GEORGIA'S SOCIO-ECONOMIC DEVELOPMENT: PROSPECTS OVER THE MEDIUM TERM

Vladimer Papava, Senior Fellow at the Georgian Foundation for International and Strategic Studies, Doctor of Economic Sciences, Professor

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The tortuous path of economic reforms in post-Soviet Georgia

Georgia's economy has undergone huge changes since the country reclaimed its independence over 20 years ago. 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. Serious mistakes were made, particularly in the initial stages of the transition from a command economy to a market economy. The cumulative effect of these mistakes was that, by 1993, the country's gross domestic product (GDP) was 30.73% of the level in 1990. Annual inflation stood at over 7.84% in 1994.

In 1995, a currency reform was successfully implemented, allowing macro-economic stability to be achieved, along with a rise in GDP of almost 24% in 1996–1997. However, the negative impact of the 1998 Russian default on Georgia's economy, together with the resulting spread of corruption, exacerbated the country's existing budget and energy crises. By 2003, more than half (52%) of the Georgian population had an income below the official poverty line.

After the "Rose Revolution" in November 2003, a fight against corruption was launched and the budget and energy crises were overcome. Since 2005, a new tax code has reduced the tax burden significantly, while procedures for registering business start-ups have been considerably simplified. In addition, new labour legislation has been passed, giving employers complete freedom of action in relation to their employees. These reforms have portrayed Georgia as a country of neo-liberal reforms. However, there were also many documented instances of violations of property rights and big business came under the complete control of the government. Moreover, the abolition of anti-monopoly legislation and its regulatory body created an economy that was dominated by monopolies. Despite the disappearance of mass corruption – mainly in the form of bribery – elite corruption has started to assume threatening proportions. These crimes represent a kind of neo-Bolshevism, and Georgia's present-day economy represents a symbiosis of neo-liberalism and neo-Bolshevism.

In the years since independence, Georgia has managed to establish itself as a transit corridor linking Europe with Asia. Major oil and gas supply pipeline projects have been completed.

After the August 2008 Russia-Georgia war, the European Union expressed its willingness to grant Georgia a free trade regime, setting a number of preconditions. The most important of these preconditions are the implementation of European-style anti-monopoly market regulation and the introduction of consumer rights protection, particularly in the area of food safety. Unfortunately, the Saakashvili government did all it could to postpone the start of talks with the EU by delaying implementation of these conditions.

In early 2009, the United States–Georgia Charter on Strategic Partnership was signed, under which the US acknowledged the possibility of the US concluding a free trade agreement (FTA) with Georgia. However, there has been little real movement on this so far and negotiations have not even begun.

The Georgian economy: in search of a development model

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

Stimulating consumption while ignoring the need to develop the real sector of the economy has led to the country importing four times as much as it exports. Of its exports, 22% are motor cars and 8% scrap metal. However, Georgia has no 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 the economy, indicates the relative economic backwardness of the country.

In total, government and private consumption accounts for around 90% of GDP. This is further evidence that the Georgian economy is more oriented towards consumption than production. The relative backwardness of the manufacturing 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 investment (FDI) and remittances to Georgian citizens from relatives living abroad.

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.

Since independence, many residents of Georgia have for various reasons left the country. At present, around 20% of the population of Georgia (more than one million people) is living abroad (two thirds of them in Russia, but also in Greece, Turkey, Ukraine, the US and Spain, among other countries). Remittances sent through banks alone amount to over US$1 billion 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. This once again provided credit for building and for purchasing home appliances. Since home appliances are not produced in Georgia, however, this led to a situation where consumer borrowing from Georgia's commercial banks promoted the development of the real sector of economies in the countries that 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 economies in third countries. 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, received US$5.8 billion in financial assistance from the international community. As a result, 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 the economy. According to official statistics, the level of unemployment is over 15%. However, 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. The main reason for this is that over 55% of the workforce is self-employed and their incomes are so low that they do not view this work as employment.

Over 80% of the self-employed work in agriculture. More than half (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 agricultural crisis of underproduction. It also explains why 80% of basic food products are being imported. Georgia's agriculture sector has also suffered from the ban announced in 2006 by the Chief Public Sanitary Inspector of Russia on the importing of agricultural products from Georgia, due to their allegedly low quality.

Promotion of tourism in Georgia has increased the demand for food, which, given the agricultural 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.

In its search for a model of economic development, Georgia has officially adopted a pro-European stance, but has not taken any practical steps in this direction. A glaring example of this is the way the government behaved over the FTA with the EU. President Saakashvili has also publicly stated that Georgia should follow Singapore's model of economic development. By initiating its policy of "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.

