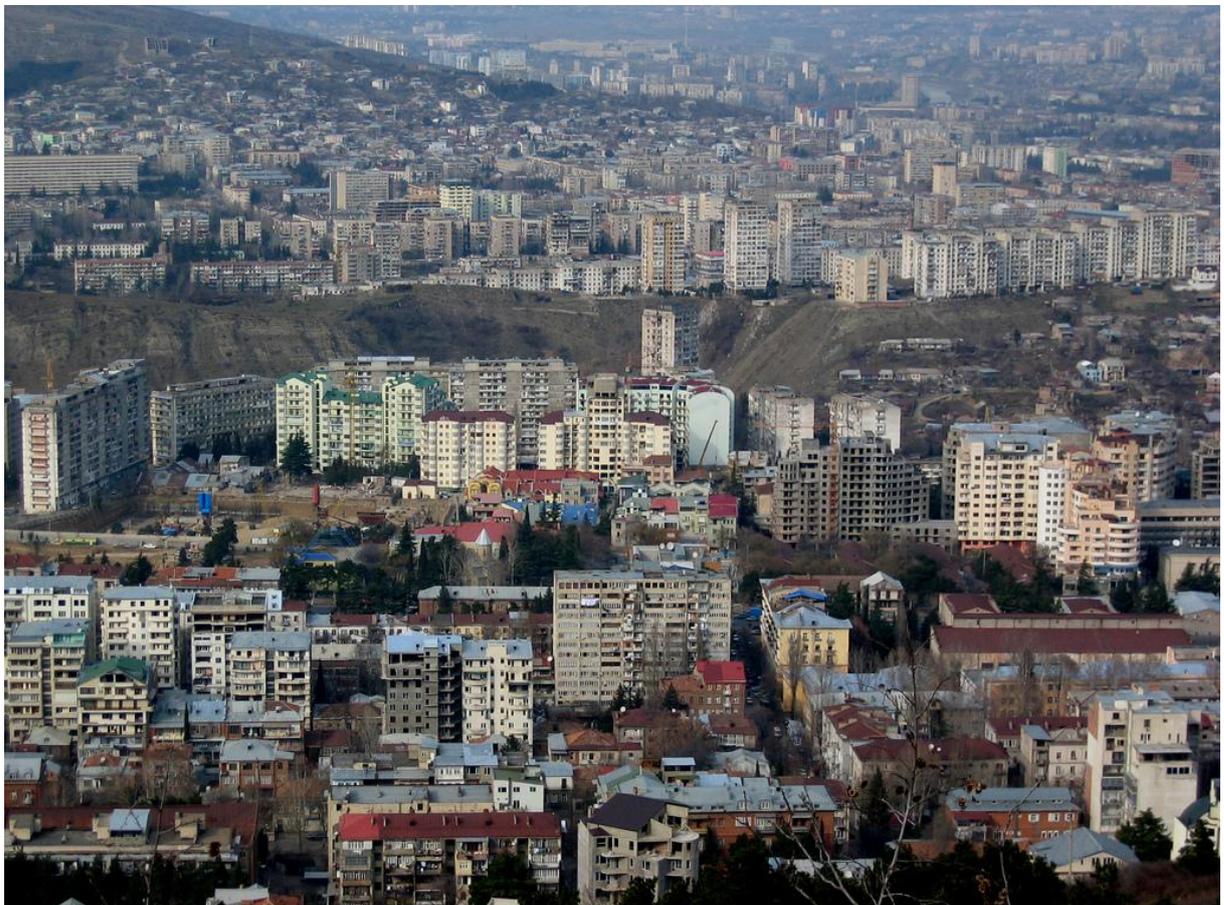


Georgia's Libertarian Revolution

Part Three: Jacobins in Tbilisi

Berlin – Tbilisi – Istanbul

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“Bendukidze’s libertarianism also helped to justify some policy decisions already taken. In his speeches he would often cite the disbanding of the Georgian traffic police in 2004 to illustrate the central tenets of his reform philosophy.

“We had a road police which was doing nothing apart from taking bribes. So one day all these policemen were fired. For three weeks there were no policemen in Georgia. People asked ‘ah what will happen?’ Well nothing happens because it is a dysfunctional institution. If I switch off the light in the room with no light, nothing will happen. There was no light before and no light after.”

Abolishing the traffic police had been an emblematic and popular part of an anti-corruption campaign in summer 2004. For Bendukidze, however, it was also a model development strategy since growth was a function of scrapping ineffective public institutions.”
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1. A Failing State

The market reforms implemented in Russia in the early 1990s were designed to transform the communist state, root and branch. Anatoly Chubais, architect of Russia's mass privatisation effort, expressed this sense of urgency in 1992: "We need to free the economy from the state, free the country from socialism. To shake off the terrible chains of that gigantic, all pervading, bureaucratic, ruinous and ineffective state." The talk at the time was of shock therapy and radical measures. Unless the changes were truly radical, reformers feared, some form of reconstituted communist party might return to power. Only the complete destruction of a system of state control could prevent any chance of a communist restoration.¹

