



THOMAS DE WAAL

GEORGIA'S — CHOICES —

CHARTING A FUTURE IN UNCERTAIN TIMES



CARNEGIE ENDOWMENT

FOR INTERNATIONAL PEACE

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Georgia and Its Neighbors



Contents

Summary	1
Introduction	2
State Building in Georgia	5
The Economy in 2011	10
Poverty in Georgia	15
A One-Party State?	20
Extreme Order	24
Modeling Georgia	27
The European Choice	31
Georgia, Europe, and Free Trade	35
Conclusions	39
Notes	45
About the Author	51
Carnegie Endowment for International Peace	53

Summary

Georgia is entering a period of transition, with parliamentary and presidential elections due in 2012–2013, after which a new constitution will take effect. The current government has made good progress in building a functioning state that delivers services to citizens, but Georgia’s economic picture is increasingly uncertain.

The governing elite, led by President Mikheil Saakashvili, has no serious domestic political opposition but faces the challenge of how to re-invent itself. It suffers from an accountability gap and risks turning Georgia into a one-party state.

After years of governing in an informal and improvisational way, the Georgian government needs to build institutions and choose a long-term development model. Three ideas pull Georgia in different directions. One is a conservative traditional conception of “old Georgia,” which commands respect but offers little as an economic or political model. A second idea, envisaging Georgia as another “Singapore” open to worldwide investment, has many supporters, especially from the still influential libertarian group who believe that Georgia needs maximum deregulation. But foreign investment is currently falling in Georgia and this model would not solve deep problems such as rural poverty and high unemployment.

The European Union (EU) offers a third path, with a prospective Deep and Comprehensive Free Trade Area that would offer privileged access to the EU single market in return for institutional reform. This path would require the governing elite to surrender both political and economic power. The EU has sold the idea poorly and will need to offer more foreign technical assistance to ease the regulatory burden it will impose. But it offers Georgia the best hope of long-term development and a European anchor.

Introduction

Georgia is entering a period of political transition. It could be called a third phase of what has been a turbulent decade. The first phase lasted from 2004 to 2008 in the aftermath of Georgia's peaceful Rose Revolution, which brought a new generation to power. A second phase came with the August 2008 war with Russia and the subsequent international effort to stabilize Georgia. Now the country will undergo parliamentary and presidential elections in 2012 and 2013, after which a new constitution will be introduced that will change Georgia's political structure. With this, the Rose Revolution generation faces the test of how and if it will be renewed.

The state of the economy will largely determine how stable the country is and how the government fares in the coming years. The economic situation looks very uncertain. In a poll, most Georgians cited economic issues, chiefly jobs and rising prices, as their major concerns, ahead of the question of conflict with Russia and the disputes over Abkhazia and South Ossetia.¹

Georgia's economy performed extremely well from 2004 to 2008. Real incomes grew substantially, and foreign investment began to flow in. However, this rapid transformation bypassed several social groups and poverty and unemployment remain firmly entrenched in much of society. More recently, the shine has also begun to come off Georgia's reputation as a super-liberal economy, as foreign direct investment (FDI) has declined and many businesses complain of harassment by the tax authorities. In the meantime, most of the big direct foreign assistance packages provided to Georgia after the August 2008 war have been spent. Although growth figures in early 2011 were healthy, the economy runs a substantial trade deficit and is vulnerable to external factors. "The government doesn't have its own resources, and everything has to come from either private investment or foreign technical assistance," says Eric Livny, an economist with the International School of Economics at Tbilisi State University.²

Georgia needs a long-term economic development model. It needs to build up institutions and tackle the problems that it has not yet faced properly, chiefly high levels of poverty and unemployment and its low export capacity. President Mikheil Saakashvili and his government, never short of ideas, have proposed not one but several models. The president has said he intends to make Georgia the “Switzerland of this region with elements of Singapore,” but also that he is committed to integration with the European Union. Stating these very different goals, he is transmitting mixed messages. When he invokes the model of Singapore, the president is talking about making the country a “business hub” with a highly deregulated economy.

Europeanization offers a different path of regulation, standards-setting, and adopting Brussels as an anchor. Occasional references to Estonia, a liberal economy within the EU, show an awareness that this circle needs to be squared, but this point of reference shows how far Georgia is from the major institutional and economic transformation that Estonia underwent in the past two decades.

This is a political issue as well as an economic one. Georgia’s current young government elite, which took power in 2004, has been effective at pushing through many reforms and is proud of its decisive style. “We have lost so much time and we need to catch up,” says Giga Bokeria, the main strategist for the president and now the secretary of Georgia’s National Security Council.³ But to a large degree the governing elite has remained in revolutionary mode—a small dynamic group of individuals who show little interest in consulting with Georgian experts or the public at large. Although Georgia is still a pluralist country by nature, this small group now runs a system that lacks domestic checks and balances.

Obviously, this heavy concentration of power in the hands of a few puts great responsibility on Georgia’s leaders to act wisely. It also puts great responsibility on Georgia’s Western partners, which, absent strong domestic checks and balances, become by default the main actors influencing the decisions of the government. The European Union in particular has the capacity, through both greater incentives and strong conditionality, to push Georgia in a more European direction. Here, an opportunity could be missed. Many Georgians’ attitudes toward Europe are warm but extremely fuzzy, while there is still a strong group that regards the EU as a bureaucratic trap for Georgia. One leading thinker in this ultra-liberal group, Kakha Bendukidze, goes so far as to label as “betrayers” Georgians who call for greater regulatory approximation with Brussels.

Georgia needs a long-term economic development model and needs to build up its institutions.

Despite Georgia's problems, it is important to stress that the country remains in many ways a positive example, compared with other countries in the post-Soviet space. It is to the credit of Georgians that Georgia *has* choices about its strategic direction and is not just set on a linear trajectory of "more of the same." The government still has the capacity to surprise and to unveil positive initiatives. But, far more so than a few years ago, Georgia now faces real dilemmas whose resolution will determine how the country develops. A foundation has been laid, but, as choices are made about what kind of state Georgia constructs, there are real dangers that good work will be undone and negative tendencies will be entrenched.

State Building in Georgia

Georgia has a long tradition of non-conformism. Set apart from many of its neighbors by geography, language, and culture, the country has strong and distinct traditions that have led it on occasion to isolationism and bold experiments. In the late Soviet period, Georgia had a reputation as one of the most prosperous and relatively liberal parts of the USSR. Then in 1990 Georgia's first post-Soviet president, Zviad Gamsakhurdia, took the country down a ruinous path of extreme nationalism and isolation. The central government collapsed, war broke out in the region of South Ossetia, and much of the country was taken over by criminalized paramilitary groups. Gamsakhurdia's successor, Soviet-era veteran Eduard Shevardnadze, took charge once again in 1992. He tamed the warlords and brought the newly independent state back from the brink of collapse. He negotiated a peace agreement in South Ossetia, but also fought and lost a conflict over another breakaway region, Abkhazia. Shevardnadze presided over an era characterized by a free press and a lively parliament, but also poverty and endemic corruption.

In November 2003, Shevardnadze resigned in the face of the peaceful Rose Revolution, a wave of popular protests triggered by a falsified election. The most prominent revolutionary leader, Mikheil Saakashvili, a former protégé of Shevardnadze, was then elected Georgia's president by a landslide, becoming the youngest head of state in Europe at the age of just 36. On January 24, 2004, the day before his inauguration, in a deliberate act of symbolism, Saakashvili visited the tomb of Georgia's eleventh-century monarch David the Builder in western Georgia to suggest that he was the new Mikheil the Builder. He said, "At the grave of King David we must all say: Georgia will be united, strong, will restore its wholeness and become a united, strong state."⁴

Saakashvili now argues that the situation he inherited from Shevardnadze was a "failed state." In March 2011, he told a Washington, D.C., audience:

[In 2003] Georgia was a classical failed state. And bureaucracy was killing any initiative in the society. There was crippling poverty, serious inadequate infrastructure, and an economy shackled by corruption. As you know, the peaceful, popular revolution brought to power a young team of reformers that I happen to lead. The situation back in Georgia was so catastrophic that we had to build our state almost from scratch.⁵

Arguably, Saakashvili's most radical reforms took place in his first year in office. A series of oligarchic figures who had dominated the economy during the Shevardnadze era were arrested, often in view of television cameras. Once in jail, most of them agreed to plea bargains in which they offered millions of dollars to the state budget in return for their freedom. As a result of this, and the introduction of a flat tax rate of 12 percent, tax collection rates soared and the budget expanded eightfold by July 2006, to \$3 billion. In the summer of 2004, the entire staff of the notoriously corrupt traffic police—around 13,000 people—was fired and a much smaller, better-paid, more honest organization was created in its place. The police force itself was savagely cut, and officers were rehired for higher wages. The customs service was entirely reorganized. The virtual elimination of everyday corruption remains an impressive achievement among post-Soviet states. As a result, most ordinary Georgians no longer must pay a bribe when driving around, gaining admission into university, buying an apartment, or acquiring a passport. A spectacular 98 percent of Georgians in a recent survey said they did not give bribes. Most Georgians praise the government for a much more efficient delivery of services—even if many now complain about the rising costs of those services.⁶

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Anticorruption reforms and a simplified tax system helped put the economy on a much sounder footing. Foreign direct investment shot up and reached more than \$2 billion a year in 2007 (after which it declined again, as a result of

the war). The slashing of regulations gave Georgia a stellar ranking in one of the World Bank's global indices, the Ease of Doing Business Index, in which Georgia currently ranks twelfth.

The benefits of economic reform, however, were spread unevenly in society. Foreign investment mainly went into sectors of the economy such as banking and real estate, which created few jobs. Pensions and social welfare payments stayed low. In 2007, socioeconomic discontent combined with a political crisis—the arrest of former defense minister Irakli Okruashvili, who accused his former partners in government of abuse of power—to trigger street protests in Tbilisi that were

brutally dispersed by the police on November 7, 2007. Saakashvili turned the political confrontation to his advantage and called early elections, which he narrowly won in January 2008. The start of Saakashvili's second term was dominated by a growing crisis over the breakaway regions of Abkhazia and South Ossetia, which eventually blew up into war with Russia in August 2008.

Saakashvili confronted the crisis of August 2008 at the age of just 40 and with a very young team: a thirty-six-year-old prime minister, thirty-three-year-old finance minister, thirty-one-year-old foreign minister, and twenty-nine-year-old defense minister. The overhaul of the government with a new post-Soviet generation is a reflection of what has been described as a "mental revolution" in Georgia.⁷ Foreign interlocutors now interact with a group of officials who are remarkable by any standards, being young and well-educated, most of them speaking fluent English. Saakashvili in effect skipped a generation in appointing a government of people in their twenties and thirties.

The speed of the overhaul brought fresh thinking into government. It also made for a pattern of improvisation and missteps that helped Georgia blunder into war in August 2008. The government lacks institutional depth. Saakashvili and a close inner circle have been responsible for all major decisions for several years, while the cabinet has been reshuffled many times in a revolving door of dismissals and appointments. Since Saakashvili came to power, he has had five prime ministers, seven defense ministers, six foreign ministers, and six finance ministers. Eyebrows are still raised at some governmental appointments. In June 2010, for example, there was much criticism of the appointment of an inexperienced twenty-eight-year-old, Vera Kobalia, as economy minister. Prior to Kobalia's being appointed to the government, her main work experience was working for her father's bakery business in Vancouver, Canada, where she met Saakashvili a few months earlier at the Winter Olympics.

There has also been until now little effort to build a professional cadre of civil servants. A Transparency International report observes,

[T]he civil service lacks independence because of the influence ministers can exert in hiring, promoting and, particularly, firing civil servants. While there are some legal hurdles to arbitrary dismissal, they are rarely put into practice. It is still commonplace for new ministers to demand significant changes in staffing, even among fairly junior staff. The main problem behind this continuing weakness is a conviction within the Georgia government that flexibility in the civil service is more important than independence, security or long-term professional development.⁸

In an informal political culture of this sort, success and failure revolves around the personality of the leader. Since the disaster of the 2008 war, Saakashvili has

achieved a kind of political resurrection. Many predicted that he would be forced to resign, following the debacle suffered by his armed forces in South Ossetia and the conflict with Russia but he has reconsolidated his position as Georgia's most popular politician. A survey in 2010 showed that the president, by an easy margin, was the most trusted political figure in the country, with an approval rating of 56 percent, an eight percentage point improvement on his rating in 2009.

