

Carpe Diem

Abstract This chapter, the introduction to Practical Economics, discusses the challenge of fixing a broken country and describes the situation in Georgia in the early 2000s. The author, Georgia’s former prime minister, Nika Gilauri, explains why he believes that other countries can learn from the reforms he oversaw between 2004 and 2012. The chapter contains an overview of the impact of this large-scale transformation in areas ranging from corruption and doing business to economic growth and energy supply, as well as a personal account of how Mr. Gilauri, a political novice at the time, became a member of the cabinet in 2004.

Keywords Practical Economics · Georgia · Prime minister · Nika Gilauri · Doing business · Reforms

As I said, you never know when you will get a chance to do something good for your country. For me, the call of duty came in December 2003, shortly after the Rose Revolution. I didn’t recognize the number on my phone’s display, but I had a distinct feeling that something important was about to happen. I took the call.

“Hello?”

“Hi, this is David. I am calling from the Prime Minister’s Office. He would like to see you.”

“When?”

“Right now?”

“Of course. I’m on my way.”

I was stunned. I had never met the prime minister. I didn’t know any other cabinet members either. I had attended the protests on Rustaveli Avenue the previous month, but I had not met any of the leaders. I really had no idea why the prime minister wanted to see me.

How did his office even get my number? Was it related to my job? I was working in the energy sector at the time, and I had a reputation as a critic of the government’s energy policy. Perhaps they had come to me for an insider’s perspective? Or had I done something wrong and was about to be reprimanded? But why would the prime minister deal with me personally?

Either way I looked at it, this was big. I hurried to the State Chancellery.

The prime minister was sitting in his office by himself. We exchanged very brief hellos.

“What do you think about the energy sector in Georgia?”

“Excuse me, but how do you even know about me?”

“Irrelevant. Answer my question.”

I described some of the challenges I had encountered, but he quickly interrupted me.

“How long do you need to prepare a presentation about the energy sector?”

“Until tomorrow?”

“Tomorrow? That’s not possible.”

“I already have a presentation. I just need to go over it one more time.”

He looked puzzled.

“Did you know that this is why I asked you to come here today?”

“No, but I have been working on improvement ideas for the energy sector for some time.”

I wasn't lying. I was so fed up with the blackouts, the mismanagement, and the corruption that I had written down my thoughts on how to make it work. But I had not shown this to anyone.

"Okay, come back the day after tomorrow."

When I went back, the prime minister was not alone. About half a dozen people were gathered at the table, including his chief of staff and the minister of finance. I started my presentation. The prime minister interrupted me with a question, but I asked him to let me continue and save his questions for later. I said this simply because the answer to his question was on my next slide, but the second I had said it, I was afraid I might have been overly brusque. Curiously, everybody present seemed to be impressed with my bold move, especially the prime minister himself.

"I think we have found our man."

He was whispering, but everybody heard him. I went on, but he interrupted me again.

"Will you be my Minister of Energy?"

Now it was my turn to look puzzled.

"Huh?"

"How old are you?"

"28."

"That's very young, but we are a revolutionary government. We have to revolutionize everything. There are opportunities in your life that you should not say no to. So will you be the Minister of Energy of Georgia?"

I mustered all my courage.

"On one condition."

"What's that?"

"I will not cut my hair."

At the time, my hairstyle was not what most Georgian's would have described as ministerial.

"Of course. No problem."

1.1 LEARNING FROM GEORGIA

Why should you read this book, even if you are neither Georgian nor a student of the country and its history? Because the lessons learned in Georgia between 2004 and 2012 are applicable to many other countries, both developing and developed. Here is why:

- In that period, Georgia was the closest thing to a *laboratory for political and economic reform* you will find in real life.
- In that short period, Georgia went through more *political permutations and economic cycles* than many other countries experience in a century.
- Although the transformation happened under unique circumstances, the *challenges* Georgia faced will be familiar to governments in many countries.

Think of this book as a blueprint for successful transformation, and I'm sure you will find something of value in it, wherever you live and whatever your position is.

1.1.1 *Laboratory of Reforms*

The nine-year period after the Rose Revolution was one of those rare occasions when the vast majority of the population is yearning for change. The new government enjoyed an 80 percent approval rating when it started conducting its reforms. In November 2003, during the Rose Revolution, people had taken to the streets, demanding a new government. When that new government was in place, they demanded fast reforms across the board – political, economic, and social. The major factions in Georgia's society were on the same page – politicians, common people, captains of industry, intellectuals, and even the opposition.

