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GEORGIAN FOUNDATION FOR STRATEGIC AND INTERNATIONAL STUDIES

4

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VLADIMER PAPAVA

EXPERT OPINION

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Introduction: Economic Reforms in Post-Soviet Georgia

Georgia's economy has undergone huge changes in the more than twenty years since recovering its independence (Papava, 2013). The initial years of independence were particularly difficult, when the country was engaged in armed conflicts and had no coherent economic policy to speak of (Papava, V., 2011a). Serious mistakes were committed, particularly in the initial stages of the transition from a command economy to a market economy (Papava, 1995).

The cumulative effect of these mistakes was that by 1993 the country's gross domestic product (GDP) was 30.73% of its 1990 level; annual inflation stood at over 7,840% in 1994 (Khaduri, 2010, p. 71). This period of post-Communist transformation of Georgia's economy, was a moving from planning to hyperinflation (Gurgenidze, Lobzhanidze, and Onoprishvili, 1994).

In 1995 a currency reform was successfully implemented (Kakulia, 2008), allowing macroeconomic stability (Papava, 1996; Wang, 1998; Wellisz, 1996) to be achieved along with a rise in GDP of almost 24% in 1996-1997 (Khaduri, 2010, p. 72). The successful reforms were supported by the international financial institutions (Papava, 2003).

The negative impact of the 1998 Russian default on Georgia's economy (Kakulia, 2008, pp. 183–184) together with the mistakes in reforming of the economy (Khaduri, 2005) and the resulting spread of corruption exacerbated the country's existing budget and energy crises (Papava, 2005). By 2003 52% of the Georgian population had an income below the official poverty line (e.g. Meskhia, 2008, p. 57).

After the 'Rose Revolution' in November 2003 a fight against corruption was launched and the budget and energy crises were overcome (WB, 2012). Since 2005 a new tax code has cut the tax burden significantly, procedures for registering business start-ups have been considerably simplified and a new labour legislation has been passed giving employers complete freedom of action in relation to their employees (Papava, 2005). These reforms have given Georgia the image of a country of neoliberal reforms (e.g. Gurgenidze, 2009; Udensiva-Brenner, 2010). However there were also many documented instances of violations of property rights (HRIDC, 2008) and big business came under the complete control of the government (Rimple, 2012); the abolition of anti-monopoly legislation and its regulatory body created an economy that was dominated by monopolies (TI, 2012). Despite the disappearance of mass corruption—mainly in the form of bribery—elite corruption has started to assume threatening proportions (Anjaparidze, 2006; Gujaraidze, 2010; Gujaraidze, Barbakadze, Gujaraidze, Mchedlishvili, and Kakhaberi, 2007). These crimes are a kind of neo-Bolshevism, and Georgia's economy under the Saakashvili's government represents a 'Neo-Liberal Fancy' (Jones, 2013, p. 4), a 'Authoritarian Liberalism' (Jobelius, 2011), a 'Symbiosis of Neo-Liberalism and Neo-Bolshevism (e.g. Papava, 2009; Waal, De, 2011, p. 13).

The authoritarian-style government, reinforced with elements of despotism, made the Saakashvili regime neo-Bolshevik and his government 'rosy' in two senses: it was the Rose Revolution which brought him to power, but it also harked back to the 'red' of the Bolsheviks (Papava, 2012b).

After the August 2008 Russia-Georgia war (e.g. Cornell, S. E., and S. F. Starr, eds., 2009) the EU expressed its willingness to grant Georgia a free trade regime, setting a number of preconditions, the most important of which are implementation of European-style anti-monopoly market regulation and consumer rights protection, particular in the area of food safety (CEU, 2008). Unfortunately the Saakashvili government did all it could to postpone the start of talks with the EU by delaying implementation of these conditions (IMF, 2008, p. 10).

In early 2009 the US Georgia Charter on Strategic Partnership was signed, within which the USA held out the possibility of the US concluding a free trade agreement (FTA) with Georgia (Civil Georgia, 2009). There has been little real movement on this so far and negotiations have not even begun.

Consumer Economy, Typical for Poor Countries

Unfortunately, the contemporary Georgian economic model is based less on increasing production and more on stimulating consumption, which has had many negative consequences.

Stimulating consumption whilst ignoring the need to develop the real sector of economy has led to the country importing three times as much as it exports (NSO, 2012). Furthermore, 22% of its exports are motor cars and 8% scrap metal. Georgia has no motor car manufacturing industry: this 22% share of exports is due to Georgia's function as a trans-shipment point, importing motor cars for resale to neighbouring countries. The significant gap between exports and imports, combined with the fact that 30% of Georgia's exports are not produced by the real sector of economy, indicates the relative economic backwardness of the country.

The total quantity of the government and private consumption accounts for around 90% of GDP (e.g. Samson, 2008, p. 73), is a further evidence that the Georgian economy is more oriented to consumption than production.

