

## Modern Challenges in Establishing Financial Base of Local Self-Government in Georgia

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**ABSTRACT.** Modern problems of establishing the financial base of local self-government, some suggestions to address them, distinguishing characteristics of local self-government being a branch of the government are considered in the paper. During the period of 10-12 years since the collapse of the Former Soviet Union and formation of new States there was a need for decentralization of public finances. The paper also analyzes the specificity of the dynamics of the share of the local self-governance budgets in the summary budget over the last decade, and it was concluded that Georgia functions within the paternalistic model of the State; it acts as stabilizing and equilizing agent, while the municipalities appear to be only the subjects that spend money. According to the conclusion taken as result of research: in order to enable local authorities to exercise their power properly, they should be provided with sufficient financial resources, for which it is necessary to reconsider the issue of expanding the revenue base. To that end, it is advisable to award the local tax status to any State tax or turn it into a regulatory fee; that model should not reduce the effectiveness of tax administration, and it should stimulate the increase of the tax basis of the local self-government.  
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**Key words:** local self-government, decentralization, financial resources, local tax, effectiveness, revenue base

To perform the functions of the governmental structures effectively, it is necessary to set clear boundaries of their responsibilities. As a rule, at the federal level, the governmental structures focus on those functions, which are entirely related to the achievement of the national State interests. It is at the regional and municipal levels that the interests of individual citizens are being achieved.

Local self-government is marked by its organizational-structural and material-financial

distinguishing characteristics. The studies, as well as foreign practice, indicate that the uniqueness of local self-government lies in its specificity, as the branch of government. In particular, this link, on the one hand, participates in the implementation of the will of State, and, on the other hand, tries to take into account the interests of the population as much as possible. In addition, governmental authorities have an obligation to foster the development of local self-government [1].

Over the last two decades, significant constitutional and municipal reforms were implemented in Georgia. They were based on the Continental (French) and British (Anglo-Saxon) models of local self-government. The mixed system for local self-government was created in post-Soviet Georgia, which was characterized by government of both elected and appointed bodies [2].

Conceptual economic and legal grounds for the formation of a financial-budgetary system of local self-government in Georgia were established in 1997, when the Organic Law of Georgia on Local Self Government Code was adopted. After that, several other laws on local taxes and fees, budgetary processes and devolution of property were adopted and added to the Organic Law. In particular, in this respect, of greatest importance was the adoption of the Law on Local Self-Government Unit Budget, for which the grounds had been prepared for several years. By the election of local representative bodies, the establishment of local government institutions was really started in 1998, which has been brought to this day through the tremendous efforts and with some shortcomings.

The problem of the efficiency of the budgetary system in post-socialist countries did not come about immediately with the collapse of the Former Soviet Union. However, later on, during the period of 10-12 years since the formation of new States, it had been highlighted that there was a of decentralization of public finances become clear. The significance of this process was also indicated by the fact that that most countries in the world have been through a budgetary decentralization to some extent [3].

Over the last few decades, the share of revenues for territorial units in the summary budget revenues in the European countries increased significantly. Analysis of recent years shows a similar trend in Georgia as well.

During the last decade, the share of local government expenditures in the consolidated

budget expenditures significantly increased both in countries with advanced economies and economies in transition, which is attributable largely to the improvement of mechanisms for fiscal decentralization. Almost one-third of the consolidated budget payments for the countries of the Organization for Economic Cooperation and Development (OECD), are taxes paid by local self-governments [4]. The share of local budgets in the consolidated expenses of the state budget varies significantly by countries: it represents 1% in Malta, 60% - in Norway and 13.6% - in Russia. The average rate in Europe is 25-30% [5]. Important achievements in socio-economic development of municipalities in the United States can be explained by broad budgetary-taxation power, autonomy in local budget formation and a large share of local taxes. The regions in Germany are able to restrict the authority of the federal center. The share of the consolidated budgets of the constituent entities of Germany in the consolidated federal budget accounts for 61.5% [6].

**Table 1.** The share of the local self-government budget (%) in the national consolidated budget

Country	Share, %	Country	Share, %
France	41	Germany	30
Canada	40	Great Britain	30
USA	45	Japan	52
Russia	13.6	Georgia	11.3

We believe that Georgia is one of the first ones among the countries, where it is necessary to decentralize the budgetary system. The problem is also complicated by uncertainty in the territorial organization of Georgia, which is linked to the restoration of Georgian jurisdiction over the entire territory of the country. Despite some positive things regarding the decentralization in Georgia, the problem of taking into consideration, combining and harmonizing goals of the territorial units and the national State interests still remains the greatest challenge for the country. This challenge derives from the fact that from governance levels existing in Georgia, the central level form is much better established [7].