There was broad consensus that change needed to come fast, if it was to come at all. The new government duly adopted what was sometimes referred to as the *Big Bang* approach. We would reform everything, and we would do it quickly. Instead of drafting comprehensive development plans, taking one step at a time, and reviewing progress every step of the way, we went in like the mavericks we were. We decided to do and learn, rather than to sit and wait. We were aware that we would get some things wrong at first, but we were willing to take that risk and prepared to learn from our mistakes.

From the get-go, we were determined to take inspiration from successful reforms in other countries, much the way I encourage the readers of this book to take inspiration from Georgia. We studied what other countries had done in similar situations, where they had succeeded, where they had failed, and what mistakes they had made along the way. We took what worked and adapted it to the new political reality and the specific local requirements in Georgia.

Post-revolution Georgia was the rare case of a country tackling reforms in all areas: fiscal and monetary policies; welfare, healthcare, and education; and public accountability, security, and agriculture. Nothing was left out. What makes this case so rare is the fact that most governments initiate reforms in one or two areas but almost never across the board. This is due to the fact that most societies are not ready to embrace change on this scale. All things considered, we set out to build a modern state – not from scratch but from the ruins left by decades of corruption and neglect – 70 years of Soviet regime; Russian-led wars on the Georgian territory and a civil war in the post-Soviet 1990s; and corrupt and criminal government’s rule in late 1990s through early 2000s. The starting position was not the best.

1.1.2 Everything that Could Have Happened, Had Happened

Between 2004 and 2012, Georgia went through more political, social, and geopolitical permutations than most countries see in a century or their entire history: a peaceful revolution; local, parliamentary, and presidential elections; country-wide protests organized by the opposition that paralyzed the capital city; breaking up the protests and announcing a curfew that eventually led to early presidential elections; dealing with breakaway regions and a Russian invasion; wartime management of supplies and finances; sheltering internally displaced persons; and battling the influence of crime syndicates that had effectively ruled the country for decades. Each stage had its own challenges, and – in most cases – its own success stories, many of which I tell in this book.

Georgia did not only go through all kinds of political change in the period in question, but all major economic cycles as well: economic growth, economic downturn, pre-election economics, and even the economic challenges specific to times of armed conflict. Each of these situations has its own dos and don’ts, and Georgia got it right under pretty much all circumstances. Despite the combined effects of a legacy of debt, the world financial crisis, the Russian invasion, and local political tensions, Georgia came out of the recession quicker than any of its neighbors.¹ Even during

the war with Russia in 2008, the economy ran like clockwork. Not even the prices of food products increased. In 2004, we found that not only had the previous government emptied all coffers at the treasury and state-owned entities but the outstanding pensions and salaries for government employees added up to 10 percent of gross domestic product (GDP). We were broker than broke. But in 2012, we handed over positive balance of just under 10 percent of GDP to the incoming government. Debt had decreased to 34.8 percent of GDP, and external reserves had increased by a factor of ten in nominal terms and almost quadrupled as a percent of GDP (Fig. 1.1).

1.1.3 Unique, but Exemplary

There is no debating the fact that the geopolitical circumstances under which we made our reforms were exceptional. The country was in shambles, and its surrounding region was in disarray. At the time, nobody would have bet on Georgia to transform itself from a failed state into a growing democracy over the course of a single decade. And yet it happened. U.S. President George Bush called Georgia a “beacon of democracy” for the region, a part of the world in which free markets and modern institutions were virtually unknown at the time. What is more, we were up against repeated Russian attempts to undermine Georgia’s development model and growth path, a string of events that culminated in the 2008 invasion.

At the same time, the challenges Georgia faced along its transformation journey resemble those many other countries struggle with: weak institutions, widespread corruption, inefficiency of the public sector, a low level of economic development, insufficient infrastructure, limited prospects of growth and prosperity, a tainted international image, etc. Many countries try and fail to solve these problems, sometimes over the course of many decades. Georgia solved these problems, and I invite other countries to take advantage of the lessons that we learned along the way.

