

“Kakha Bendukidze: There Is Only One Way – Building a Free Economy” ([«Путь один – строить свободную экономику»](#))

By Natalia Morari, *Ekho Kavkaza*, 7 December 2009.

Natalia Morari, a correspondent of Radio Europa Liberă (the Moldovan service of Radio Liberty) interviews Kakha Bendukidze, Georgia’s former State Minister for Economic and Structural Reforms.

Natalia Morari [NM]: Good afternoon, dear listeners. Our guest today is Kakha Bendukidze, the former state minister for economic and structural reforms in Georgia. This man is known in the international economic circles as the shadow author of the Georgian “economic miracle” which took place after the so-called Rose Revolution of 2003. As we all know, there are no miracles in life, so we will speak with this key individual about how Georgia has managed to achieve such impressive economic results and implement structural changes in the economic sphere.

Kakha Avtandilovich, according to the business portal Slon.ru, in only 6 years Georgia has managed to rise in the World Bank’s annual Ease of Doing Business ranking from being somewhere in the middle of the second hundred in 2004 to the 11th place in 2009. This is the best result among all developing nations in the world. *Forbes* declared Georgia to be the world’s fourth leading country with the least tax burden on business. With regard to attractiveness for foreign investors, Georgia has already reached the level of the EU’s Eastern European member states, such as Lithuania and Slovenia. The real revenues of the Georgian state budget grew fivefold from 2003 to 2008, the average annual growth rate of the real GDP stood at 9.3 percent during the five-year period from 2004 to 2008 – and this figure already takes into account the August war and the world economic crisis. How has Georgia managed to achieve so much, and what was the foundation of the economic policy implemented by the new team which came to power in 2004?

Kakha Bendukidze [KB]: I think it is very important to understand that there is one, only one real way forward for economies like Georgia or Moldova – and that is to build a free economy, an economy with minimal state intervention. How to build such an economy? There are many different options because every time the concrete historical situation gives us a chance to conduct this or that kind of reforms. But in any case, these reforms include diminished regulation, because both of our countries have inherited the same type of post-Soviet regulation. It might seem that it is not quite Soviet, on the surface it may even look European, but it’s not effective, it doesn’t bring any results and only pollutes the economy. Another mandatory measure is a significant reduction of the state apparatus, because with a big state apparatus it will be impossible to implement the necessary reforms. The state apparatus has to work, it wants to work. But what does it mean? It has to regulate something, to correct something, to interfere with people’s lives. So, these measures I find important.

NM: To what extent has the Georgian state apparatus been reduced?

KB: In various ministries the scale of reduction ranged from one-third to 80 percent, but even this seems insufficient to me. We could have reduced it even further, even more radically.

NM: But at the same time you raised the salaries in the government?

KB: Definitely, and this was very important. From the beginning of 2004 till the end of that year, the salaries quadrupled. I don't know what kind of salaries you have in the Moldovan state apparatus, whether it is possible to survive on this money...

NM: 200 dollars, and that's even considered to be a good salary.

KB: We had a clear understanding of the following fact: every extra bureaucrat who sits in the state apparatus is a real obstacle to economic development and prevents the creation of five jobs in the private sector. As long as you have a large state apparatus, you will have a small private sector. This was clearly understood, and that is why we were not afraid and were not embarrassed to radically cut their numbers. This is a very painful process because the people who are dismissed are not happy about and most of them join the opposition to the government that has dismissed them."

NM: And that's what happened in Georgia?

KB: Yes. What is the use of political power if it only seeks to protect itself and doesn't produce any results? Well, maybe you'll make it to the next elections and then you'll lose – not because you have a lot of enemies but because you haven't accomplished anything.

NM: You mentioned diminished state regulation. How did you achieve this and what elements did the reform contain?

KB: I know very little about your specific situation but I think it is approximately the same as in Ukraine, as earlier in Georgia or as in any other post-Soviet country. There are many different regulatory bodies and laws which all limit something. Many of these laws have been abolished in our country, and the respective regulatory bodies have been liquidated. It sounds simple, of course, but it is much harder in reality, yet it's very important. What characterized our countries at a certain stage in their development? That at some point they saw the triumph of the model which envisioned total regulation. And we simply have to get rid of this.

NM: As we know, the main obstacle to any reforms is corruption. According to Transparency International, Georgia has improved its ranking from the 124th place to the 67th over the period from 2004 to 2008. Today, Georgia is ahead of all other CIS countries and is approximately at the same level with the new members of the EU. By the way, over the same period, Russia descended from the 86th place to the 147th. What exactly is the Georgian panacea against corruption?

