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THE ESSENCE OF ECONOMIC REFORMS IN POST-REVOLUTION GEORGIA: WHAT ABOUT THE EUROPEAN CHOICE?

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Several countries in the post-Soviet world have completed the transition to a European-type market economy and have been admitted to the European Union. For others—either partly or totally unsuccessful in transitioning—the question of whether or not this kind of market economy could be built is not even discussed. As to the potential of EU membership, such countries have either never set such a goal for themselves or, at best, are considering it in a long-term perspective.

It is no secret that Georgia is not ready to join the EU in the near future. In view of continual official statements regarding Georgia's striving toward Euro-Atlantic organisations (see Papava and Tokmazishvili, 2006), however, we should know where we are going. One of the most important aspects is the vector of Georgia's economic development. If we see Georgia as part of Europe—even if not fully accepted until the distant future—Georgia must transform into a European-type market economy.

THE EU'S ECONOMIC MODEL AND GEORGIA

It is not easy to describe the EU's economic model, which is still in formation (Fioretos, 2003). According to Albert (1991), the EU has been a battlefield of the two key models of capitalism, i.e., the Anglo-American and the "Rhenish" (German-Japanese) ones.

In the Anglo-American model, the transfer of shareholding takes place quickly and without any obstacles, stock exchanges play a key role in companies' funding, and some 40-60 percent of company shares are owned by institutional investors (such as insurance and pension providers). At the same time, the public sector is relatively small and social policy with respect to poverty and inequality is somewhat liberal; namely, inequality is understood as one of the incentives of competition, and the fight against poverty is believed not to be

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only the government's function but, rather, also within the sphere of private charities as a part of moral practice and philanthropy.

In the Rhenish model, shareholding is somewhat stable and the banking sector plays a key role in funding shareholder companies. Stock markets are relatively constrained and, therefore, less active. The spheres of regulation are somewhat broad and the government's role in the distribution of gross domestic product, ensuring equal competition and addressing social needs, is substantial.

Remarkably, the two models have merged in a number of EU member states under the pressure of the Anglo-American model over the Rhenish.

The EU countries do not share a *unified* economic model. Instead, there is a *common* economic model which is not yet strong enough to ensure full unification. At the same time, the integration underway in the EU is dominated by the transition from the common market to the unified market which, in turn, has paved the way for economic and currency unions.

One of the most fundamental principles of the EU is the "preservation of what has been accomplished," which is important for any membership candidate to bear in mind. Whatever has been unified and achieved on the way to the integrated model must be unconditionally copied by all candidates.

Georgia understands the tension between these two models. In particular, the Rhenish model prevails in shareholding and company funding which has yielded small and passive financial markets. This is a direct consequence of official policy. On the other hand, the spheres of regulation are quite limited, which misleadingly suggest that Georgia fits the Anglo-American model. This is most evident in the government's policy on poverty and inequality, which could be described as indifference (although sometimes inaccurately called "liberalism"). In Georgia, inequality is not the government's concern at all, whereas the alleviation of poverty has forcibly (under the government's pressure) become the headache of private charities and entrepreneurs.

Under such circumstances, it is natural to ask: Are we really headed to the EU? If we consider the government's economic agenda, we see movement in three different directions: North, Nowhere, and East.

THE WAY TO THE NORTH

In post-Revolution Georgia, the so-called "Northern Way," or Georgia's integration into Russia's economic domain, has become prominent (Papava, 2006c). In 2003, Anatoliy Chubais, the President of the Management Board of RAO EES (Unified Energy Systems) Russia and a prominent Russian statesman and political figure, wrote that Russia should establish a "Liberal Empire" in the post-Soviet world (Chubais, 2003)[1] – "liberal" in the sense

[1] The origin of the Russian model of the Liberal Empire is based upon the Russian doctrine of Eurasianism (Dugin, 2005) which has deep historical roots in Russia (Gloveli, 2000). It should be emphasised that the idea of a Liberal Empire, following Krupnov's (2005) justified comment, is not Russia's, but was first put forward as early as the second half of the 19th century in Great Britain (Matthew, 1973), was elaborated at the end of the 20th century (Reiff, 1999), and increasingly acquired a clearly American hue (Farrell, 2005). What is more, in all likelihood we should agree with the opinion that the acceleration of the formation of the Russian version of a Liberal Empire was given a particular boost (Torbakov, 2003) by the US's combat action in Afghanistan and Iraq as evidence of the possibility of forming an American Democratic Empire (Kurtz, 2003).

that the new empire should be based on economics rather than political coercion wherein Russian companies (public and private) should take over the ownership of strategic companies in the former Soviet republics which, in the long run, would lead to the re-establishment of Moscow's political influence over those countries.[2]

Russia started fulfilling its master plan in Armenia, its strategic partner in the region. In late 2002, on the eve of the presidential election in Armenia, a Russian-Armenian treaty called the "debt-for-equity" swap was executed.[3] In early 2006, Russia obtained new assets in exchange for not raising Armenia's price for natural gas.

