

could give them a comparative advantage over others. The countries of the Central Caucasus, including Azerbaijan, are also faced with the prospect of hard work (primarily intellectual work) aimed at strengthening their competitive advantages. Their natural advantages due to natural resources, geographical location and other given parameters of social development should be regarded only as initial advantages. Based on these *potential* advantages, it is necessary to develop those sectors of the economy which can provide a sound basis for the country's *actual and sustainable competitiveness*.

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## NECROECONOMIC FOUNDATIONS AND THE DEVELOPMENT OF BUSINESS IN POST-REVOLUTION GEORGIA

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### A b s t r a c t

**A**fter fifteen years of economic transformations we can conclude that the transition period in Georgia and many other post-communist countries has ended but, unfortunately, the economic (and not only economic) system is far from the Western style of capitalism. It is better characterized as "post-communist capitalism." The key reason is the "necroeconomy." The collapse of the communist re-

gime and the breakdown of the command economy revealed that, with rare exceptions (hydroelectric power, mining and primary processing of raw materials), the goods produced in these countries were incompatible with international standards and could not compete with Western products. Only an efficient bankruptcy law is an effective tool against necroeconomy. In transition countries, including Georgia,

business procedures were so burdensome that some entrepreneurs corrupted officials in order to speed up the process. Others, as a means of avoiding oppressive regulations, conducted their businesses unofficially. Regulation that imposes costs beyond the expected social benefits is usually regarded as red tape. Inefficient admin-

istration and poor institutional development raise costs, which is further aggravated by a lack of business practice and regulatory experience. Unfortunately, there are a lot of problems related to the protection of human rights and the guarantee of property rights within the implementation of the new legislation.

## I n t r o d u c t i o n

The collapse of the communist regimes in the countries of Eastern Europe and the break-up of the U.S.S.R. were watershed historical events at the end of the twentieth century. More than a decade later, we can draw several conclusions about the transformation from a communist to a market economy.<sup>1</sup> Despite a vast amount of literature on transition, there are no generally accepted criteria for determining its completion. The simplest formal criterion is accession to the EU, which signifies that the country has a market-based economy.

Most of the states of Eastern Europe (as well as the Baltic states) have already joined the EU and have become “leaders” in completing the transition. What about other “outsider” post-Communist countries such as, above all, the CIS members? Are they still in transition?

Capitalism is not monolithic.<sup>2</sup> The transition period in outsider post-Communist countries has ended but, unfortunately, the economic (and not only economic) systems of some are far from a European style of capitalism.<sup>3</sup> They are better considered as “post-communist capitalism.”<sup>4</sup>

The logic of this problem appears to be rather simple. If the collapse of the communist system was essentially simultaneous in the countries of Eastern Europe and the former U.S.S.R., they were all in the same situation and, consequently, a slow transition to European capitalism is an artificial delay in economic and social reforms. To understand the principal problems of post-communist transformation in the outsiders, we will compare these countries with the leaders.

Administrative barriers can add considerable cost, time, and uncertainty to an investment project. Complex, non-transparent, and time-consuming procedures not only deter new investment (local and foreign), but also erode the competitiveness of local firms. The main task in transition countries, including Georgia, is to rationalize this process with improved regulation.

<sup>1</sup> See: A. Åslund, *Building Capitalism. The Transformation of the Former Soviet Bloc*, Cambridge University Press, Cambridge, UK, 2002; P. Mitra, M. Selowsky, et al., *Transition—The First Ten Years: Analysis and Lessons for Eastern Europe and the Former Soviet Union*, The World Bank, Washington, DC, 2002, available at [[http://lnweb18.worldbank.org/ECA/eca.nsf/Attachments/Transition1/\\$File/complete.pdf](http://lnweb18.worldbank.org/ECA/eca.nsf/Attachments/Transition1/$File/complete.pdf)]; V. Papava, “On the Theory of Post-Communist Economic Transition to Market,” *International Journal of Social Economics*, Vol. 32, No. 1/2, 2005; *A Decade of Transition. The MONEE Project CEE/CIS/Baltics*. Regional Monitoring Report No. 8-2001, United Nations Children’s Fund Innocenti Research Center, UNICEF, Florence, 2001.

<sup>2</sup> See: D. Coates, *Models of Capitalism. Growth and Stagnation in the Modern Era*, Polity Press, Cambridge, 2000; *Political Economy of Modern Capitalism. Mapping Convergence and Diversity*, ed. by C. Crouch, W. Streeck, SAGE Publication, London, 1997; R.N. Gwynne, Th. Klak, D.J.B. Shaw, *Alternative Capitalisms. Geographies of Emerging Regions*, Arnold, London, 2003; *Varieties of Capitalism. The Institutional Foundations of Comparative Advantage*, ed. by P.A. Hall, D. Soskice, Oxford University Press, Oxford, New York, 2001; *Contemporary Capitalism. The Embeddedness of Institutions*, ed. by J.R. Hollingsworth, R. Boyer, Cambridge University Press, Cambridge, 1997.