KB: I think this [fighting corruption] needs to be the main substance of the government's activities. And this is also the main mandate that the Georgian authorities received from society in 2003 and 2004. To a great extent, this helped to eliminate corruption which had permeated everything. What's the substance? First, it is something I have already mentioned. How does corruption emerge? Corruption emerges when a person has to go to the state apparatus to ask for something. They can ask for many things: to register something, to obtain some certificate or permit. The fewer situations of this kind you have, the less corruption will be there. This is the cornerstone of fighting corruption: the less regulation there is, the less corruption you have, if only because you have no contact between the bureaucrat and the citizen. Secondly, there is maximum transparency, which you can also call "zero tolerance" for corruption. I have often heard in different post-Soviet countries that their corruption is not that extensive, that people take bribes but not too much, in moderation. If you take this position, then of course, corruption will be around forever and no one will be able to eliminate it. Either you have corruption, or you don't. And you also have to send corrupt people to prison.

NM: Are there many former and current government officials in Georgia who went to prison?

KB: Yes, quite a few, and this process has to continue all the time. Corruption is changing, you cannot cure it once and for all, the fight against corruption has to go on. What is very important, there was an understanding in Georgian society: corruption interferes with our lives and we don't like it. But you be aware that the people who used to derive benefits from corruption won't be happy about the changes.

NM: Could you please briefly tell us about the road police reform which is, in my view, a very telling example of the Georgian anti-corruption drive? Our listeners in Moldova know very little about it.

KB: The reform was implemented back in 2004. In Georgia, like in all post-Soviet countries, we still had the remnants of the Soviet GAI [State Automobile Inspection]. These are people who regulate traffic, they stop those who violate speed limits and so on. Over time, they turn into a group of extortionists, and by then you can no longer cure this group by "therapeutic methods" or by explaining to them that it's not good to act this way. Because the people get used to living like this. The entire road police was simply eliminated, this state institution ceased its existence. Everyone who worked in it was dismissed. Then, instead of having two structures (road police and district policemen) we created patrol police. We organized an entry competition to hire new staff; they weren't former policemen, they were completely new people, simply citizens who lived in cities and villages and had never done such work before. From the old cadre only a few percent, less than ten, were left - those who passed the competition. The new policemen immediately received a high salary – at that time, their salaries were higher than anywhere else in the state apparatus – and they also got normal cars, to enable them to inspect and patrol their districts. These people laid the foundation for a completely new Ministry of Internal Affairs. Today, patrol police enjoy a very high level of trust among

the population, at about 85 percent. And they are still very effective. The cases of corruption are very rare, not more than 12 in a year, but if they are detected, punishment follows immediately.

The question one may ask is: who controls traffic in Georgia now? Practically no one. In Tbilisi we have a system of video surveillance installed which issues fines. But as experience shows, in the former Soviet republics that have road police and in those that have a different kind of road police or no road police at all, like Georgia, the statistics of car accidents are approximately the same. In reality, road police or GAI do not fulfill their purpose, so you cannot lose anything if you liquidate a state body which doesn't fulfill its task and instead extorts money and does nothing else.

NM: The number of state licenses which were obligatory in Georgia to start any kind of economic activity has been reduced from 914 to 144, the number of taxes –from 22 to 6. Was this the most convincing argument for attracting foreign business to Georgia (in 2007, the amount of FDI in Georgia reached 2 billion USD), or were there some supplementary measures too?

KB: There is no one single measure that would attract foreign capital. It's a combination of measures – diminished regulation, reduction in the number of taxes, transparency, fight against corruption... In my opinion, the most important thing is lessening the tax burden because this is the most fundamental factor of economic freedom. However, if you reduce the tax burden but keep a complex regulatory system in place, you won't turn around your economy. Any regulation has an impact on business as a high tax, which is payable not in money but in the form of the time lost for obtaining documents, licenses and so forth. In Moldova the situation with foreign investment has better prospects than in Georgia, since you're located directly in Europe and you have an opportunity to convince European companies to move their production to Moldova. Finally, you can go to the EU by car, it's a big market and a big investor for the economy of such a country as yours. Moldova needs to get about a billion dollars in real foreign investment per year. I think this key figure would allow your economy to grow at a fast rate. What is necessary to reach this amount? Equal rights for foreign investors, their access to the infrastructure during privatization, simplicity of obtaining licenses, and low taxes. For this, you need to change the rules of the game towards simplification of state regulation. And what is very important, your economic authorities should actively visit economic capitals like London and New York and speak there about the changes in the country.