When Kakha Bendukidze arrived in Georgia in the summer of 2004, he joined a government that shared a similar sense of urgency, but faced a very different situation. The immediate problem was not the stifling presence of an all-powerful state or resistance to reform from publicly owned enterprises. Many state institutions had more or less collapsed in the early 1990s. As Georgian expert Ghia Nodia wrote in 1995, "Georgia played out most if not all of the nightmare scenarios that a pessimistic political scientist might devise for post-communist states."² A decade later, Georgian society was still suffering from the disastrous civil war and ethnic conflicts of the early 1990s. The breakaway republics of Abkhazia and South Ossetia remained outside the central government's control, and as late as in 2009, some 220,000 to 247,000 people still remained displaced.³ In 2004, Georgia's GDP stood at a mere 45 percent of its 1989 level.⁴

The reasons for this dramatic decline were manifold. The Georgian economy had been closely integrated into the Soviet system. Many Georgian enterprises had been anchored to the needs of the Soviet military-industrial sector. One of the two Soviet complexes producing fighter planes was located in Tbilisi, as was the Lenin Electric Locomotives plant and the Rustavi Metallurgy company, which produced 90 percent of Soviet oil drilling tubes.⁵ Georgian industry was heavily dependent on imported electricity and gas, which supplied around 80 percent of its energy needs, rendering them extremely vulnerable to the collapse of the Soviet Union.⁶

In 1991, 488,000 Georgians worked in the industrial sector across 1,400 enterprises.⁷ In 1998, these Soviet-era industrial enterprises were working at below 10 percent capacity. By 2004, industrial employment had collapsed, to a mere 85,000 workers.⁸ During this period of

¹ David E. Hoffmann, *The Oligarchs – Wealth and Power in the new Russia*, 2003.

² Ghia Nodia, "Georgia's Identity Crisis", *Journal of Democracy*, Vol. 6/1, January 1995.

³ Internal Displacement Monitoring Centre, "Georgia: IDPs in Georgia Still Need Attention. A Profile of the Internal Displacement Situation," 9 July 2009, p. 6. [http://www.internal-displacement.org/8025708F004BE3B1/\(httpInfoFiles\)/4B92F2DAA0173529C12575EE004101F9/\\$file/Georgia+-+July+2009.pdf](http://www.internal-displacement.org/8025708F004BE3B1/(httpInfoFiles)/4B92F2DAA0173529C12575EE004101F9/$file/Georgia+-+July+2009.pdf).

⁴ EBRD, "Transition Report 2009: Transition in crisis?," p. 169, <http://www.ebrd.com/country/sector/econo/stats/georgia.pdf>

⁵ World Bank, *Georgia: A blueprint for Reform*, 1993, p. 84.

⁶ World Bank, *Georgia: A Blueprint for Reform*, 1993, p.94.

⁷ World Bank, *Georgia: A Blueprint for Reform*, 1993 ("Country Data Georgia: Employment, Output and Productivity").

⁸ Statistical Office of Georgia, *Industry of Georgia*, 2006, p.13.

catastrophic de-industrialisation, the sale of scrap metal salvaged from these derelict enterprises, mostly to Turkey, became Georgia's most important export.⁹

The situation was equally bad in Georgia's large agro-processing sector, which had supplied the Soviet market. Neither privatised nor reformed, the sector collapsed after the breakup of the Soviet Union. In 1990, Georgia's 58 huge canneries produced some 760 million cans of food every year – two and a half for every Soviet citizen. By 2003, output had collapsed to 1 million cans.¹⁰ At the end of the Soviet era, Georgian tea factories turned out tea for the whole Soviet Union, some 122,000 tons per year. By the mid-1990s, this had fallen to 6,000 tons, never to recover.¹¹ The meat industry also collapsed, producing less than 1 percent of what it had in the late 1980s.¹² Georgian wine, a source of national pride, had become famous throughout the former Eastern bloc, with exports reaching 1.5 million hectolitres per year.¹³ By 1994, wine and champagne exports amounted to less than 25,000 hectolitres.¹⁴ According to the World Bank, nowhere else in the former Soviet Union was the collapse of agriculture as severe as in Georgia.¹⁵

With the economy in disarray, reforms were sorely needed, and privatisation was launched in 1993. Georgia's government, however, was far too chaotic to implement such a complex reform programme successfully. Though the vast majority of companies were privatised, except for a few public utilities and so-called "strategic companies", the results were bitterly disappointing. Neither a vibrant private sector nor any serious revenues for the state budget materialised. There was almost no foreign investment.

In 1991, the nationalist writer Zviad Gamsakhurdia became Georgia's first elected president. In January 1992, he was deposed in a coup led by Jaba Ioseliani, a Georgian "thief-in-law" (criminal boss) and paramilitary leader. Ioseliani brought back Eduard Shevardnadze, one of the Soviet Union's most experienced politicians. Shevardnadze had been Gorbachev's foreign minister, and the leader of communist Georgia from 1972 to 1985. During his early years in power, formally as chairman of the Georgian Parliament, Georgia plunged deeper into lawlessness, dragged down by a losing war in Abkhazia, an autonomous republic within Georgia that declared its independence in summer 1992. By 1995, however, a sense of new stability began to emerge. The year saw the adoption of a new constitution and the introduction of the *lari* as Georgia's currency. The worst paramilitary groups were disbanded and their leaders jailed. A new party led by Shevardnadze, the Citizen's Union of Georgia (CUG), won control of parliament with 46 percent of seats in the 1995 elections. (Four years later, it increased this to 56 percent.) Giga Bokeria – then an NGO activist at the Liberty Institute, one of the leading think tanks of the period, and now one of Georgia's leading politicians – recalls the sense of possibility in the mid-90s:

⁹ Barbara Christophe, "From Hybrid Regime to Hybrid Capitalism? The Political Economy of Georgia under Eduard Shevardnadze," 2003,

<http://www.uws.ac.uk/schoolsdepts/business/cces/documents/Barbara.Christophe.rtf>.