<sup>3</sup> See: Ph.C. Schmitter, “The Emerging Europolity and Its Impact upon National Systems of Production,” in: *Contemporary Capitalism. The Embeddedness of Institutions*, pp. 395-430.

<sup>4</sup> V. Papava, *Necroeconomics. The Political Economy of Post-Communist Capitalism*, iUniverse, New York, 2005b.

## The Human Transformation

The character and possible success of economic reform in transition countries depend largely on the behavior of the person transitioning from *homo sovieticus* (formed under a command economy, wherein it was suppressed by the state and totally dependent on it)<sup>5</sup> to *homo economicus* (seeking the maximum utility in his household and the maximum profit in his firm). The latter type embodies all the changes in this category since Adam Smithian.<sup>6</sup>

The person in post-communist transformation is *homo transformaticus*. He cannot emancipate himself from his fear of the state and from his habit of living at its expense, even as he gradually begins to act in his own interests to achieve maximum utility and profit.<sup>7</sup>

Because the communist regimes in the leader countries ruled for less than half as long as in the outsider countries, *homo sovieticus* did not have time to develop fully. At the same time, *homo economicus* was not totally eradicated, as happened in the outsider countries in the 1930s. In the outsider countries, *homo transformaticus* resembled *homo sovieticus*, whilst in the leader countries it was *homo economicus*. Some market mechanisms existed even under command economies, although only in the shadow sector.<sup>8</sup> Directors of shadow enterprises were called *delets* (slick operators) and not *predprinimatel* (entrepreneurs).

After the collapse of the command economy, most former *delets* preserved their positions as directors in the state sector and during privatization; they exploited the so-called “rights of labor collectives” and became enterprise owners.<sup>9</sup> Regardless of whether or not they hired managers, especially at the initial phase of the post-privatization period, they directed their enterprises as *delets*.

Just as *homo transformaticus* is not yet *homo economicus*, neither could the former *delets* be transformed into entrepreneurs. *Homo transformaticus* in the entrepreneurial sphere is a “post-*delets*.”<sup>10</sup>

## Necroeconomics?

The overthrow of the communist regime and the collapse of the command economy<sup>11</sup> stripped bare the economy of the post-Communist countries. With some exceptions (hydroelectric power, hydrocarbon extraction and primary processing of raw materials), the goods produced in these coun-

<sup>5</sup> See: A.V. Buzgalin, *Perekhodnaia ekonomika: kurs lektsii po politicheskoi ekonomii*, Taurus, Moscow, 1994.

<sup>6</sup> See: V.S. Avtomov, *Model' cheloveka v ekonomicheskoi nauke*, Ekonomicheskaiia shkola St. Petersburg, 1998; M.K. Bunkina, A.M. Semenov, *Ekonomicheskii chelovek*, Delo Publishers, Moscow, 2000.

<sup>7</sup> See: V. Papava, “The Georgian Economy: From ‘Shock Therapy’ to ‘Social Promotion,’” *Communist Economies & Economic Transformation*, Vol. 8, No. 8, 1996; V. Papava, “On the Theory of Post-Communist Economic Transition to Market,” pp. 34-36.

<sup>8</sup> See: W. Andreff, “Corporate Governance Structures in Postsocialist Economies: Toward a Central Eastern European Model of Corporate Control?” *EACES Working Papers*, No. 4, 2005, available at [http://euroest.economia.unitn.it/Eaces/Working%20Papers/WPWA\_4\_05.pdf]; V. Papava, “On the Theory of Post-Communist Economic Transition to Market,” pp. 39-57; V. Papava, N. Khaduri, “On the Shadow Political Economy of the Post-Communist Transformation. An Institutional Analysis,” *Problems of Economic Transition*, Vol. 40, No. 6, 1997; A.N. Shokhin, *Sotsial'nye problemy perestroiki*, Ekonomika Publishers, Moscow, 1989, pp. 57-83.

<sup>9</sup> See: A. Åslund, “‘Rentoorientirovannoe povedenie’ v rossiiskoi perekhodnoi ekonomike,” *Voprosy ekonomiki*, No. 8, 1996.

<sup>10</sup> V. Papava, *Necroeconomics. The Political Economy of Post-Communist Capitalism*, pp. 35-36; V. Papava, N. Khaduri, op. cit.; A. Sulaberidze, “Osobennosti tsennostnykh orientatsii rukovoditelei predpriatii Gruzii v usloviakh ekonomicheskoi reformy,” *Obshchestvo i ekonomika*, No. 4/5, 1998.

<sup>11</sup> See: J. Kornai, *Economics of Shortage*, North-Holland, Amsterdam, 1980.

tries proved unable to compete with world standards and, in principle, *cannot* compete. These are “necroeconomies,”<sup>12</sup> which is similar to the Gaddy-Ickes “virtual economy.”<sup>13</sup>

Exposing the command economy constituted divestment.<sup>14</sup> The complement to the necroeconomy is the market or “vitaconomy.” What do the necroeconomy and vitaconomy have in common and how do they differ?

