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საქართველოს სტრატეგიისა და საერთაშორისო ურთიერთობების კვლევის ფონდი
GEORGIAN FOUNDATION FOR STRATEGIC AND INTERNATIONAL STUDIES

ON SOME GENERAL PROBLEMS OF THE TRANSITION FROM A COMMAND ECONOMY TO A MARKET ECONOMY AND THE EXPERIENCE OF ECONOMIC REFORMS IN POST-COMMUNIST GEORGIA

VLADIMER PAPAVA

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Abstract: The collapse of the Communist system and the breakdown of the Soviet Union and Yugoslavia into independent states as well as the beginning of the transition from a command economy to a market economy actually began unexpectedly. Lacking a theory for the transformation of a command economy into a market economy, economic reforms in many post-Communist countries were based on the "trial and error" method.

The article examines the issues of economic reforms carried out in post-Communist Georgia. The first generation of economic reforms carried out in post-Communist Georgia were based on the Polish experience of implementing reforms using the Shock Therapy method. Unfortunately, at the initial stage, these reforms in Georgia completely failed since they did not have institutional support. Based on the correction of mistakes made in the implementation of these reforms, macroeconomic stability was achieved in Georgia which made it possible to successfully implement the monetary reform.

After the "Rose Revolution" of 2003, ultra-liberal economic reforms began in Georgia which had great international recognition. Under the guise of ultra-liberal economic reforms, the Georgian government began to put informal pressure on business as well as violate human rights. All of this can be qualified as "neo-Bolshevism." As a result, post-revolutionary economic reforms in Georgia were a mixture of ultra-liberalism and neo-Bolshevism.

In 2014, Georgia signed an associate status agreement with the EU which opened up new opportunities for using the free trade regime with the EU. After Georgia received the European perspective from the EU in 2022, the country has new challenges and opportunities for economic convergence with the European market economy model.

A generalization of the Georgian experience of post-Communist economics is of great importance for a proper understanding of the significance of liberalism in these reforms.

Key words: Transition, Command Economy, Market Economy, Economic Reforms, Post-Communist Georgia

JEL: O52, P11, P16, P21, P26, P30

Introduction

Almost three decades after the beginning of the transition to the market economy, it is possible to generalize upon the accumulated experience and draw a number of very important conclusions about the path already traversed in transforming a Communist economy into a market economy (e.g., Åslund 2007; Ghodsee and Orenstein, 2021; Hare and Turley, eds., 2013; Havrylyshyn, 2020; Kolodko and Tomkiewicz, eds., 2011; Roland, 2000; Szelényi and Mihályi, 2019). In this context, those studies that concern the general trends of transitional and transformational processes are of particular importance (e.g., Bernholz, 2020; Olson, 2020; Polanyi, 2001; Smil, 2021). The generalization of the experience of quasi-market structures in socialist countries also deserves attention (e.g., Bockman, 2011).

More than 30 years after the disintegration of the Soviet Union and the restoration of Georgia's independence, an analysis of the processes characteristic of the transition to a market economy warrants special attention (Papava, 2013b).

The entire post-Communist space, as well as its economic science, was unprepared for the fall of the command economy and the transition to a market economy. In fact, the transition from a command to a market economy began and ended in such a way that the theory of this transition was not created (Papava, 2005b). This caused the plethora of mistakes that were made at the beginning of the initial stage of the reforms.

The countries that were successful and those that failed in carrying out their economic reforms became apparent from the very beginning. Poland led the group of successful countries. Therefore, it stands to reason that many countries began following Poland's experience, although most of them were not as successful as Poland. This is mainly explained by the fact that neither the prerequisites required for beginning such reforms, nor the realities prevailing in these countries, were taken into consideration before the reform process was launched.

The article analyzes the reforms that were carried out in Georgia both at the initial stage of the restoration of state independence and after the "Rose Revolution" of 2003. Particular attention is focused on the liberal nature of these reforms.

It should be noted that starting from 2020 due to the COVID-19 pandemic, and from 2022 due to Russia's war in Ukraine and the economic sanctions imposed by the West against Russia, the world has faced another economic crisis with exogenous roots (Papava, 2020, 2022). In such circumstances, the implementation of economic reforms is practically impossible.

Before starting to consider economic reforms in post-Communist Georgia, in our opinion, it is very important to make some general comments about the human factor which determines the success of economic reforms in the transition period.

The Key to Success

The fact is that there are no generally accepted criteria for determining the completion of the transition period. The simplest formal resolution of the problem is that if the EU recognizes a country with a transition economy as ready to enter its ranks as a member, then in all probability the transition period in this country has been completed and that its functioning economic system, for all practical purposes, has become a European-type market-based one.

Most Eastern European and Baltic states at present are members of the EU; they have thus formally completed the transition period to a European-type market economy. In other words, these countries are leaders in successfully passing through the transition period. Henceforth, the term 'leaders' will designate these countries. What about other post-Communist countries such as Armenia, Azerbaijan, Georgia, Moldova and Ukraine[1] which continue to be considered as 'outsiders'? (Papava, 2010: 362).

It is obvious that these countries are still far removed from emerging European capitalism. The transitional period in these countries has ended but, unfortunately, the economic (and not only economic) systems of some are far removed from the European style of capitalism.[2] It is better to qualify this as 'post-Communist capitalism' (Papava 2005a). In other words, if the collapse of the Communist system was essentially simultaneous in the countries of Eastern Europe and the former USSR, it follows that initially all were in the same basic situation and, consequently, dragging out the transition period to European capitalism is an artificial delay in the process of reforming the economy.

[1] It should be noted that in 2022 the EU states recognized the European perspective of Ukraine, Moldova and Georgia and granted Ukraine and Moldova the status of EU candidates. However, these countries are still far from EU membership.

[2] It should be taken into account that capitalism, by its nature, is not homogenous (e.g., Dahms, 2000; Gwynne, Klak and Shaw, 2003; Hall and Soskice, eds., 2001; Szelényi and Mihályi, 2019).