As Russia and Armenia do not share a border, and in view of the frozen conflict between Armenia and Azerbaijan, the lynchpin in the economic space of Russia and Armenia is Georgia. If Georgia is dragged into the Liberal Empire, the fate of Azerbaijan will be determined as well given the fact that all of its strategic economic projects are linked with Georgia (Papava, 2006a).

The first step toward snaring Georgia in the Liberal Empire's net was the summer 2003 takeover of the shares of the US-based company AES Silk Road by RAO EES (Gularidze, 2003).

The new Georgian government fully supported the entry of Russian capital into the Georgian economy during the broad-scale privatisation of government-owned enterprises following the Rose Revolution. The best example was the sale of Georgian gold and copper mining and processing companies to Stanton Equities, a subsidiary of the Russian holding group Industrial Investors.[4]

Encouraged by the government's affinity for Russian capital, the owners of the United Georgian Bank (privatised in 1995) sold it to Russia's Vneshtorgbank, 99 percent of which is owned by the Russian Government.[5] The sale resulted in the nationalisation of the United Georgian Bank by the *Russian* Government. This takeover came on the tails of Vneshtorgbank's acquisition of Armenia's Armsberbank.[6]

Gazprom is especially aggressive. It has made several attempts to take over the gas pipeline connecting Armenia with Russia. In late 2005 and early 2006, the Georgian

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[2] According to its architects, a Liberal Empire should be created not by forced armed occupation of the former Soviet republics but by gaining control over the main economic facilities (by means of acquiring and developing assets) located on their territory. An essentially universal analysis of Russian investments in the CIS countries is presented in an article by Crane, Peterson and Oliker, 2005. It is also important to note that in the Russian idea of a Liberal Empire, its developers and executors imply non-military methods of creation in the word "liberal," and not of the functioning (which they do not mention at all) of this "empire" which is essentially not surprising if we keep in mind the far from democratic and "liberal nature" of the regime in Putin's Russia (Åslund, 2005; Trenin, 2005). Herein we should note the interrelation in Russian policy in the post-Soviet space of energy dependence and political independence (Balzer, 2005) whereby when the former increases the latter weakens (Smith, 2004, pp. 5-8). It is no accident that for Russia, along with the formation of a Liberal Empire, a targeted advance towards creating an Energy Empire is of particular importance (Hill, 2004).

[3] See *Armenia: Economic Hai-Lights*, July, 2002, online at http://www.bisnis.doc.gov/bisnis/bisdoc/020809ARHaiLights.htm.

[4] See: "Novosti: 97% aktsii GOK "Madneuli" prodano za $51 mln" (News: 97% of Shares JSC Madneuli are Sold at US $51.1 Million), *CITOH*, 7 November 2005, online at http://www.citon.com.ua/news.php?id=10.

[5] See: "Vneshtogbank priobriol kontrolnyi paket aktsii Ob'edinionnogo banka Gruzii" (Vneshtorgbank Purchases the Control Packet of Shares of the United Georgian Bank), *News.ru*, 18 January 2005, online at http://www.newsru.com/finance/18jan2005/vnesh.html.

[6] See: "Russian Vneshtorgbank Continues Transcaucasian Expansion," *Mosnews.com*, 31 May 2004, online at http://www.mosnews.com/money/2004/05/31/vtbgeorgia.shtml.

Government negotiated with Gazprom, ostensibly to sell the gas pipeline (Voropaeva, 2005). It is not clear, however, why selling the pipeline to the Russian Government-owned gas company should be considered "privatisation." After America's intervention, the Georgian Government's talks with Gazprom came to an end,[7] dealing a heavy blow to Russia's plans.

In late 2006, in the context of doubling the price for Russian gas, Gazprom once again tried to take over some of Georgia's energy assets (Socor, 2006).

It must be kept in mind that RAO EES has not given its last word and it is very likely that sooner or later it will, at least, try to use the same scheme it once successfully implemented with respect to AES Silk Road.

Regrettably, it is evident that Georgia is being culled into Russia's Liberal Empire.

THE WAY TO NOWHERE

Some of the Georgian Government's actions defy both economic theory and common sense. Chief among these was the President's generous summer 2006 initiative to add 50,000 people to a national employment programme.[8] The idea was to require private entrepreneurs to give three-month jobs to unemployed persons. For this, the latter were to be paid USD$85 a month out of the national budget. (In the summer of 2006, after the enactment of the new Labour Code, unemployment allowances [USD$12.40 per month] were abolished.) The programme cost the national budget USD$12.7 million. In principle, no business with the demand to expand needs any direct assistance from the national budget. The government was required only to provide for the development of professional training or retraining programmes, and the Georgian Government has rightly assumed this duty.