Both of these economies can produce goods and so there is a supply within each of them.<sup>15</sup> In contrast to the goods produced by the vitaconomy, however, there is no demand for the goods produced by the necroeconomy and so there are no sales and no equilibrium price.

If a segment of the economy is moribund, there should in principle be no problem, since a moribund economy should not have any influence on its vital counterpart. This is so in a market economy. Uncompetitive goods simply “disappear” with no effect on the rest of the economy. Transition countries, however, are in a fundamentally different position.<sup>16</sup> What accounts for the durability of the necroeconomy in post-communist countries? The answer draws upon the evolutionary theory of economic change<sup>17</sup> and the concept of “routines” or the rules and methods of conduct of firms that regulate their behavior and production.<sup>18</sup>

Command economy routines are the main reason that dead enterprises persist, even though the command economy has disappeared. As a result, their warehouses are filled with uncompetitive goods and they accrue unpayable debts, which creates a web of mutual indebtedness.<sup>19</sup>

When an enterprise amassed debts in a command economy, its director would appeal to the superior state organs (in the leading organs of the Communist Party, State Planning Committee (Gospplan) and Ministry of Finance) in order to write off the debts. As a rule, they achieved their goal and so there was no disincentive to indebtedness. This routine persists in post-communist countries as tax amnesties,<sup>20</sup> “purchasing” decrees, legislation, and influence on the central bank.

Post-*delets* stand behind the necroeconomy in both the state and private sectors, and maintain the routines of a command economy. They use their connections to penetrate state structures and prolong the existence of the necroeconomy. The necroeconomy serves the interests of the post-*delets*, and it will retain a solid base until they are replaced with entrepreneurs.

## The Georgian-Type Necroeconomy

Dead enterprises, regardless of whether or not they are owned by state or private companies, need to attract new investments through privatization or provide a long-term concession of certain

<sup>12</sup> See: V. Papava, “Necroeconomics: The Theory of Post-Communist Transformation of the Economy,” *International Journal of Social Economics*, Vol. 29, No. 9/10, 2002; V. Papava, *Necroeconomics. The Political Economy of Post-Communist Capitalism*.

<sup>13</sup> See: Cl.G. Gaddy, B.W. Ickes, *Russia's Virtual Economy*, Brookings Institution Press, Washington, DC, 2002.

<sup>14</sup> See: P.F. Drucker, *Innovation and Entrepreneurship: Practice and Principles*. Harper Business, New York, 1986; M.L. Taylor, *Divesting Business Units*, Lexington Books, Lexington, MA, 1988.

<sup>15</sup> See: A. Sánchez-Andrés, J.M. March-Poquet, “The Construction of Market Institutions in Russia: A View from the Institutionalism of Polanyi,” *Journal of Economic Issues*, Vol. XXXVI, No. 3, 2002, p. 10.

<sup>16</sup> Necroeconomy is not only a problem for transition countries because it also has serious implications on other parts of the world as well (see: K.R. Matshedisho, *Development & Peace in Africa*, p. 15, available at [http://www.codesria.org/Links/conferences/general\_assembly11/papers/matshedisho.pdf]).

<sup>17</sup> See: R.R. Nelson, S.G. Winter, *An Evolutionary Theory of Economic Change*, The Belknap Press of Harvard University Press, Cambridge, MA, 1982.

<sup>18</sup> See: P. Murrell, “Evolutionary and Radical Approaches to Economic Reform,” *Economics of Planning*, Vol. 25, No. 1, 1992, pp. 79-95.

<sup>19</sup> See: A. Åslund, *How Russia Became a Market Economy*, The Brookings Institution, Washington, DC, 1995, Chapter 6.

<sup>20</sup> See: I. Nikolaev, “Perspektivy nalogovoi amnistii v Rossii,” *Obshchestvo i ekonomika*, No. 6, 2002, pp. 49-67; I. Shul'ga, “Opyt nalogovoi amnistii v Kazakhstane,” *Obshchestvo i ekonomika*, No. 6, 2002, pp. 69-71.

assets to strategic investors. Privatization alone, however, will not eliminate the necroeconomy. Strategic investors may be uninterested in mere long-term concessions. If they do not prove to be attractive enough to investors, the government will have to privatize such enterprises at symbolic starting prices because dead enterprises have little worth.

Starting from the middle of the 1990s, the *delets* obtained privileges in privatization in Georgia through their former dealings with the state.<sup>21</sup> They were able to acquire state property directly by “shadow” means and bribed officials to privatize enterprises at a low cost. Despite the broad privatization through vouchers, few foreign investors participated. The transaction cost of privatization was very high because state-owned enterprises were not subjected to bankruptcy prior to privatization, although many should have been. The corrupt operation of enterprises diminished the motivation for investment.