¹⁰ Elizabeth Cullen Dunn, "Postsocialist Spores: Disease, Bodies, and the State in the Republic of Georgia", *American Ethnologist*, Vol. 35/2, pp. 246, 249.

¹¹ World Bank, "Georgia: Reform in the Food and Agriculture Sector", 1996, p. 5.

¹² World Bank, "Georgia: Reform in the Food and Agriculture Sector", 1996, p.121.

¹³ Georgia then also exported an additional 100,000 hectoliters of champagne (World Bank, 1996, p.109).

¹⁴ World Bank, "Georgia: Reform in the Food and Agriculture Sector", 1996, p.109.

¹⁵ World Bank, "Georgia: Reform in the Food and Agriculture Sector", 1996.

“When Shevardnadze came to power things seemed to be going in the right direction. 1994, 1995, 1996 – those were good years... he got rid of the armed people in the streets. And a new wave of reforms started in 1996. So we were all supporting Shevardnadze.”¹⁶

Among those supporting Shevardnadze at the time was a young lawyer named Mikheil Saakashvili, who had been persuaded to return from Columbia University in New York in 1995 and stand for parliament. He recalls:

“There was not even one hour of electricity per day in the centre of the city, and no gas. I remember that I bought two rabbits for our son and they died of cold. When there was a fire the firemen never arrived since there was no gas in their trucks. It was very sad to see my country poorer after five years of independence than under the Soviet regime which I had detested.”¹⁷

Saakashvili was now a member of the governing party and chairman of the parliamentary committee responsible for legal reforms. He was in charge of creating a new electoral system and an independent judiciary. A panel of journalists and human rights activists named him Georgia’s “man of the year” in 1997.¹⁸ In 1998, he informed journalists that his goal was “to make Georgia a model democracy for the whole region.”¹⁹

Shevardnadze was widely respected in Europe and America. It was under his watch as Soviet foreign minister, after all, that the Cold War had come to an end. Many in Georgia believed that Shevardnadze would be able to use his connections to anchor Georgia to the West. Their hopes did not seem misplaced. Georgia became one of the leading recipients of US and German financial assistance. In 1999 it joined the Council of Europe. In 2000, it gained entry into the World Trade Organization. At the 2002 NATO summit in Prague, Shevardnadze declared that Georgia was “determined to be a full member of NATO” and was “resolved to work hard to prepare for this historic mission.”²⁰

NGOs like the Liberty Institute marked the emergence of a new civil society. They wielded genuine influence, and their investigations could lead to the dismissal of elected politicians. Policy issues were openly discussed both in the media and in the parliament. All this set Georgia apart from many of its neighbours in the post-Soviet region. As the foreword to the UNDP’s 2000 Georgia Human Development Report notes, “the country’s commitment to a free press and respect of political rights have been remarkable in a region of the world not yet known for ensuring respect of such rights to their full extent.”²¹ Every Sunday evening, an independent TV channel, Rustavi 2, would feature high-quality investigative reports.

And yet, throughout the period of Shevardnadze’s rule the Georgian state remained weak and any real economic recovery elusive. Georgia performed abysmally when it came to one of the most important attributes of statehood – the ability to collect revenues. From 1992 to 1994,

¹⁶ ESI interview with Giga Bokeria, May 2009

¹⁷ Mikheil Saakashvili avec Raphael Glucksmann, *Je vous parle de liberté*, 2008, p. 78.

¹⁸ Stephen Kinzer, “Tbilisi Journal – The ‘Man of the Year,’ Just 29 and Via Manhattan”, *New York Times*, 4 June 1998. <http://www.nytimes.com/1998/06/04/world/tbilisi-journal-the-man-of-the-year-just-29-and-via-manhattan.html?pagewanted=1>

¹⁹ Stephen Kinzer, “Tbilisi Journal – The ‘Man of the Year,’ Just 29 and Via Manhattan”, *New York Times*, 4 June 1998. <http://www.nytimes.com/1998/06/04/world/tbilisi-journal-the-man-of-the-year-just-29-and-via-manhattan.html?pagewanted=1>

²⁰ NATO, “Statement by President of Georgia Eduard Shevardnadze at the EAPC Summit,” 22 November 2002. <http://www.nato.int/docu/speech/2002/s021122h.htm>

²¹ UNDP, *National Human Development Report Georgia*, 2000, Foreword B, http://hdr.undp.org/en/reports/nationalreports/europethecis/georgia/georgia_2000_en.pdf

during a period of virtual anarchy, Georgia suffered a total budgetary collapse. In 1994, its revenues accounted for a mere 2 percent of GDP. By January 1995, the budget was still only US\$190 million, of which about \$101 million was foreign aid.²² The following years saw only modest improvements: total revenues rose from 5 percent of GDP in 1995 to 10 percent in 1997 and 14.5 percent in 2003.²³ To put this in context: the last year in which public spending in the United Kingdom was below 14 percent was 1914. Among developed countries, average government spending in 2000 stood at 45 percent of GDP. Ireland, which is about the size of Georgia (4.4 million people), had public spending of some 40.6 percent in 1989.²⁴ Around the world, the only national governments spending as little as Georgia were Cambodia, Bangladesh, Turkmenistan and Afghanistan.²⁵

