for comparison (Annex 5.)
   a. *potential sources of aggregate data and statistics needed for the LFB surveys*
   Ministry of Finance, state treasury database; Budget department of the MoF is regularly monitoring the LSGs budget. Thus, the LSGs regularly submit detailed financial data (draft and enacted budget, execution reports) to the MoF

   b. *disaggregate information and data on local government budgets, revenue sources*
   From 1st January, 2015 all local government accounts are closed and banking operations are done through the Treasury. Thus detailed info per income/expenditure type can be collected from treasury in PDF or Microsoft xls format. Thus, the interested person should submit an official request for info.

2) Problems and obstacles in LFB implementation
   a. *national government incentives for comparison, competition;*
   The state is interested to measure the efficiency of LSGs. The Ministry of Regional Development and Infrastructure, that is in charge of LSG coordination, is considering to establish the model/standard for measuring the performance of sub-national governments.
   In addition, experience of the Easter Partnership countries and comparison with existing practises will be valuable information for policy makers at national level.

   b. *willingness of local governments to participate in the future LFB programme*
   Large self-governing cities, including capital will be eager to participate, with the support of the Ministry of regional Development and Infrastructure.

   c. *government units, national agencies, independent bodies, civic organizations possibly interested in hosting the benchmarking programme*
   Ministry of Regional Development and Infrastructure, National Association of Local Governments of Georgia (NALAG); Centre of Effective Local Governance and Territorial Arrangements (CEGSTAR: http://www.lsg.gov.ge/),

   d. availability of information, disaggregated data
   Already noted above

   e. *publicity of and access to local internal documents (rules and procedures, resolutions, decrees, budgets, audit reports, etc.)*
   Rules and regulations issued by LSGs are public. Legal acts are registered in the Ministry of Justice database that maintains the database of legal acts. The legal documents are available on the designated website: www.matsne.gov.ge. Internal documents and procedures that are not available publicly can be withdrawn from LSG. In this case the fee for provision of public information has to be paid (covering the costs of photo-copy). Audit reports are available of the State Audit Office website: www.sao.ge

f. local technical capacity to manage external evaluation of local finances
All LSGs can temporary designate one or two persons for external evaluation. For local public servants it is an opportunity to get acquainted with international practice.

g. election years (parliamentary, local)
Parliamentary elections will be organized in 2016. Presidential and LSG elections is due to 2018.

3) Guidance and programme for adapting the (national and local) LFB toolkit

a. *options for raising central and local government public interest for LFB*
Fiscal benchmarking is an opportunity to take stock of implemented reforms in this area. The Council of Europe, that has contributed to establishment of standards in this area, is highly respected in Georgia. The cross-country data and comparisons will allow supporters (Ministry of Regional Development and Infrastructure) on LSG reform to increase awareness on the subject.

b. *major ongoing local government reform and modernization programs*
Currently fiscal decentralization is in the agenda of authorities. It is widely recognized that LSGs do not have enough capacity to cope with the assigned responsibilities. However, Georgia is a developing country with high level of unemployment and social needs. High expenditure needs at the State level, coupled with economic crisis in the region do not allow the government to allocate more finances to sub-national governments. In order to foster development in regions, state plans to introduce economic stimulation (smaller taxes and communal service fees and exemptions; more state subsidies) measures in depressed and mountainous regions. Parliament already passed the law by the second reading on Mountains (regions) that envisages above noted economic activity stimulation measures.

c. *potential partners for hosting the future LFB programme (national, local)*
Potential counterparts can be the Ministry for Regional Development and Infrastructure and Centre for Effective Governance and Territorial Arrangements. The Association for Local Authorities of Georgia could also be partnered in the LFB.
At local levels respective local self governments should provide their contribution.

d. *potential local sources of financing LFB programme*
Number of international organizations, like European Union, USAID and its projects, UNDP, Swiss Agency for Development, that are active in the local governance/decentralization field should be willing to finance the study. Government of Georgia may be interested in co-funding the project.

