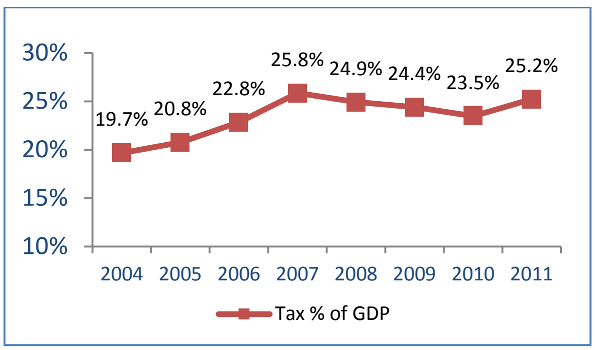
DOMESTIC RESOURCE MOBILIZATION

Business-Friendly Reforms Boost Revenue for Georgia's Transition

Following the "Rose Revolution" and the election of a reform government in 2004, the Republic of Georgia embarked on a flurry of reforms designed to stamp out public sector corruption and create an attractive environment for investment and job creation.

Perhaps less well known outside Georgia is that, in just a few years, the country also saw dramatic growth in tax revenue to tackle poverty, fulfill pension commitments, and meet growing demands for public services that had eroded during the 1990s. Sustained USAID assistance between 2005 and 2010 was integral to this success.



Georgia achieves dramatic growth in tax collections
Source: Ministry of Finance, Republic of Georgia

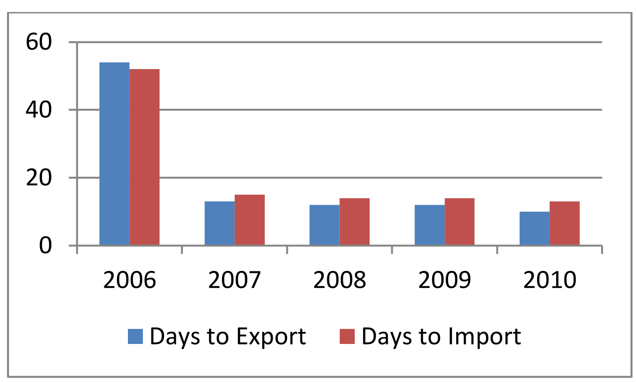
Leveraging $12 million in USAID support, the Government of Georgia completely transformed its customs operations, which improved the trading environment, sparked a surge in trade volumes, and virtually eliminated petty corruption at what had been perceived to be the most corrupt organization in the government—the Customs Department.

At the same time, the Tax Department underwent radical reforms that modernized systems, streamlined compliance procedures, and brought more taxpayers into the tax net. The resulting improvement in compliance rates and collections helped Georgia boost domestic revenue by close to $4 billion between 2005 and 2011—resources that were vital to the expansion of social services and infrastructure in the country.

Transforming border management

When USAID-supported reforms began in 2005, the process of getting goods in and out of Georgia was opaque and unpredictable. At points of entry, traders could be required to prepare any of two dozen forms. Containers would be inspected without clear grounds. Meanwhile, valuation procedures were subjective and inconsistent with those set by the World Trade Organization (WTO), to which Georgia acceded in 2000. As a result, traders and their agents could not know in advance what they had to do or pay.

New Customs leadership began in 2005 by focusing on transactional efficiency. With USAID support, the department identified bottlenecks and logjams at particular sites and with specific processes. Initial efforts focused on streamlining entry procedures for trucks queuing to enter Georgia. Among them, the government introduced a single service window for obtaining licenses and permits, where documents were processed in back offices, thereby reducing contact points between traders and customs officers. These changes quickly addressed endemic delays at Georgian borders. Based on the World Bank's cross-country metrics for "Trading Across Borders," clearance times were slashed from more 7 weeks to just over 10 days for export and import.



Georgia slashes import-export times
Source: World Bank's Doing Business Survey, 2006-10

Businesses saved considerable money as well. Because of the high volume of cross-border trucking—including robust transit trade with Russia, Azerbaijan, and Armenia—expedited border procedures saved private traders and truckers an estimated $91 million per year after 2005.

However, border reforms did not stop there. From February to July 2008, USAID helped Customs develop and roll out a new, risk-based cargo selection system at all customs clearance offices. Applying a range of selection criteria (past violations, high-risk goods, etc.), the new system identified cargo to be inspected, assigned the case to an inspector and issued specific instructions about which aspects or sample lots within the cargo to scrutinize. This approach enabled a dramatic reduction in the time and number of customs officers devoted to physical inspection of shipments, as well as further cost savings for low-risk traders. The transition to risk-based inspection yielded estimated annual savings to the government and private sector equivalent to $88 million.

