
ANALYSIS OF THE FORMATION AND USE OF BUDGETARY POLICIES ENSURING THE SOCIO-ECONOMIC DEVELOPMENT OF TERRITORIAL UNITS

Prof. Abuselidze George, DSc (Econ)¹

*Head of the Department of Finance, Banking and Insurance,
Batumi Shota Rustaveli State University, Georgia*

Abstract: The main function of the state in nowadays-civilized world is to maintain the macro-economic proportions throughout the country and avoid financial and economic crises in regions that have priority in the formation of the new economic system in Georgia.

The object of the research is the formation and use of Budget policy of Georgia;

One of the most problematic places is socio-economic development of territorial units;

As a result of the research it is shown that current economic and political system's radical transformation process, creation of new economic system and ensuring its efficiency, requires mobilization of huge financial resources, which is impossible without proper functioning of the financial mechanism. This in turn requires implementation of sufficient financial and economic policy. The government should take responsibility of supporting financial-economic independence for territorial units.

In the future, the proposed forms of financial mechanisms and features of use for the arrangement and territorial integrity of the government.

Key words: fiscal policy, state and local budget, intergovernmental relations, forms of financial mechanisms, Georgia.

JEL: E62, H61, H72, H75, H76, H77.

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¹ E-mail: george.abuselidze@bsu.edu.ge / abuseri@mail.ru

Introduction

Fiscal decentralization, which grants tax-collection and budgetary powers to local governments, was one of the most important reforms in many developing countries. Fiscal autonomy of local self-governance is the main aspect of political decentralization.

The distribution of power between the government and the central and local governments is still a subject of active discussion in many countries. One of the main goals of fiscal centralization reform is to ensure efficient spending of public resources and allocation of sufficient financial resource to the local authorities to exercise their powers.

In the modern conditions when Georgia has taken the course of the European structure, it is very important to develop a strategy for development of municipalities, which should ensure social economic development of the municipalities and increase their competitiveness.

Therefore, relevant is the study of the influence of budget policy on the socio-economic development of territorial units.

1. Methodological aspects of the study and literature review

The object of research is territorial units, their income and expenses. The calculations of the basic data and directions document (BDD).

One of the biggest problems is that the planned budget evaluation indicators are too general and do not allow for effective result evaluation.

The aim of this research is to analyze the allocation of budget revenues between the central and the regional governments and determine the typical flaws of the current system for allocation of budget funds, which hinders the establishment of sound financial budgets of territorial units and their financial independence, to prove the need for improvement of these budget relations and their generalization, and to give appropriate proposals and recommendations.

The results of the review of existing literature on the development of territorial units show that they address specific features and problems associated with budget policy that are considered mainly in the context of accelerating economic growth (Kline & Moretti, 2014; Gottlieb & Glaeser, 2008; Newmark & Simpson, 2014; Seliverstov, 2014; Busso, Gregory & Kline, 2013; Becker, Egger & Ehrlich, 2017; Skliar, 2011) and development of inter-budgetary relations, regional budgets or budget policies in other countries (Ehrlich & Seidel, 2018; Glaeser & Summers, 2018; Rodriguez-Pose, 2018; Khanduev & Tsydenmunkuev, 2007; Blöchliger et al., 2007;

Kliyanenko & Grechana, 2013; Dvoyenosenko, 2004; Demydenko, 2012). The existing publications include various concepts, ideas, and suggestions regarding regional division, stakeholder rights and the allocation of powers among central, regional and local authorities. The problems associated with the regulation of the transfer policy were considered mainly in the context of budgetary system regulations (Henkel et al., 2018; Sluhay, 2012).

This research uses various methods (quantitative qualitative, statistical, synthetic, component and comparative analysis) and practical approaches used in by Georgian and foreign economic researchers in their studies of budget relations and budgetary policy. It is based on the current laws and regulations in force in Georgia and in particular regarding the National Statistics Office of Georgia, the Economic Development and Finance Ministries, the Georgian National Statistics Office, the Parliamentary Finance and Budget Committee and other related departments.

2. Research results

Presently, the central government of Georgia undertakes certain measures to promote the economic independence of territorial units. Its main objective is to maintain the macroeconomic proportions throughout the country and avoid financial and economic crises in regions that have priority in the formation of the new economic system in Georgia.