1.2 GEORGIA BEFORE AND AFTER

Between 2004 and 2012, Georgia was transformed from a failed state that faced bankruptcy into a stable economy with excellent growth prospects. Here is an overview of some of the telltale indicators of this transformation: corruption, ease of doing business, economic growth, and energy supply.

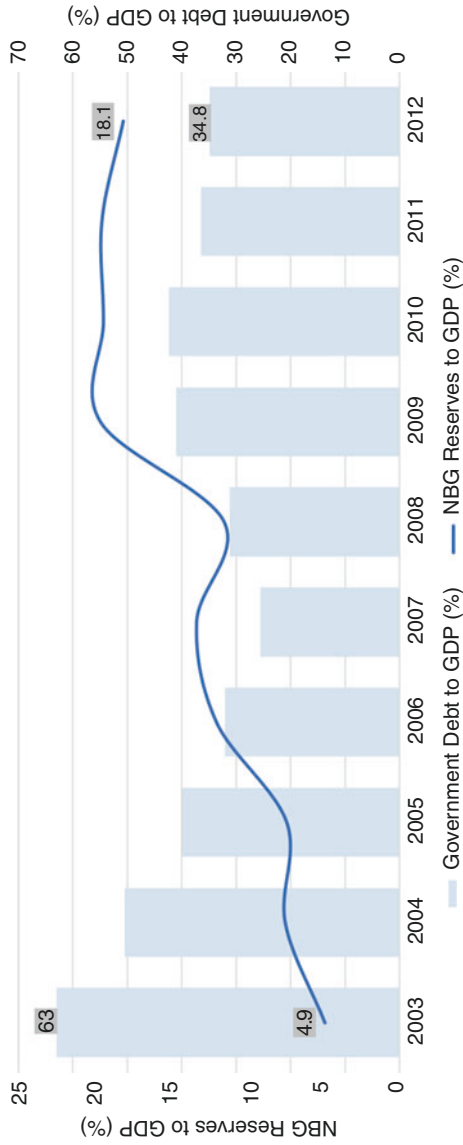


Fig. 1.1 NBG reserves to GDP/government debt to GDP. (*Source:* National Bank of Georgia; Ministry of Finance of Georgia.)

1.2.1 *Corruption*

In 2003, Transparency International's Global Corruption Index revealed Georgia to be one of the most corrupt countries in the world (ranked 127th out of 133), along with or behind much of Africa and many former Soviet Union countries, and a long way away from "clean" countries such as the United States, Canada, Japan, Singapore, South Korea, and much of Western Europe. Georgia was on par with Angola and behind Zimbabwe and Republic of Congo.² Even small businesses needed "krishas," a Russian term that describes a "caretaker" who is well connected with the government, to survive. To get a job as a police officer that paid USD 20 per month, you had to pay a USD 2000 bribe. It was still a worthwhile investment because you didn't live on the salary but rather on the bribes. Traffic police officers would actually pay bribes to their superiors to have additional traffic signs and traffic lights put up – not to improve safety on the streets, but to increase their opportunities to take bribes. In the *Corruption Barometer* survey, about 80 percent of Georgians said that corruption was a major part of their lives.

In 2010, Transparency International conducted a similar survey, asking nationals of 183 different countries whether they, or a member of their family, had paid a bribe in the past 12 months. Only 4 percent of Georgians said that they had, compared with 5 percent in the European Union (average) and the United States. Georgia was outranked only by a handful of countries, including the United Kingdom, Canada, Singapore, and New Zealand.

In the 2012 Global Corruption Index, Georgia was ranked 51st out of 174 countries, ahead of many EU countries such as Czech Republic, Slovakia, Latvia, and just behind South Korea.³ According to the 2012 *Corruption Barometer*, Georgians reported only very few cases of corruption (none when dealing with the revenue service, 2 percent when dealing with utilities, 4 percent when dealing with the police, and 5 percent when dealing with the court system), one of the best results in the world. To make this happen, the government did not shy away from radical measures. For example, the entire traffic police force (16,000 employees) was fired in one day, in July 2004, and traffic was much safer without the traffic police on the streets. They were replaced with a new, well-paid, much smaller force of about 2500 officers. If they were caught taking a bribe, they went to prison. Before, police officers had been hiding behind corners to demand a bribe as soon as a driver ran a red light. After the cleanup, officers were out in the open, warning drivers not to run a red light or turn right where it wasn't

allowed. This goes to show that innate corruption does not exist. Corruption is a disease. Every nation wants to get rid of it. If the time is right, and all forces in society pull together, it can be eradicated in a very short period of time. If there were such a thing as innate or cultural corruption, Georgia would still be as corrupt a country as it was just a decade ago.