Building a modern tax authority

Complementing reforms at the border were broad and aggressive efforts to transform Georgia's Tax Department into a modern, professional revenue service. With USAID's assistance, the government streamlined tax procedures, upgraded collection capacity, and rolled out information technology (IT) infrastructure that brought thousands of taxpayers into the tax system, lowered compliance burdens, and enabled better fraud and corruption control.

Enhanced taxpayer registration

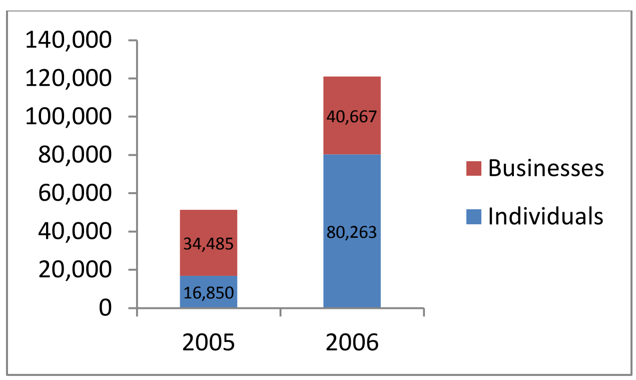
At the outset of USAID support, Georgia's tax base was challenged by the existence of thousands of businesses in operation yet not formally registered with the tax authorities. Recognizing this problem, the Tax Department put a strong initial focus on improving the taxpayer registry and expanding voluntary registration.

A key milestone was the government decision, in October 2005, to transfer responsibility for business registration from the courts to the Tax Department. Previously, businesses were required to register in two separate locations, involving separate but similar application procedures to obtain a business registration number and a distinct tax registration number. Costly and time-consuming processes took 21 days to complete and included the preparation and notarization of no less than eight documents.

With its new mandate, in 2006 the Tax Department took steps to streamline registration procedures for businesses, while also simplifying tax registration procedures for individuals. Simultaneously, with strategic but modest investments to upgrade its IT infrastructure, the Tax Department was able to digitize paper-based business registration archives and merge them with the Department's own tax registration database—facilitating the development of a more accurate electronic record of taxpayers, improving management of taxpayer current accounts, and supporting execution of compliance programs. An array of forms and other requirements was reduced to just one form that taxpayers could present at one of six newly established registration service centers.

The changes vastly reduced the time required for businesses to prepare, notarize and present registration documents and the time required of tax authorities to review and process them. Today, tax and business registration can be completed in about two hours, compared to three weeks before the reform.

The impact on taxpayer registration was similarly impressive. Between 2005 and 2006, more than 70,000 businesses and individuals were newly registered, more than doubling the size of the taxpayer registry. This surge in registration was ultimately responsible for much of the 30 percent increase in tax collections that the government realized in 2006.



Taxpayer registration increases 137% in the span of a year
Source: Ministry of Finance, Republic of Georgia

Streamlined returns filing

With USAID support, electronic (e-) filing of tax declarations became available to taxpayers in late 2006 through the Tax Department's online services. Before e-filing was launched, businesses had to submit their tax declarations in person each month, resulting in needless costs and long queues at the tax office close to filing dates. Once submitted, the department manually entered the tax return into its database, a process that was prone to data entry errors, the burden of which commonly fell on taxpayers to resolve.

E-filing really took off in 2008, resulting in estimated annualized benefits for Georgian businesses and the government of about $8.6 million in its first full year of operation. E-filing virtually eliminated the need to visit the tax office, significantly reducing transportation time and costs, while at the same time saving companies and the government time and money related to the preparation and processing of forms.

After initial roll-out to the business community, e-filing was subsequently expanded to cover personal income and property tax returns, with great success. Since 2011, almost all tax returns in Georgia have been filed electronically.

Expedited VAT refunds

For value-added tax (VAT) payers, e-filing also reduced wait times and aggravation in securing VAT refunds. Before 2008, Tax Department procedures had required a tax audit at the taxpayer's premises for each refund, subjecting exporters to frequent disruptions and, ultimately, long refund delays—with lag times up to 18 months. During that time, the refund in question was tied up, starving businesses of vital working capital.