In order to understand the principal problems of post-Communist transformation in the 'outsider' countries, it is expedient to conduct a comparative analysis of these countries with those in the 'leader' group.

From the beginning of the transition period, a special circumstance of great importance has not been taken into account: the presence of the institutions of statehood. In particular, the states that formed as a result of the collapse of the federal formations (the USSR, the Socialist Federal Republic of Yugoslavia and Czechoslovakia) but were not the direct legal successors of these federal states were lacking the institutions of statehood. As a result, their process of transition was compounded by the need to construct these institutions from scratch (Balcerowicz, 1995: 146).[3] Under these conditions, the implementation of economic reforms according to plans which had counted on utilizing the corresponding institutions of the state (which were lacking in these countries) was foreordained to fail.

The advantage of most leader countries, as compared with the outsider countries, was the presence of institutions of statehood that significantly simplified and thus accelerated the resolution of tasks associated with the transition to a market economy. Nevertheless, this factor cannot be deemed decisive in delaying the transition to a market economy in all the outsider countries as illustrated by the examples of the EU member Baltic countries, Croatia, Slovakia and Slovenia. Their examples refute the thesis of the fundamental impossibility of a rapid transition to a market economy amidst the process of creating these state institutions.

The human factor, as a rule, has a decisive significance in practically any economic process. The character and possible success of economic reform in countries with a transition economy depend, to a large degree, upon the behavior of the person who finds himself in a transition process – from *homo soveticus* (i.e., someone who was formed under the conditions of a command economy and was hence suppressed by the state and totally dependent upon it) to the type of person characteristic of a market economy, *homo economicus* (i.e., someone whose driving motivation is to receive the maximum utility in his household and the maximum profit in his firm). The type of person carrying out the process of post-Communist transformation is characterized herein by the term *homo transformaticus* (i.e., someone who cannot completely emancipate himself from fear of the state and from the habit of living at the latter's expense, although he is gradually beginning to act upon the basis of his own private interests in order to achieve maximum utility and profit) (Papava 1996b: 261–262).

[3] The process of transition to a market economy and the building of the institutions of statehood in the former German Democratic Republic were considerably simpler since they had been preceded by a union with the Federal Republic of Germany (see, e.g., Derlien, 1999).

Because Communist regimes in leader countries ruled almost half as long as in the outsider countries, the *homo soveticus* type of person did not have time to develop fully. At the same time, *homo economicus* was not totally eradicated as was the case in the outsider countries at the end of the 1930s. Consequently, in the outsider countries, *homo transformaticus* was dominated by the characteristic features of *homo soveticus*; in contrast, in the leader countries, it was the features of *homo economicus* that prevailed. It is precisely this difference which explains the greater readiness of *homo transformaticus* in the leader countries to undertake the transition to a market in contrast to the situation in the outsider countries.

The key challenge for the post-Communist countries outside the EU is to achieve some general standards of the European market economy. The main actor who must solve this problem is *homo transformaticus*.

The Georgian Modification of the Polish Version of Shock Therapy

As is well known, the Shock Therapy method of economic reform was first developed and used in West Germany after World War II. New life was breathed into it in post-Communist Poland with the introduction of the Balcerowicz Plan in 1990 (Balcerowicz, 2014). The implementation of this approach with respect to macroeconomic stabilization requires the active involvement of several different governmental institutions. Shock Therapy cannot be successfully applied in the absence of these crucial institutions and any attempt to do so is doomed to failure. Georgia's experience also supports the validity of this view. It is not difficult to demonstrate this. It is enough to elaborate what Shock Therapy means according to the so-called Balcerowicz Plan (considered to be the modern and already classical version of Shock Therapy) and then to study the mistakes made in implementing Shock Therapy in Georgia (Papava, 1996a, 1996b, 1999, 2011).

Shock Therapy generally assumes implementing a tight fiscal policy. It entails the simultaneous adoption of measures involving price liberalization, a considerable reduction in the national budget deficit by canceling budgetary subsidies and stringent control over the money supply and income of the population. The plan developed by the former Polish Finance Minister, Leszek Balcerowicz, is considered an excellent modern example of the Shock Therapy method and is frequently referred to favorably by other transition economies. In accordance with this plan, the following measures were simultaneously implemented in Poland from the very start:

1. Multiple increases in all types of prices; a deliberate, although it was hoped temporary, increase in inflation aimed at ensuring and maintaining market equilibrium;
2. Tight restrictions on the (real) income of the population;
3. A substantial increase in (nominal) interest rates and restrictions of the money supply;
4. Increases in the interest rates on deposits aimed at encouraging the population to save;
5. Sharp cuts in national budget expenses by reducing government investments and by refusing to subsidize unprofitable enterprises any longer;
6. Issuing government bonds to help cover the national budget deficit;
7. Regulating the tax system and moving toward a more uniform, Western-type taxation;
8. Introducing a common rate of exchange of the Polish currency, the zloty, to the dollar (involving substantial initial devaluation) and ensuring zloty convertibility on the domestic market;
9. Introducing a common customs tariff in order to restrict imports and stimulate exports;
10. Providing social assistance to the population within the limits of the government's capacity;
11. Eliminating monopoly positions and effecting a substantial withdrawal of administrative intervention in enterprise activities.