1.2.2 *Ease of Doing Business*

In 2006, Georgia ranked 112th in the World Bank’s “Ease of Doing Business” report, just behind Nigeria and Kyrgyzstan. At the time, BP was the only foreign investor, and even this was just because the pipeline the company was building (from Baku in Azerbaijan to Ceyhan in Turkey) passed through Georgia.

In 2012, Georgia was the only developing country that made the top ten of the World Bank’s “Ease of Doing Business 2013” report, as well as the only country to make the jump from a rank below 100th place to the top ten, reaching 8th place, just behind the United Kingdom and Denmark, and ahead of Germany and South Korea. Georgia was number one worldwide in the “registering property” category, third in “dealing with construction permits,” fourth in “getting credit,” and seventh in “starting a business.” In 2011, the World Bank proclaimed Georgia the world’s top reformer for the period 2006 to 2011 (Figs. 1.2 and 1.3).

1.2.3 *Economic Growth*

In 2003, Georgia was widely regarded as one of the least developed countries in the World. GDP per capita was only USD 922. The government’s budget revenues were less than 7 percent of GDP, although taxes were higher than in any other country in the region. The unemployment rate was 17 percent. Growth prospects were grim, given the very limited natural resources and low level of foreign direct investment.

By 2012, Georgia had quadrupled its economy in nominal terms and doubled its GDP per capita in terms of purchasing power parity (PPP). So far, it is among only a handful of non-oil exporting countries to have achieved such growth in the twenty-first century. According to my research, only 18 non-oil exporting countries have managed to double their GDP per capita in terms of PPP in any given decade since 1980 – Singapore, Hong Kong, South Korea, Ireland, China, Latvia, Lithuania, and some other former members of the Soviet Union. Georgia did it

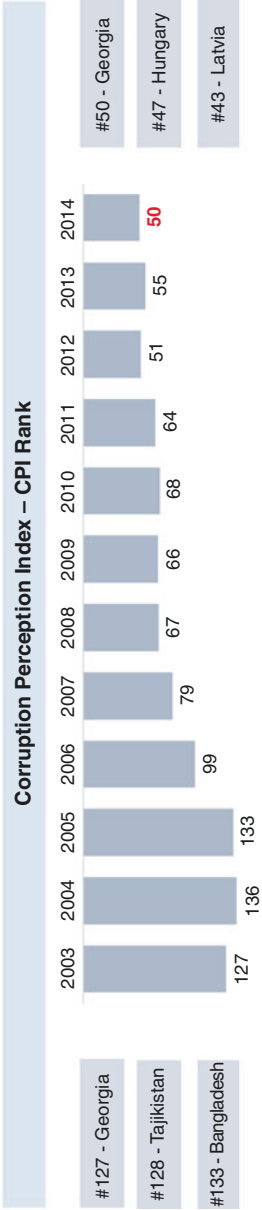


Fig. 1.2 Georgia in international rankings: Corruption Perception Index. (Source: TI “Corruption Perception Index Reports.”)

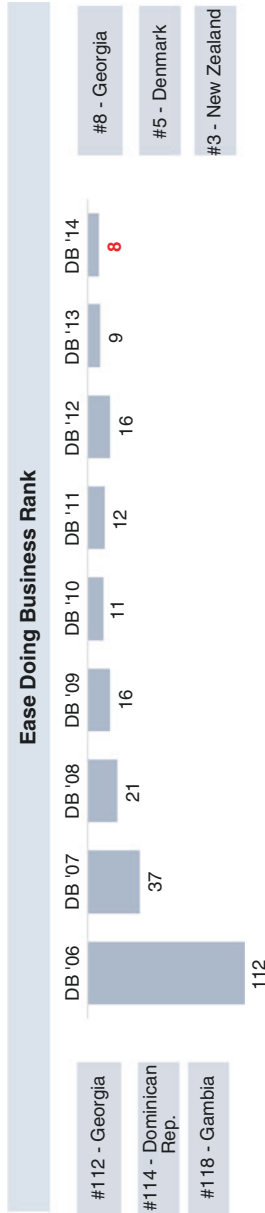


Fig. 1.3 Georgia in international rankings: Ease of Doing Business rank. (*Source:* World Bank Group, Ease of Doing Business reports.)

consistently in all decades ending between 2006 and 2012, i.e., GDP per capita in terms of PPP in every one of those years was twice what it had been ten years before – 2006 vs. 1996, 2007 vs. 1997, and so on, through 2012 vs. 2002. Georgia’s achievement is even more remarkable in light of the worldwide financial crisis that broke out in 2007 and the military invasion by Russia in 2008.