There are three broad reasons for the turnaround in Saakashvili's political fortunes. One is his own political talent. Even his opponents acknowledge that Saakashvili remains Georgia's most dynamic politician. His skills as a communicator were on show at the end of 2010 and the beginning of 2011 when he fielded questions for several hours in two big public events, first live on television and then after his annual address to parliament. In the parliamentary address

he also showed his skill in creating a narrative and setting the political agenda—on this occasion laying out a new series of ambitious targets for the country to attain by 2015. Archil Gegeshidze, a political analyst with the Georgian Foundation for Strategic and International Studies, says the president

and his circle are constantly setting the agenda and leaving others far behind.

“At any particular moment they are two or three moves ahead. Everyone else is reacting. They are proactive.”

Another reason for the president's revival is the ineffective performance of the opposition. Georgia's opposition parties are numerous but small, divided among each other and tending to be dominated by one leader. In 2009, with Saakashvili's approval ratings very low, especially in the capital city Tbilisi, the radical opposition opted for a tactic of street protests that alienated mainstream voters. The governing elite sat out the protests and emerged the stronger for it. The president himself has mocked his opponents' performance, saying that if he were the opposition he would give the government a lot of trouble.

The opposition does not have its own version of the Saakashvili of 2003 to challenge the Saakashvili of 2011. The two most effective opposition politicians, Irakli Alasania and Giorgi Targamadze, both have fairly modest ratings with voters. Alasania, who served with distinction as a diplomat and mediator under Saakashvili, polled 19 percent in the mayoral elections in Tbilisi in 2010 against the victorious incumbent, Gigi Ugulava. He has thus far failed to make a big impact as a public politician. Targamadze is the head of the Christian Democratic Party and a small opposition faction in parliament consisting of twelve deputies. He has had a zig-zagging political biography during which he has worked with several controversial

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figures in Georgian politics such as Aslan Abashidze, the former leader of the autonomous republic of Ajaria, and the oligarch Badri Patarkatsishvili.

Crucially, the opposition has fewer resources at its disposal than the government does. The president has effective control of the three most watched and wealthiest television channels and their news programs. Opposition parties complain that they have problems getting access to funding and that businesspeople are afraid to support them. In the municipal elections of May 2010, the governing United National Movement (UNM) outspent Alasania's Alliance for Georgia by a factor of more than one hundred to one.⁹

A third reason for the recovery of Saakashvili is that the Georgian economy was protected from the double shock of the war with Russia and the global financial crisis by a generous financial stabilization package from its Western friends. A conference of international donors held in Brussels in October 2008 resulted in a \$4.5 billion package of aid and low-interest loans from the United States, the European Union, the World Bank, the Asian Development Bank, and other donors. Much of this went toward reconstruction work and help for displaced people from the conflict two months earlier, but the sums raised exceeded expectations and helped keep the economy as a whole afloat. The United States gave \$250 million of assistance directly to the government budget. In addition to the money pledged in Brussels, the International Monetary Fund approved for Georgia a standby program of \$750 million to boost its depleted reserves. This aid and loan package cushioned Georgia from the worst effects of the global financial crisis (the GDP in neighboring Armenia, by contrast, contracted 14 percent in 2009). Some aid will continue. Georgia won a good rating for its implementation of the \$295 million U.S. Millennium Challenge program between 2005 and 2010, which was mainly used to build infrastructure, and it is likely to secure another Millennium Challenge compact in 2011. However, the Georgian government will not receive again the big sums it was promised in 2008 and it is possible the rescue program merely postponed difficult times for Georgia.

The Economy in 2011

In 2011, the Georgian government faces the challenge of a worsening socioeconomic picture, just as it is entering a period of political transition.

Most of the foreign assistance package pledged in 2008 has been spent. This places a greater priority on the Georgian government's need to attract FDI to fuel economic growth. One international financial official says, "Almost everyone says and agrees that FDI is the real lifeline Georgia needs to survive and prosper." However, FDI has declined since 2007, when it reached a peak of more than \$2 billion. In 2008, the year of conflict, it declined to \$1.5 billion and then to \$658 million in 2009. In 2010, foreign investment underwent another decline, of 16 percent, to \$553 million.

Some sectors are developing. Georgia once suffered from acute energy problems, but is developing a strong hydroelectric sector and is now a net exporter of power, including to Russia. The government is also working hard on expanding the tourism sector—which, unlike the energy sector, could provide many jobs. There has been an ambitious construction program in the Black Sea city of Batumi, and there are plans to develop the mountainous region of Svaneti as a ski resort. However, tourism is a very unpredictable sector that depends on many factors beyond a government's control—to take one example, there was not enough snow in Svaneti in 2010–2011 to make for a proper ski season. Saakashvili predicted in his address to parliament on February 11, 2011, that the tourism drive will result in 5 million tourists coming to Georgia in 2015, but did not say what the basis was for this optimistic forecast.

Other economic trends are negative. Inflation topped 13 percent in the early months of 2011. The current account deficit remained high, at 10 percent. The longer-term fiscal picture is clouded by a heavy burden of external debt that stands at more than \$4 billion. The debt problem is a long-term headache for Georgia. As

in the rest of the former Soviet Union, domestic savings rates are very low. In late 2010, the country's external debt stood at 46 percent of GDP. Much of the foreign debt is in private hands. In April 2008, the Georgian government issued five-year Eurobonds worth \$500 million to private investors. Around \$130 million of the money earned was immediately spent on the Ministry of Defense, while the remaining amount was invested in sovereign wealth funds. However, the government was forced to repatriate the money immediately after the August 2008 war, and all the money had been spent by the beginning of 2009. In March 2011, the government succeeded in redeeming more than 80 percent of this debt and reissued ten-year dollar bonds with the help of J. P. Morgan and Goldman Sachs. The interest rate was a fairly healthy 7.125 percent. This has gotten Georgia off the hook of a looming repayment but added to its overall debt burden.¹⁰

The foreign debt accumulation poses a dilemma for the Georgian government in that it wants to keep the Georgian currency, the lari, strong so as to ease debt repayments in dollars, but that in turn holds back Georgia's weak export capacity. A writer for the *Economist* commented, "The real challenge for the government is closing the country's huge imbalance between imports and exports."¹¹ Currently imports outweigh exports by a factor of more than four to one. In 2010, Georgia's three main exports were ferro-alloys, (re-exported) vehicles, and ferrous waste or scrap—in other words, scrap metal.

Georgia's fiscal problems and the need to raise revenue also hurt Georgia's reputation as a business-friendly environment, with reports that the government is consistently targeting businesses in order to raise more funds. This provides one explanation for the recent high-profile case of the Israeli businessman Rony Fuchs, who was jailed in April 2011 for offering a bribe to a Georgian government official. Fuchs and his lawyers say his arrest was the result of a sting operation designed to stop the Georgian government from paying a heavy international arbitration award.

Georgia's fiscal problems and the need to raise revenue also hurt Georgia's reputation as a business-friendly environment.

THE FUCHS CASE—CORRUPTION, BRIBERY, OR ENTRAPMENT?

Three of the Georgian government's different agendas—to attract foreign investors to Georgia, raise revenue, and crack down on corruption—have all clashed in jarring fashion around the case of the Israeli businessman Rony Fuchs. Fuchs was given a seven-year jail sentence on April 1, 2011, by a Tbilisi court after being found guilty of offering a bribe to a Georgian government official in Istanbul. Fuchs and his lawyers say that the businessman is the victim in the case, accusing the Georgian government of entrapping Fuchs after it failed to pay him and his Greek partner an arbitration award of nearly \$100 million.

The political and moral complexities of the story are worthy of a John le Carré novel. It dates back to the early 1990s, when Fuchs was one of the first investors in a pipeline project in turbulent post-independence Georgia. By 1996, bigger players, such as the oil giant BP, had entered the energy market in the Caucasus, and the Georgian government issued a decree canceling all previous contracts in the sector, including that of Fuchs and his Greek partner, Ioannis Kardassopoulos. The two men demanded reimbursement, but successive Georgian governments refused to pay. Eventually, the pair sought arbitration. In March 2010, a London panel of the International Centre for Settlement of Investment Disputes (ICSID), an affiliate of the World Bank, awarded the two men compensation from the Georgian government of \$98 million.¹²

The Georgian government was furious at being told to pay for a contract that had been canceled more than a decade earlier under a previous administration and sought to appeal the judgment. In September 2010, it then tried a more direct approach. Georgian Deputy Finance Minister Avtandil Kharaidze invited Fuchs to a meeting in Istanbul. In four hours of discussions, much cognac was drunk and Kharaidze encouraged Fuchs to make a deal. Fuchs apparently offered to pay Kharaidze \$7 million in return for Fuchs and his partner receiving \$72 million of the arbitration award.

A month later Fuchs received a personal letter from Georgian Prime Minister Nika Gilauri, inviting him to Georgia for a meeting to “affect an amicable solution of the matter.” He accepted the invitation, flew to the Black Sea city of Batumi, and was promptly arrested on corruption charges. The Istanbul meeting had been a sting operation, secretly filmed by the Georgian side.

Fuchs decided to fight the case. He hired two top Western attorneys, former White House counsel Greg Craig and famous London-based lawyer Geoffrey Robertson, who wrote a legal opinion on behalf of Fuchs, arguing that Kharaidze had

carried out an “entrapment operation” that breached the Georgian government’s obligations under the European Convention on Human Rights. Fuchs’s lawyers say that their client was approached in jail and told that if both he and Kardassopoulos renounced their arbitration claim, he would be freed.

The case is very murky. Diplomats in Tbilisi say that by working in Georgia in the 1990s, Fuchs would have been aware that he was operating in a risky and legally ambiguous environment. They also speculate that he would have had a difficult time making a defense against the bribery charge in court in another country. However, the circumstances of Fuchs’s arrest, and the personal involvement of the prime minister in persuading him to come to Georgia, reflect badly on the Georgian government. The case is already having political repercussions: A visit to Israel by Georgian parliamentary speaker David Bakradze was postponed at the request of the Israeli government, in part because of Fuchs.¹³

On sentencing him, the Georgian judge told Fuchs, who is in poor health and in his sixties, that he is eligible for a pardon from President Saakashvili. His lawyer argues that even if Fuchs eventually goes free, the Georgian government may still face a “lose-lose situation,” for having jailed him and still facing the international arbitration fine.

The incident has certainly caused bad publicity for the Georgian government. One Western diplomat says, “We’ve made the point repeatedly that you can spend money on *Economist* and CNN ads that will get you one look. As part of that look, they will talk towards people doing business here. And if they don’t hear about an open and predictable business environment, they will go somewhere else.”

Vladimer Papava, a consistent economic critic of the government, sums up its apparently schizophrenic attitude toward business by saying, “The façade of Georgian economy is neo-liberal; the content is neo-Bolshevik.”¹⁴ Local businessmen complain that, despite nominally low tax rates, they frequently suffer from what one Tbilisi-based diplomat calls “parallel tax collection”: unexpected raids by the tax police, who impose draconian fines for what businesses say are minor infractions. Transparency International Georgia labels the practice “tax terrorism.”¹⁵ It looks as though, in its zeal to eliminate a culture of tax evasion and cheating, the Georgian government has now gone to the opposite extreme. A 2009 World Bank report concludes,

While there was widespread recognition of the improvement in the business environment in recent years, in terms of taxes, red-tape, corruption and so on, one area where investors continue to find fault with the government is in tax administration. Across sectors, there is a widespread perception that the tax authorities are overly aggressive in levying taxes and penalties on those companies that are doing their best to comply; and they are overly slow in processing appeals or reimbursing VAT.¹⁶

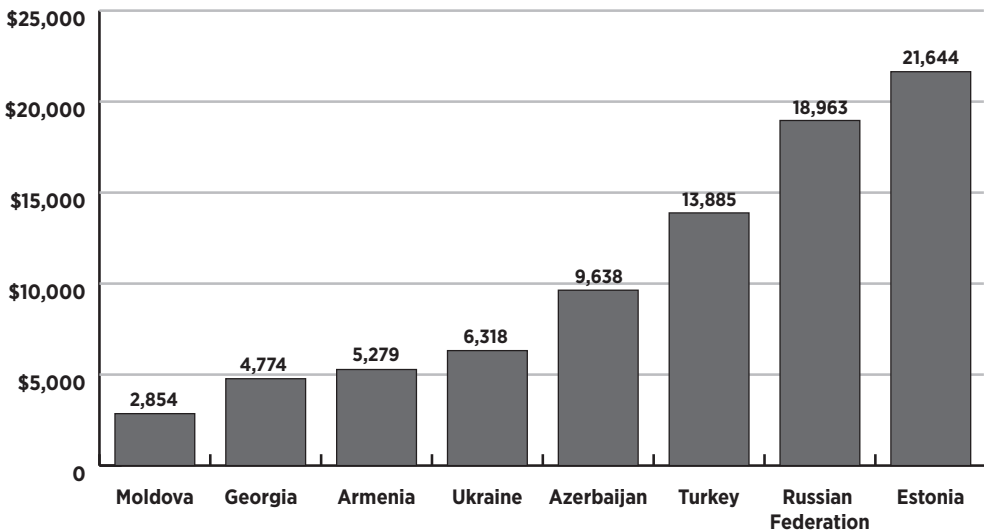
In 2010–2011, many businesspeople complained of government interference. David Lee, chairman of the American Chamber of Commerce in Georgia and general director of MagtiCom, a mainly U.S.-owned telecommunications company that is the largest private taxpayer in the country, praised the reforms that have made Georgia more business-friendly over the past few years. “We are so far away from where we were,” he says. “Corruption is no longer endemic. It’s important that we don’t pull the rug from under the government’s feet.” At the same time, Lee expressed frustration about recent incidents, including one in which two of his employees were arrested by masked police and jailed in 2010. “There are frequently cases when ordinary business and commercial disputes become the reason for detention and subsequent pressure over the businessman,” he says. Lee also complained that the tax system has become arbitrary and unpredictable. A new excise tax duty of 10 percent on gross revenue of mobile telephone companies, for example, was introduced effective September 1, 2010. Lee described the move as unprecedented and especially unwelcome to management and shareholders for being introduced halfway through the financial year, when business plans had already been approved.