Theoretically, a bankruptcy law should be an effective tool against a necroeconomy. Georgia’s Law on Bankruptcy, however, was stillborn. It was drafted with the help of German experts and it is nearly identical to the German legislative model. Although foreign experts are often helpful, the bankruptcy law was a disaster because none of the de facto bankrupt enterprises were considered as such under the law. Its enactment was halted by the 1999 Law on Tax Arrears Restructuring, which was prepared with the help of World Bank experts, and which panders to the most anti-reformist wing of the industrial lobby in Georgia by demonizing bankruptcy. The continued operation of a bankrupt enterprise is equivalent to the maintenance of bad management without any operational changes, which destroys the company’s development prospects. Moreover, restructuring tax arrears is particularly susceptible to corruption because preparing the draft approval on restructuring and determining deadlines and other elements depend upon the approval of a public official.

After Georgia’s Rose Revolution, the Parliament of Georgia adopted two amendments to the Law on Tax Arrears Restructuring, according to which the restructuring period increased from three to fifteen years (2004) and a company was permitted two opportunities to restructure (2005). This decision means that Georgia will not free itself from the necroeconomy in the near future.

Documents at the Securities Commission of Georgia show that more than half of the corporations have tax arrears, which subjects them to restructuring. Nevertheless, bankruptcy proceedings have not been brought against them in court.

Georgia suffers from the same lack of investment as other post-communist countries. These problems apply mainly to joint-stock companies, which do not stimulate much growth. They have been created through privatization, as have the securities industry and infrastructure. Most joint-stock companies, however, have been created according to political desires rather than with the aim of attracting investments. Liquidity is low and Georgia is still known as a high-risk zone for investors.

The Government retains an ownership interest in more than 1,500 enterprises, the employees of which make up 43 percent of commercial sector employment. The share of such enterprises in the total number of Georgian companies, however, is as little as 14.6 percent.

According to the Ministry of Finance, restructured tax debts account for 68 percent of the 2006 national budget revenues. Two years ago, the situation was even worse as restructured tax debts accounted for 86 percent of the 2005 budget.

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<sup>21</sup> See: Ch. Cordonnier, R. Gamisonia, “Georgian Industry: Situation and Prospects for Development,” *Georgian Economic Trends*, January 2007, p. 52, available at [[http://www.geplac.org/newfiles/GeorgianEconomicTrends/2007/english—january\\_2007.pdf](http://www.geplac.org/newfiles/GeorgianEconomicTrends/2007/english—january_2007.pdf)]; E. Djugeli, I. Gvaramadze, “‘Nulevy’e’ auktsiony: tseli i analiz rezul’tatov,” *Studies and Analyses*, No. 140, CASE, Warsaw, 1998; “Privatizatsia za liubuiu tsenu. Analiz opyta Respubliki Gruzia v 1997-1998 godakh,” ed. by Wl. Pankow, B. Gaciaz, *Studies and Analyses*, No. 141, CASE, Warsaw, 1998; Wl. Pankow, B. Gaciaz, G. Grigolashvili, “Transformatsiia gosudarstvennykh predpriatii v Gruzii,” *Studies and Analyses*, No. 93, CASE, Warsaw, 1996.

Table 1

**Distribution of Tax Debts and Government Lending by Sectors,  
1999-2006**

Sector	Share (percent)
<b>Energy</b>	<b>23</b>
<b>Industry including:</b>	<b>41</b>
<b>Food Industry</b>	<b>9</b>
<b>Agriculture</b>	<b>14</b>
<b>Construction</b>	<b>2</b>
<b>Services</b>	<b>5</b>
<b>Culture, Sports</b>	<b>5</b>
<b>Communications, Transport</b>	<b>7</b>
<b>Health Care</b>	<b>3</b>
<b>Total</b>	<b>100</b>
<i>Source:</i> Ministry of Finance of Georgia.	

In 1999-2006, industrial- and energy-sector enterprises accounted for 64 percent of all those with tax debts and relying on government lending (see Table 1). Additionally, in more than half of all the enterprises, restructuring was granted for a period of three years; in 19 percent of the enterprises for five years, and in 10 percent of the enterprises for 15 years.

In recent years, the proportion of enterprises that failed to pay tax debts ranged from 2 percent to 14 percent. In 2002, restructured debts exceeded GEL 100 million and 14 percent of all indebted companies failed to repay (see Fig. 1). All of this resulted from a routine management style on the part of most companies.

Control of corporate governance is one cause of a necroeconomy. There is no mechanism for control by a corporate board. Theoretically, a board should have control over the director of a company. In practice, however, the directors choose the board if it suits them, while the board is merely a formality and exercises no real authority. As a result, the interests of the owners are inadequately protected and there is a high probability that insider manipulations will be carried out.