This programme, however, employed only a few persons. In most cases, a simple deal was made. Businessmen agreed to subscribe to any contract under which they could pretend that they employed some people who did some job. Such a deal made an unemployed person happy, too, because he made USD$255 in three months for doing nothing. There were, however, rather situations as well. Some businessmen agreed to subscribe to such contracts on the condition that new "employees" shared half of the sum with them.

The average share of salaries in the costs of production is typically twenty percent, so USD$12.7 million spent on salaries should produce goods and services worth about USD$60 million. Although there are no official employment statistics under this programme, we estimate that about ten percent of the targeted number of beneficiaries were actually employed. This means, then, that USD$12.7 million was spent out of the national budget for the production of goods and services with an aggregate value of perhaps USD$6 million.

In essence, it can be said that USD$12.7 million allocated from the national budget was nothing but an allowance for the unemployed. This amount went to market ostensibly with the purpose of producing consumer goods, but because no actual goods and services were produced, the only contribution was to the growth of inflation. Consequently, any measures

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[7] See: "Millennium Challenge Corporation Board Approves $295.3 Million Compact with Georgia," *Georgian Business Week*, 16 August 2005, online at http://mca.gov/press/releases/2005/release-081605-boardapprovesgeorgiacompact.php.

[8] See: "Saakashvili Unveils New Economic Initiatives," Civil Georgia, 5 August 2006, online at http://www.civil.ge/eng/article.php?id=13256.

of this kind, however generous their objectives might be, cannot, in fact, produce any desired results. On the contrary, all they can do, along with other similar measures, is to contribute to macroeconomic destabilisation.[9]

Another senseless decision was the subordination of the State Department for Statistics of Georgia directly to the executive which now controls official statistical information. Any government has a temptation to make statistics produce politically advantageous information. Under these circumstances, official statistics are unreliable. The only remedy is to amend the law on statistics, liberating the department from the executive's control.

In the context of the fight against corruption,[10] the government abolished some important institutions (for example, the Antimonopoly Service and the Food Quality Control Service). This left the public unprotected and the state weakened. Such measures could be compared to fighting a headache by cutting off one's head.

In the transition to a market economy, de-privatisation is a matter of considerable concern. On the pretext of remedying mistakes committed during privatisation (mistakes which in some instances have not been proven), properties are taken from their owners and returned to the state for repeated privatisation. In other words, the formation of private ownership is to be started anew, which only indicates that private property is not protected in this country (Papava, 2006b). Without private ownership, however, a market economy is untenable. Georgia has a serious problem with the protection of property rights (Christiansen, 2006).

Another danger associated with de-privatisation is the spirit of revenge held by those who were deprived of their property, waiting for the appropriate opportunity to take it back. This undermines the stability of the institution of private ownership and is something which is all too common in Georgia.

THE WAY TO THE EAST AND THE DISEASE OF "RATING-O-MANIA"

Deregulation, such as reducing the number of licenses and permits, has limited the legal grounds for government's interference with businesses. Cutting tax rates significantly eased the tax burden for businesses (Khaduri, 2006). Reducing the import-tax base for agricultural produce and construction materials as well as the reduction of the import tax rate have made Georgia much more competitive.

The new Labour Code is revolutionary. By limiting the rights of employees, it has substantially broadened those of employers. Although this may encourage businesses to develop, it also leaves employees unprotected.

These sorts of reforms resemble the Southeast Asian (Hong Kong, Singapore) and Anglo-Pacific (Australian, New Zealand, US and Canada) economic models. It should come as no surprise, therefore, if Georgian reforms track the way to the East and, in fact, we are moving toward the American-Canadian model along the path through Southeast Asia and Australia-New Zealand.

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9 See: "IMF Warns Georgia on Inflation," Civil Georgia, 19 August 2006, online at http://www.civil.ge/eng/article.php?id=13350.

10 See: "WB Reports on 'Largest Reduction' of Corruption in Georgia," Civil Georgia, 27 July 2006, online at http://www.civil.ge/eng/article.php?id=13187.

The Kazakh capital invasion of the Georgian economy fits this model only formally in that Kazakhstan is an "Eastern" country. Both Kaztransgaz and its only shareholder, Kazmunai'gaz, however, are government-owned companies (Men'shikova, 2006). (Kazakhstan's government-owned holding company, Samruk, in turn, is the only shareholder of Kazmunai'gaz[11]). Despite this, the entry of the Kazakh government-owned companies into the Georgian market is, for some reason, labelled as "privatisation," probably in order to present an image of government reform.