Simplification and streamlining removed cumbersome audits and other nuisances that reduced the number of steps in the refund process from 27 to 20. This, in turn, reduced the waiting time for refunds and transfers by roughly 12 months—particularly important for exporters who were in a regular refund position. With the new, streamlined process, the only control procedure that exporters faced was a desk audit at the Tax Department to confirm the exporter's entitlement to the refund.

The reform had a huge financial impact. In 2008 alone, streamlined refund procedures put an estimated $18 million in working capital back in the taxpayers' pockets.

Improving staff integrity

Before the Rose Revolution, the Georgian government had one of the worst reputations in the former Soviet Union for bribe-taking and corruption, including within its tax and customs departments. However, the reform government that took office in 2004 placed tackling corruption among its highest priorities.

The Ministry of Finance was a leader in this effort, adopting aggressive measures to eliminate fraud in its ranks. At Customs, for instance, the new leadership announced a "zero tolerance" policy, introducing a series of approaches to identifying and removing corrupt customs officers.

Some proved less effective than others. For instance, despite attempts to simply terminate the most flagrant violators, many discharged employees successfully appealed their case to the courts and secured reinstatement.

Greater success was achieved through undercover investigations by the Ministry's Financial Police. Using falsified invoices for dummy trading companies, investigators collected video-taped evidence of customs officers soliciting bribes and kickbacks. Some 200 customs officials, and a number of customs brokers and traders, were prosecuted and convicted on such evidence.

Those corrupt officials who were not snared by undercover surveillance operations often succumbed to competency testing. Developed and administered to all staff in corruption-prone positions, the Customs used these tests of technical knowledge to weed out hundreds of unscrupulous officers, many of whom had obtained their positions through bribery or nepotism in the first place. This testing process led to the largest number of employee terminations.

For its part, the Tax Department was resolute in dealing with corruption. Official misconduct was addressed though arrest and prosecution, often resulting in harsh fines and sentences.

This commitment to higher integrity has worked. In the World Bank's 2008 Enterprise Survey of Georgia, only 8% of respondents answered yes when asked whether firms are "expected to give gifts in meeting with tax officials," compared to 39% in 2005. At the most recent survey in 2013, a mere 0.2 percent of businesses complained about expectations of bribes.

Professionalizing the workforce

Efforts to purge corruption from its ranks helped the Ministry trim fat and at the same time make room for a new cadre of motivated and higher skilled staff. In fact, combined staffing of the tax and customs departments declined from 3,600 in 2007, before the departments were merged to create a unified Georgia

Dollars to Results

***$12 million** in USAID support*

***$4 billion** in increased revenues*

Revenue Service, to roughly 2,700 in 2011. Yet even within this modest human resource envelope, the Revenue Service continued to outperform peers with far larger levels of staffing.

A notable success in professionalizing the Revenue Service's workforce was in the placement and cultivation of IT staff. Early in the reform process, USAID and government partners identified the automation of processes and procedures as critical to successfully rooting out corruption, reducing business and administrative costs, and improving the efficiency of tax and border administration.

Priority was placed on the recruitment and retention of IT professionals, with salaries commensurate with the private sector to stem the turnover of IT experts. By 2010, the Revenue Service's IT personnel had expanded to 50 professionals, nearly double 2005 staffing when tax and customs functioned separately. Since 2010, IT professionals have been eligible to share in "bonus funds," up to or even exceeding base salary, which certain fee- or revenue-generating public enterprises are permitted to pay to match market requirements.

Sustained impact

On the heels of the Rose Revolution, Georgia enjoyed several years of rapid economic growth fueled by a wide range of economic and institutional reforms.

While the 2008 conflict with Russia and the global financial crisis put the brakes on economic growth, the impact on revenues was short-lived. The government has since recovered, sustaining tax revenues at or close to 25% of GDP since 2011—well above levels achieved by its closest comparator countries.

In turn, the strong revenue base has allowed the government to invest in infrastructure and social services that are literally changing the lives of everyday Georgians. For instance:

- Introduction of a flat universal pension for all elderly (including those lacking contributory pension history) – to relieve the grinding poverty that affected most of the retired population;
- Investments in physical infrastructure have galvanized regional trade and improved the stability of power supply to homes and communities; and
- Increased health spending during the period -- rehabilitate of primary and hospital facilities and to broaden the coverage of health insurance.

With its more secure revenue base, the government embarked in 2013-14 on a further scaling up of social spending to

- Provide universal coverage now of emergency and non-emergency health services (to reach the half of the population not previously included);
- Raise the basic pension substantially and to double the monthly cash transfers for (approximately 10 percent of the population) poor households.