The use of Shock Therapy began in Russia on 2 January 1992. A month later, it began in Georgia. To explain how the Shock Therapy method used in Georgia deviated from the Polish approach, it will be helpful to compare each step taken in Georgia with the corresponding item in the Balcerowicz Plan:

1. The reform of pricing started in Georgia as early as the spring of 1991 when free prices on some types of goods were introduced. Whereas in 1991 these changes were still of an exceptional nature, by February 1992 (that is, a month later than in Russia), radical changes had occurred in the pricing system in Georgia. For example, the price of one group of goods and services were liberalized while the regulated price of another group increased considerably. All of this was aimed at balancing the market. Whereas in 1991 the consumer price index stood at 1.8 percent, it rose to 25 percent in 1992. At the same time,

it is worth noting that regulated consumer prices increased 68-fold in 1992 as compared to1991 (for bread, the main food product in Georgia, this hike was 100-fold). Therefore, we can say that the first item of the Balcerowicz Plan was on the whole fulfilled in Georgia;

2. In 1992, indexation of minimum wages and social security benefits was introduced in Georgia. In 1991, this indexation was carried out only once but in 1992, during price liberalization, income indexation was performed six times. In 1991, the minimum wage and the average wage of employees increased as compared to the previous year 1.85-fold and 1.26-fold, respectively, and in 1992, as compared to 1991, 13.14-fold and 17.94-fold, respectively. True, no strict regulatory measures were carried out in Georgia to control increases in the wage fund (as was done in Poland when the penalty imposed on an enterprise was equal to 200 percent of this sum in the event of a 2 percent overdraft from the wage fund. If the overdraft were more than 2 percent, the penalty was 300-500 percent of the corresponding sum); however, increases in wages and social security benefits lagged behind the price increases. Thus it can be considered that item two of the Balcerowicz Plan was also more or less fulfilled in Georgia;

3. and 4. In 1992, the interest rate on deposits increased from 2 percent to 5 percent per annum as compared to 1991 and it increased from 9 percent to 80 percent for ten-year deposits. This increase in the interest rate still far from reflected the actual inflation rate. It should also be noted that it was generally impossible to restrict the money supply in Georgia in those days by raising the interest rate because the country had no monetary system of its own; only the ruble of the already disintegrated U.S.S.R. and the newly issued Russian ruble were in circulation in Georgia. In the summer of 1992, it was decided to double cash deposits on a deferred withdrawal basis. In particular, a decision was made on 25 July to double cash deposits devalued by inflation on 1 August. The population immediately responded by depositing more money in cash deposits. On 1 August, a new decision was made to prolong the time for placing money in cash deposits for doubling until 10 August. After doubling, the additional money could not be withdrawn for another year unless the money was to be used for privatization (which was, however, suspended at that time in Georgia). As it became rather difficult to receive the necessary quantity of banknotes from Russia in a timely manner in the second half of 1992, the money accumulated in this way was paid out as wages and pensions which essentially prevented the government from restricting the money supply. As a result, it can be concluded that items three and four of the Balcerowicz Plan were not fulfilled in Georgia;

5. In 1992, the share of government investment in the total expenditure of the national budget was not reduced and it fluctuated within the range of 20-25 percent until that year. The nominal amount of subsidies in 1992 increased about 5.1-fold as compared to 1991. However, in 1991 the share of subsidies in budget spending amounted to the remarkably high level of 47 percent and was cut back to 30.1 percent in 1992. Even so, this does not make it possible to say that item five of the Balcerowicz Plan was realized in Georgia;
6. Government internal bonds were formally issued in 1992 but they were not offered for sale until the fall of 1993 and mainly in order to convert former Soviet Union (FSU) bonds into new Georgian bonds. As for using government bonds to cover the national budget deficit, this did not prove feasible in subsequent years in Georgia. Therefore, it is clear that item six of the Balcerowicz Plan was not implemented either;
7. A comprehensive reform of the tax system in accordance with the requirements of the market economy started as early as the spring of 1991. For this reason, it can be considered that item seven of the Balcerowicz Plan was essentially fulfilled in Georgia at that time;
8. In 1992, there was no national currency in Georgia and so it was essentially impossible to fulfill item eight of the Balcerowicz Plan;
9. In 1992, general customs tariffs were introduced at rates of 2 percent on imports and 8 percent on exports. Obviously, this policy did not favor either import restrictions or the export stimulation and, therefore, item nine of the Balcerowicz Plan was clearly not fulfilled in Georgia either;
10. It has already been mentioned that there was income indexation in 1992 as in 1991, albeit imperfectly applied and subject to lags. At that time, any type of assistance to families with small incomes was disregarded; that is to say, the social protection system did not differentiate income levels in a way that supported those with low real incomes. As a result, the real minimum wage in 1992 amounted to only 86 percent of that of 1991. Despite the income indexation carried out in 1992, targeted assistance to the neediest families was inadequate. Item ten of the Balcerowicz Plan was unfortunately not fulfilled;
11. In 1992, legal and government resolutions and decrees restricting monopolistic institutions and practices and promoting competition were issued for the first time in Georgia, although their effective implementation was significantly delayed. True, as early as 1991,

the Soviet procedures ensuring centralized supply of resources to enterprises and final customers were disrupted and gradually abandoned but many elements of state administrative interference in enterprise activity were still preserved. Hence, item 11 of the Balcerowicz Plan was not carried out at that time.

Thus, eight out of the 1 items in the Balcerowicz Plan (that is, all apart from items one, two and seven) were not fulfilled in Georgia in 1992.

Such important measures as the cancelation or at least the serious restriction of budgetary subsidies and a tough restriction of the money supply were also neglected. Many of those items were indeed doomed to failure, particularly since there was no independent monetary system at that time in Georgia. In these conditions, implementing a defective version of Shock Therapy based only on price liberalization could hardly be expected to succeed. In other words, it was essentially impossible to make the transition to a market economy using Shock Therapy in the absence of corresponding state institutions.

From the Introduction of the Georgian Coupon to Hyperinflation

The most important policy mistake was made in late 1992 and early 1993. The government, for some reason, did not expect that it would receive additional banknotes from Moscow and so it put temporary banknotes of Georgia—the coupon of the National Bank of Georgia (NBG)—into circulation (Gotsiridze, 2008: 164-166). Unfortunately, representatives of the Georgian Government and the NBG were unable to take the new currency seriously, sometimes showing a contemptuous attitude toward it. This had a decisive impact on the already serious devaluation process underway. Basically, the nature of the mistake was the illusion that it was economically expedient for Georgia to remain temporarily or even permanently in the proposed "ruble zone." As a result of this unfortunate illusion, the Georgian coupon (GC) did not become the sole legal tender of payment until July-August 1993 when Russia carried out a partial currency reform of its own and withdrew the FSU ruble from circulation. This act made it clear that Georgia would have to introduce its own currency.

