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# PRACTICAL ECONOMICS

Economic Transformation  
and Government Reform  
in Georgia 2004–2012

**Nika Gilauri**



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Economic Transformation and Government  
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*To Maiko, Mari & Zuka*

## PREFACE

In 2003, Georgia was a broken country: riddled with corruption, devoid of natural resources, and in economic decline. Nine years later, Georgia was a driver of change and renewal in the region. The economy was growing fast, international investors responded well to Georgia's business-friendly environment, Transparency International acknowledged the successful fight against corruption, and the World Bank had proclaimed Georgia the world's top reformer for the period from 2006 to 2011.

What happened? After the Rose Revolution in 2003, a new generation of leaders took charge. Following a rigorous "less is more" approach, the new government cut regulation and bureaucracy down to size. The number of taxes was slashed from 21 to 6, while tax revenue as a percentage of GDP soared from 7 to 24 percent. In parallel, the government invested in critical infrastructure and one-stop public services to attract foreign investment and encourage private enterprise. In a nutshell, Georgia went for growth and implemented a plethora of radical reforms in parallel tracks.

What happened in Georgia between 2004 and 2012 is one of only a handful of examples of true transformation on a national scale in the twenty-first century, and perhaps the most comprehensive case. Between 2006 and 2011 alone, Georgia successfully completed 35 reforms qualifying under the World Bank's "Doing Business" criteria, i.e., half a dozen per year. According to the World Bank's "Ease of Doing Business" report, the global average for such reforms was 1.7 per year at the time. What is more, all Georgian reforms were initiated and overseen by the same small group of people, rather than by different consecutive administrations. "Since the World Bank began keeping records, no other country has

made so many deep reforms in so many different areas so consistently.”<sup>1</sup> Of course, not all Georgian reforms were 100 percent successful. A few of them failed, and others could not be finalized, at least for the time being, for political, economic, or social reasons. But the vast majority of the reforms were success stories that helped transform Georgia from a failed state into a fast-growing economy with great prospects.

Drawing on my experience in Georgia, I currently advise a number of governments around the world and analyze dozens of national economies, and I observe that most of them are facing very similar problems. While developing countries may have the most to learn from Georgia, a surprising number of developed countries share many of their objectives, such as bridling bureaucracy, easing the regulatory burden, and fighting corruption. To my great dismay, many governments are unwilling to learn from one another. As a result, the same mistakes are made over and over again.

Of course, there are significant differences between countries – culture, history, the stage of economic development, the geopolitical situation, the levels of education, and social maturity. But at the same time, there are many things that are the same for almost all countries and their governments. Most of them strive for a higher standard of living, better education, more effective healthcare systems, greater security, economic growth, and lower unemployment rates. And most governments share not only these objectives but the challenges that make it difficult to achieve them as well: tight budgets, increasing levels of debt, corruption, and inefficient public services. So why not learn from one another? There are only so many ways to fund the healthcare system, to collect taxes efficiently, to provide better services to the public, to prepare for a downward economic cycle, or create a business-friendly environment. Don’t get me wrong – I’m not advocating a copy-and-paste approach. In practical reality, there are too many differences, big and small, between different countries. All I am saying is that it is worthwhile studying what others have tried, what has worked, what hasn’t worked, and drawing the right inferences for one’s own situation. According to *the Economist* and its most recently published article in July 2016, Georgia’s knowledge and experience in fighting corruption serves as a powerful example and model of how to crusade corruption globally, even in such big countries like Nigeria.<sup>2</sup>

And this is exactly what this book is all about – it is a record of what happened in Georgia between 2004 and 2012. Specifically, I set out to chronicle the reforms that thoroughly transformed Georgia – from one of the most corrupt countries in 2003 to one of the least corrupt countries in

2010; the reforms that took Georgia from 112th place in 2006 to 8th place in 2014 in the World Bank’s “Ease of Doing Business” report, that helped quadruple the economy (in nominal terms) within nine years; and the reforms that helped Georgia come out of the 2008/2009 recession faster than any other country in the region despite its lack of natural resources and despite the combined burden of the world financial crisis and the Russian invasion.

This book provides a detailed analysis of the reforms made in Georgia. It starts by discussing why the Georgian case is exemplary for other countries and proceeds to describe the fight against corruption, the rightsizing of government, the creation of a business-friendly environment, tax and customs reform, the privatization of state-owned enterprises, energy sector reforms, and smart spending approaches applied to welfare, healthcare, education, and procurement. In some cases, the description draws on the experiences of other countries, either because they served as an inspiration for Georgia’s reforms or because approaches pioneered in Georgia were successfully applied there.

In a nutshell, this book is my attempt to answer one question: how do you manage a transformation to bring about fast and sustainable growth? In what follows, I approach this question from two angles:

- What is the right size for a government, both in terms of its regulatory footprint and in terms of its budget in relation to the size of the economy?
- How do you ensure a government’s efficiency in terms of its decision making, its interaction with the private sector, its financial flows, and the services it provides?

The book concludes with a discussion of leadership, in recognition of the fact that even the best approaches would not apply themselves. It takes determined leadership to make them work – the courage to fix what is broken, to try innovative approaches, and to learn from one’s mistakes.

So is this a book for leaders only, for heads of state and government? Far from it. I believe there is something here for everyone who takes an interest in public affairs – politicians, civil servants, consultants, and all active citizens who may be interested in how governments function and how they can be transformed. This book also shows that none of the major economic theories stands the test of practical application. Some people believe that the state should redistribute wealth from the rich to the poor. Others believe that the



freedom of enterprise is more important. Many believe that a monetarist approach is the best solution to the world's economic problems, while others favor Keynesian economics. In my experience, none of these theories is universally applicable. Every given economic problem requires its own solution. This is why I advocate what I call *Practical Economics*. Practical Economics is about finding the right mix of economic policies for a given country at a given moment. This book is about the mix of economic policies that transformed the Georgian economy between 2004 and 2012. While some of these policies may not be applicable to any other country, I will make the case that many of them are relevant for many countries, developing as well as developed, today.

You never know when you will get a chance to do something good for your country. In my case, it came when I least expected it. I had never worked in politics. I was never the member of any political party, not even when I was prime minister. I was not personally acquainted with any of the political leaders who came into power in 2004 before they asked me to be their minister of energy.<sup>3</sup> And yet I was fortunate enough to get to work side by side with many outstanding people. I was fortunate enough to get to drive and lead many groundbreaking reforms. I was fortunate enough to get a chance to help build a better future for my country. But before I got the call, I would never have imagined that I would get to do any of those things, although I had always wanted to do something for my country, waiting for my moment to come. So when your moment comes, be prepared. I hope this book will help you seize the day.

*Carpe diem!*

Nika

## NOTES

1. World Bank (2011); see <http://www.ccifg.ge/de/business-in-georgia/why-to-invest-in-georgia/10-reasons-to-invest-in-georgia/> (retrieved in May 2016).
2. <http://www.economist.com/blogs/economist-explains/2016/07/economist-explains-13>.
3. For the full story, please see [Chapter 7](#), Reforming the Energy Sector.

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