The state's inability to collect revenues had a lot to do with the miserable shape of the Georgian public administration. The Ministry of Finance, for one, lacked even the most basic information required for budget forecasting. "At every stage of implementation of the budget process one finds incorrect calculation and accounting, and total disintegration of management and coordination systems," noted the Chamber of Control Chamber in its 1998 review on budget implementation. "In all departments connected with budget implementation there is an atmosphere of incompetence, negligence, irresponsibility and impunity." With industry and agriculture in a state of collapse, the tax base had already been decimated. Even functioning enterprises preferred to conduct most of their activities in the informal sector. According to a World Bank-sponsored study, in 1999-2000 Georgia's shadow economy, at 67.3 percent of GDP, was the largest among all transition countries in Central and Eastern Europe and the CIS.²⁶

In the second half of the 1990s, Georgia adopted a number of important laws inspired by European models, including a new tax code.²⁷ It acquired "a modern constitution, a well developed Civil Code and Code of Civil Procedures, improved court systems (mainly composed of certified judges)," according to a 2000 UNDP report. Likewise, its legislation on human rights protection met "almost all" of the Council of Europe's requirements.²⁸ But writing new laws was one thing, and implementing them quite another. Here, Georgia's record was decidedly less impressive.

Nepotism and corruption were omnipresent. As the IMF noted in 2002 "the main constraint to private sector investment remain the unpredictability of the legal and regulatory environment, not the laws and regulations themselves."²⁹ Very few rich Georgians paid any income tax whatsoever, and firms with good connections to high-level government officials were

²² CIPDD, *The Georgian Chronicle*, January 1995, p. 12.

http://www.cipdd.org/files/61_265_631991_GeorgianChronicle-January95.pdf

²³ UNDP National Human Development Report Georgia, 1998, Chapter 3. For the 2003 figures see: IMF Country Report no. 07/299, August 2007, p.4. <http://www.imf.org/external/pubs/ft/scr/2007/cr07299.pdf>

²⁴ See: http://www.ukpublicspending.co.uk/uk_20th_century_chart.html

²⁵ See the table here: "Government Spending as a Percentage of GDP by Country", 12 March 2008, <http://anepigone.blogspot.com/2008/03/government-spending-as-percentage-of.html>. This table only looks at national level government spending.

²⁶ Friedrich Schneider, "Size and Measurement of the Informal Economy in 110 Countries around the World," July 2002, p. 14. http://www.amnet.co.il/attachments/informal_economy110.pdf

²⁷ Ghia Nodia and Álvaro Pinto Scholtbach, *The Political Landscape of Georgia. Political Parties: Achievements, Challenges and Prospects*, 2006, p.14.

²⁸ UNDP, "National Human Development Report Georgia", 2000, Chapter 1, p. 10.

http://hdr.undp.org/en/reports/nationalreports/europethecis/georgia/georgia_2000_en.pdf

²⁹ IMF, Georgia – Joint Staff Assessment of the PRSP Preparation Status Report, 27 June 2002.

considered untouchable. Talk of future tax amnesties did little to entice tax evaders to pay.³⁰ A vicious circle developed. Deprived of revenues, the state could not pay its civil servants or provide services, which created incentives for even greater corruption.

One of the most striking examples of this was the state of the police, which was considered, along with customs, the most corrupt institution in the land. The restructuring of the Ministry of Interior after 1995 had turned it into a self-financing, mafia-type organisation. Police officers' salaries were measly – less than US\$15 per month – and were paid not regularly. As a result the Ministry “relied almost entirely on informal sources of finance.”³¹ In practical terms, this meant that police officers depended on petty extractions as their main source of income. They could also be rented out for personal or private protection. The result was a very large, underpaid police force. As the UNDP noted in 1998, “it is extremely hard to establish the true number of police officers in Georgia. Declarations by representatives of the Ministry of Internal Affairs are often contradictory, but suggest a figure in the region of 30 to 35 thousand.” By contrast, the total number of police officers in Ireland's National Police Service was 14,000.³² The first Minister of Interior following the Rose Revolution was himself never able to establish exactly how many police officers were on the government's payroll. It was simply not documented.³³

The ready access to bribe money made work as a street-level official with access to the population still an attractive business:

“Many policemen (including police chiefs at rayon level), judges, tax and customs officials and even some centrally-appointed district administrators (*gamgebelis*) paid anything from US\$500 to US\$ 50,000 for their posts. Having put down their investment for their posts, these officials were naturally obliged to repay that investment by means of corruption and extortion.”³⁴

The most visible part of the system was the deeply corrupt traffic police. As Charles King observed in 2001, traffic cops made a habit of waving down cars loaded with produce for the purpose of extorting a few *lari* in ‘fines’. For most Georgians outside of Tbilisi, King dryly observed, this was just about “the only interaction with the Georgian state.”³⁵

As Barbara Christophe analysed in a gripping case study of the political economy of Kutaisi, Georgia's second city, state weakness served many interests.³⁶ While institutions were failing in providing public services, it was impossible to engage in economic activity without being targeted for bribes. Officials took pains to ensure that they would have plenty of room to impose arbitrary fines. Many rules – including tax laws – were drafted in such a way as to make compliance virtually impossible. In public markets, for instance, rules prohibited sellers from selling more than one type of product (such as flowers), enabling inspectors to extort regular bribes to ignore enforcement. Bus drivers in Tbilisi were expected to undergo daily health checks – or pay up. In 2000, a working group run by a Georgian member of parliament

³⁰UNDP, “National Human Development Report Georgia”, 1998, Chapter 3, p. 10. http://hdr.undp.org/en/reports/nationalreports/europethecis/georgia/GEORGIA_1998_en.pdf

³¹ Jonathan Wheatley, *Georgia from National Awakening to Rose Revolution*, 2005, p. 109.