Annexes

Annex 1. Summary of the proposed areas of benchmarking: local own source and shared revenues	
National systems, level of decentralization: with references to Rec (2005) No. 1.-36.; 68.-72.	
General principles	
Area No. 1…..	Rec (2005). No. x
…..	
Local taxation	
Area No. …..	Rec (2005). No. y
…	
Local governments: with references to Rec (2005) No. 9.-31.	
General principles	
Area No. 1…..	Rec (2005). No. x
…..	
Local taxation	
Area No. …..	Rec (2005). No. y
…	
Fees and charges	
Area No. …..	Rec (2005). No. y
….	
Other resources	
Area No. …..	Rec (2005). No. y
….	

Annex 2. Summary of the proposed areas of benchmarking: fiscal equalization and grants	
National systems, level of decentralization: with references to Rec (2005) No.37.-67.	
Financial equalization	
Area No. …..	Rec (2005). No. z
….	
Grants to local authorities	
Area No. …..	Rec (2005). No.
….	

Annex 3. Summary of the proposed areas of benchmarking: local borrowing	
National systems, level of decentralization: with references to Rec (2005) No. 73.-76	
Borrowing	
Area No. …..	Rec (2005). No.
….	
Local governments: with references to Rec (2005) No. 30.-31.	
Borrowing	
Area No. …..	Rec (2005). No.
….	

Annex 4. Summary of the proposed areas of benchmarking: financial and budgetary management	
National systems, level of decentralization: with references to Rec (2004) No. 1.-43	
General principles	
Area No. …..	Rec (2004). No.
….	
Limitations on financial autonomy	
Area No. …..	Rec (2004). No.
….	
Fiscal estimation methods	
Area No. …..	Rec (2004). No.
….	
Financial risk management	
Area No. …..	Rec (2004). No.
….	
Local elected representatives and employees	
Area No. …..	Rec (2004). No.
…..	
Control	
Area No. …..	Rec (2004). No.
….	
Recovery of local authorities in financial difficulty	
Area No. …..	Rec (2004). No.
….	
….	
Local governments: with references to Rec (2004) No. 44.-87.	

General principles	
Area No. …..	Rec (2004). No.
….	
Information and openness	
Area No. …..	Rec (2004). No.
….	
Budget preparation	
Area No. …..	Rec (2004). No.
….	
Financial risk management	
Area No. …..	Rec (2004). No.
….	
Budget approval	
Area No. …..	Rec (2004). No.
….	
Budget approval	
Area No. …..	Rec (2004). No.
….	
Budget implementation	
Area No. …..	Rec (2004). No.
….	
Budget accounts	
Area No. …..	Rec (2004). No.
….	
Recovery of local authorities in financial difficulty	
Area No. …..	Rec (2004). No.
….	
….	

Annex 5. Availability of information and data on local governments

<u>Aggregate data of local (subnational) finances in ml. Gel (2.25 gel = 1 USD)</u>

Item	2012	2013	2014
Current expenditures	1123.4	1246	1306.9
Capital expenditures	586.6	291	295.7
Expenditures by functions (service areas)			

Total revenues	1710	1537	1602.6
Local own source current revenues	424.1	453.7	534.8
• local taxes	230	230.7	245.9
• dues, fees	194.1	223	288.9
• user charges, tariff revenues			
Local capital revenues			
Shared revenues:			
• origin based	0.1	0.1	0.1
• allocated by formula	0.1	0.1	0.1
Grants, transfers, donations, subventions, etc.	1285.9	1083.3	1067.8
Local debt (stock)	8.8	12.3	9
Annual net borrowing			

References, further readings, websites

1. Constitution of Georgia
2. Budget Code of Georgia
3. Local Self Government Code of Georgia
4. Tax Code of Georgia
5. Law on local fees
6. Law on fee systems of Georgia
7. Code on Administrative Fines of Georgia
8. Decree of the Ministry of Finance defining the budget classification
9. Decree of the Ministry of Finance defining the fiscal equalization transfer allocation mechanism
10. State budget of 2015 of Georgia
11. 2015 budget of self-governing city Tbilisi
12. Web-pages:
    a. www.mof.ge
    b. www.treasury.gov.ge
    c. www.geostat.ge
    d. www.sao.ge
    e. www.matsne.gov.ge
    f. www.procurement.ge
    g. www.e-auction.ge