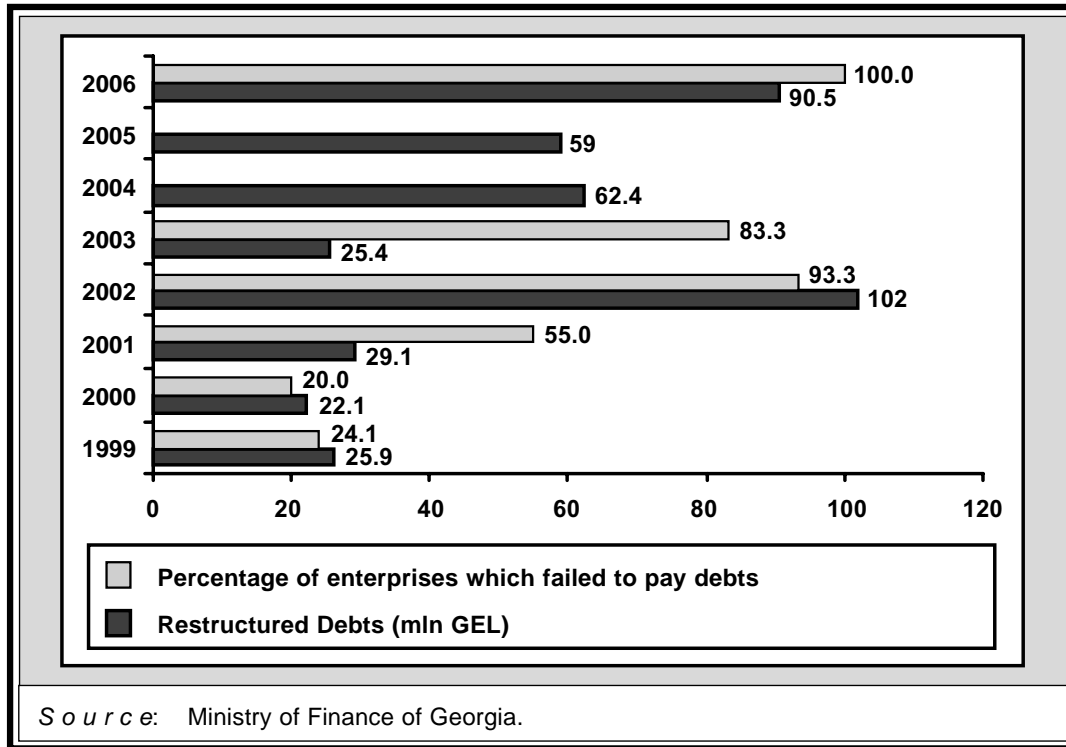
More than 40 percent of managers of joint-stock companies in Georgia own large blocks of shares in their companies. They avoid trading on the stock exchange and the shares of these companies are often not quoted. For these reasons, the stock exchange's control over such corporations is low and the activities of managers are ineffective. Nevertheless, even the supervising body does not make attempts to improve the situation.

The situation is exacerbated by poor corporate management, and so it is not surprising that few directors are fired despite the fact that most joint-stock companies are not profitable year after year. In some corporations, the director owns a larger part of the shares than the members of the board, and the latter's influence over the company is, therefore, negligible.

The negative influence of the necroeconomy on the development of outsider countries is evident, as is the need for market mechanisms. The key to solving these problems lies in the evolutionary theory of economic change cited above.

Figure 1

## Share of Enterprises that Failed to Repay Government Debts



The government should devote special attention to the private sector created exclusively on the basis of private investments. The government should promote its consolidation and expansion and should take steps to create a stable political and macroeconomic environment when new firms are created through private investments.

## Georgia's Prospects for a Vitaeconomy: The Legislative Framework for Business Liberalization

The key challenges to economic development come from the uncertain environment for entrepreneurs, small markets, poor skills, weak infrastructure, and restrictive legal and regulatory regimes. Licensing fees, delays in obtaining regulatory approval, and time-consuming dealings with officials impose costs on firms which can be so burdensome that entrepreneurs have to bribe officials to speed up these processes.

Until 2004, no efforts were exerted in Georgia to build an economy conducive to entrepreneurship and the active participation of civil-society institutions. Instead, government inactivity and economic stagnation were the norm. The Rose Revolution of November 2003 began a period of institutional changes in all spheres of social and economic life. The new government has eliminated and simplified many business regulations to boost the country's competitiveness and facilitate international integration.

Since 2004, the main goals of the new government have been to establish new fiscal discipline, restore the legal basis of the economy, destroy shadow structures, and simplify regulations. Apart from the construction of the Caspian-Mediterranean oil and gas pipelines,<sup>22</sup> foreign direct investment in Georgia prior to this time was very limited because of bureaucratic interference, political instability, and the enormous shadow economy.

The post-revolutionary period is especially remarkable because of the government's effective fight against petty corruption. A consensus on the path to progress has developed among civil society, entrepreneurs, and the authorities through liberalization of the tax and customs codes and the removal of state control over various sectors. In 2005 and 2006, Georgia made considerable strides in reversing policies that previously stifled private initiative. These reforms mainly concerned business registration with an emphasis on reducing economic and administrative regulations. According to the World Bank's "Doing Business 2007" report, Georgia leapt from 112th to 37th position and is now ahead of some EU countries.<sup>23</sup>

**Simplification of Tax Regulations.** In 2005, the tax code was simplified and the number of different taxes was reduced from 21 to 7. The old tax code had been in use since 1997. It imposed excessive burdens on entrepreneurs and was difficult to administer since it had many loopholes and possibilities for different interpretations. Together with the poor administration of tax-collection agencies, this encouraged entrepreneurs to bribe tax officials or move to the shadow economy. The many exemptions, allowances, and deductions in the old tax code created an unfavorable environment for competition. Since 1997, many changes have been made to the tax code, which exacerbated these problems and served mainly to create favorable conditions for selected business groups.