Uncontrolled credit emissions caused the inflationary process in Georgia. Attempts to solve agricultural problems (e.g., the procurement of agricultural products in the fall of 1993 and carrying out the essential agricultural work in the spring of 1994) from a national budget that had been practically non-existent since the fall of 1993 resulted in initially unreported budgetary emissions that ultimately ruined the country's financial system. Georgia developed a hyperinflationary spiral with inflation galloping at a rate of about 60-70 percent per month from 1993 until the fall of 1994. In the long run, this money was not, unfortunately, used for agricultural purposes. In conditions of such high inflation, the coupon could not perform the normal function of sustaining commercial turnover because the real value of the coupon supply was constantly falling. All other things being equal, this promoted the wider use of the ruble as a means of payment instead of the coupon (Gurgenidze, Lobzhanidze, and Onoprishvili, 1994).

The incorrect policy of the NBG toward restricting cash circulation (which gave rise, contrary to common sense, to restrictions on the withdrawal of GCs from the banking system) resulted in substantial discrepancies between cash and non-cash monetary values. This further restricted the circulation of the GC. Also, state-owned commercial banks tolerated excessive overdrafts which promoted hidden credit emission. Subsidized prices on bread, gas, electricity and transport put an additional load on the national budget and also prompted budgetary emissions.

Minimum Shock with Maximum Therapy

At the beginning of 1994, the Head of the Georgian State, Eduard Shevardnadze, initiated preparations for implementing an anti-crisis program of macroeconomic stabilization and systemic change. The program began in the spring of 1994 and this gave a good start to the stage of the correction of the mistakes committed during the earlier stages of the economic reforms.

This new stage of economic reform was also characterized by problems of a non-economic nature. By the spring of 1994, the hostilities in Abkhazia had come to an end. This fact had a positive influence on the economy as a whole but it also gave rise to a new problem: the social protection of internally displaced persons (IDPs) which placed a heavy burden on the national budget.

Law-enforcement institutions intensified the fight against criminals in order to improve the situation. Definite positive results were achieved but the country still had a long way to go to solve the problem. Many enterprises, for instance, were afraid to undertake high levels of production for fear of being robbed by organized (including semi-official) and other criminal elements.

In the spring of 1994, the government gradually changed its attitude toward the GC. According to the standard policy of the International Monetary

Fund (IMF), it was ready to assist any country that had its own currency and whose government was doing its best to strengthen it. If Georgia stayed within the ruble zone, the IMF would undoubtedly prefer to work with Russia—the country issuing the ruble. This fact undermined the position of those in the Parliament and the Government (like the Speaker of the Parliament and the Minister of Finance) supporting the ruble zone since they would have had to openly advocate for the Russian ruble to be the sole legal tender. Conversely, it assisted those in power who realized from the very beginning that the Georgian economy had no prospects without its own national currency. All of this, together with the relative stabilization of the GC and the worsening depreciation of the ruble, encouraged the population to take the coupon more seriously.

Uncontrolled monetary emissions became impossible owing to the increasing resolve of the authorities of the NBG. In the fall of 1994, the National Bank cancelled the prevailing restrictions on the withdrawal of cash from banks under obvious pressure from the IMF. As a result, cash and non-cash money values drew considerably closer to each other.

In late 1994 on the advice of the IMF, the NBG started regulating the banking system by means of the classical methods widely used elsewhere in the world. In addition to solving other problems, this also prevented the state-owned commercial banks from continuing to work in overdraft conditions. Moreover, corporatization of state-owned commercial banks began in the second half of 1994.

According to the program developed with the IMF in September 1994, the price of gas and electricity was raised to world levels, the price of bread increased 285-fold, subway fares increased greatly and so did tariffs on other municipal services. Budget-supported employees enjoyed a wage increase and pensions and social welfare payments were also raised but these increases lagged considerably behind inflation. This enabled a great reduction in the budgetary subsidies needed to cover the discrepancies between consumer and production prices or between production prices and actual costs. This was followed by a substantial strengthening of the rate of the GC. Whereas before the price rise on bread, one dollar was worth 5.3 million GCs, one dollar was already valued at 2.4 million GCs after the price rise. This process continued; at the end of 1994, the price of bread increased again by 40 percent and resulted in the establishment of a stable GC exchange rate (at one USD = 1.3 million GCs) (Wang, 1999).

Unfortunately, Georgia could not manage full money recovery on either gas or electricity. However, whereas enterprises and the population did not pay for their gas and electricity supplies, or paid only negligible sums, the cost of bread had to essentially be covered in full by the population. Delays in enforcing these payments encouraged economic entities to be more skeptical about the coupon: trade organizations, enterprises and banks delayed corresponding money transfers and conducted speculative operations in the currency market, sustaining significant losses in the process. Starting in 1995 when the coupon rate became stable, the timely withdrawal of these sums was also prevented by some local authorities using these sums temporarily in order to manage their local budget problems and not only by the sluggishness of the banks.

The impossibility of collecting the full cost of gas and electricity also meant that the government could not revise the corresponding prices because of its general commitment to the reforms. The dollar prices of gas and electricity increased every month as a result of the strengthening of the GC. This led to an artificial increase in the product cost which primarily had an adverse effect on industrial enterprises. Following a review of its commitments to the IMF, the Georgian Government reduced GC prices. In particular, the cost of gas was reduced by 35 percent and the cost of electricity by 25 percent from April 1995. At the same time, the government refused to purchase gas after June 1995. Instead, purchases had to be undertaken by immediate consumers; namely, Sakenergo (Georgian State Energy Company), big industrial enterprises and municipalities.

The liberalization of foreign trade began in 1995 (Papava, and Beridze, 1996/1997).

The parliament's approval of the national budget at the beginning of 1995, after a two-year interval, can be considered a very important step toward establishing order in Georgia's financial system. The real significance of this budget was that credit and monetary emissions themselves were not used to balance budgetary revenue and expenditure. In 1995, only 47 percent of the expenditures of the national budget were covered by tax revenues and the remaining 53 percent had to be covered through the monetization of wheat and flour received as humanitarian aid (mobilizing the proceeds from sales in the national budget). In that way, the unbalanced national budget could be balanced without money emission. This was achieved with the help of donor countries and institutions promoting reforms in Georgia.