Not only has the Georgian economy grown at an average rate of 6.7 percent between 2003 and 2012, one of the highest growth rates among countries worldwide that do not produce oil, it also was the fastest country in its region to come out of the recession that was triggered by the world financial crisis (Figs. 1.4 and 1.5).

1.2.4 *Energy Supply*

In early 2000s, Georgia suffered from the worst power shortage in the region. The Ministry of Energy itself was without electricity. During the winter months, the country’s utilities delivered electricity only for two hours per day. People took to the streets, demanding to know when exactly they would get their two hours. They had long given up hope of 24-hour electricity supply. In the evenings, you could actually hear people shouting “hurray” every time that electricity supply was restored. At the same time, stealing electricity was a national sport. One of the more innovative techniques that some customers used to cheat distribution companies was a sensor-based remote control that switched on the meter when an inspector came within a four-meter radius of the meter (from beyond four meters it was impossible to see whether a meter was running or not).

By 2007, less than three years after the new government had taken office, not only did Georgia enjoy 24-hour electricity supply but it had also become a net electricity exporter, supplying electricity to all neighboring countries. Total distribution losses (including commercial and technical losses in the distribution network) decreased from more than 60 percent to less than 8 percent (Fig. 1.6).

1.3 ROOM FOR IMPROVEMENT

If the transformation was such a success story, why did Georgia’s ruling party lose the elections in October 2012? Was it because the reforms went too far? No. In fact, the opposite is true. It was because the reforms didn’t go far enough.

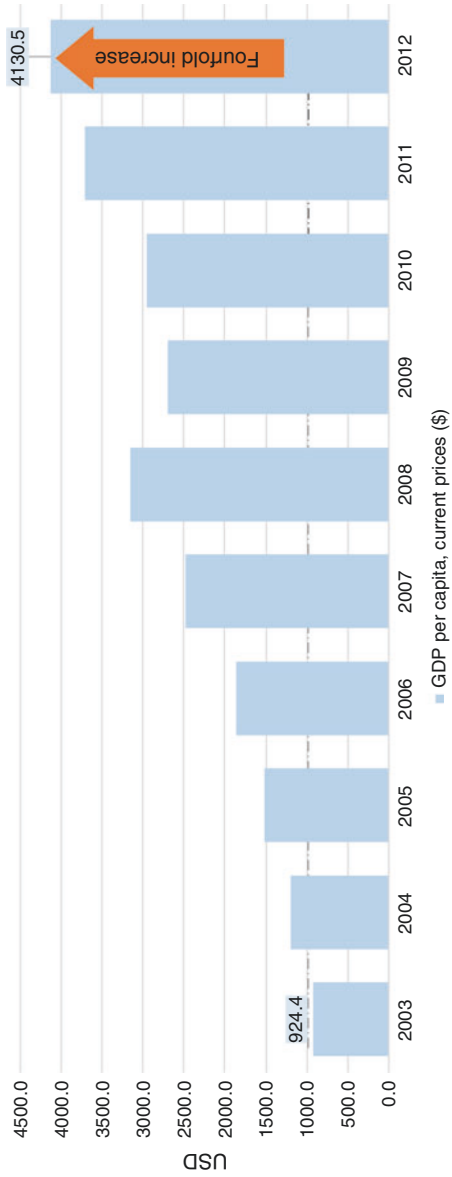


Fig. 1.4 GDP per capita. (Source: IMF.)