**Table 2.** Changes in the regulations of percentages from taxes into the budgets of municipalities,%

Tax type	1994-1997	1997-2000	2001-2003	2004-2005	2006-2007	2008-2015	Since 2016
VAT	30	0	0	0	0	0	0
Income tax	50	60	85	100	100	0	Only from the certain types
Corporate income tax	50	60	85	100	0	0	0
Land tax	50	60	100	100	100	100	100

**Table 3.** Dynamics of the budgets of the local self-government units and the summary budget in 2012-2016 (mln GEL)

	2012	2013	2014	2015	2016
Budgets of the local self-government units	501.8	594.8	684.3	792.8	1095.5
Summary budget	7560	7434.3	8118.9	8963.3	9675.5

In the current circumstances, the economic basis of local self-government in Georgia is set by property, budget and local taxes and fees. According to article 90 of the Budget Code in force, the budget of municipality is independent of the budgets of other municipality and autonomous republic, as well as of the State budget of Georgia. Independence of the municipality budget is linked to its own revenues and powers for determining independently taxes to fulfill its own mandate.

Conceptualized economic reforms carried out in Georgia in 2004-2012, had negative impact on the budgets of the local self-government units as well. Despite overcoming the threat of fiscal separatism after the "Rose Revolution", we received absolute fiscal centralism, when the central government controls almost 100 percent of the financial resources and the local self-government became a mere fiction [8]

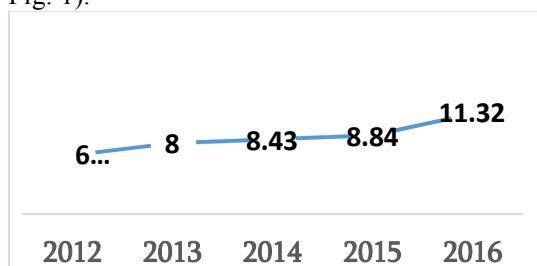
In particular, percentages from the income and corporate income tax in 2000-2007 were increased in favor of the budgets of the self-government units, but since 2008, they equaled zero (see Table 2). Centralization of funding for public schools (the so-called "voucher system") was unable to compensate for the losses caused to the budgets of the self-government units by the relocation of the state budget revenues from the corporate income tax.

This is confirmed by analyzing the dynamics of the absolute volume and the share of the budgets of the self-government units in 2003-2010. In 2003 the total revenues of these budgets was GEL 387.8 million that amounts to 30.5% of the consolidated budget revenues. In the subsequent period, in spite of the fact that the total budget revenues of the self-government units were growing (2004-2007), their share in the consolidated budget revenues dropped to 16.6%. At the end of the reporting period, the total budget revenues of the territorial units were GEL 444.4 million, which is only 7.6% of the consolidated budget [9]. The situation did not change during the following period (see Table. 1) [10].

The summary budget revenues in 2012-2016, were increased from GEL 7560 million to GEL 8963.3 million, while the budget revenues of the self-government units were also characterized by the growth trend (from GEL 501.8 to GEL 1095.5 million). The share of the budget revenues of the self-government units at the beginning of the reporting period amounted to 6.64% and 11.32% by the end of this period.

It can be said that Georgia functions in a paternalistic model of State. It acts as a kind of stabilizing and equalizing agent that is also indicated by a low share of the budgets of the

territorial units in the consolidated budget (see Fig. 1).



**Fig. 1.** The share of the budgets of the territorial units of Georgia in revenues of the consolidated budget in 2012-2015, (%)

Of course, replenishment of budgetary commitments of the local self-government units is carried out from the top-level budgets (State budget). This is expressed by a large share of budgetary transfers, as well as by a high level of budgetary centralization. The share of grants in the budgets of 10 municipalities of Georgia exceeds 91% of revenues [4].

In spite of the fact that according to legislation in force, financial assistance should not block local authorities from pursuing an independent policy within the limits of their competence, the situation is different in practice. A special regional development fund (RDF) is created for the development of the second largest donor infrastructure projects for the budgets of the territorial units for regional development purposes, from which the funds are allocated to the infrastructure projects in the municipalities. The allocation, agreement and transferring procedure of these sums spread out over time, which leads to the need for making frequent changes in the municipal budgets.

With regard to the budgets of the territorial units, against the background of the above mentioned trend, complete transferring of a part of income tax from its certain types into revenues of the budgets of municipalities, which came into force since the year of 2016, should be considered to be a step forward. In the revenues of municipal budgets from 100% of the income tax part, from certain types of taxation to 2016.

**Table 3.** The types of income tax, transferred into the budgets of municipalities in 2016-2017 (mln GEL)

Type of income tax	2016	2017
Income tax withheld by employer	168.9	210
Tax withheld from dividends achieved by natural person	6.5	7.8
Tax paid by natural person from incomes received as a result of renting the property	28.6	32.7
Tax from revenues received by activities of entrepreneur natural persons	102.4	81.1
Others	19.2	17.1
Total	325.6	348.7

As shown in the table, the municipalities of Georgia benefited from this substantial sums (3256 million GEL in 2016, and 348.7 million GEL in 2017), however, to some extent, transfers from the state budget to them decreased. The highest tax rate is characteristic of the income tax withheld by employer, which amounts to 60% of the income tax credited to the territorial budget.

We believe that one of the core problems of municipality development in Georgia consists in equipping local authorities with inadequate powers and the lack of material and financial resources available to them. On the other hand, the irrational and asymmetric distribution of resources is the main condition for weakening the country. In particular, the absolute majority of registered entities (43.7%) are concentrated in the country's capital. In addition, a major part of GDP is created in Tbilisi. The largest part of state revenues (more than 90%) is accumulated in the central budget, which administered by the central government disposes, on which the regions remain dependent [11].