The appointment of a new tax ombudsman, Giorgi Pertaia, in early 2011 to arbitrate disputes between businesses and the tax authorities was broadly welcomed. Pertaia reportedly revoked a large fine due to be imposed on the French brewing company Castel. The fact that Pertaia was a former aide of the prime minister’s and began his work by saying that Georgia’s business problems were exaggerated did not, however, reassure skeptics.¹⁷

Poverty in Georgia

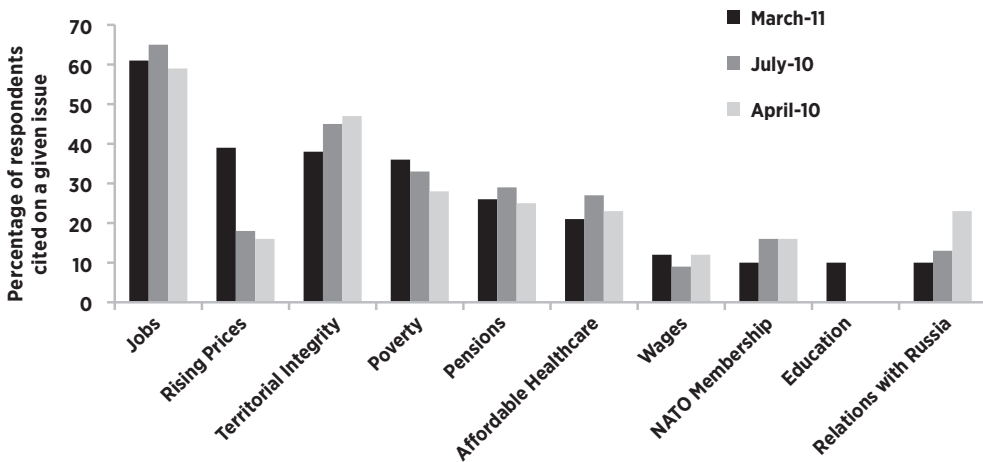
Georgia is still a poor country, both in absolute terms and relative to most of its neighbors (having a Purchasing Power Parity GDP per capita of \$4,774 in 2009). Of its former Soviet European neighbors, only Moldova is poorer. Even a relatively small downturn can have a serious socioeconomic impact. In a November 2010 survey, 25 percent of respondents said their household did not have enough money for food and 42 percent said they could afford food but not clothes. In a March 2011 poll commissioned by the National Democratic Institute, respondents named six economic problems among the top seven political issues for them, with jobs (61 percent) and rising prices (39 percent) being the most pressing concerns.

GDP per Capita (PPP) in 2009 (in international dollars)



Source: World Bank

Most Important National Issues



Source: The Poll on Public Attitudes in Georgia 2010–2011 was carried out by CRRC for the National Democratic Institute.

Officially the unemployment rate hovers around 16 percent, but this does not cover the large number of people who live on subsistence farming, scratch together a poor self-employed living, or live off other government benefits. In November 2010, Saakashvili conceded that according to government data, “30 percent of Tbilisi residents are either totally or partially unemployed” and called this “a catastrophically high figure.”¹⁸ CRRC’s latest survey gives an even grimmer picture, recording that only 27 percent of respondents described themselves as having a full- or part-time job.

The World Bank’s Poverty Assessment Report for 2009 throws some light on these figures. It notes,

While the average real earnings in the economy have increased noticeably since 2003, this did not contribute much to poverty reduction. The main reasons for this are: (a) comprehensive economic and public sector reforms since 2003 have so far resulted in the shedding of labor—job destruction surpassed job creation; and (b) those sectors that did register an increase in employment and/or wages (for example, construction, financial services, mining, public sector) account for only a minor share of overall employment.¹⁹

Since the Rose Revolution, inequalities have deepened between town and country. Persistent rural poverty is now Georgia’s deepest socioeconomic problem. The World Bank survey notes that poverty in the countryside accounts for 60 percent of the overall total. The substantial labor migration from Georgia to Russia and Turkey is mostly from rural areas. Agricultural employment accounts for 55 percent

of total employment but is mostly self-subsistent, and incomes have risen in the countryside at a much lower rate than in urban areas. The problem is especially acute in what is known as the Northern Mountain Arc north and east of Tbilisi, the regions of Shida Kartli, Mtskheta-Mtianeti, and Kakheti.

Georgia is proud of its rural traditions. Around half of Georgia's population still lives on the land, and many urban Georgians retain links to ancestral villages and own land or property there. In Soviet times, Georgia exported food to much of the Soviet Union. In the early 1990s, land privatization handed out small plots to millions of farmers in a project that was equitable and saved many from hunger but also made for a system of inefficient subsistence farming. Since Saakashvili came to power, the situation looks to have gotten worse. Between 2002 and 2009, the amount of cultivated land decreased by 43 percent, and levels of wheat production dropped dramatically from 199,000 tons to 80,000 tons.²⁰ Despite the number of Georgians living on the land, government expenditure on agriculture in 2010 was less than 1 percent of total budget spending, at just 53 million GEL (around \$32 million)—less than half of what was allocated for the prison system. The results of this situation can be seen on the shelves of a Tbilisi supermarket, where there is more milk from Ukraine and Belarus than from Georgia, and where Turkish tomatoes are on sale. This reflects the fact that more than 80 percent of Georgia's food is imported—something that fueled high food inflation in 2011.

In 2011, the president for the first time signaled that agriculture should be a priority sector in the economy, along with infrastructure and tourism. Declaring there was a need to turn the country's "medieval agriculture sector into the agriculture of the 21st century," he promised extra government spending for agriculture worth 150 million GEL (around \$90 million), well in excess of the confirmed budget for 2011.²¹ At the same time, the opposition party of Irakli Alasania launched a strategy for agriculture, signaling that this will be a battleground issue in the 2012 elections. But there is no easy solution to the problem. Experts warn that it is unrealistic to expect a quick turnaround in a sector where products need years to grow. For the sector to become more efficient, the small plots would need to be consolidated into bigger ones, which would drive many small farmers off the land.

Persistent rural poverty is now Georgia's deepest socioeconomic problem.

THE GEORGIAN ECONOMY IN A GLASS OF WINE

The fields around Jumber Khutsishvili's farmhouse stretch into the distance. The horizon is punctuated by an old medieval church perched on a rock and framed by snowy mountains. But few of the fields are covered in vines. The wine industry in Kakheti, a beautiful eastern region of Georgia that has been making wine for centuries, perhaps millennia, has suffered badly in the last few years.

Khutsishvili himself is positive. "Life is good because we have land and enough to feed everyone," he says. The small company named Eniseli that he works for keeps himself and his sons busy and has produced 30,000 bottles of wine. Since the Russian embargo of 2006 hit the Georgian wine market, Eniseli and other firms like it have built a new marketing strategy: downsize production but raise standards. Ukraine and Belarus are the biggest market, and Eniseli wines, one of which has won a prestigious Gold Medal, now reach a few supermarkets in the United States.

Georgia's wine industry, one of its main exports and brands for the outside world, hit a turning point in March 2006. The Russian government banned both Georgian wine and mineral water on the legalistic grounds that there was a big problem with fake products on the market. But the move had a clear political context: Moscow had political grievances with Georgia and kept importing dubious products from friendlier countries. The immediate results for Georgia were catastrophic. In 2005, Russia had imported almost 90 percent, or around 52 million bottles, of Georgia's wine. Suddenly the biggest market disappeared. Kakheti's sweet red wines had traditionally been drunk almost exclusively by Russians—Russian women in particular—and now had nowhere to go. In 2010 Georgia exported just 10 million bottles of wine.²²

"Russia was a huge market. It was our main market not just for wine, but for alcoholic spirit," Khutsishvili says. "There was one factory here which produced 6,000 tons of grapes a day. There used to be vineyards everywhere around here. Now we have to look for a new market. . . . So it was a big blow. But it meant the forgers went into other business. Now we take less from one hectare, but it's better quality. No one buys the poor quality stuff."

Georgian wine is at the forefront of bargaining between Georgia and Russia over Moscow's bid to join the World Trade Organization (WTO). The United States and EU support the move, which could provide Western companies with billions of dollars of extra business. But Georgia, as a WTO member, has the capacity to block Russia's accession and is, unsurprisingly, using that leverage over its neighbor and adversary. Georgian officials say that lifting the wine embargo would not be enough in itself to remove their objections and say that the wine industry is now recovering well on its own.

Much of Kakheti, Georgia's prime wine-producing region, would probably not be so sanguine. The embargo cost thousands of people their jobs. Kakheti used to be one of the richest rural farming areas in Georgia, but a World Bank study in 2009 estimated that 46.3 percent of its population was living in poverty, making it the second-poorest region in Georgia.

There is a bigger, unspoken issue here: If the Russian market were to reopen to Georgia on favorable terms, it could—thanks to proximity, old connections, and the large Georgian diaspora in Russia—have a hugely positive effect on the Georgian economy.

In the meantime, Eniseli's biggest problem is with the Georgian government, not the Russian one. In September 2010, shortly before the wine harvest, Georgian tax officials entered the company's offices, froze its accounts, and demanded that Eniseli pay a fine of 700,000 GEL (\$425,000)—a sum sufficient to bankrupt the business. The wine-growers objected that the tax department had made a bureaucratic mix-up. After vigorous complaints by the company's U.S. investor, the fine was lowered to 50,000 GEL, but as of this writing the matter has not been cleared up.

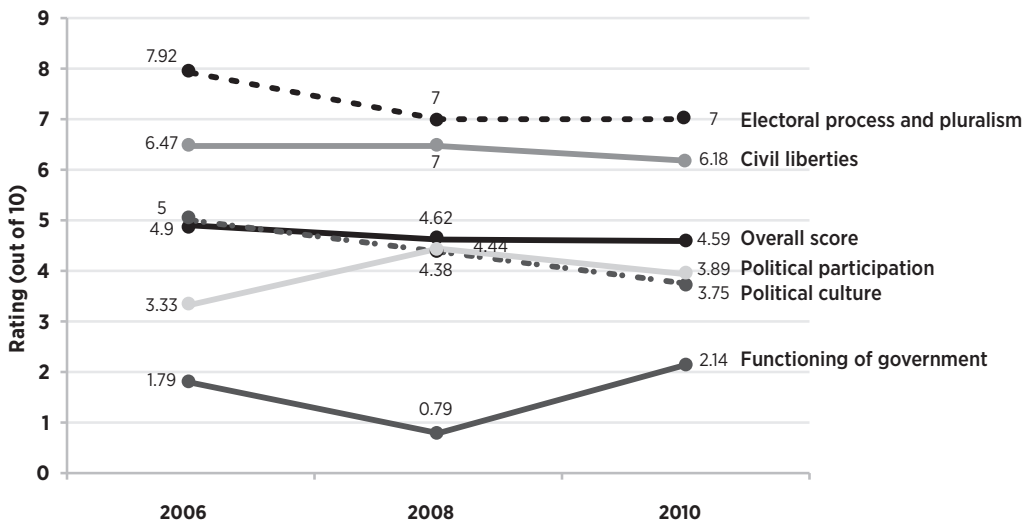
Whatever the rights and wrongs of the tax dispute, rural Georgia certainly needs more successful wine businesses, like this one. The map to the south of Khutsishvili's farm is dotted with the names of some of Georgia's oldest and most famous wines: Kindzmarauli, Mukuzani, Tsinandali. But the look of the village of Vanta is less than glorious. It has only one shop with a meager array of products. Outside the shop, a group of unemployed or underemployed men dressed in gray and black is milling around. On a brick wall nearby is the symbol of the Number 5 in a circle. It was the number on the ballot form for the governing party, the United National Movement, in the last parliamentary election and can be seen all over rural Georgia.

