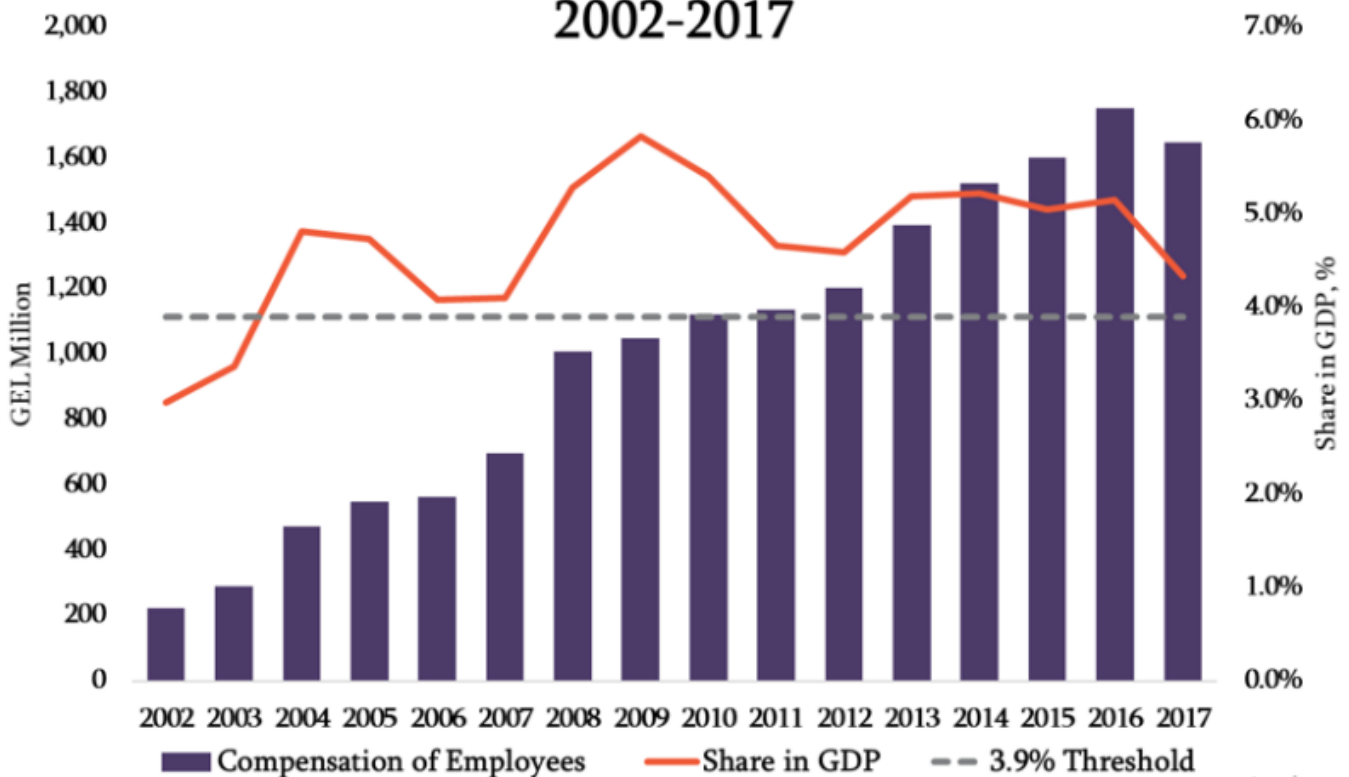


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Challenges in Determining the Governmental Bureaucratic Costs in Georgia

Compensation of Employees from the General Government Budget and Share in GDP, 2002-2017



The FINANCIAL -- In his first few days in office, the newly appointed Prime Minister of Georgia, Mamuka Bakhtadze, announced several reforms and initiatives such as reducing bureaucratic costs and introducing the concept of a small government. In

Georgian politics, the public is accustomed to hearing such promises in election campaigns rather during the everyday running of government. Therefore, this ought to be viewed as a positive development.

One of the most ambitious initiatives put forward by Bakhtadze was a promise to decrease governmental expenses, setting the cap at 3.9% of Georgian GDP. However, the specific nuances of this 3.9% threshold require further examination. Indeed, upon further inquiry, we have identified that the Prime Minister defines governmental expenses as the Compensation of Employees as classified in the budget of the general government (central, municipal, and autonomous republic).