Observations in recent years demonstrate that local self-governments, acting as subjects, which spend money, regard the transfers as "cheap money". This causes certain disincentives for them.

The study of various sources and experiences confirms that the greater is financial independence of self-governments, the higher is the level of social and economic development. At the modern stage, we felt it necessary to expand the revenue base for local self-governance. To this end, probably the most appropriate is to award the local tax status to

any tax or turn it into a regulatory fee, when its part remains in the municipality budget. At this stage, we believe that this is the corporate income tax. Of course, on the one hand, the adopted model should not reduce the efficiency of the tax system, and on the other hand, it must stimulate the local authorities to increase the tax base.

We think that in regard to the processes examined, the institutional problem is essential, as well as study of the state of the institutional situation with local self-governments, against the background of changes in focus for the development of society in Georgia. We share the opinion that society is in the process of transformation and changing its targets, but in order to accelerate these processes, it is necessary to conduct the audit of the institutions, which constitute the organizational structure of political governance. Such political entities, with their negative feedbacks, negatively impact the existing rules of citizens' coexistence and shaping the future directions [12].

On the other hand, the improvement of financial independence of self-governments will reduce the paternalistic role of State. Greater financial independence requires greater political responsibility, for which the readiness of society is an essential component.

### **Conclusions**

It is desirable that local self-governance resources should be diverse, and the policy on their use should be flexible that will allow these bodies to perform their activities without constraint;

Local self-government bodies shall be provided with sufficient financial resources for the implementation of their resective mandates, for which it is necessary to reconsider the issue of increasing the income base for them;

With respect to the revenues, which are mobilized in the given territory and characterized by the growth tendency in a certain period of time, a stimulating mechanism should be developed, that is, to give them more transfer or subsidies;

In order to increase the income base for local self-governance, at the initial stage it is advisable to award the local tax status to any tax (we believe that this is the corporate income tax), or turn it into a regulatory fee, when its part remains in the municipality;

In order to be prepared for new challenges, it is necessary to set the right priorities and actually carry out training and retraining of public civil servants;

It is necessary to ensure high level of public involvement in the establishment of the economic system of local self-governance.

### **Acknowledgement.**

The work was carried out with the financial support of the Ministry of Education and Science of the Russian Federation under the Peoples' Friendship University of Russia (RUDN University) Program "5-100" among the world's leading research and educational centers for 2016-2020.

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მოსკოვის სახელმწიფო სამხარეო უნივერსიტეტი, საკონსტიტუციო და მუნიციპალური სამართლის კათედრა*

(წარმოდგენილია აკადემიის წევრის ა. სილაგამის მიერ)

ნაშრომში გამოკვლეულია ადგილობრივი თვითმმართველობის საფინანსო ბაზის ფორმირების თანამედროვე პრობლემები და მოცემულია მათი გადაჭრის ზოგიერთი წინადადება, ადგილობრივი თვითმმართველობის, როგორც სახელისუფლებო შტოს სპეციფიკური განსაკუთრებულობა. ავტორთა დასაბუთებით, ყოფილი საბჭოთა კავშირის დაშლისა და ახალი სახელმწიფოების ფორმირებიდან 10-15 წლის განმავლობაში საჯარო ფინანსების დეცენტრალიზაციის აუცილებლობა აშკარად გამოიკვეთა. გაანალიზებულია ნაერთ ბიუჯეტში ადგილობრივი თვითმმართველობის ბიუჯეტების ხვედრითი წილის დინამიკის თავისებურებები ბოლო ათწლიან პერიოდში და გაკეთებულია დასკვნა იმის შესახებ, რომ საქართველო სახელმწიფოს პატერნალისტური მოდელის ფარგლებში ფუნქციონირებს; იგი გამოდის გარკვეული მასტაბილიზირებელი, გამათანაბრებელი აგენტის როლში, ხოლო მუნიციპალიტეტები მხოლოდ „მხარჯავ სუბიექტებად“ გვევლინებიან. კვლევის შედეგად მიღებული დასკვნით: სათანადო უფლებამოსილების განხორციელებისათვის ადგილობრივი თვითმმართველობის ორგანოები უნდა აღიჭურვონ საკმარისი ფინანსური რესურსებით, რისთვისაც აუცილებელია გადაიხედოს მათთვის საშემოსავლო ბაზის გაზრდის საკითხი. ამისათვის ყველაზე უპრიანია რომელიმე სახელმწიფო გადასახადისათვის ადგილობრივი გადასახადის (მიმაგრებული გადასახადი) სტატუსის მინიჭება ან მარეგულირებელ (ზიარ) გადასახადად გადაქცევა; ამ მოდელით არ უნდა შემცირდეს საგადასახადო სისტემის ეფექტიანობა და მოხდეს ადგილობრივი ხელისუფლების სტიმულირება საგადასახადო ბაზის გასაზრდელად.

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*Received December, 2018*