Potential scenarios and the situation most likely to be in place by 2020

One scenario that can be ruled out in relation to Georgia's economic policy up to 2020 is the 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 unfolding, since the elections 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 the promotion of the real sector of the economy, along with social support for the poor segments of the population. Ivanishvili, now head of the government that he himself formed, has begun to implement his pre-election promises.

Based on these new realities, a more realistic scenario is the stepping up of negotiations with Brussels on an FTA with the EU. The new government's announcements that it will implement anti-monopoly regulation 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, the de-monopolising of the Georgian economy will provide a significant impetus for business development.

It is entirely feasible that Georgia will achieve an FTA with the EU by 2014 at the latest. This would in itself attract private investment into Georgia's real sector of the economy, since the combination of a relatively low-cost (compared with the EU) workforce with a simplified system of business registration and relatively low tax burdens (again compared 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, an 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 in the Turkish market in view of the FTA already reached with Turkey in 2008.

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

Given that almost four years have passed since the signing of the Charter between the US and Georgia, without any negotiations on a free trade regime even having started, the earliest expected date for an FTA with the US is likely to be 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, since this is more of a political than an economic issue. The fact that Georgia and Russia are both members of the World Trade Organization (WTO) is not in itself a sufficient condition for establishing trade between these two countries. This means that it is virtually impossible to predict a resumption of trade with Russia in any forecast of Georgia's economic development up to 2020.

Achieving full-scale trading relations with Russia also raises the question of re-opening the Trans-Caucasus Railway. The railway passes through Abkhazia, linking Georgia and Armenia with Russia, but was suspended back in August 1992.

Based on the realistic scenario whereby an FTA is reached with the EU, opening up trade with Turkey, the likely average economic growth in Georgia in the period 2013 to 2020 would be between 5% and 10%. The more pessimistic figure of 5% assumes that the global economic crisis will worsen; the more optimistic figure of 10% average growth assumes that the world economy will achieve steady growth. However, this would mean that by 2020 Georgia's per capita GDP would be about 2.8 times the 2011 level, at US$9,120 (in 2011, the figure was US$3,215.4).

Studies on the comparative advantages of Georgia's economy have identified the main sectors as: transportation, primarily of energy resources; agriculture and the food industry; hydro-electric power; and tourism. Clearly, the economic growth referred to earlier has to be provided by the sectors where Georgia has a comparative advantage. The government's emphasis on investing in the real sector of the economy means that industry's share of GDP would have to double on average by 2020, rising to at least 50%.

The natural and climatic conditions in Georgia also present enormous opportunities for developing agriculture, supported by an agriculture development fund currently being set up by the new government with an annual budget of GEL 1 billion (about US$604 million as at 14th January 2013). This could increase agriculture's share of GDP to around 30% by 2020, which would be 3.5 times what it is now.

Developing the real economy, passing new European-style labour legislation and a suitable social policy, taken together, will help to improve the quality of life of Georgia's citizens, which could lead to at least a 2.5 times reduction in poverty levels.

On the basis of World Bank figures on global economic development, by 2020 Georgia's economic situation will be better than the current situation in EU countries such as Bulgaria and Romania, but worse than that in Latvia and Lithuania.

Proposals and recommendations

A primary objective for the Georgian government is to sign an FTA with the EU as quickly as possible, in order to realise the full potential entailed in 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 labour relations.

Negotiations on establishing a free trade regime with the US must be launched under the US Georgia Charter on Strategic Partnership. However, it is very important that the terms of an 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 must themselves present the Office of the Chief Public Sanitary Inspector of Russia with all the necessary documentation confirming the quality of the products they manufacture, as well as evidence that these commodities are present in the markets of various countries of the world (the US, EU countries, China, Japan, etc.). If their products are once 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.

Topics for discussion

The following topics can be singled out for discussion:

- How steady will the new Georgian government's focus be on developing the real sector of the economy by reaching an FTA with the EU? This is an important issue, given the system of dual power currently in place: accordingly, the local offices of the state administration are subordinate not to the government, but to President Saakashvili, who has officially declared that he is moving to the opposition.
- What positive impact can an FTA with the EU have on the Georgian economy if the eurozone crisis continues?
- How likely is an FTA with the US by 2020 and how might this affect the Georgian economy?
- How likely is the resumption of normal trading relations with Russia? Even if this issue is resolved, will these trading relations reach the level at which they were when suspended in 2006?
- How would opening the railway passing through Abkhazia and linking Georgia and Armenia with the southern regions of the Russian Federation affect the economy – both following the resumption of trading relations between Georgia and Russia and if the status quo is maintained?