The men complain that there is almost no work in the wine industry. They say that the prices of sugar, tea, and fuel have shot up but that grapes are still far too cheap. "My father and brother send remittances from Moscow. But very rarely," says Dato. "The government makes promises but they just talk, talk, talk." Others in the crowd voice complaints about the government, before Dato comes back in, saying, "They say that now, but at the next election, they will all vote for Saakashvili." There is laughter.

A One-Party State?

Georgia under President Saakashvili has undoubtedly modernized but not necessarily democratized. Government is stronger but not noticeably more open or tolerant. A range of indicators of democracy has undergone little change over the past few years, with several having declined.

Georgia Democracy Index 2006–2010



Source: Economist Intelligence Unit's Democracy Index

Supporters of Saakashvili and his team argue that they needed a strong disciplined executive to push through their reforms. Even if this is the case, there are many signs of overreaching. Saakashvili and the governing United National Movement control the executive, have a large majority in parliament, and constitute all of the regional governors. One foreign observer reports that the president himself did not object to the characterization of Georgia as a “benign one-party state.”²³ For various reasons, this dominance looks set to continue in the parliamentary and presidential elections scheduled to take place in 2012 and 2013. Those elections will usher in a new political system for Georgia, with a new constitution due to take effect as soon as Saakashvili ends his second and final term as president in January 2013. That constitution will reduce many of the powers of the new president and will give the country a much more powerful prime minister, who will be elected by parliament.

Recent political debate has focused on two big issues. One is how the new 150-seat parliament will be formed. In talks with the government, an eight-party coalition of opposition parties insists that it wants to change the system to avoid a repeat of the situation in the last election, in 2008, in which the United National Movement won 71 of the 75 single-seat constituencies by a simple majority. While the party is widely expected to win the next parliamentary election, experts warn that if its majority in parliament is much larger proportionally than its overall share of the vote, there could be a backlash from disgruntled opposition voters.

The second issue is whether Saakashvili, on leaving the presidency, will try to retain his status as the most powerful man in Georgia by becoming prime minister under the new constitution. Pressed on this question, Saakashvili has said he does not want to answer because he does not want to become a “lame-duck” president as his term comes to an end.²⁴

Saakashvili is well aware that his reputation would suffer if he is seen to be “doing a Putin” and merely taking on a new high office in a specially reengineered constitution. An alternative scenario, scarcely less controversial, is that Saakashvili could seek another role, such as head of the United National Movement party or governor of Ajaria Province, remaining a power “behind the throne” while a trusted ally, such as the powerful interior minister, Vano Merabishvili, becomes prime minister.

The government currently holds almost all the cards in this debate about the political future of the country. As noted above, the opposition is weak. Experts speak of a state of political inertia in the country, reflected in the turnout in the 2010 municipal elections, which was well below 50 percent. Ivlian Khaindrava, a leading member of the small liberal Republican Party, says that “Saakashvili has created a situation where there is no alternative to him,” and the “intellectual part of society is in apathy.”

The governing elite commands the political debate in large part because it has the support of Georgia's three major television channels.

The governing elite commands the political debate in large part because it has the support of Georgia's three major television channels, Rustavi-2, Imedi-TV, and TV Channel 1, the Georgian public broadcaster. The two most powerful channels, Rustavi-2 and Imedi-TV, are privately run, and their ownership is opaque—although legislation passed in April 2011 is intended to improve that by banning the ownership of television companies by offshore companies. Rustavi-2 has spent years

under the control of two offshore companies.²⁵ The ownership of Imedi-TV is an even more complex story. It went from being Georgia's main opposition channel in 2007 to being its most pro-government outlet. In March 2010, Imedi-TV notoriously broadcast a fake news program, suggesting that Russia was invading Georgia, provoking panic at the time and severe international criticism later.

Imedi-TV issued an apology; its director, Giorgi Arveladze, a former cabinet minister and political ally of the president, resisted calls for his resignation.

Bias in news coverage is less evident in Georgia than in other post-Soviet states, but the main news broadcasts nonetheless give strong and mostly favorable coverage to the activities of the president and government. The International Crisis Group writes, "The phrase 'it came down from above' has become part of journalists' private vocabulary. Another major problem is that many journalists consider their job security is dependent upon self-censorship, whether they work for pro- or anti-government outlets."²⁶

The three main channels also carry the bulk of television advertising, which in turn is virtually monopolized by one company, General Media, which now controls 95 percent of the market. Newspaper editor and media expert Lasha Tugushi quotes figures showing that in the first eight months of 2010, the leading three television channels, Rustavi-2, Imedi-TV, and TV Channel 1, spent 57 million GEL (\$34 million) out of the total advertising expenditure of 68 million GEL (\$41 million). This has implications for the forthcoming elections. In the municipal elections of 2010, almost 90 percent of the expenditure of around \$9 million was carried out by the pro-government United National Movement. Most of that money was spent on television advertising.²⁷

Georgia does have alternative sources of information on television. Maestro, a cable channel more sympathetic to the opposition, screens news coverage nightly, although it does not broadcast much outside Tbilisi. Another pro-opposition channel, Kavkasia, transmits only to the capital. Both stations suffer from a lack of funds and spent less than 2 million GEL on advertising in the first eight months of 2010. The Georgian Public Broadcaster's Second Channel TV is also an

alternative outlet for information, having been converted into what has been described as a “Georgian C-SPAN.” It screens news conferences and other political events of all parties. Many ordinary Georgians, however, complain that they miss the televised “talk shows” with lively political debate that were characteristic of the Shevardnadze era.

Despite their relatively comfortable position, the governing elite at times displays a very intolerant streak toward critics from the Tbilisi intelligentsia and elsewhere. Many Georgians speak of a “you are either with us or against us” attitude against critics or those who are associated with a previous administration.²⁸ Several experts critical of the government who were interviewed for this report—all of whom are well regarded in the West and are invited to conferences there—said that they had not appeared on any of the three main channels in several years. One of them, Paata Zakareishvili, jokingly said that he had been *uchvnebeli* on the three main channels for the past five years, explaining that Saakashvili had used this word, meaning “unshowable,” about himself when he was in opposition under Shevardnadze.

The price of this mastery of the public discourse is what one Western expert calls an “accountability gap” and “transparency gap” in Georgia on the part of the government and president.²⁹ Decisions are taken in a very untransparent fashion. For example, the unexpected and expensive decision to construct a new parliament building in Georgia’s second city of Kutaisi—a decision that, needless to say, is unpopular in the capital Tbilisi—was made with little consultation and some sleight of hand. Questions about the financing of the project were raised but not answered.³⁰ Several experts see the move of the parliament away from Tbilisi in itself as being a sign that the government is seeking to avoid accountability. Certainly the capital was the only place in Georgia where a majority of electors voted against Saakashvili and for the opposition candidate, Levan Gachechiladze, in the 2008 election. Says analyst Zakareishvili, Saakashvili “wants to make Tbilisi a depoliticized city. Kutaisi is the least politicized city in Georgia. In Tbilisi people ask difficult questions.”

Extreme Order

The contradictions of Saakashvili's new Georgia are keenest in the sphere of law enforcement and justice. Having come to power in a country characterized by corruption and widespread criminality, Saakashvili first entirely reshaped the old police force and then empowered its successor to spearhead a “zero tolerance” policy on crime. The main enforcers of this policy are two close associates of the president, who are widely regarded as being the most powerful officials in Georgia after Saakashvili himself: Interior Minister Vano Merabishvili and Justice Minister Zurab Adeishvili. Merabishvili has held the same post since December 2004, a rare figure of continuity in a government where many ministers have come and gone. Adeishvili has held various posts in the governing elite but always remained in Saakashvili's inner circle.

Under Merabishvili's guidance, crime rates have fallen in Georgia. Levels of street crime, car theft, and murder have all dropped. Polls show the police have a high degree of public support. However, there are concerns that police officials wield power that makes them politically unaccountable. In 2011 the European Court of Human Rights rebuked the Georgian government for obstructing justice in a notorious case in which police officers were accused of murder.³¹ At the same time, the “zero tolerance” policy on crime has swelled the prison population from 6,654 in 2004 to 23,684 in 2010. That makes Georgia the state with the fifth-highest prison population per capita in the world.³² Prison overcrowding is a major problem, and the public defender complained that in 2010, 142 prisoners had died in jail, a sharp increase from the year before. Several people were detained after protesting conditions in Georgian jails in two separate demonstrations in Tbilisi in March and April 2011.³³

The judicial system is currently strongly weighted against defendants. Anyone prosecuted in a criminal case in a Georgian court is highly unlikely to be acquitted.

In Tbilisi City Court in 2010, the acquittal rate was 0.04 percent, or 21 acquittals out of 7,296 criminal cases heard. More than half the cases before Georgian courts are now settled by the system of plea bargaining. Defendants negotiate with the prosecutor and generally end up paying a fine in return for a reduced sentence or no sentence at all. In 2009 the fines resulting from plea bargaining amounted to more than 61 million GEL (\$36.2 million). Supporters of the system say that it is efficient, saves time, and prevents even greater jail overcrowding. As Transparency International notes in a detailed report on the issue, however, “Lack of transparency regarding the calculation of the required fine and the amount of imposed and collected fines leads to widespread suspicion towards prosecutors and plea bargaining in general.”³⁴

The government has embarked on a process of judicial reform that promises to correct some of these flaws. Jury trials, initially for homicides and then potentially for other criminal cases, are set to be introduced, which will add an important element of accountability into the criminal process. Under the new constitution, judges will be appointed for life, a move approved by the Council of Europe’s Venice Commission. The commission expressed concern, however, with the requirement that judges be nominated by the president, saying it “does not seem to be a good mechanism with a view to guaranteeing their independence” and also criticized the provision to give judges a three-year probationary period because “setting probationary periods can undermine the independence of judges, since they might feel under pressure to decide cases in a particular way.”³⁵

This political culture of “extreme order” also has an economic dimension. There is a widespread perception that the government has set the rules of business practice to suit its own interests. Several Georgian nongovernmental organizations (NGOs) have reported an alleged abuse of individuals’ property rights in places where the government has a direct interest, such as the new tourist resorts of Anaklia, Batumi, and Svaneti. More broadly, many Georgian analysts allege that much of Georgian business is still controlled by officials and politically connected figures—although in a much more discreet manner than in previous times. If so, this is a strong disincentive for the dominant political group in Georgia to share power and make the system more transparent. For obvious reasons, this is a very obscure topic. Put simply, there is little public information about who owns large sections of Georgian business and media, and very little can be proved one way or the other. But both local observers and foreign commentaries, such as

Much of Georgian business is still controlled by officials and politically connected figures—although in a much more discreet manner than in previous times.

the U.S. State Department's Human Rights Report on Georgia for 2010, mention concerns about "elite corruption."³⁶

Officials and liberal supporters of the government firmly reject the allegation that there are concealed monopolies or "high-level corruption" in the economy. Prominent economist Kakha Bendukidze, the architect of most of the government's liberal reforms, argues forcefully that Georgia's economy is so open that anyone who wants to form a monopoly will be undercut by competitors. Government strategist Giga Bokeria says, "There is zero chance of any tangible change on a low level if corruption exists on a high level." He says that plans to institute an electronic system for procurements will bring greater transparency to that procedure.

However, top officials have been accused of corruption in the past. In 2007, two high-level insiders who left office after an internal political feud were later accused of massive embezzlement. They were Irakli Okruashvili, who had been the defense minister, and Mikheil Kareli, who had been governor of the Shida Kartli region. This raises the question of whether their alleged financial misdemeanors would or could have been exposed if they had managed to stay in office.