The main goals of the new tax code were to encourage economic activity and to limit the shadow economy. It reduces the overall tax burden, makes collection simpler and more transparent, and saves the taxpayers' time. Public administration has improved in general since the Rose Revolution and corruption in the tax-collecting agencies has also declined.

The new code creates the institution of tax ombudsmen to protect honest taxpayers, but this progressive change has not yet been implemented. Additionally, some tax procedures have been amended. The time for solving tax disputes was reduced to two months and arbitration has become the alternative mechanism for resolving tax disputes. Taxpayers are granted the right to take a dispute to court or engage in arbitration procedures at any time. Unfortunately, the ombudsmen and arbitration were abolished three months after the new tax code was adopted. It seems that Georgia's tax legislation failed to fully protect entrepreneurial rights.

**Business Registration Simplifications.** Business-environment reforms mainly concerned business-registration simplifications. The emphasis has been on reducing the cost of excessive economic and administrative regulations by lowering the effective rates of protection and reducing uncertainty. Some state organizations that were corrupt and created barriers to doing business were removed.

In practice, delayed registration suggests that there are too many procedures in place. The Ministry of Justice had authorized firms. Registration procedures were reformed in Georgia with the removal of the Ministry of Justice and courts from the registration procedures and reduction of the time for processing an application to three days. Now, local tax administrations are responsible for registration.

At the same time, the new law on entrepreneurs reduced the minimum charter capital tenfold. All these procedures simplified starting a business and reduced the cost of registration. These reforms reduced transaction costs and Georgia now ranks among the best performers in this measure. Accord-

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<sup>22</sup> See: S.F. Starr, S.E. Cornell, "The Politics of Pipelines: Bringing Caspian Energy to Markets," *SAISPHERE*, 2005.

<sup>23</sup> See: *Doing Business. How to Reform. Comparing Regulation in 175 Economies*, The World Bank, Washington, DC, 2006, available at [[http://www.doingbusiness.org/documents/DoingBusiness2007\\_Overview.pdf](http://www.doingbusiness.org/documents/DoingBusiness2007_Overview.pdf)].



ing to the current legislation, a representative of an international company is not considered a legal entity in Georgia. The registration procedure, however, is the same as for other types of enterprises, and foreign investors enjoy the same rights as Georgian companies.

Simplified start-up procedures are part of a comprehensive reform package to support business, including clear deadlines for processing enterprises' requests, granting licenses or authorizations, and carrying out tax-registration and social-insurance registration procedures. These include the company-registration certificate, tax registration, social-security registration, and statistical-office registration. Institutional reforms transferred the delegation of authority over business registration from courts and notaries to tax departments and provide for one-window registration with trade, tax, and labor authorities.

**Licensing and Standards Liberalization.** Before 2005, some thirty state organizations issued 65 types of licenses and permits, which created barriers to market entry. In 2005, licensing reforms retained only 150 out of the previous 950 licenses to defend consumers' rights and ensure public safety. A one-stop shop was created for license applications.

Despite simplified license procedures, the cost and time required to receive permits and licenses are still higher than in EU countries.

Until 2006, Georgia used the obsolete Soviet GOST standards, which numbered approximately 26,000. Georgia is moving away from these standards, available only in Russian, to voluntary standards compatible with WTO rules.

**Customs Reforms.** Customs reforms are the most successful regulatory reforms in Georgia, following WTO accession in 2001. The new 2007 customs code will reduce the sixteen types of custom duties to three, as well as the rates, which ranged from 1 to 25 percent. Duties now range from 12 percent (agricultural products) to five percent (construction materials) to zero (all other goods).

This code stimulates exports. Wine, for example, is a major export and accounts for 80 percent of production. Many inputs are imported; previously, these imported items were duty-free if used in re-exported products within six months. This duty-free period has been extended by up to two years.

The new regime also stimulates imports. An association of oil producers and importers has asked the government to create "closed" (duty-free) customs terminals. This allows them to create stores that reduce their costs, especially when oil prices increase.

The new custom code envisages leaving only seven of the former 15 custom regimes. Moreover, it also envisages simplifying custom regulations and, at the same time, eliminating the brokerage system that caused problems with import declarations.

There is still a large outstanding agenda of reforms, but the pace is limited by the command-economy-type "routine" management and by the slow introduction of mechanisms to engage vital entrepreneurs.