Another circumstance that should be discussed separately is that all reforms described here are associated with a malady that could be labelled as "rating-o-mania."

After the publication of the World Bank's rating list in 2006 entitled "Doing Business," according to which Georgia had made an impressive jump from 112th to 37th place among the world's nations, the Georgian Government announced that its next year's objective would be to push the country forward and to ensure that Georgia would be found among the 20 best nations of the world in the World Bank's rating list for the following year and, in fact, it did assume the 18th place in 2007.[12] (Remarkably, the four best nations in the WB ranking include such non-European nations as Singapore, New Zealand, the US and Hong Kong).

The government should strive to provide for public wealth and prosperity rather than for higher rankings on rating lists. As far as ratings are concerned, the government should pay more attention to the Economist Intelligence Unit Quality of Life Index[13] and the UNDP Human Development Index[14] by which, much to the people's disadvantage, Georgia ranks 87th and 96th, respectively.

The "Doing Business" ranking is not of any particular value for Georgia, as evidenced by Armenia's 39th place ranking. Furthermore, the 45th, 55th, 56th, and 74th places belong, respectively, to Hungary, Slovenia, the Czech Republic, and Poland, all of which joined the EU and are developing rapidly. Similarly, neither Bulgaria's 46th place nor Romania's 48th closed their doors to the EU.

Ratings of this kind are useful for PR but are entirely worthless for serious economic analysis. Professional economists use statistics rather than rating lists. Regarding the former and as noted above, Georgia has nothing of which to be proud.

WHAT IS THE VALUE OF THE PATH THAT LEADS AWAY FROM EUROPE?

The reader may well ask: Does anything with origins in the West — in Europe — take root in the Georgian economy? The answer is: Yes, it does. The recent purchase of Bank Republic by the French Société Générale, for example, or the Bank of Georgia's offering at

[11] See: "Ziat' Nazarbaeva vozglavil 'Kazmunai'gaz'" (Nazarbaev's Son-in-Law Takes Over "Kazmunai'gaz"), *Catalog SMI*, 27 June 2006, at http://www.catalogueofmass-media.ru/index.php?dn=news&re=print&id=22922.

[12] See: *Doing Business. Economy Rankings*. Washington, DC: The World Bank Group, 2007, online at http://www.doingbusiness.org/EconomyRankings/.

[13] See: "The Economist Intelligence Unit's quality-of-life index," online at www.economist.com/media/pdf/QUALITY_OF_LIFE.pdf.

[14] See: "Statistics in the Human Development Report," online at hdr.undp.org/hdr2006/statistics/.

the London Stock Exchange show this to be true, but these examples are exceptions rather than the rule.

The way to the North leads only to Russia and has nothing to do with the European choice because "… Russia and the EU are already dancing together, but not necessarily to the same tune."[15] Moreover, Georgia's joining the Liberal Empire exposes it to even greater danger than does staying in the CIS. Georgia may withdraw from the CIS whenever it wants to. Withdrawal from Russia's Liberal Empire, were it even possible, would entail immense difficulties and costs.

Some economic measures taken by the government are senseless. The path to nowhere is the most dangerous. The only more-or-less sound path is the Eastward one but what if, by taking this path, Georgia distances itself even more from the EU?

WE CAN LEARN FROM COLUMBUS' EXPERIENCE!

As the Earth is round, one may eventually arrive in Europe by travelling eastward from Georgia but one would approach Europe from a different direction! It is worth noting that following the five top nations in "Doing Business" (the Georgian Government's favourite rating list), the next five include Great Britain, Denmark, Australia, Norway and Ireland, supporting the idea that Georgia may reach the European Union from the West rather than from the East, the obviously shorter path.

Columbus also counted on the fact that the Earth is round. To reach India, he took the opposite path and travelled west. If he had not mistaken America for India, he would have continued travelling and, most probably, would have reached the Indian shore. Like Columbus, the Georgian Government has not fully realised that it is heading toward its goal in the opposite direction.

Georgia is not the first state to make its way to the EU via this strange route. The Baltic states, especially Lithuania and Estonia, reached their goals in the same way long before Georgia. Another indication that this path can be effective is the recently-adopted European Neighbourhood Action Plan.

CONCLUSION: GEORGIAN UNDERSTANDING OF LIBERALISM

If the way to the East sooner or later will lead us to the EU then why, we may ask, is the Government treading two other hopeless, even destructive paths? The Georgian concept of aspiring to "liberalism" lies in one group of people destroying government institutions while another simultaneously drags its country into the Russian Liberal Empire. Neither is the true liberal. Both are the ignorant children (the lesser of all evils) of the Georgia "gone-astray."

[15] See: Sapir (2003, p. 13).

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