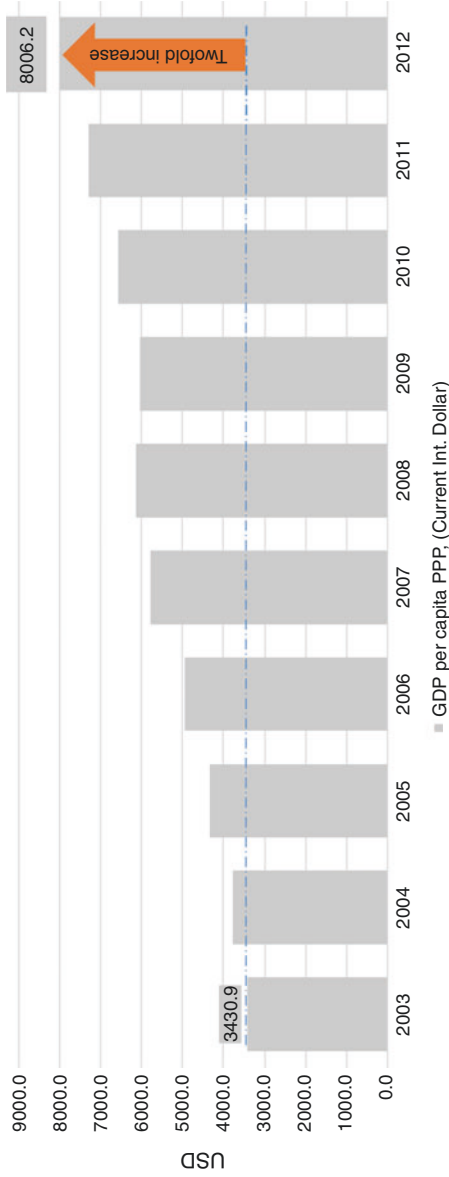


Fig. 1.5 GDP per capita PPP. (Source: IMF.)

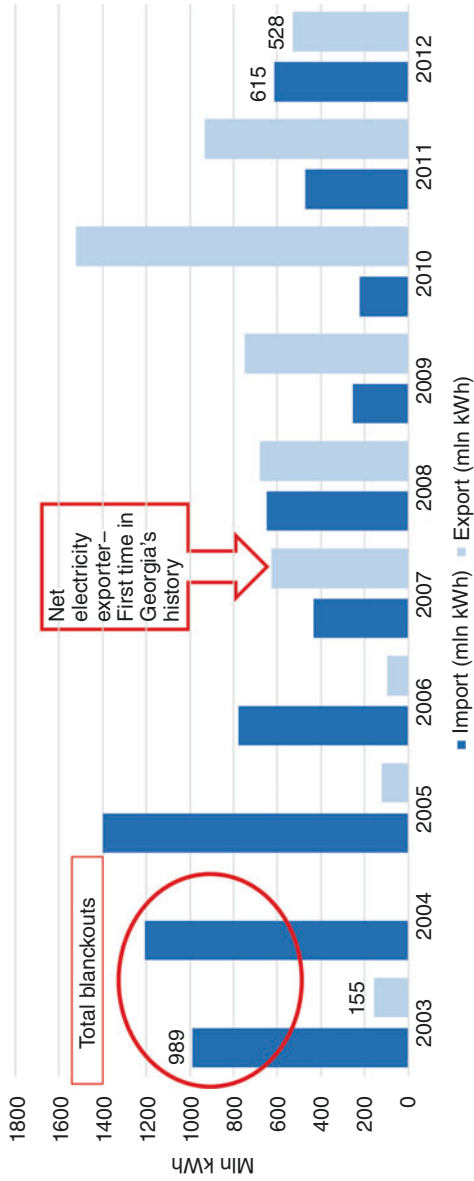


Fig. 1.6 Electricity export and import. (Source: Ministry of Energy of Georgia.)

The biggest mistake the government made was not to reform the justice system in time. Even though some changes were introduced, the pace was slow and the results were barely visible. For example, in 2010, 98 percent of all cases, both criminal and civil, were settled in favor of the prosecutor's office. The prosecutor's office in some cases abused its powers, especially when dealing with local businesses. This was a period when businesses were learning to pay taxes. In majority of cases, the deals made by prosecutor's office were understandable – there were clear cases of tax evasions, but as it appeared there were cases where the approach was excessively harsh and by far not fair. As a result, people got frustrated with the inappropriate conduct of the prosecutor's office.