³² Ireland's National Police Service, “Garda HRM Division”, <http://www.garda.ie/Controller.aspx?Page=33>

³³ ESI Interview with Giorgi Baramidze, January 2010.

³⁴ Jonathan Wheatley, *Georgia from National Awakening to Rose Revolution*, p. 105.

³⁵ Charles King, “Potemkin Democracy: Four Myths about Post-Soviet Georgia”, *The National Interest*, June 2001.

³⁶ Barbara Christophe, 2005. See also her English language text available online: “From Hybrid Regime to Hybrid Capitalism? The Political Economy of Georgia under Eduard Shevardnadze” (<http://www.uws.ac.uk/schoolsdepts/business/cces/documents/Barbara.Christophe.rtf>)

scrutinised the assets of 384 top-level public officials. 184 were found to possess assets worth more than half a million USD.³⁷

Under Shevardnadze, there was no shortage of reform initiatives ostensibly addressing the corruption issue. A highly revealing chapter of what became a regular theatre of reform was the series of anti-corruption initiatives launched between 1997 and 2001. In 1997, which Shevardnadze declared “the year of the crusade against corruption,” the government launched its first anti-corruption campaign.³⁸ Some ministers were dismissed, only to be replaced by no less corrupt successors. A newly created expert group created by presidential decree in October 2000 published an impressive and very detailed anti-corruption strategy, only to see no follow-up whatsoever.³⁹ From simplifying the tax code to improving the management of customs, there was hardly a good idea that went unmentioned. On paper things looked great, but the reality was very different.

“One can gauge how seriously Georgia takes customs-duty collection by visiting the country’s border station at Azerbaijan: it’s not on the border. The station sits nearly four kilometres inside Georgian territory – and before one gets there, numerous unmonitored roads head off in various directions ... When a progressive customs commissioner tried a couple of years ago to move the customs house, there was a shoot-out – and the chief was soon reassigned.”⁴⁰

The most striking aspect of the anti-corruption measures was that they did nothing to address the impunity enjoyed by corrupt senior officials. In general, the most severe sanction applied was dismissal, leaving the individual to enjoy the results of their ill-gotten wealth. As Stefes noted in his detailed study on Georgian corruption, “not a single higher official under Shevardnadze went to jail or even lost his/her position.”⁴¹ Reform initiatives were undertaken purely to pull the wool over the eyes of foreign donors and an increasingly skeptical Georgian public.

The inevitable result was a highly ineffective public administration, in pretty much any sphere of its operations. In the health sector, an impressive array of plans and reform initiatives coincided with abysmally low spending (0.6 percent of GDP in 1999) – lower than most low-income African countries. The public health system became for all practical purposes privately funded. As the UNDP noted in 2000,

“The Georgian population is de facto paying almost all health-care related expenses directly from its own pocket ... Staff supplement their meagre salaries via under the table payments and patients buy almost all the medical supplies they require from the black market.”⁴²

Out-of-pocket payments by private citizens, officially introduced in 1995, amounted to 70 to 80 percent of total health care expenditures in 2004.⁴³ One article described the situation as

³⁷ Jonathan Wheatley, *Georgia from National Awakening to Rose Revolution*, 2005, p. 106.

³⁸ Christoph Stefes, *Understanding Post-Soviet Transitions. Corruption, Collusion and Clientelism*, p. 87.

³⁹ The group was chaired by Lado Chanturia, then chairman of the Supreme Court. Its executive secretary was David Usupashvili. Renowned expert Gia Nodia was a member. ESI interviews with David Usupashvili and Gia Nodia, January 2010.

⁴⁰ Ken Stier, “Entrenched Corruption Begins at Georgia’s Border”, *EurasiaNet*, 27 June 2002.
<http://www.eurasianet.org/departments/insight/articles/eav062702.shtml>

⁴¹ Christoph H. Stefes, *Understanding Post-Soviet Transitions: Corruption, Collusion and Clientelism*, Palgrave, 2006, p. 111.

⁴² UNDP, “National Human Development Report Georgia”, 2000.

⁴³ Paolo Belli, George Gotsadze, Helen Shahriari, “Out-of-Pocket and Informal Payments in Health Sector: Evidence from Georgia”, *Health Policy* 70 (2004), p. 111.

“near collapse.”⁴⁴ Most of the rural and half of the urban population preferred treating themselves.⁴⁵ With good cause: studies showed that delivering a child in a public maternity ward substantially increased its risk of death. Life expectancy – as elsewhere in the former Soviet Union – was on the decline, illustrating the growing development gap between Georgia and the countries of the former Soviet bloc that joined the European Union. In 1990, a male Georgian was expected to outlive a male Pole by two years. By 2005, he was expected to live four years less.⁴⁶

The problems in the health sector were mirrored in education. From 1991 to 1994, public expenditure on education in Georgia dropped from 7 to 1 percent of GDP, a decline described by the World Bank as “unique in the history of education worldwide.”⁴⁷ Things improved only marginally in the years that followed, with spending increasing to only 2.4 percent by 1998.⁴⁸ At the same time, the sector was vastly overstaffed. According to a 2005 assessment, the teacher-student ratio was higher than the European average.⁴⁹ The result was dramatic deterioration in education infrastructure. Falling quality led to another unique situation. As a 2006 Open Society Institute study found, over 80 percent of respondents in a sample of higher education students claimed to have received some form of private tutoring.⁵⁰ In 2000, payments for such services, combined with bribes to enter schools and universities, amounted to more than 16 times the level of public spending on education.