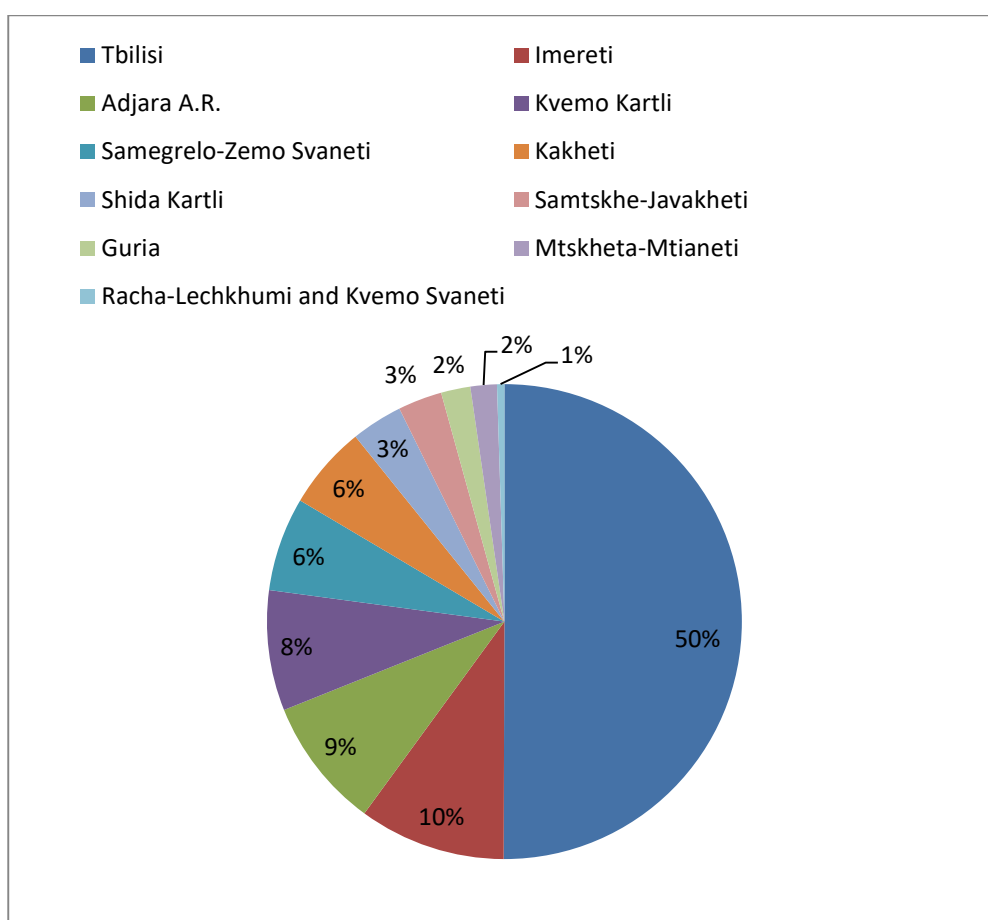
The current process of radical transformation of the economic and political system in Georgia and the implementation of a new and more efficient economic system requires the mobilization of huge financial resources, which is impossible without proper functioning of the financial mechanism. This, in turn, requires the implementation of an adequate fiscal policy.

The aim of any budget system (unitary or federal) should be to ensure economic efficiency, political stability and social justice. Otherwise, it would lead to sub-optimal allocation of budget resources, increase the levels of inflation and unemployment, result in shortages of qualified employees, and aggravate the problems associated with budgetary relations, among others.

Georgia's fiscal policy remains a challenging and still unresolved macroeconomic problem.

The developing character for the post-socialist countries defines the role and significance of territorial unit budgets. Therefore, the government should adopt an adequate policy to use the budget revenues and expenditures of the various territorial units to improve the economic, political and social situation in the country, and eventually to guarantee its real economic and political independence.