In 2011, many ordinary Georgians also cite high prices for gasoline and for some food products or medicines as evidence of hidden oligopolies or cartels in the economy. There is anecdotal evidence for this. One interlocutor in Tbilisi tells the story of how Israeli businesspeople he knows wanted to enter the pharmaceuticals market but were not granted the necessary licenses, for what looked like political reasons. This sketchy picture was given much more detail by a special edition of *Liberali*. The independent magazine's reporters investigated several obscure areas of the Georgian economy and turned up cases ranging from the national water company and lottery to the management of slaughterhouses and parking spaces to a network of low-price kiosks that sprang up in Tbilisi shortly after city authorities had ordered the closure of other street kiosks.³⁷

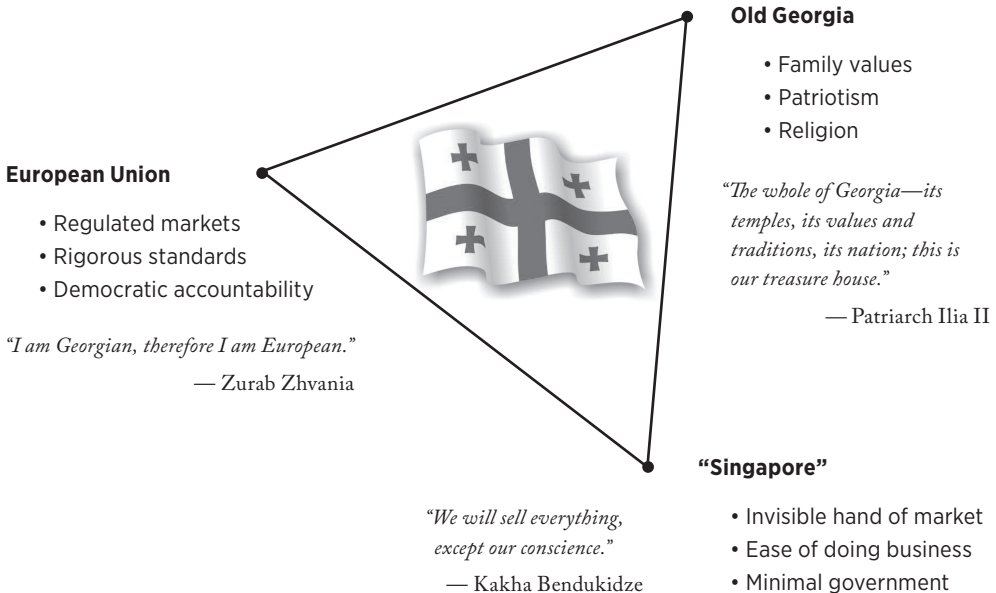
The reports on these very different cases found a tendency for one player to dominate the market and set the prices, a general rise in costs for the product in question, and obscure ownership structures, with several businesses being registered in the Virgin Islands. Transparency International Georgia has also tried to investigate hidden monopolies in Georgia and come across closed doors. Transparency International's Mark Mullen says, "Once you get above a certain level, you always seem to end up in Cyprus or a P.O. box in the Bahamas." Georgia's economy has some shadowy places that merit deeper investigation.

Modeling Georgia

As it seeks a long-term development model, Georgia has a number of choices. Nothing in Georgia's varied history and multiple cultural influences predetermines an answer. President Saakashvili has been characteristically extravagant in predicting a bright future for his country and citing a number of other countries as future state models. Each citation reflects a different constituency and a different philosophical approach to Georgia's future.³⁸

To make a very schematic distinction, three models for Georgia stand out as the corners of a triangle pointing the country in different directions.

Georgia's Models



The first choice could hardly be called a “model” and stands for what can loosely be called “Old Georgia.” It represents the country’s traditional value system and old way of conducting relationships and doing business. The philosophical approach behind this idea is that Georgia is an ancient civilization that should not be corrupted by foreign influences. Its most eloquent spokesman is the head of the Georgian Orthodox Church, Patriarch Ilia II, who speaks of Georgia as a “treasure house.” In 2010 he warned young Georgians not to yield to the temptation of living abroad and to resist the “danger” of globalization.

The current governing elite is socially liberal and Western-educated and not close to the church. Saakashvili pays due respect to the patriarch and had his son baptized. In August 2010, attending a ceremony with the patriarch, the president said, “Our statehood and faith is indivisible. Here is our patriarch, he is our symbol of our invincibility.” However subterranean tensions between the governing elite and the church occasionally come to the surface over a variety of issues, whether it be the social mores of young people, education reform, or

In modern Georgia the Orthodox Church is perhaps the only institution that has the authority to challenge the government, albeit mainly on secondary issues.

relations with Russia. This reflects the fact that in modern Georgia the Orthodox Church is perhaps the only institution that has the authority to challenge the government, albeit mainly on secondary issues. Ilia II, who has been the patriarch since 1977, is virtually untouchable and enjoys approval ratings in society of around 90 percent.

With all due respect to what is indeed an old and rich civilization in Georgia, this philosophy offers the country little when it comes to plotting its economic or political future. In business terms, “Old Georgia” is shorthand for closed family networks and economic stasis. Politically speaking, this approach has associations with Georgia’s feudal past or, more recently, the disastrous nationalist presidency of Zviad Gamsakhurdia in 1990–1991, when Georgia’s minority communities faced ethnic discrimination.

The second model projects Georgia as a hub for business, a place keen to attract businesspeople of all kinds as long as they invest their money. Its most famous exponent is the Georgian businessman and economic guru Kakha Bendukidze, who was the main driver of reforms between 2004 and 2009 and more recently founded Tbilisi’s Free University.

Bendukidze is a libertarian who believes in the invisible hand of the market, minimal government, and maximum deregulation. In June 2004, on his arrival in

Tbilisi to take up his new position, he famously declared, “We will sell everything, except our conscience.”

He masterminded the mass privatization of state assets, the slashing of bureaucracy and red tape, the abolition or mass reduction of government agencies, and the introduction of Georgia’s hyper-liberal labor laws and low taxes. These policies were largely responsible for the large influx of FDI into Georgia in 2007–2008.

Bendukidze is now out of power and less influential than previously. Despite this, many of his pupils are still in government and his spirit lives on in the vision, espoused enthusiastically by Saakashvili, of Georgia as a would-be “Singapore.” The president’s references to Singapore date to 2007, when he also cited Dubai and Hong Kong as models. In March 2010 he told an audience in Batumi that Georgia was moving toward becoming “the Switzerland of this region with elements of Singapore.”³⁹ In all cases the reference was to a place that had few natural resources but underwent rapid economic growth by introducing a liberal, investor-friendly business environment.

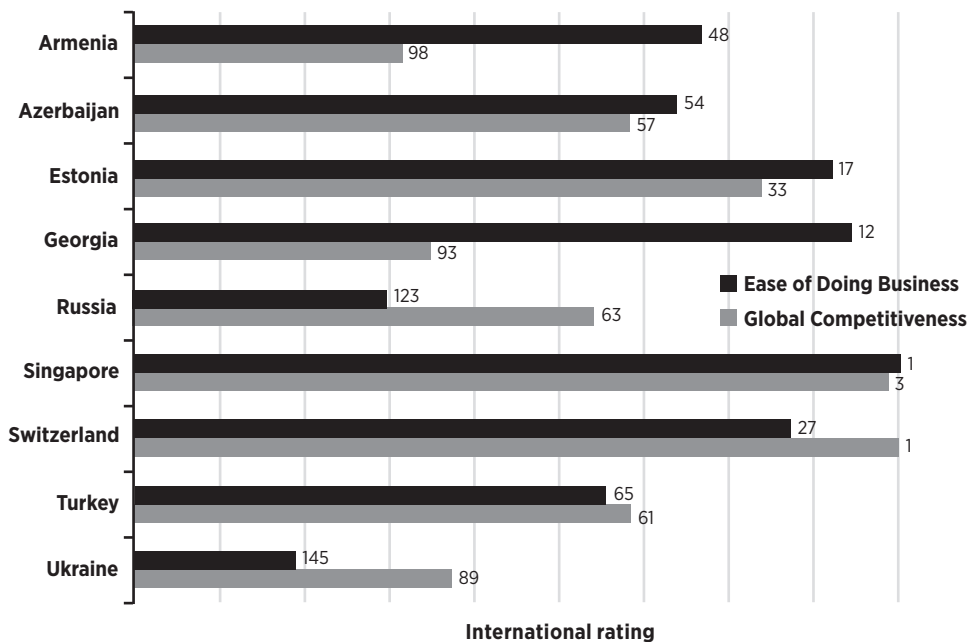
Singapore is, like Georgia, a small country with few natural resources and an almost identical population of 4.5 million. Obvious differences exist, though. Singapore is basically a city-state, while Georgia remains a largely agrarian country. Singapore has a very large and strong civil service, much of the economy is state-owned, and it has an almost puritanical culture of hard work—none of which can be said to be true of Georgia. The comparison is most controversial because Singapore has a poor democratic record and has been governed by the same party for more than half a century. Questioned more and more about this, Saakashvili has clarified his message. He now refers to Georgia as a “European” or “democratic” Singapore. In his March 2011 speech in Washington, Saakashvili said that Singapore was a model because of its dynamic economy. He said, “When we are talking about Singapore we don’t mean, as I said, that we are banning chewing gum or we’ll appoint parliament members, but we are looking at their pension funds very carefully. We are looking at the way they stimulate investment in different fields of economy through some kind of incentives that the government gives and through liberal economics. We are looking at them as being, you know, in a very hostile geopolitical environment.”⁴⁰

The drive for “Singaporization” was given impetus by Georgia’s steep climb in the World Bank’s Ease of Doing Business Index, something that was again masterminded by Bendukidze as he drastically simplified the regulations required to open a business in Georgia. Singapore itself is in first place in this index, while Georgia has risen to twelfth place, something that spurred a worldwide advertising campaign for investment in Georgia that champions the country as “The world’s number one reformer 2005–2010.” One group’s success story is, however, another group’s cause for complaint. The high ranking stems in large part from the

Georgian government’s extremely employer-friendly labor laws, which allow businesses to fire workers easily and inhibit trade union rights. To the EU and the United Nations’ International Labor Organization, these laws are discriminatory to workers. Georgia risks being stripped of some of its international trade privileges if it does not revise its labor laws.⁴¹

The Ease of Doing Business Index is a snapshot of just one aspect of the many factors and regulations that make a country competitive and investment-friendly. A more comprehensive survey is the World Economic Forum’s Global Competitiveness Index, which gives a broader picture of a country’s business environment. Here Switzerland is in first place and Singapore third. Georgia comes in at ninety-third place. It gets a very high score for lack of regulations and progressive tax rates but rates badly on property rights, judicial independence, and protection of minority shareholders’ interests—an indication of how the government’s hand is much heavier than its liberal economic reputation suggests.

World Bank Ease of Doing Business 2011 & Global Competitiveness Index 2010–2011



Global Competitiveness Index 2010–2011
Source: World Economic Forum

World Bank Ease of Doing Business 2011
Source: World Bank

The European Choice

A third development model for Georgia is provided by “Europe,” although Europeanization obviously takes many forms and the idea needs to be examined in more detail. Georgia faces the challenge that it identifies itself as a European country but has no prospect of EU membership. That in turn raises the question of how Brussels and Georgia can forge a mutually beneficial relationship.

Georgians make a strong emotional commitment to the idea of Europe. Georgia joined one important European institution, the Council of Europe, in 1999. Speaking to the Parliamentary Assembly of the Council of Europe on the day of accession, Georgia’s leading reformer of the day, parliamentary speaker Zurab Zhvania, famously said, “I am Georgian, therefore I am European.” The Council of Europe adopted as its flag the symbol of twelve golden stars on a blue background in 1955, long before the European Union did. This allowed President Saakashvili, as the president of a Council of Europe state, to perform the sleight of hand of having the European flag hung in front of Georgian public buildings when he came to power in 2004.

In his speeches, Saakashvili talks about Europe in terms of “civilization,” “culture,” and high standards of behavior. In the president’s first inaugural address in 2004, he said of the European flag, “This flag is a Georgian flag as well, as far as it embodies our civilization, our culture, essence of our history and perspective, and vision of our future.” Speaking in April 2008, as he departed for the NATO summit in Bucharest, Saakashvili looked to the distant past, saying, “When we speak about the European future of Georgia, we must understand that this is not only today’s choice; our ancestors chose Europe from ancient times and defined it, as our compass. European and Georgian civilizations are so intertwined that it is difficult to determine whether Europe is our roots or on the contrary.” The president referred to ancient archaeological discoveries on Georgian soil and proudly said that “medicine” was named after the ancient Georgian queen Medea.

Yet at this time, the United States was a much more important partner for Saakashvili's Georgia. Washington was Georgia's main political, economic, and security patron. One EU official says that in his experience, pro-American sentiments are still very strong in the government: "If they could have the Stars and Stripes above Tbilisi, they would have it. The EU is their second-best choice."