With the support and efforts of the IMF, most of the countries to which Georgia owed approximately $1 billion agreed to debt rescheduling. All of this was expected to create conditions for Georgia to preserve financial stability, carry out currency reform and put the lari (the national currency) into circulation, avoiding the errors previously committed by the government in connection with the coupon (Kakulia, 2008).

The exchange rate of the national currency was expected to remain unaltered until the end of 1995. After July 1995, the price of bread increased by 7 percent on average while the wages of budget sector employees increased by an average of 50 percent. In the fall of 1995, there were plans to liberalize bread prices. The planned elimination of the government monopoly in this sphere was expected to make this possible.

Beginning on 1 July 1995, the minimum monthly wage of those employed in the budget sector was just $2.69 and the maximum $12.69. These figures are, of course, very low, although it should be recalled that the minimum wage was less than ten cents and the maximum a little more than one dollar (all evaluated based on the exchange rate at that time without adjustment for purchasing power parity) at the beginning of September 1994.

As for sectoral development, the reforms in Georgia were being implemented most vigorously in healthcare where the reform project was elaborated in close cooperation with experts from the World Bank. A gradual transition to paid medical services and establishing a system of medical insurance began in the public health system.

In May 1994, the head of Georgian state issued a decree according to which enterprise personnel were given precedence in corporatization. This speeded up the process. At the same time, privatization by means of direct purchases was also encouraged. In 1995, the use of privatization vouchers began in Georgia as in many other former Communist countries: a part of public property was distributed to people free of charge (Silagadze and Beridze, 1996). This approach was justified by the necessity to give everyone a fair chance to acquire assets during privatization.

The success of Shock Therapy in 1994-1995 rests on the paradox “The Worse, the Better.” This situation can be classified as Minimum Shock with Maximum Therapy. Whereas there is a big question mark over the country’s future and its ability to survive, there can be no doubt about whether or not Shock Therapy was really needed since the country had no other choice under the circumstances and positive results were almost guaranteed. Another way to describe this situation is a Soft Big Bang (Papava, 2005a: 23-24; 2005b: 85-86).

The Mixture of Ultra-Liberalism and Neo-Bolshevism

The “Rose Revolution” of November 2003 was the outcome of the Georgian people’s desire for a more democratic society, the reduction of corruption and an improvement in the national economy and social conditions

(Coppieters and Legvold, eds., 2005; Fairbanks, 2004; Karumidze and Wertsch, eds., 2005; Khutsishvili, 2008; King, 2004; Miller 2004).

However, within two years of the "Rose Revolution," the euphoria that followed it, both inside and outside the country, quite naturally diminished. It was replaced by a more sober assessment and a more realistic evaluation of the results of post-revolutionary change. This 'sobering up' took place in Georgia rather more quickly than overseas as Georgian citizens experience the discomforts of the revolution on the ground. Georgia's international friends, on the other hand, often mistook what they would like to happen for what was actually happening (Mitchell, 2006; Papava, 2006). Nevertheless, even those analysts who have been a priori supportive of Georgia's revolutionary leaders cannot turn a blind eye to some recent anti-democratic developments in Georgia such as the executive's domination of the judiciary (Jones, 2006).

From the outset, the post-revolution political regime of the United National Movement (UNM) political in Georgia was represented as a mixture of democratic and authoritarian elements (Nodia, 2005: 44–45). Such hybrids are not new and are characteristic of many post-Communist countries (Bunce, 1999) that avoided 'colorful revolutions.' To many Western observers, the crushing of peaceful demonstrations in the Georgian capital of Tbilisi in November 2007 appeared to be totally unexpected and, consequently, shocking. However, these events were more or less predictable for many local analysts (Areshidze, 2007; Lanskoy and Areshidze 2008).

The young "Rose Revolutionaries" – in terms of age and experience – inherited numerous unresolved problems from the Eduard Shevardnadze administration. The most important included an energy crisis, which meant whole winters without electricity and heating, and a budgetary crisis created by the inability and unwillingness of public servants to collect taxes. The government accumulated huge arrears of pensions and salaries in the public sector. These problems were conditioned primarily by a high degree of corruption. The key challenge of the new post-revolution government, therefore, was to combat sleaze and dishonesty. In order to do this, the government, which had come to power by means of a revolution, was tempted to strengthen the vertical axis of power and minimize any decentralized foci of resistance. It justified its actions by the need to reinstate the country's territorial integrity.

From the moment of his accession to power, President Mikheil Saakashvili set about concentrating power in the presidential hands. As early as February 2004, a number of amendments were made to the Georgian

Constitution which gave the president the power to dismiss the government or, alternatively, to disband the parliament and order extraordinary parliamentary elections should the parliament and the government be in conflict with one another. The consequence of this type of constitutional innovation was the growth of parliament's loyalty not only to the president but also to his government which, in turn, led to the significant weakening of parliament as an independent political institution.

The strengthening of the presidential powers in Georgia had some positive results in terms of establishing financial order. Significant increases in tax revenues led to the neutralization of the budgetary crises (Areshidze, 2007: 191–195). The post-revolution government succeeded in paying off all of the accumulated debts to pensioners and public sector employees. In the summer of 2004, this led to the renewal of the IMF agreement which had been terminated in 2003 due to the incompetent and corrupt nature of the Shevardnadze administration. Among some other accomplishments of the post-revolution government, the qualitative improvement of the criminality in the country should be emphasized (Kupatadze, 2007).

The strengthening of the presidential powers enabled the government to start an effective fight against corruption. The abolition of the old Soviet traffic police and the creation of a Western-style patrol police were accomplished in a short 'revolutionary' period of time. As a consequence, the shameful practice of bribery across the country's roads and highways was abolished. The fight against corruption in the energy sector resulted in overcoming the energy crisis and, since the winter of 2006–2007, the whole of Georgia has been enjoying an uninterrupted supply of electricity. Among the post-revolution government's accomplishments, the introduction of national entrance examinations for admission to universities replaced the old corrupt system of separate admission exams in individual universities that had existed since Soviet times.