## Obstacles to Georgia's Vitaeconomy

Since the Rose Revolution, Georgian officials have enjoyed a greater sense of impunity. The judiciary has been degraded and judges have become tools of the prosecutors.<sup>24</sup> The government now exercises tremendous control over the media and especially television.<sup>25</sup> It is hardly surprising that democratization and progress on human rights have been slow.<sup>26</sup>

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<sup>24</sup> See: Z. Anjaparidze, "Critics Press for Improved Judicial Independence in Georgia," *Eurasia Daily Monitor*, The Jamestown Foundation, 26 April, 2006, available at [[http://www.jamestown.org/edm/article.php?article\\_id=2371020](http://www.jamestown.org/edm/article.php?article_id=2371020)].

<sup>25</sup> See: "Newspaper: Government Controls Editorial Policies of the Private TV Stations," *Civil Georgia*, Tbilisi, 28 February, 2005, available at [<http://www.civil.ge/eng/article.php?id=9202>].

<sup>26</sup> See: *One Step Forward, Two Steps Back. Human Rights in Georgia After the "Rose Revolution,"* Human Rights Information and Documentation Center, Tbilisi, 2004, available at [<http://66.116.100.86/humanrights.ge/eng/files/>].

Corruption in post-revolutionary Georgia has been transformed. Extra-budgetary accounts are paid into by those accused of corruption, who pay the “price of liberty.”<sup>27</sup> Spending from these accounts is not transparent and was made even worse as they started to receive “voluntary contributions” from businesses.<sup>28</sup> Whereas pre-revolutionary functionaries opened their pockets for bribes, their post-revolutionary successors have opened bank accounts. These accounts were abolished in spring 2006 under IMF pressure.

Privatized state property is now being deprivatized<sup>29</sup> and the new rounds of privatization are non-transparent. This process presents a false populist image of providing for social justice whilst redistributing property to the newly formed elite.

The new government’s disrespect for property rights is particularly frightening, as in its recent decision to demolish—with no judicial orders—some pre-revolutionary facilities whose owners had valid documentation.<sup>30</sup> The executive’s only argument was that it was “improving the city’s appearance,” but the right to property was not its concern. Such blatant interference with property rights threatens democracy and the business environment.

Finally, the non-transparent behavior of the Georgian Government is strengthened by the absence of an economic development program. The IMF and other international financial institutions have been cooperating with the Georgian Government under the Economic Development and Poverty Reduction Program,<sup>31</sup> which was adopted in 2003 but never implemented. These institutions have cheated themselves by alleging that they have been working with the Georgian Government under this program. These institutions must require the government to come up with a new program that would establish clear deadlines for implementation.

## C o n c l u s i o n s a n d R e c o m m e n d a t i o n s

With a reputation for democratic transformation, Georgia attracted international attention and support after the Rose Revolution. The Government has taken steps to reorient economic policy, foster private-sector growth and foreign investment, and eliminate many regulatory obstacles. Significant challenges, however, still remain.

Liberalization and deregulation have created a framework for unrestricted economic activity. Reducing regulatory burdens to the level necessary only for protecting public interests encourages

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REPORT.pdf]; *Country Reports on Human Rights Practices-2006*. Released by the Bureau of Democracy, Human Rights, and Labor, 6 March, 2007, U.S. Department of State, Washington, DC, available at [<http://www.state.gov/g/drl/rls/hrrpt/2006/78813.htm>].

<sup>27</sup> See: V. Papava, “The Political Economy of Georgia’s Rose Revolution,” *Orbis. A Journal of World Affairs*, Vol. 50, No. 4, 2006.

<sup>28</sup> See: Z. Anjaparidze, “Georgian Government Questioned about Secret Funds,” *Eurasia Daily Monitor, The Jamestown Foundation*, 12 April, 2006, available at [[http://www.jamestown.org/edm/article.php?article\\_id=2370970](http://www.jamestown.org/edm/article.php?article_id=2370970)].

<sup>29</sup> See: A. Åslund, “Georgia on My Mind,” *The International Economy Magazine*, Winter, 2006; V. Papava, *Necroeconomics. The Political Economy of Post-Communist Capitalism*, pp. 60-61.

<sup>30</sup> See: R.E. Christiansen, “Property Rights, Institutions and Growth: Will Georgia Make the Transition?” Presentation Delivered at Cato Conference, *International Monetary Fund, Resident Representative Office in Georgia*, 27 October, 2006, available at [<http://www.imf.ge/view2.php?lang=1&view=239>]; M. Corso, “Georgia Moves to Defend Property Rights,” *Eurasia Daily Monitor, The Jamestown Foundation*, 9 February, 2007, available at [<http://www.eurasianet.org/departments/insight/articles/eav020907a.shtml>]; R. Sakevarishvili, “Georgia: Property Rights ‘Bulldozed’,” *Caucasus Reporting Service*, No. 378, 16 February, 2007, available at [[http://iwpr.net/?p=crs&s=f&o=333314&apc\\_state=henpcrs](http://iwpr.net/?p=crs&s=f&o=333314&apc_state=henpcrs)].

<sup>31</sup> See: *Economic Development and Poverty Reduction Program of Georgia*, Government of Georgia, Tbilisi, 2003.

entrepreneurship and private-sector investment, but the new legislation has not been fully implemented.