The budget deficits and excesses of many Georgian territorial units, such as Kakheti, Imereti, Samegrelo-Zemo Svaneti, Shida Kartli, Guria, and Mtskheta-Mtianeti, clearly indicate that wrong forecasting data is considered in the formation of future planning. The calculations of the basic data and directions document occasionally do not correspond to the real potential of the country's economy. Program budget result evaluation indicators are too general and do not allow for effective result evaluation. This is evidenced by the created gross domestic product by types of economic activity by territorial units. In 2017, Georgia's Gross Domestic Product (GDP) at current prices amounted to 15 138.6 million USD. The largest share of GDP by region was reported for Tbilisi (50.1 %), followed by Imereti (10.0 %), Adjara (8.9 %), Kvemo Kartli (8.2 %), Samegrelo-Zemo Svaneti (6.4 %), Shida Kartli (6.4 %), Guria (3.2 %), Racha-Lechkhumi and Kvemo Svaneti (3.2 %), Kakheti (2.8 %), Samtskhe-Javakheti (2.8 %), Mtskheta-Mtianeti (2.8 %), and Imereti (1.0 %) (Fig. 1).



Source: National Statistics office of Georgia

Figure 1. Structure of Gross Domestic Product by Regions in 2017

The largest share of the added value of Tbilisi comes from Trade (27.4 %), followed by Transport and Communication (14.8 %) and Construction (13.7 %). In Imereti the primary sectors include Industry (17.2 %), Agriculture (12.9 %) and Public Administration (12.2 %), while in Adjara – the third region of Georgia in terms of value-added volume – Construction (16.0 %), Trade, repair of vehicles, personal & household goods (12.2 %) and Transport and Communication (8.8 %) represent the main spheres of economic activity. In Kvemo Kartli prevail the sectors of Industry (37.2 %), Agriculture (17.9 %) and Public Administration (7.1 %).

The economic disproportions in regional development are especially harmful during the crisis development leading to sharp increase in socio-economic differences among the relatively large administrative–territorial units and other entities within the country. Although there are many factors that cause income differences, the most important one is the absence of real sectors of the economy (Reshina & Vocish, 2011).

The condition of the local budgets is not able to provide social-economic development of cities, towns, districts and others. As we can see, Georgia’s budget revenues and expenditures are planned without any analysis of the current and the expected indicators of financial and economic activities and without expert estimation. Consequently, a budgetary revenue analysis and planning system is not yet established. According to the “Development Plan” of the country, the macroeconomic parameters and the socio-economic development program are determined formally. The control over the revenues and expenditures carried out by the financial and tax authorities is considered to be ineffective. Budget indicators do not fully reflect the actual situation of the country. Budgetary revenues do not have any effect on the socio-economic situation of territorial units (Table 1).

Table 1

Local self-governance budget revenue statistics by years

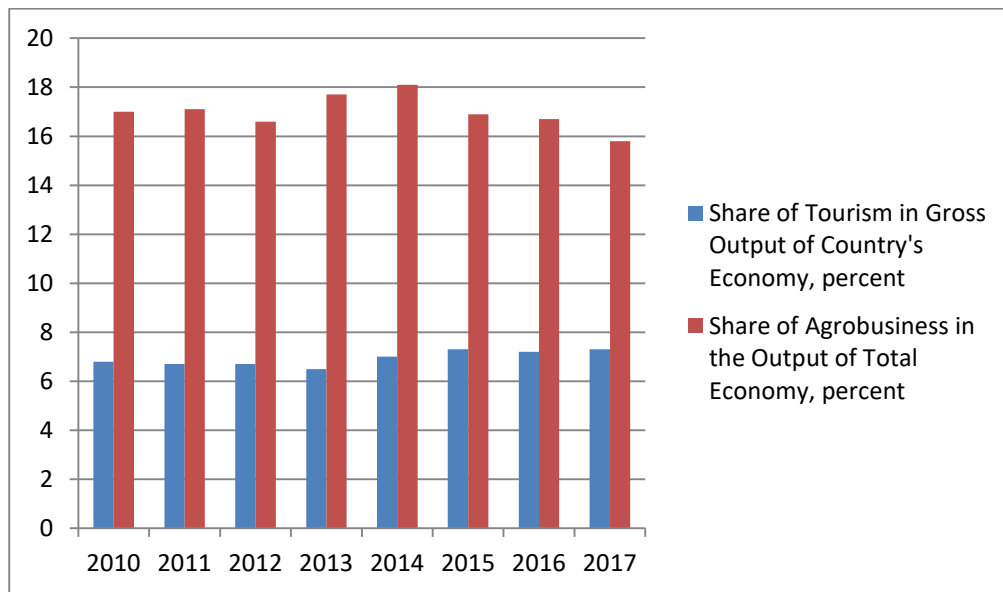
Local budget revenues			
Year	2016	2017	2018
Municipality	million USD	million USD	million USD
Tbilisi	298 870.7	315 925.4	312 287.9
Batumi	49 948.7	62 196.3	58 162.0
Rustavi	16 123.0	15 092.3	16 013.3
Kutaisi	25 850.0	24 716.9	23 597.4
Borjomi	8 018.4	8 595.8	7 551.5