The lack of public revenue hit the poorest parts of the population hardest. In the late 1990s, an estimated 2,000 street children lived in Tbilisi, many having escaped unbearable conditions in state orphanages. The welfare system was reeling. Although old-age pensions were the only functioning form of social insurance, payments were far below subsistence level. Pensions (and public sector wages) were not paid for months or years on end. Spending was chaotic, with many ghost recipients remaining on pension lists. As Akaki Gogichaishvili revealed on Rustavi 2 television, 25 percent of pension payments was allocated to people already dead. Though the Ministry of Social Welfare was abolished in response, arrears continued to build up until the Rose Revolution.

In the field of welfare – as in policing, health or education – oversized institutions, insufficient resources and an environment of corruption produced the worst possible outcomes. In 1999, only 3 percent of all unemployed (some 10,000 people) were registered under the United Employment Fund. The Fund spent only 949,000 GEL on these few

⁴⁴ Dina Balabanova, Martin McKee, Joceline Pomerleau, Richard Rose, and Christian Haerpfer, “Health Service Utilization in the Former Soviet Union: Evidence from Eight Countries”, *HSR: Health Services Research* 39, no. 6, Part II (December 2004): p. 1928.

⁴⁵ UNDP, “National Human Development Report Georgia”, 2000

⁴⁶ For a comparative context see WHO, “Highlights on Health in Georgia”, 2005, <http://www.euro.who.int/document/E88548.pdf>

⁴⁷ World Bank, “Georgia Poverty Assessment,” 2009, p. 119. http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2009/04/29/000350881_20090429111740/Rendered/PDF/444000ESW0P1071C0Disclosed041281091.pdf

⁴⁸ Total public spending on education as a percentage of GDP in 2004 was 8.4 percent in Denmark, 7.1 percent in Sweden, 5.4 percent in Austria, 5 percent in Estonia and 3.8 percent in Greece. The lowest in the EU in 2004 was Romania at 3.2 percent. See:

<http://www.uws.ac.uk/schoolsdepts/business/cces/documents/Barbara.Christophe.rtf>

⁴⁹ The student-teacher ratio in Georgia was 14.4 in primary and 9.2 at secondary level, compared to 16 and 12 in the Europe-Central Asia region of the World Bank. See World Bank, “Georgia Poverty Assessment”, 2009, p. 119.

⁵⁰ Open Society Institute, “Education in a Hidden Marketplace: Monitoring of Private Tutoring”, 2006, p. 14. http://www.soros.org/initiatives/esp/articles_publications/publications/hidden_20070216/hidden_20070216.pdf

unemployed, a rate of about 7 GEL per month. Nearly as much money (930,000 GEL) was spent on the Fund's own administration.⁵¹

The shortage of public funds also affected the situation in prisons. Sanitary conditions were disastrous. In 1998 UNDP estimated that one in every eleven inmates suffered from tuberculosis. Convictions were often based on confessions extracted under torture. A 1999 Law on Prisoners, though good in intention, could not be implemented due to the lack of both resources and political will. In 2000, according to the US State Department, 57 prisoners died in Georgian prisons due to beatings and abuse. In Armenia, the figure was nine.⁵²

By 2000, a renewed sense of despair had begun to settle on Georgia. British journalist Wendell Steavenson, living in Tbilisi at the time, described the popular mood before the presidential elections.

“At the watchwords of Western political campaign, Future and Change, they simply shrugged their shoulders and rolled their eyes in mock cynicism at the ceiling. A taxi driver in Bolnisi was as tired of it and indignant as the next man. 'So, we're in the European Union {sic: he meant the Council of Europe} and we're talking to NATO: what difference does that all make for the working man?' He told me he did not have enough money to fix his cracked windscreen. No one did in Georgia; half the cars on the streets had cracked windscreens.”⁵³

By 2001, the atmosphere in Tbilisi was dire. Electricity was becoming a luxury good. Troops began to mutiny after going 16 months without pay. In 2001, conscription was a quarter of the target figure. For those who served, there was no food, gasoline or ammunition.⁵⁴ In January 2002, a British paper warned that “while international attention has been focused on Afghanistan, Georgia has slithered towards disintegration.”⁵⁵ In 2001 and 2002, over the course of 18 months, there were at least four kidnappings, two murders and several serious assaults against foreigners.⁵⁶ In July 2001 Georgi Sanaya, one of the leading journalists and presenters on TV channel Rustavi 2, was shot dead. In November 2001 gunmen kidnapped an Orthodox monk and held him in the Pankisi Gorge on the Georgian border with Chechnya.

“Corruption deterred foreign investors ... yet, even more than bribery did the rising crime rates alarm foreign officials and entrepreneurs who were often the victims of assault, abductions or even murder. Shevardnadze publicly admitted that an increase in crime against foreigners harmed the national interest ... yet Georgia's state officials either turned a blind eye to this crime or were actively involved in kidnappings and robberies.”⁵⁷

To make things worse, when Shevardnadze's governing party fell apart in 2001, external support to Shevardnadze's regime started to wane. Among international donors, there was growing frustration with the lack of tangible progress in the country. In July 2002, in response

⁵¹ UNDP, Human Development Report,

⁵² Christoph H. Stefes, *Understanding Post-Soviet Transitions: Corruption, Collusion and Clientelism*, 2006, p. 135.