A four-fold growth of the national budget revenues was achieved as a result of these anti-corruption measures, including the arrest and release of former government officials and their relatives for what might be called a 'liberty price.' Officially, the price officials were forced to pay to secure their release was described as paying back the state monies and properties that had been stolen. However, such revenues cannot be raised on a regular basis. At best, they can be collected once and only thereafter with diminished effect. The government established extra-budgetary 'law-enforcement development accounts' specifically for this purpose where those suspected of corrupt practices were compelled to transfer payments to buy their liberty.

Deregulation measures, such as reducing the number of licenses and permits, has limited the legal grounds for the government's interference with businesses. Cutting tax rates significantly eased the tax burden. Reducing the import-tax base for agricultural produce and construction materials, as well as the annulment of the import taxes for other goods, has made Georgia much more competitive. The new Labor Code was revolutionary. By limiting the rights of employees, it has substantially broadened those of employers. However, although this may encourage businesses to develop, it leaves employees unprotected.

These types of reforms resemble the Southeast Asian (Hong Kong, Singapore) and Anglo-Pacific (Australian, New Zealand, the US and Canada) economic models. Therefore, it should come as no surprise that the Georgian reform model looks toward the East. Georgia is moving towards the American–Canadian model along a path that passes through Southeast Asia and Australia–New Zealand (Papava, 2009b).

Many of the Georgian Government's actions defy both economic theory and common sense. Chief amongst these was the president's generous summer 2006 initiative to add 50,000 people to a national employment program (Civil Georgia, 2006c). The idea was to require private entrepreneurs give jobs lasting three-months to unemployed persons. For this, the latter were to be paid $85 a month out of the national budget. (In the summer of 2006, after the enactment of the new Labor Code, unemployment allowances [$12.40 per month] were abolished.) The program cost the national budget $12.7 million. In principle, no business that wishes to expand needs any direct assistance from the national budget. All the government needs to do is to provide for the development of professional training or retraining program and the Georgian Government has rightly assumed this duty.

However, this program re-employed only a few people. 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 a job. Such a deal made an unemployed person happy because he made $255 in three months for doing nothing. However, there were more perverse results. Some businessmen agreed to subscribe to such contracts on the condition that new 'employees' shared half of the total amount with them. The average share of salaries in the costs of production is typically 20 percent. Thus, in theory, $12.7 million spent on salaries should produce goods and services worth about $60 million. Although there are no official statistics of employment under this program, it is expected that approximately 1 percent of the targeted number of beneficiaries were actually employed. This means that $12.7 million was spent out of the national budget for the production of goods and services with an aggregate value of perhaps $6 million (10 percent of $60 million).

In essence, it can be said that $12.7 million allocated from the national budget was nothing but an allowance for the unemployed. This amount went to the market ostensibly with the purpose of producing consumer goods but the only contribution was to the growth of inflation because no actual goods and services were produced. Consequently, any measures of this type, however generous their objectives might be, cannot, in fact, produce the desired results. On the contrary, all they can do is contribute to macro-economic destabilization together with other similar measures (Civil Georgia, 2006a). The same type of national employment program covering 100,000 people was started in December 2007.

Among the negative consequences of the strengthened presidential and weakened parliamentary powers is an intensified feeling of impunity among government officials which manifested itself in a gross disrespect for the rule of law. The significantly weakened parliament is often called the 'Government's Notary.' With regard to the judiciary, it has become an appendage to the General Prosecutor's Office and the whole executive branch (Anjaparidze, 2006a).

Redundancies in the government were combined with gross mistakes in staffing and institutional policies. In all government agencies, the most experienced employees were simply dismissed (in most cases in violation of the law). All governmental institutions were staffed by youth with some international training but with little 'institutional memory.' The government's mistakes in the radical reorganization of the ministries and departments were compounded with non-professionalism among many post-revolution ministers. The most blatant example of non-professionalism was in the spring of 2006 when the Minister of Defense was charged with the marketing of Georgian wines abroad. A further example of this type of inexperience was the abolition of the state anti-monopoly service in late 2004 and its replacement with the Ministry of the Interior (which in Georgia combines the police and the national security forces) on President Saakashvili's initiative in the fall of 2007. Its new function was to deal with anti-monopoly regulation in the domestic market. Later, after the Russian-Georgian war in August 2008, President Saakashvili added to the Ministry of Interior's responsibilities by charging it with the supervision of the construction of houses for internally displaced persons (IDPs).

The revolutionary wave of 2003 and its aftermath led the government to reorganize other ministries and departments. In particular, the State Department of Statistics, which had been an independent agency accountable to the president before the revolution, fell victim to revolutionary reorganizations. It was incorporated into the Ministry of Economic Development which is perhaps the most palpable example of a conflict of interests. As a consequence, statistics in Georgia played the same role as they did in Soviet times when they were assigned a political function. A clear example of statistical manipulation for political purposes was an accidental 'leak' of information in August 2006. In July 2006, the Department of Statistics declared that the annual inflation rate in Georgia had reached 14.5 percent which led the IMF to criticize the Georgian Government. The government found an 'ideal' remedy: the head of the State Department for Statistics was dismissed and his successor, following the government's instructions, started a gradual reduction of the inflation rate until it dropped to 9.2 percent in December 2006.

Corruption has diminished in Georgia but it has also been transformed. For example, the extra-budgetary accounts, which were used to accumulate income from individuals accused of corruption, were outside budgetary control. There was no transparency in spending from these funds. The problem worsened as the government started replenishing these accounts by means of the so-called 'voluntary contributions' of businesses (Anjaparidze, 2006b). If pre-revolutionary functionaries had their pockets open for bribes, their post-revolutionary successors transformed open pockets into bank accounts. Initially the IMF turned a blind eye to the existence of such accounts due to the erroneous assumption that all means should be used to fight corruption. Obviously, the IMF had forgotten a simple truth – that it is futile to beat corruption by means of further corruption. Later in the spring of 2006, the 'extra-budgetary' accounts were abolished under IMF pressure.