Defenders of the harsh approach say that this was the only way to break the overpowering influence of crime families, bring the crime rate down, and root out corruption. They are right, and in fact, many citizens initially accepted the hardline approach as necessary. Severe diseases call for severe treatment. Centralizing power and showing no mercy were the right remedies during the first five years after the Rose Revolution. But by 2010, the rule of corruption and crime had been broken. The mentality of the population had changed. Before 2004, crime and corruption had been the norm. When you asked teenagers what they wanted to grow up to be, most of them said that they dreamed of becoming a “thief in law,” a local expression referring to the head of a crime family. But only a few years later, most teenagers said that they wanted to become a police officers or businesspeople, according to a survey conducted in 2010.

Once these results had been achieved, however, the justice system should have been thoroughly reformed. But this reform never came. As a result, citizens felt that they were being treated unfairly by the government. This frustration set in motion a course of events that eventually led to the defeat of the ruling party in the 2012 elections. In *Getting Georgia Right*, Svante Cornell puts it this way: The government of Georgia “found that to build the state, they [government] had to centralize power and exert stronger control over society and moribund state institutions. A functioning state is a prerequisite for liberal and constitutional democracy, rather than the other way around. Especially for a country subjected to the type of external pressure that Georgia has been, it would be utopian to believe that a liberal democracy could develop without the framework of a sovereign and functioning state. Thus, the priority accorded to state-building was understandable. The problem in Georgia was that the revolutionaries [. . .] failed in some areas to

halt the practice – perhaps necessary in the early years – of cutting corners in terms of due process and the rule of law.”⁴

Failing to reform the justice system was not the only reason the ruling party was defeated in the 2012 elections. Another reason was that the ruling team started to believe that it was unbeatable. It had performed nothing short of an economic miracle, after all. Thousands of corrupt and underperforming civil servants had been fired. Despite these and many other initially unpopular reforms, the ruling party had won numerous local, presidential, and parliamentary elections. It had survived the Russian invasion and a coup staged by an oligarch.⁵ It could simply not imagine losing an election to anyone. In fact, some people still struggle to accept the fact that they lost in 2012. This sense of invincibility weakened the team. If you think that your team is immune to outside challengers, unhealthy internal competition will arise, and your political radar will invariably deteriorate.

So it’s not for a lack of success of its reforms that the ruling party was defeated. It was defeated because the reforms did not go far enough, and because the many successes instigated an unhealthy sense of complacency in the top team. I encourage the readers of this book to take inspiration from Georgia’s successes and learn from its mistakes. To this date, our reform agenda was the most comprehensive and – all things considered – most successful of such efforts in the twenty-first century.

NOTES

1. The only year of economic decline was 2009 (–3.9 percent). By 2010, the economy was growing again – at a rate of 6.4 percent. The average growth rate between 2003 and 2012 was 6.7 percent. See subsequent chapters for details.
2. Georgia was on par with Angola, Cameroon, Tajikistan, and Azerbaijan, behind Libya (118th), Sierra Leone, the Republic of Congo (joint 113th), and Zimbabwe (112th). The only countries that were ranked below Georgia were Myanmar, Paraguay, Haiti, Nigeria, and Bangladesh (*Transparency International Report* for 2003).
3. In 2012, Georgia ranked 51st, ahead of many EU countries, such as the Czech Republic, Latvia (joint 54th), Croatia, Slovakia (both 62nd), Romania (66th), Italy (72nd), and Bulgaria (75th), and just behind South Korea and Lithuania (*Transparency International Report* for 2012).

4. http://www.martenscentre.eu/sites/default/files/publication-files/getting_georgia_right_-_website.pdf (retrieved in May 2016).
5. <http://www.independent.co.uk/news/uk/home-news/georgian-billionaire-declared-enemy-of-the-state-is-found-dead-in-surrey-exile-782016.html> (retrieved in May 2016).

Open Access This chapter is distributed under the terms of the Creative Commons Attribution 4.0 International License (<http://creativecommons.org/licenses/by/4.0/>), which permits use, duplication, adaptation, distribution and reproduction in any medium or format, as long as you give appropriate credit to the original author(s) and the source, provide a link to the Creative Commons license and indicate if changes were made.

The images or other third party material in this chapter are included in the work's Creative Commons license, unless indicated otherwise in the credit line; if such material is not included in the work's Creative Commons license and the respective action is not permitted by statutory regulation, users will need to obtain permission from the license holder to duplicate, adapt or reproduce the material.