The relative backwardness of the production sector means that this increase in consumption has been funded by flows of monies from abroad: in the first years after the 'Rose Revolution' this was mainly in the form of foreign direct investments (FDI) (e.g. Shmidt, 2007) and remittances to Georgian citizens from relatives living abroad (Kakulia, 2007).

FDI mostly went into real estate, creating a new financial resource within the country. This financial resource, mediated mainly through the banking system, sparked a housing boom which without appropriate government regulation soon turned into a "financial pyramid" scheme (Papava, 2010, p. 46).

Since independence many residents of Georgia have for various reasons left the country. At present around 20% of the population of Georgia (more than a million people) are living abroad (2/3 of them in Russia but also in Greece, Turkey, Ukraine, USA and Spain amongst other countries) (e.g. Samson, 2008, p. 74). Remittances sent through banks alone are over 1 billion US dollars per year. This money is mainly used to meet basic needs.

Given the low level of savings, the main source for maintaining and increasing the funds available for lending at commercial banks was borrowing on the European financial markets which once again provided credit for the building and for purchasing home appliances. Since home appliances are not produced in Georgia, however, this led to a situation in which consumer borrowing from Georgia's commercial banks has promoted the development of the real sector of economies in the countries that do produce these goods. In other words, the banking sector in Georgia acted as a conduit for foreign loans that provided credit to develop the real sector of economy in third countries (Papava, 2010, p. 46).

The increased capital flows into Georgia following the 'Rose Revolution' thus created a new demand without enabling the development of the manufacturing sector to meet it.

With the start of the global financial crisis, FDI in Georgia fell sharply. A further factor in this was the Russian-Georgian war in August 2008. However Georgia, as the victim in this war, was provided with USD 5.8 billion in financial assistance by the international community (Papava, 2008a), with the result that the impact of the global financial crisis on Georgia was relatively mild.

Unemployment levels are relatively high as a result of the backwardness of the real sector of economy. According to official statistics the level of unemployment is 13-15% (e.g. Tokmazishvili, 2007, p. 49), although a number of sociological surveys of the population carried out by local and foreign non-governmental organisations state that 70% of those questioned consider themselves to be unemployed (e.g. Messenger, 2010). The main reason for this is that 50-57% of the workforce is self-employed (e.g. Samson, 2008, p. 71; Tokmazishvili, 2007, p. 49) and their incomes are so low that they do not view this work as employment.

Over 80% of the self-employed work in agriculture. 54% of the workforce is employed in the agriculture sector, but agricultural production only accounts for just over 8% of GDP. Given that Georgia's natural and climatic conditions are excellent for agriculture, this is evidence of an agrarian crisis of underproduction. It also explains why 80% of basic food products are imported.

Georgia's agriculture has also suffered from the ban announced in 2006 by the Chief Public Sanitary Inspector of Russia on the import of agricultural products from Georgia, due to their allegedly low quality (e.g. Livny, Ott, and Torosyan, 2009; Uzagalieva, 2007).

Promotion of tourism in Georgia has increased the demand for food, which given the agrarian crisis can only be met by increasing imports. Given the agflationary processes in the global economy, agflation is thus also being 'imported' into Georgia.

It is therefore hardly surprising that 40% of the population is living below the poverty line and 64% of the self-employed population has an income below the minimum subsistence level (Meskhia, 2008, p. 57).

In its search for a model for its economic development (e.g. Beridze, 2009; Gogolashvili, 2011; Samson, 2006), Georgia has officially adopted a pro-European stance but has not taken any practical steps in this direction (e.g. Papava, and Tokmazishvili, 2006). A glaring example of this is the way the government has behaved over the FTA with the EU (e.g. Papava, 2008b). President Saakashvili has also publicly stated that Georgia should follow Singapore's model of economic development (Civil Georgia, 2008, 2010a, 2010b). By initiating its policy of the 'Singaporisation' of the Georgian economy, the Saakashvili government is in fact increasingly distancing Georgia from the EU and generally from a European-style economic system (e.g. Israelian, 2011; Maksoeva, 2010).

What about 2020?

One scenario for the economic policy up to 2020 that can be ruled out is that based on a continued promotion of consumerism. The outcome of the Parliamentary elections held on 1st October 2012 means that there is virtually no chance of this scenario being implemented since the elections (in 'post-Rosy' Georgia) were won by the opposition coalition Georgian Dream, headed by the billionaire Bidzina Ivanishvili. During its election campaign Georgian Dream criticised the economic policy of the Saakashvili government and focused on promotion of the real sector of economy along with social support for the poor segments of the population (e.g. Jones, 2013, pp. 8-10). Bidzina Ivanishvili, now head of the government he himself formed, has begun to implement his pre-election promises.

Based on these new realities, a more realistic scenario is one in which the tempo of negotiations with Brussels on a FTA with the EU is stepped up (Kobzova, 2013). The new government's announcements that it will implement anti-monopoly regulation (TI, 2013, pp. 9-10) and a European-style consumer rights protection system support this view.