A process of 'de-privatization' was launched after the "Rose Revolution." De-privatization in the post-revolutionary Georgian context means that certain assets that had been privatized before the revolution were forcibly taken back by the government which then offered them for re-sale as privatization. There is no guarantee that another de-privatization will not be considered necessary sometime in the future.

Additional examples of the post-revolution government's defiance of property rights include extra-judicial decisions to demolish privately owned residential houses built before 2003. This was despite the possession by owners of all the relevant documents certifying both ownership and the legality of construction. The only argument presented by the government justifying such demolitions was a desire to improve the city's 'image.' The fact that property rights were grossly violated did not generate much concern in government circles (HRIDC, 2008; Rimple, 2012).

Against the background of a relatively successful fight with mass corruption, there remains the problem of elite corruption involving high-level government officials who, in defiance of public procurement regulations and with total impunity, have used budgetary resources for their own benefit or used their official status to protect and favor certain companies. The most palpable example was the case of the former Defense Minister, Irakli Okruashvili, who was charged with corruption. While Okruashvili remained a cabinet member, he was an ideal minister and an example to others (Civil Georgia, 2006b). After he left office, the presidential team chose not to press any criminal charges until he publicly announced his political ambitions and his alliance with the opposition.

Significant mistakes were made in the reform of the economy in post-revolutionary Georgia (Papava, 2009a). These mistakes can be qualified as neo-Bolshevism which was combined with elements of ultra-liberalism (Waal, 2011: 13). Georgia was a country not so much of liberal reforms as of a symbiosis of ultra-liberalism and neo-Bolshevism (Papava, 2013a).

Economic Primitivism vs. Economic Optimism

Coming to power in late 2012, the "Georgian Dream" (GD) political party was faced with a number of challenges (Kakulia, 2013; Papava, 2013c) with one of the most crucial comprising the reaching of an Association Agreement with the EU. A key constituent of the Agreement is the Deep and Comprehensive Free Trade Area (DCFTA) agreement with the EU. For the UNM government, adherence to the "European track" was, unfortunately, largely confined to articulation while in actuality efforts were being directed at ensuring that Georgia's rapprochement with the EU did not materialize. The country had instead mapped a path towards "Singaporization" (Civil Georgia, 2010a, 2010b, 2011; Dumienski, 2011).

The GD government managed to secure Georgia's signature of the Association Agreement in June 2014, entering into force as of 1 July 2016. Signing the EU Association Agreement and the entry into force of the DCFTA should be assessed as the most significant positive measures taken by the GD government. This, in turn, served to bolster economic optimism among a large part of the population.

The basis for economic optimism ensued from the GD's guarantees that the harmful practice of state pressure on businesses, a phenomenon highly prevalent throughout the UNM's tenure, would be eradicated (Waal, 2011: 11–14). It can be legitimately stated that the GD has fulfilled this promise (Civil Georgia, 2012) in its entirety.

A vivid example of the economic optimism upheld by the GD government is the approval in 2014 of the Social-Economic Development Strategy of Georgia – Georgia 2020 (hereinafter, Georgia 2020) (Government of Georgia, 2014). According to Georgia 2020, the economic policy of the Georgian Government should be based on three key principles. The first implies ensuring rapid and efficient economic growth driven by the development of the real sector of the economy. The second principle implies the implementation of economic policies that facilitate inclusive economic growth. The third principle is based on the rational use of natural resources, the provision of environmental safety and sustainability and natural disaster risk mitigation throughout the process of economic development (Government of Georgia, 2014: 3).

According to the document, the government of Georgia should have focused on the country's innovative development and the establishment of a knowledge-based economy which, undoubtedly, was a beacon of hope. The launching of the Startup Georgia program was also crucial in the promotion of innovative business (Agenda, 2016a).

The resolution of the government of Georgia, which approved Georgia 2020, also instructs ministries and other state agencies to draw up mid-term action plans based on Georgia 2020 by 30 June of every year. Unfortunately, the government has yet to fulfil this task which has raised questions about the feasibility of the objectives and goals set forth in the Georgia 2020 document.

An illustration of economic primitivism is the Governmental 4-Point Plan initiated in 2015 by the Prime Minister, Giorgi Kvirikashvili (Agenda, 2016b).

The four points of the Governmental 4-Point Plan are as follows: 1. economic reform, 2. education reform, 3. spatial planning and 4. governance reform.

The cornerstone of point 1 is the corporate income tax exemption for businesses in the case of profit reinvestment.

According to point 2, the vocational education system should be oriented towards a dual or work-based learning approach which entails training programs implemented jointly by educational institutions and potential employers; university education would be focused on the actual requirements of the economy identified as a result of labor market analysis.

According to point 3, spatial planning measures around the country should be conducive to mindful urban and rural development and the advancement of an inter-regional transport network, ultimately aiming to transform Georgia into a year-round tourist destination.

Point 4 aims at increasing governance efficiency.

One does not need to be an experienced economist to be able to pinpoint the difference between Georgia 2020 and the Governmental 4-Point Plan: a more-or-less comprehensive strategy aimed at the country's innovative development is reduced to four fragmented points.

The key issue is that the Governmental 4-Point Plan promotes the maintenance and reinforcement of a non-productive and, at the same time, consumerist economic model in Georgia (Papava, 2013c). Unfortunately, due to the low level of development of the real sector of the economy, the country consumes more than it produces. As a result, import over the years is 2.7 times higher than export while import goods constitute an average of 80 percent of the consumer basket (as well as the food basket).

Under these circumstances, the first point of the Governmental 4-Point Plan will bolster those Georgian firms that are typical of a non-productive and simultaneously consumerist economy. The system, known as the Estonian Model, which entails the exemption of reinvested profit from corporate income tax, entered into force in Georgia as of 2017. It is unclear as to why tax breaks for profit reinvestment should be granted to restaurants and hotels: such businesses are abundant in the Georgian economy even without the tax benefits (Papava, 2018). It would have been more advisable to afford tax breaks to only those firms within the real sector of the economy which would apply innovative technology to reinvest their profit. Given the severe shortage of such firms, the Estonian Model for corporate income tax contribute to the enhancement of the consumerist structure of the economy in Georgia.