Note: the calculations are based on data from the Ministry of Finance of Georgia. The GEL/USD exchange rates used for the calculations are as follows 2016 - 2.4, 2017 - 2.5, 2018 - 2.66.

Table 1 shows the budget revenues of several municipalities in Georgia. Obviously, the difference in the budget revenues of any particular municipality, as well as among municipalities, is due to various reasons:

1. Budget policy of municipality.
2. Different management system.
3. Different sources of revenue: tourism, agriculture (Fig. 2), production, services, etc.

Despite the growth of revenues in some municipalities, the decrease in others is very bad for both the municipalities and the country's economic growth.



Source: Calculations by the Author based on National Statistics office of Georgia

Figure 2

According to one researcher (Kolodko, 1999) “This is valid for all economic systems, countries with differing scopes of economic activity, various GDP levels, and odd institutional advancement, so it is even more valid for transition economies. In countries where the rules were previously fundamentally different from the current post-socialist regulations, the introduction of new codes of conduct and the enforcement of new regulations for economic entities calls for even harder and more focused state intervention than elsewhere.”

The main measure that the government must take to increase the GDP growth rate, to decrease unemployment, and to improve living standard is to

develop individual (separate) and priority sectors. Special attention should be paid to the improvement of the business environment, as it is the main condition for national farming development. Namely, this sector has decisive word in the complexity of economic development. For the time being business has complications not only with the beginning of development, but also with escaping from the deep economic depression caused by political, social or economic cataclysms (Abuselidze, 2018). The economic power of the state depends on the successful activities of private entrepreneurs. In turn, private business needs a "source of energy"- budget funds accessible through a capital market that is completely independent from bank financing (Abuselidze 2018, p. 1930).

This can be achieved through schemes for allocation of powers among the different levels of government and establishment of a comprehensive multilevel fiscal system. Consequently, the political and administrative legislation of the country regulating its economic development and its economic, financial and social policies should have a marked regional focus. According to some authors (Abuselidze & Slobodyanik, 2018), differentiated approaches are needed in the field of budget, taxation, credit, business support, industrial and agricultural development, employment, healthcare, education, foreign trade, regional and national markets.

The above objectives of the regional tax system enhancement should be supported by a theoretically grounded strategy for regional structural reforms. Their performance effectiveness is achieved through efficient activities of production-economic complexes and various type of enterprises and creation of the region-specific structures (Ishina, 2012).

Generally, welfare delivery is regulated through the following methods (Abuselidze, 2013):

1. Rendering services to the state and municipalities;
2. State and municipal subsidies;
3. Government and municipal public procurement works (contracts);
4. Regulation of supply by means of budgetary tax and money-and-credit instruments.

Georgia is one of the most unique countries in the world in terms of variety of climatic conditions. However, this fact in turn influences the development of the different sectors of its national economy, and the economy of the separate regions. Therefore, the government can use the local finances as a tool to support the social and economic development of the territorial units that are least developed because of their specific history and natural conditions (Abuselidze, 2018).

Fiscal policy has a major role in the regional policy implementation of territorial units which reflects the fact that financial resources are provided for

those territorial units which lag behind the country's average level of development due to their location, natural conditions, or other objective reasons. The central government is obliged to provide relevant assistance to such territorial units in the framework of the pre-draft program. Provision of public goods only by central government bodies is associated with significant costs because of the uniform approach to all areas (in some areas there will be an excessive supply of public goods, while in others the supply will be insufficient) (Oates, 1972; Tanzi, 1996). The decentralized decision-making process allows for the evaluation of different solutions and encourages the exchange of best practices. In this case, it is essential that the powers transferred to the local governments should be adequate to their capacity and the results they can achieve (Bahl, 1999; Khaleghian, 2003). For this purpose, special authorities should be created in the form of committees and departments. For instance, such committees exist in Germany and include the of ministers of economy and ministers of “land” economy. The committee annually approves the Regional Development Programs and defines the deadlines for their implementation. Recent contributions by Glaeser et al. (2008), Austin et al. (2018) and Rodriguez-Pose (2018, pp. 189-209) discuss those policies in the context of the recent rise in populist vote shares in lagging regions. See Blöchliger et al. (2007) for a recent cross-country overview of fiscal equalization schemes and an estimation of their overall volumes across OECD countries. The volume of fiscal equalization also dwarfs the classical regional development policies within Germany.