Anti-monopoly regulation will help competition to develop. Together with an end to unofficial government intervention in business, signalled loudly and clearly on more than one occasion by the leaders of 'Georgian Dream' (Civil Georgia, 2012), the de-monopolising of the Georgian economy will provide a significant impetus for business development.

It is entirely feasible that Georgia will achieve a FTA with the EU by 2014 at the latest. This would itself attract private investment in Georgia's real sector of economy since the combination of a relatively low-cost (in comparison with the EU) workforce with a simplified system of business registration and relatively low tax burdens (again in comparison with the EU) could act as a stimulus for job creation in the Georgian economy. Given that the EU economy is currently 2,000 times the size of Georgia's economy (e.g. Samson, I., 2008, p. 75), a FTA with the EU would massively expand the market for Georgian goods.

Once Georgia starts manufacturing high-quality products for the EU market, there will also be a demand for these products on the Turkish market in view of the FTA already achieved in 2008 with Turkey (e.g. Tsikhelashvili, Chkhutishvili, Shergelashvili, and Geybullayeva, 2011).

This scenario for the development of the Georgian economy, based on achieving a FTA with the EU and a growth in exports to the EU and Turkey appears entirely realistic.

Given that five years have passed since the signing of the Charter between the USA and Georgia without any negotiations on a free trade regime even having started, the earliest expected date for a FTA with the USA is rather closer to 2020. This agreement, even if it is actually achieved, will therefore have little impact on the Georgian economy before 2020.

Resumption of full-scale trading relations with Russia is difficult to predict (Silaev, and Sushentsov, 2012, p. 62) since this is more a political than economic issue (Papava, 2012a, pp. 65-66). The fact that Georgia and Russia are both members of the WTO is not in itself a sufficient condition for establishing trade between these two countries (Papava, 2011b, p. 60). This means that it is virtually impossible to include a resumption of trade with Russia in any forecast of how the Georgian economy might develop up to 2020.

Achieving full-scale trading relations with Russia also raises the question of re-opening the Trans-Caucasus Railway which passes through Abkhazia, linking Georgia and Armenia with Russia and which was suspended back in August 1992 (e.g. Ismailov, and Papava, 2006, pp. 114-115).

Based on the realistic scenario in which a FTA is reached with the EU, opening up trade with Turkey, likely average economic growth in Georgia in 2013-2020 would be between 5 and 10%. The more pessimistic figure of 5% assumes that the global crisis worsens and the more optimistic figure of 10% average growth assumes that the world economy achieves steady growth. However this would mean that by 2020 Georgia's per capita GDP will be 2.3 times the 2011 level, at USD 7,367 (in 2011 the figure was USD 3,203) (WB, 2013).

On the basis of World Bank figures on global economic development, by 2020 Georgia's economic situation will be approximately same as it was in 2011 Bulgaria (per capita GDP was USD7,158) and Romania (per capita GDP was USD8,405) but worse than Latvia (per capita GDP was USD12,726) and Lithuania (per capita GDP was USD13,339) (WB, 2013).

The investments should be accumulated in industry and agriculture, with a huge potential of economic growth (e.g. Burkadze, 2007; Cordonnier, 2007, 2008).

Studies of the comparative advantages of the Georgian economy have identified the main sectors as: transportation, primarily of energy resources; agriculture and the food industry, hydro-electric power, tourism (e.g. Papaphilippou, 2008, p. 49; Samson, 2008, p. 76).

Clearly the economic growth referred to earlier has to be provided by the sectors where Georgia has a comparative advantage.

Developing the real economy, passing a new European-style labour legislation (TI, 2013, p. 10) and a suitable social policy taken together will help to improve the quality of life of Georgian citizens.

Conclusions

A primary objective for the Georgian government is to sign a FTA with the EU as quickly as possible to realise the full potential entailed by economic integration with the EU. To do this the Georgian government needs to focus its economic policy on promoting production by implementing European models of anti-monopoly regulation, consumer rights protection and labor relationship.

Negotiations on establishing a free trade regime with the US must be launched under the US Georgia Charter on Strategic Partnership. It is very important that the terms of a FTA with the US do not conflict with the terms of an FTA with the EU. This requires coordination between Brussels and Washington with the active engagement of Tbilisi in the process.

The new Georgian government must not stand in the way of Georgian companies wanting to return to the Russian market. These companies themselves must present the Office of the Chief Public Sanitary Inspector of Russia with all necessary documentation confirming the quality of the products they manufacture and also evidence that these commodities are present in the markets of various countries of the world (USA, EU countries, China, Japan etc.). If their products are again banned from the Russian market the Georgian government must defend these companies' interests under the WTO framework.

Implementing these recommendations will stimulate the expansion of Georgia's export potential, which is a priority for its socio-economic development.

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