Only recently has the EU become more of a daily presence in Georgians' lives. In 2008 the EU as a whole made a greater commitment to Georgia after the August war, sending the European Union Monitoring Mission to monitor the administrative boundaries of Abkhazia and South Ossetia and then, in 2009, launching the Eastern Partnership project for six of its eastern neighbors, Georgia included. The Eastern Partnership has already delivered one important result for Georgians: easier and cheaper visas for several categories of people wishing to visit the EU.

STIFFENING A PAPER PARTNERSHIP

The European Union's Eastern Partnership (EaP) was launched in 2009 to give greater institutional strength to Brussels's relationship with six of its former Soviet neighbors to the east: Belarus, Ukraine, Moldova, Azerbaijan, Georgia, and Armenia. The fact that in Russian, which is still the lingua franca of the six countries, the six form an acronym that reads BUMAGA, or "paper," can be called an unfortunate coincidence.⁴² The idea is to build a project of what has been called "enlargement-lite." These countries have no prospect of EU membership (at least in the next decade) but are offered some of the benefits of a closer relationship with the EU, such as visa liberalization and trade privileges in return for a commitment to reform their own institutions and markets.

Funding for the project is relatively modest, though not insignificant for the countries concerned. The EaP says that from 2010 to 2013 it will allocate €600 million more for the six countries than was promised earlier. The focus is as much on society as on the state. In an acknowledgment that many nongovernmental groups in these countries are more pro-European than the governments themselves, the EaP also established a permanent Civil Society Forum.

As with most EU external initiatives, the EaP reflects a juggling of the different priorities of the 27 member states. The EaP runs in parallel to the Union for the Mediterranean, which offers some of the same incentives to the EU's southern neighbors. For obvious reasons, Mediterranean countries such as France, Italy, and Spain are more focused on the south—especially in the wake of the 2011 "Arab spring"—while

countries such as Poland and Sweden (the co-architects of the Eastern Partnership) and the three Baltic states remain more interested in the post-communist East.

The grouping of six very different countries also presented Brussels with a policy challenge. Moldova and Ukraine have far more interest in EU integration than do Azerbaijan and Belarus, both of which have moved in a more repressive direction since the EaP was founded. EU officials argue, however, that the multilateral approach has focused minds in member states and that achievements such as visa facilitation for Moldova, Ukraine, and Georgia would not have been so attainable without the broader framework of the EaP. The visa agreement signed with Georgia, which came into force on March 1, 2011, is a substantial prize. It makes it much easier and cheaper for many categories of Georgians, such as those with family in the EU, businesspeople, scientists, students, and journalists, to visit most EU countries.

There is, however, growing concern that the EaP is too technical and does not sufficiently take into account the big political realities of these countries, such as political repression and smoldering conflicts. This is leading to a review of the policy in 2011 and the slogan of “more for more”—the idea that if the partnership countries do more, they will deserve and get more funds from Brussels. With this comes an unstated corollary of “less for less.” The idea was articulated by Polish Foreign Minister Radek Sikorski in Brussels in March 2011.

Well, I believe that we've run out of steam on the model that brought us in Central Europe into the EU. And the model was this: We give you a very large carrot—membership—at the end of a grueling period of reform, which requires a sort of national obsession on the part of the candidate countries. Since we are not prepared to give that big promise to the Eastern Partnership countries, we should create a system of small carrots spaced out in synch with their political calendars, so that particular governments are incentivized to make reforms from which they themselves can benefit. And this requires a more political approach.⁴³

The second Eastern Partnership summit, due to be held in September 2011 in Warsaw, will be the first test of this more proactive philosophy.

Government officials say that Saakashvili has now firmly made a decision in favor of closer integration with the European Union. Giga Bokeria says, “There is no other environment. There is no other family we can move to.” Tornike Gordadze, a young Georgian scholar who lived in France for many years and who was appointed deputy foreign minister in 2010 with responsibility for negotiations with the EU, says, “It took one or two years to formulate EU policy. The EU is a priority now. There is no more discussion to say we don't need the EU.” In typically flamboyant fashion, the president now mentions the prospect of Georgian

membership in the EU, even though it is not on the table in discussions with Brussels. In Washington, D.C., in March 2011, he said a membership prospect was “not so far away.”

There are still big question marks about what this commitment means in practice. Public attitudes in Georgia toward Europe reflect the president’s civilizational rhetoric, being both unrealistically optimistic and rather fuzzy. In a 2009 poll, more than half of Georgians harbored unrealistic hopes about EU membership: around a third of respondents believe that Georgia will be ready to join the European Union in less than five years, and a fifth think that the country will be ready in five to ten years. Ignorance about the EU is vast. In the poll, a fifth of respondents thought that Georgia was already a member of the European Union, while 39 percent incorrectly said that Georgia was *not* a member of the Council of Europe. Asked about the EU’s Eastern Partnership program, only 9 percent of respondents correctly answered that its purpose was “political and economic integration with the European Union.” More respondents thought that the aim of the Eastern Partnership was the “restoration of territorial integrity” or “EU membership.”⁴⁴

Moreover, the idea of Georgia as an “ancient European civilization” does not seem to translate into modern European attitudes on social, sexual, or gender issues. The CRRC surveys also suggest that many Georgians still hold very traditional attitudes about different ethnic groups and the role of women, and are hostile to homosexuality and sex before marriage.

It is a picture with many nuances. For example, the same influential ideological group that is ultra-liberal in its social and economic outlook is also very Euro-skeptical when it comes to relations with Brussels. One of the leading libertarian thinkers, Levan Ramishvili of the Liberty Institute, has likened joining the EU to buying a ticket on the Titanic. Writing in Liberty Institute’s main publishing outlet, *Tabula* magazine, another member of this group, Mikheil Tavkhelidze, wrote, “The European Union today is nothing more than institutionalized developed socialism. Moreover the ideology of socialism, in the

The European Union represents more of a flag or a symbol than it does a specific economic and political model or a set of social norms.

opinion of the modern European bureaucracy, is obligatory not only for members of the European Union but for all the neighbors, including us.”⁴⁵

To summarize, most Georgians take their cue from Saakashvili in regarding “Europe” as a seat of culture and traditional values, but they are much less clear about what the modern EU stands for. The European Union represents more of a flag or a symbol than it does a specific economic and political model or a set of social norms.

Georgia, Europe, and Free Trade

The most important issue in EU-Georgian relations is both mundane and technical, and critical for Georgia's development: a projected Deep and Comprehensive Free Trade Area (DCFTA) between Georgia and Brussels that promises to open up the EU market to Georgia in return for institutional and regulatory reforms.

The prospect of a free trade agreement is, along with visa facilitation, the biggest carrot available to Georgia as part of continuing negotiations over an Association Agreement with the EU. A DCFTA is a new concept arising out of the European Union's "neighborhood policy." Countries that are judged to be important neighbors but are not being offered a membership perspective are offered the prospect of eventual privileged access to the vast EU single market. In return, they are called upon to adopt regulations and standards that will bring their economy in closer harmony with the EU, a process that, as one EU official puts it, "creates the reality of Europe in these countries." An important goal of this harmonization process is that, by raising standards, it gives Georgia an increased export capacity. As noted above, Georgia has a big import-export imbalance that makes its economy very reliant on external factors, and agriculture in particular is very weak. A 2009 World Bank study notes that Georgia has also underutilized its capacity in such sectors as construction materials, apparel (clothing), and pharmaceuticals and medical devices, all of which will also create many jobs.⁴⁶ There is a positive model here in Georgia's neighbor Turkey, which has dramatically increased its production capacity and exports to the EU since 1996, when it began to make use of a Customs Union signed with the EU.

A feasibility study on EU-Georgia trade, carried out in 2008, argued that a simple free trade agreement would do little for Georgia, since the Georgians had already eliminated most trade tariffs with their new liberal trade policy. The study concluded that a more ambitious "deep and comprehensive" agreement with the

EU was the best model. It “would achieve a notable reduction in the perceived risk premium on investment, reflecting a sustained re-branding of Georgia as a favorable and safe place to invest” and could provide Georgia additional annual growth of more than 6 percent.⁴⁷

The harmonization process for a DCFTA is onerous but falls well short of demanding that a country adopt the tens of thousands of pages of *acquis communautaire* required for full membership in the EU. The process is anticipated to be long. Formal negotiations are expected to take more than two years, and then a transition phase to full implementation of the agreement could last ten years.

Brussels launched negotiations for a DCFTA with Ukraine in 2008, but they have proceeded very slowly and painfully, especially since the election of a new government in Kiev in 2010. EU officials say their bad experience with the government in Kiev is a major reason that they decided to put more conditionality at the beginning of the process, demanding that Tbilisi start the process of regulatory approximation before formal negotiations on a DCFTA are even launched. “We want to be sure they are on a good track and that they don’t backtrack,” says one EU official. “We need good insurance.” The first “talks about talks” between Brussels and Georgia took place in 2008, but for two years very little progress was made. In the meantime, Moldova proved to be more enthusiastic and has won a reputation in Brussels as the member of the six-country Eastern Partnership most ready for EU integration.

The requirements made by Brussels cover four main areas: technical barriers to trade; sanitary and phytosanitary measures in agriculture; competition policy; and intellectual property rights. They require the Georgian government to pass new legislation and set new regulations, all in the name of raising Georgian products to European standards and allowing them into the EU single market. For two years, almost nothing was done in these areas, but then some progress was made at the end of 2010 and the beginning of 2011. Georgia established a new food standards agency (the old one having been abolished in 2006 under the Bendukidze reforms), and the first veterinary inspections were made of farms. A new competition agency was also created, although legislation underpinning it had not been passed.

In the spring of 2011, talks were still dragging out and the two sides exchanged recriminations over why this was the case. One of the Georgian government’s two main trade negotiators, Vakhtang Lezhava, expressed optimism that all differences would be overcome in 2011, but he complained that his government was being asked to hit a “moving target.”

The Georgians complain that the EU’s Directorate General for Trade does not understand their aspirations and is concerned only with big economies such as China and India. Georgian officials have also angered EU officials by suggesting publicly that Brussels may be dragging its feet because it wants to push Georgia

into dropping its objections to Russia's bid to join the World Trade Organization. "We hope that is not true, but we are worried about that," said Bokeria.

European officials express concerns that the Georgian side is only going through the motions of starting negotiations for political reasons but without wishing to make a long-term commitment. This, they say, is why they need to show more evidence of institutional reform. As one EU official put it, "For them the start of implementation is what's important. For us it's 'first action accomplished.'" Another EU official said, "We worry that they are just interested in starting the negotiations because it will attract FDI—but never actually concluding them." A pro-European Georgia expert, Kakha Gogolashvili, echoes these fears, saying of the government, "They need DCFTA more as a political label."

A study by the Centre for European Policy Studies (CEPS) critical of Brussels's handling of the negotiations further inflamed the issue and threw down the gauntlet to the EU. The report told the EU directorates in Brussels that they were taking a "narrow-minded approach" and applying a "one-size-fits-all" policy by recommending a DCFTA that entails an unreasonable regulatory burden. "Until Georgia becomes rich, its attempt to get a fast rate of growth should not be taxed or hampered," says Michael Emerson, one of the authors of the study.

The issues raised by the CEPS study can be competently ruled on only by economists and trade professionals. Suffice it to say that EU officials respond robustly to the critique by saying that many of its assumptions are wrong. They say that the approximation process will be gradual and that the difficult regulation, which is required for the farming sector, can be implemented over years. EU officials and one of the authors of the original feasibility study also defend their data and conclusions.⁴⁸

More broadly, the Brussels argument is that as countries in Georgia's neighborhood, such as Ukraine and Turkey, adopt EU standards, it should, too, for its own sake, if it wants to stay competitive and gain access to the vast European market. They cite, for example, a survey of Georgian agricultural producers by the World Bank's International Finance Corporation, which found that most of the producers accepted this principle and were ready to meet improved food safety standards, even though it entailed higher costs.⁴⁹

Resistance to the DCFTA in Georgia comes from two main groups. Economically liberal Georgians are contemptuous of EU regulatory approximation. Libertarian thinker Kakha Bendukidze rejects the idea, saying, "We need a simple FTA

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that means free movement of goods, first of all. After that we can talk about other things.” Of the negotiations over a deeper agreement, Bendukidze says, “I think it was partially inspired by some Georgian experts and government employees who were benefiting from having negotiations with Europe and the flow of expert money coming in. They were betrayers of our interests.” Ramishvili of the Liberty Institute expresses the concern that EU regulations will re-introduce corruption into Georgia. He says, “A corrupt system can adjust and survive inside a European envelope. The danger is that European laws will mask ugly Soviet practices.”