The second point in the Governmental 4-Point Plan carries the same connotation. Once again, considering that Georgia has virtually no real sector of innovation economy, the focus of the vocational education system solely on work-based learning approaches and the focus of university education solely on the actual requirements of the economy will never be able to ensure the training of specialists befitting a knowledge-based economy. Thus, the focus of vocational and university education on solely the current rather than prospective needs of the economy will further contribute to enhancing the consumerist structure of the Georgian economy.

As per the third point in the Governmental 4-Point Plan, proper spatial planning in the country should make Georgia a year-round tourist destination. It is noteworthy that tourism was a priority issue in the Georgian economy both under the UNM (Civil Georgia, 2010c) as well as the GD (Civil Georgia, 2016) governments. Given that, as mentioned above, import goods take up 80% of Georgia's consumer and food baskets, the needs of tourists, as additional consumers, should be supplemented by additional import since Georgia produces only 20 percent of its food products and, unfortunately, none of the means of transportation or fuel necessary for travel within the country. Hence, the government tending solely to the development of tourism truly fails to contribute to the country's diverse economic development and sustains trends applicable to a consumerist economy.

Evidently, the first three points of the Governmental 4-Point Plan oppose the country's innovative development strategy and, thus, the Georgia 2020 plan mentioned above. It is an unfortunate fact that the Government's 4-Point Plan constitutes a vivid example of economic primitivism resulting from a disregard for economics (Papava, 2017b).

The primitivist approach to the fourth point of the Government Plan is most clearly illustrated by the privatization of the building of the Ministry of Economy of Georgia in 2015 (Papava, 2017a). As a result, the building was sold for $9.45 million to the Chinese company, Hualing, via an online auction. The company plans to turn the building into a hotel (Civil Georgia, 2015).

Starting from 2015, the Ministry of Economy of Georgia is forced to rent a relevant premises. Unfortunately, such an approach to the building of the Ministry can hardly be considered in the context of increasing governance efficiency (Papava, 2017a).

Conclusions

There are no generally accepted criteria for determining the completion of the transition to a market economy. The simplest formal resolution of this question, however, seemingly suggests itself: if the EU recognizes a country with a transition economy as one which is ready to enter its ranks, then in all probability, one should concede that the transition period in this country has been completed and that its functioning economic system for all practical purposes has become a European-type market-based one.

The acceptance into the EU means that the countries are 'leaders' among the post-Communist countries. Other post-Communist countries, which remain as 'outsiders,' are still far from the European standards of a market economy.

The character and possible success of economic reform in countries with a transition economy depend, to a large degree, upon the behavior of the person who finds himself in a transition process from *homo soveticus* to the type of person characteristic of a market economy, *homo economicus*. The type of person who carries out the process of post-Communist transformation is characterized herein by the term *homo transformaticus*; that is, someone who cannot completely emancipate himself from fear of the state and from the habit of living at the latter's expense even though he is gradually beginning to act upon the basis of his own private interests in order to achieve maximum utility and profit. In the 'outsider' countries, *homo transformaticus* was dominated by the characteristic features of *homo soveticus*; in contrast, it was the features of *homo economicus* which prevailed in the 'leader' countries. It is precisely this difference which explains the greater readiness of *homo transformaticus* in the 'leader' countries to undertake the transition to a market – in contrast to the situation in the 'outsider' countries.

Transition to a market economy was on Georgia's agenda immediately after regaining its independence. The attempt to blindly copy the Polish model of Shock Therapy was not successful either which is not surprising since Georgia did not even have its own monetary system.

The failure of Shock Therapy in Georgia gave the green light to populism in Georgia's economic policy. As a result, Georgia did not have a state budget approved by the Parliament in 1993-1994. The country was caught in a hyperinflationary spiral and its temporary currency – the Georgian Coupon – was unacceptable to the market and the population alike.

Steps were taken to achieve macroeconomic stability in a country facing economic failure. These steps included a tight monetary policy, the liberalization of bread prices and the enhancement of budget discipline. As a result, the Shock Therapy that initially started was successfully completed and macroeconomic stability was achieved in Georgia in 1995. This made it possible to carry out a successful currency reform.

In the sphere of economic transformation, the post-revolutionary government initially showed the political will to establish financial order and eradicate corruption. This allowed the country to overcome budgetary and energy crises. At the same time, the government made numerous mistakes along the revolutionary road to market democracy, including repeated violations of property rights.

The government's authoritarian style and isolation at the top prevents the ruling party from recognizing and correcting its mistakes. The post-revolutionary economic reforms in Georgia were, by their nature, a mixture of ultra-liberalism and neo-Bolshevism.

The GD government, having won the 2012 and 2016 parliamentary elections, took a number of steps associated with economic optimism in the early stages of its tenure, among which the signature of the Association Agreement with the EU is of historical significance. Based on the Agreement, Georgia's economy aligned itself with the EU's DCFTA. In this context, the government's adoption of the Social-Economic Development Strategy of Georgia – Georgia 2020 was essential, consolidating the government's aspiration to establish an innovation- and knowledge-based economy. The liberation of businesses from the informal pressure exerted by the state constituted a substantial step in avoiding the vicious legacy of the previous authorities.

Unfortunately, these optimistic measures have yet to be further developed and expanded. For instance, instead of the ministries being tasked with the development of action plans on the basis of the Georgia 2020 strategy (as envisioned by the government decree), the Prime Minister has entirely overlooked this complex document and replaced it with a primitive Governmental 4-Point Plan whose implementation cannot and will not lead to the improvement of the distorted consumerist economic model into which the country has been absorbed.

Clear examples of economic primitivism have been showcased by the privatization of the premises of the Ministry of Economy.

The successful completion of the work carried out by the government and parliament of Georgia in order to obtain the status of EU candidate opens up new prospects for the country's economic development.

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