Eliminating the enduring necroeconomy is a great challenge and it requires an effective law on bankruptcy. The existing law (drafted by foreign experts) was confirmed by parliament in the mid-1990s, but it was incompatible with other institutions and was stillborn, not only in Georgia but also in many post-communist countries as well.<sup>32</sup>

New institutions in post-communist countries, created under pressure from international financial organizations and based upon Western models, often prove unviable. In the worst case, they can cause great harm. The IMF is often criticized for its forced and simplistic approach to institutional reforms, which is putting a drag on establishing a market economy.<sup>33</sup>

The fact that the European Union recognizes that the leader countries are ready for admission attests to their lack of a necroeconomy, which is the main barrier to transition in the outsiders. The experience of other countries demonstrates that change cannot be sustained without political will and common goals among the government, the private sector, and the international community.

The post-revolutionary government has a mixed record. Since opposition political groups are weak and lack influence, the international community needs to help the government to correct or avoid those mistakes. There can be four main recommendations for the international community to exercise its influence over the Georgian government as follows:

1. The United States, as a key political partner in Georgia's fight for independence from Russia, can wield the most effective influence over the Georgian Government. First, it could convince international financial institutions not to unconditionally support the present Georgian leadership in some of its anti-democratic efforts. The Millennium Challenge Account could also be effective if the funding of more projects were made contingent on successful reform.
2. The EU and its member states have an equal role in Georgia's democratization. Unlike the United States, European attitudes toward the Georgian government have been rather moderate, as with discussions about Georgia's admission to NATO. This, however, is not enough. Europe should exploit Georgia's interest in EU integration more aggressively. The Council of Europe has been much more critical of the Georgian leadership's mistakes. Because it has limited financial resources, however, the Council has little influence over democratic developments.
3. The IMF and other international financial institutions have not used the financial tools at their disposal to influence the situation in Georgia. With their tacit approval, de-privatization, violations of property rights, and the judiciary's complete dependence upon the executive's will have done immense harm to Georgia's potential for economic development. International organizations should have a stricter attitude toward Georgia and condition their programs upon further economic reforms.
4. These institutions have been cooperating with the Georgian Government under the Economic Development and Poverty Reduction Program which was adopted in 2003 but never implemented and is now outdated. They must require the Georgian Government to devise a new program with firm deadlines for implementation.

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<sup>32</sup> See: A. Sánchez-Andrés, J.M. March-Poquet, op. cit., pp. 10-11.

<sup>33</sup> See: J.E. Stiglitz, "Whither Reform? Ten Years of the Transition," Paper Presented at the Annual Bank Conference on Development Economics, April 1999, in: *Joseph Stiglitz and the World Bank. The Rebel Within*, ed. by Ha-Joon Chang, Anthem Press, London, 2001, pp. 127-171.

The time has come for the international community to exercise its influence over the Georgian Government and to return it to the track of human rights protection and market economy development.

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## THE BAKU-TBILISI-CEYHAN PIPELINE IN THE CONTEXT OF HUMAN RIGHTS

### A b s t r a c t

**T**his article considers human rights protection, as well as the complicated legal collisions associated with this problem that have arisen during the building and operation of the Baku-Tbilisi-Ceyhan (BTC) pipeline. It analyzes both the Inter-Governmental and Host Government Agreements on the BTC relating to the

content, procedures, and mechanisms of human rights protection. In addition to describing the main obligations of the BTC International Consortium and the Republic of Azerbaijan with respect to human rights, the author also offers her vision of ways to improve the regulatory base of this project.

### I n t r o d u c t i o n

Building the Baku-Tbilisi-Ceyhan (BTC) oil pipeline was an important stage in implementing the Contract of the Century entered as early as 1994 by the Republic of Azerbaijan and world oil companies. Its introduction into operation made it possible to transport crude oil from the Azerbaijani sector of the Caspian Sea to the Turkish port of Ceyhan located on the Mediterranean coast. The BTC crosses Azerbaijan, Georgia, and Turkey and is the second longest oil pipeline in the world.<sup>1</sup> The consortium consists of eleven oil companies headed by the largest shareholder, British Petroleum (BP). The building and launching of the BTC is one of the largest investment projects for Turkey and Azerbaijan and the largest for Georgia.<sup>2</sup> The BTC is important for the three countries because its

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<sup>1</sup> See: M. Piskur, "The B.T.C. Pipeline and the Increasing Importance of Energy Supply Routes," *Power and Interest News Report*, 2006, available at [<http://www.pinr.com/report.php?ac=view-report&report-id=537&language-id=1>], 10 March, 2007.

<sup>2</sup> See: The BTC Inter-Governmental and Host Government Agreements (LONDON 186.702.2), available at [[http://www.bakuceyhan.org.uk/correspondence/BP\\_re\\_legals\\_sept\\_02\\_p3](http://www.bakuceyhan.org.uk/correspondence/BP_re_legals_sept_02_p3)], 10 March, 2007.