Opposition to closer European integration is also likely to come from another quarter that is less public and open—representatives of the “Old Georgia” oligarchic culture who maintain business interests that have so far eluded the close attention of both local NGOs and European negotiators. One EU official says that there is a fear in all Eastern Partnership countries that closer economic integration will be a Trojan horse exposing hidden business practices to unwelcome scrutiny. This phenomenon is much more obvious in Ukraine, where one observer talks of “a small group of big businessmen in Ukraine for whom the DCFTA may pose an existential threat.”⁵⁰

These factors act as a drag on the Georgian team negotiating with Brussels. Georgian government negotiator Vakhtang Lezhava, along with his colleague Tamara Kovziridze, is a former pupil of Bendukidze’s. In an interview, Lezhava said he believed in the merits of the DCFTA. “As EU legislation is a result of consensus building, it always has room for intelligent application,” he said. “Although the burden will increase for me, the potential benefits are higher than the burden.” He was less enthusiastic about the philosophical rationale for the regulatory demands of the EU, appearing to see them as a means to an end. Lezhava said, “I am a pragmatist. These things are good in exchange for free trade, but not per se.”

The benefit of a DCFTA is potentially very high but in this important debate on Georgia’s development model, the EU has so far done a poor job of communicating a clear and consistent message about the rewards of institutional reform, as well as explaining how the costs can be met. After the passing of the Lisbon Treaty, the EU was supposed, in theory, to acquire a more focused and holistic foreign policy, with the new External Action Service taking the lead. In Tbilisi this means that the new EU ambassador, Philip Dimitrov, a former prime minister of Bulgaria, is now “the face of Europe” and can deliver a more coherent message. In practice, Brussels continues to emit confusing messages about its strategy toward its eastern neighbors and its overall philosophy. The abolition on March 1, 2011, of the position of European Union Special Representative for the South Caucasus, removing from his post Peter Semneby, an experienced diplomat who had a high profile in the region and a good working relationship with all its leaders, was a retrograde step, which appeared to show less rather than more interest in the region on the part of Brussels. For all the good practical work it does and the money it spends, the EU is not delivering its message consistently or eloquently in Georgia.⁵¹

Conclusions

The new Georgian elite has tried something different from its post-Soviet neighbors by forming one of the youngest governments in the world and embarking on a distinct state-building and modernizing project. Through a combination of skill, luck, excellent PR, and the support of Western friends, these young leaders have attracted a lot of favorable attention to Georgia.

They have achieved real results. They have very successfully eliminated everyday corruption and criminality. They have attracted foreign investment. Georgia now has efficient state services, something that cannot be said of most of its neighbors. You can buy an apartment or obtain a driver's license quickly and without paying a bribe—no mean achievement given the country's traditions and those of its region. Giga Bokeria argues, "The first thing was to clean the Augean stables and create a government that could do elementary things and deliver basic services."

As even that remark indicates, however, this is still the beginning, not the end, of a process. In 2011 there are worrying signs about the direction Georgia is heading. The modern Georgian project has many internal contradictions to it and is much less free than it looks. Some of the modern Georgian reforms have cured one problem while creating another. Reform of the police force and a broadly successful fight against crime and corruption, for example, have resulted in a criminal justice system in which acquittals in criminal cases are almost impossible, the prisons are overcrowded, and the Interior Ministry is the most powerful arm of government. Law enforcement bodies, such as the tax police, possess great power and are perceived as an instrument of political control. This raises Juvenal's famous old question, *Quis custodiet ipsos custodes?*, "Who is guarding the guards themselves?"

The governing elite looks as though it will navigate the transition of 2012–2013 intact. There is still no strong political opposition, and the government has sufficient control of much of the state to be able to prevent one from emerging. As political

analyst Archil Gegeshidze says, “If anything will challenge them, it will be themselves.” The economy has worsened in 2011, with high inflation and persistent unemployment driving more Georgians into poverty. But Georgia does not have a tradition of socioeconomic protest, and this is more likely to be translated into apathy than into strong political dissent that will be utilized by opposition parties.

For international watchers of Georgia, an immediate issue will be the conduct of the coming elections. A bigger question will be the political future of the man who has dominated Georgia since 2004. If Mikheil Saakashvili is able to leave the political scene quietly, that will be a positive step forward—although there is, of course, no guarantee that leaders who come after him will be more progressive.

A still bigger issue is what the ruling party wants to do with the power it is likely to wield in 2012–2013. The long-term strategy of the governing elite is not yet clear to outside observers—and is quite probably not clear to the governing elite itself.

President Saakashvili’s dynamic political style has always led him to promise more than he could deliver. He is fond of making bold statements about Georgia’s successes and its prospects, less so of explaining the need for gradual institutional reforms. In his annual speech to parliament in February 2011, Saakashvili set a series of highly ambitious, if not impossible, targets for 2015. They included dou-

bling agriculture production, doubling exports, doubling the state budget, halving the current level of unemployment, increasing average public-sector salaries by 50 percent, achieving population growth of 5 million, and signing free trade agreements with the European Union and United States.

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Gegeshidze, the political analyst, says that the invocation of a bright future a few years down the line is a favorite political tactic of the president: “Every time he faces a problem, he sets another goal in the future with different words, a differently articulated future.” Obviously, however, this tactic risks raising undue expectations now and increased cynicism later, if and when the goals are not met. This might be called living in the future perfect tense, telling Georgians that at a point in the future they will have somehow made a transition to a better future, when everyday realities suggest a different story.⁵²

So far the strategic messages are many and mixed. Saakashvili has variously invoked the examples of Singapore, Dubai, Switzerland, and Estonia to model Georgia’s future. One Western diplomat jokingly calls this “the Yogi Berra strategy,” a reference to the famous advice, “When you come to a fork in the road, take it.”

This report has laid out, in obviously over-schematic fashion, three broad directions of strategic and economic orientation for Georgia, all of which have adherents

in the country. One of them, “Old Georgia,” is not an economic model as such but sums up a traditional way of life that revolves around the family, patron-client networks, and inscrutable business practices. Georgia is likely to lapse back into this model only by default if the economy worsens, Western countries lose interest, and more regressive figures in the power structures get stronger.

The second idea is summed up as Georgia’s “Singapore model,” even though it diverges from the reality of Singapore in key respects. This is the vision of Georgia as a low-regulation, low-tax, business-friendly environment that can enjoy rapid economic growth if it opens its borders to investors of all kinds and does not burden itself with rigorous regulations. These ultra-liberal ideas still inspire much of what the Saakashvili administration does, as for example its promotion of the Black Sea port of Batumi as a center for tourism and casinos for visitors from a wider region.

Anything that makes Georgia a hub and magnet for investors is to be welcomed. But citing Singapore as a model raises many more questions than it answers. The main critique of this approach is that it is simply unachievable for cultural, geographical, and political reasons and that if it were to be applied dogmatically, Georgia’s social divisions could widen. The successful parts of the current government’s policies have indeed benefited an urban elite (which Singapore has) but have done almost nothing to address the problems of the rural poor (which Singapore does not have).

A third economic model is provided by the European Union, which promises gradual integration into the EU single market. The idea is to use institution building and regulatory approximation to build an economy that will eventually produce high-standard goods and find a niche in the broader European market. Additionally, closer integration with the EU would provide other benefits for Georgian citizens, such as eventual visa-free travel to the EU. Membership prospects are not on the table now but can be raised in the future if Georgia continues to converge with EU standards.

The European choice also has a geopolitical component to it, which has been mainly beyond the scope of this report. Russia and its volatile North Caucasus form a difficult neighborhood for Georgia to the north, while the disputes over the breakaway territories of Abkhazia and South Ossetia look unlikely to be resolved for many years. Greater integration with the EU will not deliver an economic miracle to Georgia, but having a European anchor would ensure greater political stability for Georgia, which in turn would benefit the economy.

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Official Georgian language on the issue of Europe is often vague. So it is a positive development that Saakashvili and other officials have made an attempt to square the Singapore-Europe circle by referring to the example of Estonia, a small post-Soviet country that has undergone liberal economic reforms and also joined the EU. On February 1, 2011, the president said, “We say we learn from Singapore and Estonia.”

The fact that Estonia retains its competitive business-friendly edge but has opted firmly for the EU route is indeed a positive example for Georgia. But on closer inspection, it also shows Georgians what a very long path they need to travel if they are to approximate with the EU. Speaking alongside Saakashvili in Tallinn in January 2010, Estonian President Toomas Ilves counseled his Georgian counterparts to be patient, advising them to focus more on domestic state building: “It would not be fruitful to waste energy on problems that cannot be resolved in the near future. Georgia needs to show strategic patience and commitment to the successful construction of its country.”⁵³

To join the EU, Estonia took a very proactive and systematic approach to the task of regulation and institution building, adopting into law the more than 75,000 pages of *acquis communautaire* needed for accession.⁵⁴ Estonia also took the bold step of joining the Eurozone in 2011. An Estonian diplomat who knows Georgia, while very sympathetic to its problems with Russia, faults the Georgians for not getting down to this kind of mundane hard work. Of Estonia’s own accession to the EU, he says, “We simply understood that if you want to join the club, you need to play by the club rules,” and of the Georgians, “They keep changing between Singapore and Europe. It’s hard to say what the ultimate goal is. There are mixed messages.”

As we have seen, there is widespread suspicion in Georgia that the EU approach would weigh Georgians down with a painful regulatory burden. Deputy Foreign Minister Tornike Gordadze, while supportive of the European way, also predicts that it would be domestically unpopular. He argues, “Politically [the EU idea] is quite risky. We need to compensate. The Singapore model is mainly for symbolic and internal use.”

More importantly still, a concerted move toward the EU inevitably means the current Georgian governing elite will be forced to abandon its informal political culture and virtual monopoly on most aspects of the Georgian state. This converges with the key issue of whether Georgia is turning imperceptibly into a one-party state. A one-party state is not the same as an authoritarian state—Georgia’s history of pluralism and the degree of Western scrutiny it is under provide checks on that—but the continued dominance of one group is unhealthy in even the most robustly democratic countries. Georgia has weak institutions and is vulnerable to political turbulence in the future. This in turn poses a challenge to international actors: Can they use their leverage to nudge the Georgian governing elite away

from a narrow focus on preserving their own power and toward a more open and fully democratic system?

If Georgia does want to make a stronger European choice, clearer signals are needed from both Tbilisi and Brussels. On the Georgian side, that means a signal that the commitment to Europe is to the EU economic and political model, not just to European civilization in a general sense. EU officials note that Moldova has now overtaken Georgia as the most pro-European country in the Eastern Partnership.

On the EU side, that means a clearer commitment that Georgia will be rewarded for a pro-European stance and that “enlargement-lite” has clear benefits for a country with no obvious membership perspective. That means a much more proactive public relations strategy in promoting the philosophy behind the European Neighborhood and the DCFTA. It means more reassurances that the EU can be flexible on smaller issues, even if it is determined to apply tough conditionality on bigger ones.

A DCFTA and closer economic harmonization with the EU is not a panacea for Georgia and, if implemented, will involve painful institutional reform. But it is probably the best—perhaps the only—long-term development model on offer. If Georgia shows a strong commitment to this process, Brussels should promise greater political and technical support to help ease the regulatory pain that will result. Aid will need to be targeted on those areas, agriculture in particular, where the transformation will be most difficult. In September 2011, the EU launched a new Comprehensive Institutional Building Program for 2011–2013 for Georgia, worth €31 million (\$46 million), to strengthen government institutions such as the new food standards agency. That is a good start, but much more aid will be needed to embed Georgia’s new institutions.

This “more for more” strategy can be employed not just by Brussels but also by Washington—which has also not loomed large in this report. The United States remains the biggest ally of and donor to Saakashvili’s Georgia, but it finds itself in the strange position of being perceived to have been in strategic retreat, for having pulled back from what was an excessively close relationship up until 2008. In retrospect, U.S. rhetoric under the previous administration that Georgia was a “beacon of democracy” looks at best exaggerated and at worst unhelpful. Washington’s word is still important, and it can help nudge Georgia in the right direction by giving an honest and unvarnished verdict of Georgia’s political and economic trends.

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Conditionality is important here—if international actors are overly lenient on the Georgian government over its mistakes and backsliding, there is almost no one else to correct them. The outgoing EU ambassador to Georgia, Per Eklund, made this point forcefully in a speech in Tbilisi in 2010, telling his audience,

As most of you know, I harbour a strong affection for Georgia and its people. . . . We will continue to give you all [the] support we can, and so far we have delivered on our promises. And as said before, you know that we love you, but it is not an unconditional love. You will also have to deliver.⁵⁵

“Conditional love” is the most desirable approach to help Georgia preserve the best of its recent reforms and avoid dangerous tendencies as it enters what could be difficult times.