In summary, we would like to state that it is impossible to achieve the socio-economic development of territorial units without improvement of the financial relations which should ensure economic equalization of individual units. This can be done by implementing differentiated, protectionist, and proactive regional economic policies in the country, one of the main tasks being a budgetary system reform.

The analysis of the social development in the territorial units should include a population employment efficiency coefficient (Abuselidze, 2015), which can be calculated by using the formula:

$$Kde = 1 - \sum_j \frac{Pe + Pu}{Pea}, \quad (1)$$

where Kde – population employment efficiency coefficient;
 i, j – quantity of population groups according to employment;
 Pe – quantity of population employed at a disadvantage;

Pu – percentage of unemployed population;
Pea – economically active population.

The author of this paper believes that in order to provide proper fiscal policy, it should be based on the budget federalism principle as central and regional units will manage their budgets and responsibilities by taking into consideration their own budget revenues for budget formation, approval and implementation.

In the socio-economic development of territorial units, it is important to separate the competences between the central government and the territorial units in three groups:

1. Special competences of the Center.
2. Issues assigned to the special authority of territorial units.
3. Issues related to joint management.

It should also be noted that the issues related to the special tasks of the center are clearly stated in the Constitution of Georgia, but nothing is mentioned about the competences of the joint and territorial units.

From the point of view of the author of this paper, it is probably acceptable to establish the model of the competences defining the special legal competences of the central and the local authorities. As for issues not included in any of the competences, they should be subject to joint management.

The author of this paper believes that the separation of central and regional financial authority can generally be based on two principles: according to the first principle, the financial dependence of the center and territorial units should be separated, which means that local governments should have independent budgets and manage their finances independently. However, the problem of maintaining the economic balance, which guarantees the independence of the state and is a key factor for the country's socio-economic development, should not be excluded from the agenda. This ideology is the basis of the second principle separating the finances of the center and territorial units, according to which the state within its territory should promote common banking, tax, and insurance policies, thus providing financial equalization of certain underdeveloped territorial units. Although these two principles of financial authority are contradictory, this contradiction could be overcome by implementing a reasonable fiscal policy.

3. SWOT analysis of research results

Strengths. The article analyses the opportunities of budget decentralization in the light of forming and functioning of local self-government system. Special attention is paid to the principles of separation of expenditure responsibilities, to the problem of fixing tax revenues and to variants of regulation of vertical and horizontal inequalities in state budget system.

Weaknesses. The performance of the expected results of municipalities in some cases is aggregated at the level of programs and does not provide them with subsequent detailing as subprograms that make it impossible to separate the final from the interim results. Consequently, there is a reasonable relation between financial and non-financial information.

Opportunities. New value-added tax rates were enforced at the beginning of 2019. Since this tax generates 19% of the budget revenue, this change will affect the expected municipal budget revenues and create conditions for decentralization.

Threats. In certain cases, the performance of the results is incompatible with the predetermined targeted indicators, which makes it difficult or impossible to compare the predicted and achieved results. Moreover, there are frequent changes in legislation.

Conclusions

1. The model provides an acceptable separation of powers, which defines the specific authority of the central and the local governments, and the areas of budget management that shall be subject to joint management.

2. It is shown that the problems related to maintaining the economic balance, which is a guarantee for the national independence and a key factor for the socio-economic development, should not be disregarded.

3. The disbalance between the revenue of one concrete municipality and the revenues of all the rest of the municipalities as well as among the municipalities affects negatively both the municipalities and the country's economic growth.

4. The second underlying principle of fiscal decentralization should ensure the financial cohesion among the territorial units by supporting the underdeveloped ones to reach the country-average level.

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