⁵³ Wendell Steavenson, *Stories I Stole*, London, 2002, p. 176.

⁵⁴ Anatoli Lieven, “Partners in Despair: The Georgian Army”, *Eurasia Insight*, 6 June 2001. <http://www.eurasianet.org/departments/insight/articles/eav060601.shtml>

⁵⁵ Patrick Cockburn, “Collapse of Georgia Is Ignored by the World,” *The Independent*, 14 January 2002. <http://www.independent.co.uk/news/world/europe/collapse-of-georgia-is-ignored-by-the-world-663265.html>

⁵⁶ Ken Stier, “Kidnapping of British Businessman in Georgia Focuses Attention on Law-Enforcement Corruption”, *Eurasia Insight*, 7 October 2002. <http://www.eurasianet.org/departments/insight/articles/eav071002.shtml>.

⁵⁷ Christoph H. Stefes, *Understanding Post-Soviet Transitions: Corruption, Collusion and Clientelism*, 2006, p. 89.

to the government's failure to implement required measures in the fiscal sphere, the International Monetary Fund suspended its Poverty Reduction and Growth Facility (PRGF), blocking Georgia's access to major international creditors.⁵⁸

Ominously, the Kremlin was carefully taking stock of the weakness of the Georgian state. The word in Moscow was that Georgia had already turned into a failed state, and that this could justify Russian intervention to fight terrorism on Georgian territory. Russian pro-government expert Andranik Migranyan wrote in 2004,

“It {Georgia} has failed to build efficient and consolidated economic, political and military institutions. It continues to depend to a great degree on the financial support of the Western countries, international financial institutions and other organizations ... Against this background, Abkhazia and South Ossetia resembled islands of stability, relative affluence, legitimate existence, and consolidated power... From this viewpoint, Abkhazia and South Ossetia have more right to be considered successful states than Georgia, not to mention official Tbilisi.”⁵⁹

The disastrous condition of Georgia's public institutions had become a threat to national sovereignty. In 2002 Russian defense minister Sergei Ivanov warned that due Georgia's chaotic conditions Russia might have to carry out anti-terror offensives on Georgian territory.⁶⁰ On 12 September 2002 Russian president Vladimir Putin wrote a letter to UN Secretary General Kofi Annan arguing that Russian military action in Georgia would be a matter of self-defense.⁶¹ Some of the younger politicians, led by Mikheil Saakashvili, reached the conclusion that drastic reforms were needed to preserve Georgian statehood.

2. No country for old men

On 4 January 2004 Mikheil Saakashvili, the leader of the Rose Revolution, was elected as Georgia's new president with 96 percent of the popular vote. He was 35 years old.⁶² He had witnessed the failures of the Shevardnadze style of governance for almost a decade. He had seen the impotence and incoherence of international donors and advisors. And he had heard the argument that the real obstacle to fighting corruption was “Georgian culture”. As one foreign expert told the New York Times in early 2004

“Georgia is what in the 1960s people used to call an honor-and-shame society. It has relied to heavily in the last few decades on social networks and kinship that this not only demands corruption but ultimately economic stasis.”⁶³

Georgian criminologist Georgi Glonti wrote that Georgians “automatically resist law in any and all forms.” This explained previous failures of reform:

⁵⁸ Vladimer Papava, “The Georgian Economy: Problems of Reform”, *Eurasian Studies*, Vol. 2/2, p. 53.

⁵⁹ Andranik Migranyan, “Georgia Propelling Its Disintegration”, *Russia in Global Affairs*, October-December 2004, <http://eng.globalaffairs.ru/engsmi/712.html>

⁶⁰ Ariel Cohen, “Moscow, Washington and Tbilisi Wrestle with Instability in the Pankisi Gorge”, *Eurasia Insight*, 19 February 2002. <http://www.eurasianet.org/departments/insight/articles/eav021902.shtml>

⁶¹ Steven Lee Myers, “Echoing Bush, Putin Asks U.N. to Back Georgia Attack”, *New York Times*, 12 September 2002, <http://www.nytimes.com/2002/09/13/world/echoing-bush-putin-asks-un-to-back-georgia-attack.html?pagewanted=1>.

⁶² Turnout in January 2004 was also very high, at 88 percent. OSCE/ODIHR, “Georgia: Extraordinary Presidential Election 4 January 2004,” *OSCE/ODIHR Election Observation Mission Report*, Warsaw, 28 February 2004, p. 16. http://www.osce.org/documents/odihr/2004/02/2183_en.pdf

⁶³ Georgia expert Christopher Waters, quoted in New York Times, The not-so-velvet revolution, 30 May 2004.

“Assuming that American laws and market rules could be grafted onto Georgian society was like trying to graft an artichoke onto an orange tree. The reforms wither and die. The Georgians politely do what the Americans and other Western reformers ask by way of passing laws, adopting constitutions, changing police procedure, customs and tax procedures and instituting whatever other reform measures are suggested. And then, basically nothing happens.”⁶⁴

In this view, what *was* working in Georgia were the unwritten laws upheld by the so-called thieves-in-law, criminal groups with their own codes and hierarchies, who managed to “infiltrate every aspect of Georgian life.” These thieves existed across the former Soviet Union but Georgians were vastly overrepresented among their ranks. Georgian thieves like Shakro Kalashov, Gogi Chikovani or Tariel Oniani were among the leaders of organised crime in Russia. The fact that following the coup against Georgia’s first elected president in early 1992 a Soviet-era thief, Jaba Ioseliani, ended up running the country “shows that Georgia had developed a unique relationship with its criminal institutions.”⁶⁵ In March 2003 Ioseliani was buried in Didube, Georgia’s pantheon for its most respected public figures.