The dynamics of governmental expenses, as defined by the Prime Minister, are of some interest. Governmental expenses have exceeded the newly set threshold every year since 2005 with the ratio increasing annually from 2012 to 2016. The year 2017 was the first for some time in which a major decrease occurred dropping from 5.2% to 4.3%. Succinctly put, the Prime Minister's initiative entails gradually decreasing the current proportion of governmental expenses to Georgian GDP from 4.3% to 3.9%.

Assuming that governmental expenses should entail all administrative costs, we see two possible complications regarding the Prime Minister's target: in the existing budgetary framework, governmental expenses cannot be comprehensively accounted for in the Compensation of Employees budgetary classification; and the existing definition leaves room for bureaucratic handling to decrease the existing governmental expenses to national GDP ratio and meet the publicly stated threshold, without actually reaching the initially intended goal.

The rationale behind our belief that the existing definition of governmental expenses is not sufficiently comprehensive is as follows: even though there is no official definition of governmental expenses, critical analysis leads us to confidently assert that a significant portion of administrative costs is omitted. We identify two complications regarding the current definition of governmental expenses: the administrative costs included in the Use of Goods and Services and Net Acquisition of Nonfinancial Assets budgetary classifications are not included; and the version of

governmental expenses suggested by Bakhtadze, in addition to administrative costs, includes program costs, which, in our view, should under no circumstances should fall under bureaucratic costs.

According to the current version of the document regulating the budgetary classifications of Georgia (Order of Minister of Finance of Georgia – 672, 25.08.2010) there is no mechanism in place to differentiate between the administrative and program portions of Compensation of Employees. Additionally, administrative costs are present in the Use of Goods and Services as well as the Net Acquisition of Nonfinancial Assets budgetary classifications of the general government budget in the form of temporary staff and goods valued below GEL 500.00 in the case of Use of Goods and Services, and goods valued above GEL 500.00 in the case of Net Acquisition of Nonfinancial Assets. These expenses are omitted from the Prime Minister's definition of governmental expenses. Besides, as in the case of Compensation of Employees, there is no mechanism to differentiate between the administrative and program costs in the Use of Goods and Services and Net Acquisition of Nonfinancial Assets budgetary classifications.

The current legal framework denies us the ability to comprehensively and accurately calculate the administrative costs of all relevant budgetary classifications. Therefore, the introduction of the target threshold put forward by the Prime Minister was a step he was ill-prepared to take.

The second major problem, namely the ability to bureaucratically handle the existing component of governmental expenses in order to meet the publicly stated target threshold, has two implications: Compensation of Employees can potentially be reduced through decreasing the program portion of the expenses rather than the administrative portion as desired; and there will be a greater incentive to decrease the number of permanent staff and to increase the number of temporary staff, the compensation of whom falls under the Use of Goods and Services budgetary classification.

To guarantee a transparent and comprehensive account of governmental expenses, we recommend that the Ministry of Finance of Georgia start the process of amending the existing Order of Minister of Finance of Georgia regarding the

budgetary classifications, putting a mechanism in place to regulate and differentiate between administrative and program portions of governmental expenses. Compared to the Use of Goods and Services and Net Acquisition of Nonfinancial Assets, it is a relatively attainable goal to clearly differentiate between the program and administrative portions of the Compensation of Employees. Therefore, we recommend starting the amendment process for this budgetary classification before moving on to the remaining two classifications. Additionally, we recommend introducing a new target threshold only when all three budgetary classifications can be clearly split into program and administrative portions.

The abovementioned recommendations are complex and are considered capable of being realized in a medium- to long-term timeframe. In the short-term, we suggest focusing on a functional approach to decrease governmental expenses, with an emphasis on the central government, which would be in line with the Prime Minister's other initiative of a small government. There are two ways of decreasing the central governmental expenses via the suggested functional approach: entirely eliminate certain functions and responsibilities; and shift certain functions and responsibilities from the central government to the municipal governments, a process which would complement the Strategic National Vision on Municipality and Decentralization presented at the Georgian Parliament by Bakhtadze's predecessor in March 2018.

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