Notes

This report was compiled after visits to Georgia in November 2010 and February 2011 and to Brussels in March 2011. Unless specified otherwise, all quotations are from interviews with the author from those trips. I am very grateful to Carnegie Endowment Junior Fellow Jane Kitaevich for her valuable assistance with many aspects of this project. I also thank a number of Georgian friends and colleagues for their help, in particular Sopho Bukia and Margarita Akhvlediani.

- 1 Unless specified otherwise, polling data come from the Caucasus Research Resource Centers, or CRRCC “Caucasus Barometer” from Georgia from 2009 and 2010, retrieved from www.crrccenters.org/caucasusbarometer.
- 2 Telephone interview with Eric Livny, April 13, 2011.
- 3 Telephone interview with Giga Bokeria, April 11, 2011.
- 4 “Saakashvili Vows Improvements with Drastic Measures,” *Civil Georgia*, January 25, 2004.
- 5 Transcript of a speech made by President Mikheil Saakashvili at the Brookings Institution, Washington, D.C., “From Popular Revolutions to Effective Reforms: The Georgian Experience,” March 17, 2011.
- 6 Georgia has made a strong improvement in Transparency International’s Corruption Perception index. In 2003 it received a poor rating of 1.8 (on a ten-point scale) and in 2010 had a ranking of 3.8. See www.transparency.org/policy_research/surveys_indices/cpi/2010/results.
- 7 “Georgia’s Mental Revolution,” *Economist*, August 19, 2010.
- 8 Transparency International Georgia, “Monitoring Georgia’s Anti-Corruption Commitments,” 2010, http://transparency.ge/sites/default/files/post_attachments/ENP_TI_Georgia.pdf.
- 9 “Election Campaign Funds,” *Civil Georgia*, June 15, 2010. The UNM also spent GEL 312,888 (\$177, 223) on the services of the U.S.-based research and strategic consulting firm Greenberg Quinlan Rosner.
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- 11 “Georgia cannot live on frog exports alone,” *Economist*, November 18, 2010, www.economist.com/blogs/easternapproaches/2010/11/georgias_economy.

- 12 For a detailed account of the case, see Paul M. Barrett, “Trapped in Tbilisi,” *Business-week*, February 24, 2011.
- 13 Georgian-Israeli relations took another knock on April 8, when Israeli defense electronics firm Elbit Systems, which supplied reconnaissance drones to Georgia in 2007, said it had filed a lawsuit against the Georgian government for what it said was about \$100 million in unpaid debts.
- 14 Papava is the author of a large body of work, much of which forms a sustained critique of the government’s economic policies. His work can be read at www.papava.info.
- 15 Transparency International Georgia, “The Georgian Taxation System—An Overview,” May 2010.
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- 18 “Saakashvili on Three Pillars of Georgia’s Economy,” *Civil Georgia*, Tbilisi, November 8, 2010.
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- 20 The figures come from an internal EU report in Tbilisi, made available to the author.
- 21 “Saakashvili Calls for ‘Active State Involvement’ to Boost Agriculture,” *Civil Georgia*, March 8, 2011.
- 22 On the economics of the Georgian wine business, see Manana Vardiashvili, “One Brand and Many Problems,” *Liberati*, March 14, 2011.
- 23 David Goodhart, “Misha’s freedom laboratory,” *Prospect*, February 23, 2011, www.prospectmagazine.co.uk/2011/02/mikheil-saakashvili-interview-georgia-freedom-tbilisi. Goodhart writes, “When I described the country to Saakashvili as ‘a benign one-party state’ he didn’t protest but countered with how they are grafting BBC-style impartiality onto the main public television channel.”
- 24 See Saakashvili’s interview with Charlie Rose on March 11, 2011, www.charlierose.com/view/interview/11538.
- 25 In 2011, 70 percent of Rustavi-2’s shares were owned by Degson Limited, which is registered in the British Virgin Islands. The other 30 percent used to belong to Georgian Industrial Group, a conglomerate founded by Robert Bezhuashvili, whose sons are parliamentarian Davit Bezhuashvili and Gela Bezhuashvili, chief of the Georgian intelligence service. The elder Bezhuashvili then transferred the share to another company registered in the Marshall Islands.

- 26 International Crisis Group, Georgia: “Securing a Stable Future,” Europe Policy Briefing no. 58, December 13, 2010, 12.
- 27 Lasha Tugushi, “Financial Freedom of Media, Sustainability and Management Problems and Perspectives,” USAID Georgia paper, April 2011.
- 28 In November 2010, for example, the pro-Western former foreign minister Tedo Japaridze, a man with many friends in Washington after serving as Shevardnadze’s ambassador there for seven years, was on the receiving end of an attack in a report by Imedi television, which accused him, without evidence, of being a “Russian agent of influence.” At the time, Japaridze was alternate general director at the International Centre for Black Sea Studies (ISBSS) in Athens, a position that carries diplomatic status. All of the countries associated with ISBSS favored Japaridze’s continuing in his post—with the exception of the Georgian government, which withdrew its support for him.
- 29 S. Neil MacFarlane, “Post-Revolutionary Georgia on the Edge?” Chatham House Briefing Paper, March 2011, 14.
- 30 Finance Minister Kakha Baindurashvili told parliament in November 2010 that he was unable to say how much the new parliament construction project cost because it was being paid for with funds transferred to the municipal budget of Kutaisi. Eka Saatashvili, “Zdanie parlamenta v Kutaisi stroyat v ramkakh programmy reabilitatsii” [The parliament building in Kutaisi is being built within the framework of a rehabilitation program], *Novosti Gruzii*, November 19, 2010. An article in *Liberalli* magazine also alleged that the two companies that were chosen to construct the new parliament building both belonged to the former chief director of the pro-government Rustavi-2 television channel. See Note 37 below.
- 31 In April 2011, the European Court of Human Rights sharply rebuked the Georgian government and ordered it to pay €50,000 to the father of Sandro Girgvliani, a young bank official who was tortured and killed by police officers in 2006. The court suggested there was a culture of impunity inside the Interior Ministry that had prevented proper investigation of the police. Its press release on the Girgvliani case said, “[T]he Court noted with particular concern how the different branches of State power—including the Ministry of the Interior, the prosecution authority, the domestic courts and the President of Georgia—had all acted in concert in preventing justice from being done in that gruesome homicide case.” See “Georgian authorities did not investigate effectively the kidnapping and killing of 28 year old man,” European Court of Human Rights press release, no 366, April 26, 2011, <http://cmiskp.echr.coe.int/tkpr197/view.asp?action=open&documentId=884704&portal=hbk&source=externally&docnumber&table=F69A27FD8FB86142BF01C1166DEA398649>.
- 32 Georgia has 538 prisoners per 100,000 of population, which is more than four times the average in the European Union. The four countries with higher incarceration rates in the world, according to a list compiled by King’s College London, are the United States, Russia, St. Kitts and Nevis, and Rwanda. See King’s College London, World Prison Brief, www.kcl.ac.uk/depsta/law/research/icps/worldbrief/wpb_stats.php?area=all&category=wb_poprate.

- 33 “Protesters Arrested Outside Supreme Court,” *Civil Georgia*, April 5, 2011.
- 34 Transparency International Georgia, “Plea Bargaining in Georgia: Negotiated Justice,” December 15, 2010, 23, http://transparency.ge/sites/default/files/post_attachments/Plea%20Bargaining%20in%20Georgia%20-%20Negotiated%20Justice.pdf.
- 35 “Final Opinion on the Draft Constitutional Law on Amendments and Changes to the Constitution of Georgia,” Venice Commission, October 15–16, 2010, paragraphs 86–90.
- 36 The report states, “High-level corruption remained a concern. Observers considered the official anticorruption campaign too heavily focused on prosecution as opposed to prevention and unstructured rather than systemic and participatory. Areas of concern included democratic institutions, civil society involvement in the planning and execution of public policy, property rights, and elite corruption.” See U.S. Department of State, “Human Rights Report on Georgia, 2010,” www.state.gov/g/drl/rls/hrrpt/2010/eur/154425.htm.
- 37 “Ram shechama kartuli biznesi?” [What has swallowed Georgian business?], *Liberali*, no. 63, February 2011, 12–25.
- 38 For an excellent study of this issue, which partly inspired this report, see “Reinventing Georgia: The Story of a Libertarian Revolution,” European Stability Initiative, April 2010, www.esiweb.org/index.php?lang=en&id=322&debate_ID=3.
- 39 “Saakashvili: ‘Georgia Switzerland with Elements of Singapore,’” *Civil Georgia*, March 9, 2010.
- 40 Taken from the video recording of Saakashvili’s speech at the Brookings Institution, March 17, 2011, www.brookings.edu/events/2011/0317_saakashvili.aspx.
- 41 For the trade union view, see International Trade Union Confederation, “Georgia: Labour Code Tears Fundamental Rights to Shreds,” May 2008, www.ituc-csi.org/IMG/pdf/VS_georgia_EN.pdf.
- 42 Turkey is not part of the program because it is a candidate country for the EU. Russia is not in the grouping because of its own priorities; it has a different strategic partnership with the EU.
- 43 From remarks given at the Brussels Forum, March 26, 2011, in a session on The European Neighborhood Policy, available at http://brussels.gmfus.org/wp-content/uploads/2010/11/The-European-Neighborhood-Policy_Mar26.pdf.
- 44 Caucasus Research Resource Centers, 2009 and 2010, “Caucasus Barometer,” www.crrccenters.org/caucasusbarometer.
- 45 Mikheil Tavkhelidze, “Mashasadame” [From Henceforth], *Tabula*, June 7, 2010, www.tabula.ge/article-1479.html.
- 46 World Bank, “Georgia Manufacturing Sector Competitiveness Assessment,” May 2009, [www.ifc.org/ifcext/georgiasme.nsf/AttachmentsByTitle/2GeorgiaManufacturingSectorCompetitivenessAssessmentExeSumEng/\\$FILE/2GeorgiaManufacturingSectorCompetitivenessAssessmentExeSumEng.pdf](http://www.ifc.org/ifcext/georgiasme.nsf/AttachmentsByTitle/2GeorgiaManufacturingSectorCompetitivenessAssessmentExeSumEng/$FILE/2GeorgiaManufacturingSectorCompetitivenessAssessmentExeSumEng.pdf).

- 47 Maryla Maliszewska, ed., “Economic Feasibility, General Economic Impact and Implications of a Free Trade Agreement Between the European Union and Georgia, Final Report,” Center for Social and Economic Research, May 8, 2008, 113.
- 48 One of the authors of the original feasibility study cites data from the British organization CARIS that Georgia’s “utilization rate of the GSP+ (Generalized System of Preferences)” is in fact very high, according to the latest figures. If true, this means that a simple free trade agreement, which simply removes tariffs, will not give the country many more perceptible benefits and that a more ambitious trade agreement is needed.
- 49 Data on food poisoning in Georgia are hard to come by, but the IFC reports that there was a significant increase in Georgia in cases of bacterial food poisoning from 408 cases in 2004 to 2,035 cases in 2007. See www.ifc.org/ifcext/eca.nsf/Content/GeorgiaProjectFSI.
- 50 Olga Shumylo-Tapiola, “EU and Ukraine: Trade Is Not the Main Issue,” *New Europe*, issue 930, April 10, 2011, www.neurope.eu/articles/105783.php.
- 51 In confirmation of this poor communications strategy, despite half a dozen meetings with EU officials, it was not possible to get an on-the-record quotation from a senior EU official for this report.
- 52 In the past, Saakashvili has made many promises he has been unable to keep. They included the reintegration of Abkhazia and South Ossetia into Georgia within his first presidential term and a pledge to raise pensions to a minimum of \$100 per month.
- 53 See Salome Modebadze, “You Will Not Get Your Land Back Soon, Says Estonian President,” Messenger Online, January 22, 2010, www.messenger.com.ge/issues/2028_january_22_2010/2028_salome.html.
- 54 See Kaja Tael, ed., “Estonia’s Way into the European Union,” Estonian Ministry of Foreign Affairs, Tallinn, 2009.
- 55 Welcoming words by Ambassador Per Eklund, head of the European Union delegation to Georgia, at the opening of the European Neighborhood Policy conference, http://eeas.europa.eu/delegations/georgia/press_corner/all_news/news/2010/20100212_01_en.htm.

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