NM: (...) A number of Georgians who were living and working in the West have joined the new Georgian team. Could you please explain how it was possible to convince someone who was working in London and earning 20 thousand pounds to come to Georgia to a 200-dollar salary? Did you use special funds for that? And why was there this goal to attract Georgians from abroad?

KB: In this regard Moldova and Georgia are very similar because a large part of our population lives and works abroad. I think you will have the same effect as we did. Why do they come back? They are Georgians, they must do it for their country.

NM: As far as I know, there was a special extra-budgetary fund established in order to pay salaries to such returning experts.

KB: This was only during 2004, and then at the end of the year the fund was liquidated because it caused some unevenness, discontent and doubts, because the rest of the salaries were just ludicrously low. A minister's salary was 50 dollars, and the returning people said that 50 dollars would only be enough to have a coffee. The process of attracting Georgians from the West is ongoing, and they are still coming back. These are people who lived and did business in New York, London, Moscow, and now they want to do something good because they see that their country is rising from its knees. Your degree is worth nothing if you cannot even come to your country because you're afraid of being mugged or robbed, and your parents are living there in poverty. The Georgians who returned decided that they have a chance to change the situation and set the country on the right development path so that in 20 years they won't be ashamed of themselves.

NM: There are two major opinions among the critics of the Georgian economic miracle. The first one is the economic starting point from which Georgia began rising in 2004 was so low that high growth rates were to be expected – but soon, this effect will be exhausted. The second opinion says that the economic miracle can be explained exclusively through the mass inflow of Western money, which came in particular from the US, into the Georgian economy, in order to anger Russia. Could you comment on this?

KB: Concerning the first opinion – it's just a lie. There is no such concept in economics. Otherwise we would see a huge number of impoverished nations rise to a certain level and stagnating there, but this is not happening. Concerning foreign aid, the situation is rather the opposite of what you said - the more loans the government takes and the more foreign aid goes to the state budget, the lesser the growth effect will be. An economy will only develop on the basis of private investment. No America, no Russia, and no European country can pour in private investment because private investment comes and goes on its own.

NM: So you would not advise taking loans from the IMF and the World Bank?

KB: I don't know the specific macroeconomic situation in Moldova and am hesitant to make a judgment – at the moment, perhaps, you do need some macroeconomic stabilization. But in general, the less government borrowing you have, the better it is for the country. I repeat, every dollar that comes to Moldova through the government crowds out several dollars that can come from private sources, and it's private money that creates jobs. The smaller the share of the state budget in the GDP, the more private investment and the less state investment there is, the better. I assure you, in such a case Moldova will also make a leap forward, and in five years you will be walking in a very different city.

NM: I hope this comes true! Georgian President Mikheil Saakashvili proposed quite a provocative initiative this autumn. He challenged the global trend of growing government intervention in the economy and proposed to transform Georgia into the last bastion of liberalism by adopting the so-called Act on Economic Freedom. As far as I know, you stood behind this Act. Please tell us more about it.

KB: I was one of the participants of the process, I wouldn't want to take the entire credit for it. The Act includes several fundamental criteria for building an economy. First, it prohibits tax increases that aren't based on the wide societal consensus, which means that any tax increase has to be approved by a referendum. Secondly, it prohibits the financing of social needs which goes past the individual citizen. You can give money to schools but you can also give money to citizens who will then decide to which schools they will give this money and how it will be spent. You can finance hospitals, but you can also give money for insurance to the citizens, and they will choose an insurance company for themselves. Also, specifically for our situation, the Act establishes limits on the total amount of sovereign debt, on the amount of budget deficit, on the amount of borrowing, as well as provisions on how to act in extraordinary, force majeure situations. The goal of the Act is to preserve our achievements and make them irreversible.

NM. Finally, my last question. As you know, 2009 became a year of change for Moldova. After the communists' eight years in the government, a new team came to power, called the Alliance for European Integration, and the West has high expectations of them. As a person who has frequently consulted different governments, what would you recommend to the new Moldovan team, which has not yet exhausted the credibility potential? What should they start with, what should they focus on, pay attention to?

KB: There are two things you can do fast: implement a tax reform (reduce the number of taxes and their rates and improve tax administration) and start fighting against corruption.

NM. Thank you very much! Let us hope that our government heeds your advice.