As Saakashvili and his associates saw it, however, Georgia’s problems had not stemmed from a lack of policy ideas, but from implementation. Culture was not an acceptable excuse, and the fact that criminal structures, such as the Thieves-in-Law, had begun to replace state structures in providing protection and arbitration was a threat that had to be confronted. What had been lacking was courage and political will to reassert the state’s authority. Now, the Rose revolutionaries believed, Georgia’s voters had given them the chance and the mandate to do just that.

The government that Kakha Bendukidze joined in the summer of that year was the first truly post-Soviet cabinet in the history of independent Georgia. None of its members – 20 ministers and state ministers – had held any position in the Soviet era. Only three had been ministers in previous governments. Six had worked or studied abroad and eight had worked in the NGO sector.⁶⁶ Above all, it was a government dominated by (largely) young men in their mid 30s. As one observer noted, Georgia’s governing party had long been home to “urbane, thirty something, English-speaking politicians.”⁶⁷ The Rose Revolution was their cue to take the reins. Analyst Gia Nodia described the new elite in June 2005 as “a very juvenile government, probably the youngest in Europe and sometimes inexperienced, sometimes it makes blunders, and sometimes it is ineffective, but it is certainly extremely motivated.”⁶⁸ One thing these new leaders did not have, and were convinced Georgia could not afford, was patience.

Their first two initiatives made it clear how reforms would be handled in the post-revolutionary era. As early as 29 January 2004, Mikheil Saakashvili argued that the Georgian constitution should be amended as to allow a complete overhaul of the entire

⁶⁴ Virginia Davis Nording and Georgi Glonti, *Thieves of the Law and the Rule of Law in Georgia*, Caucasian Review of International Affairs, Winter 2006.

⁶⁵ It was Ioseliani who in 1992 invited Shevardnadze back into Georgian politics. In 1995 he was arrested. Gavin Slade, *Review Article: Georgia and Thieves-in-Law*, Global Crime, August 2007.

⁶⁶ Lincoln Mitchell, p. 117 and p. 162.

⁶⁷ Charles King, *Potemkin Democracy: Four myths about post-Soviet Georgia*, The National Interest, 1 July 2001.

⁶⁸ Gia Nodia, Interview with Radio Free Europe, 15 June 2005. LINK

system of governance.⁶⁹ On 5 February, already as president, he urged legislators to pass the necessary constitutional changes as soon as possible.⁷⁰ Parliament approved them with almost no debate. By the time renewed parliamentary elections arrived in March 2004, Georgia had a super-presidential system.

Under the new system, the prime-minister – a newly created post in its own right – was to be appointed by the president. The power of the parliament was seriously curtailed. From now on, even parliamentary majorities could neither reject the president's choice of prime minister nor his proposed budget without risking the Parliament's dissolution (whereby the president could still impose his prime minister and his budget by decree). Even in cases where the Parliament adopted a vote of no confidence, the President could dissolve the legislature and retain his government.⁷¹ The so-called "power ministries" (interior and defence) were made directly subordinate to the president, not the prime minister. In Saakashvili's Georgia the presidential office was to be the absolute centre of power – even more so than under Shevardnadze. The March 2004 elections were the icing on the cake. With 65 percent of the total seats, Saakashvili's party coalition obtained a super-majority in parliament.⁷² As one observer wrote in February 2004 "the amendments create a system in which the people's ability to influence their life through the political process and to voice their grievances through their elected representatives is more limited than it was in the past."⁷³

After the constitutional consolidation of power, the new administration's second immediate objective was to eliminate graft from state institutions. The promise to end the impunity of corrupt officials had been central to Saakashvili's appeal. In his inauguration speech in January 2004, the new president warned, "As far as I am concerned, every corrupt official is a traitor who betrays the national interest."⁷⁴ Two weeks later Saakashvili told BBC:

"People voted for me with the main mandate to clean up the country. I warned them against extravagant expectations, we should not expect that overnight Georgia will be exuberantly rich or relatively rich, we are unfortunately a devastated country with huge poverty. But what I promised them was that we will really start to clean up the country and we really did start that, even before I stepped into the office."⁷⁵

The new leadership wasted no time. Already on 12 December 2003 the former president of the Georgian Football Association, Merab Zhordania, was detained on charges of misappropriation of funds.⁷⁶ A new wave of arrests followed Saakashvili's inauguration. On 16 January the former Chief of the Georgian Railway Company, Akaki Chkhaidze, was

⁶⁹ "Saakashvili wants strong presidency", January 30, 2004; available at

<http://civil.ge/eng/article.php?id=6140&search=Saakashvili>

⁷⁰ "Parliament approved constitutional changes", February 6, 2004; available at

<http://civil.ge/eng/article.php?id=6174&search=Saakashvili>

⁷¹ OSCE/ODIHR, "Repeat Parliamentary Elections, 28 March 2004," *Georgia OSCE/ODIHR Final Report*, p. 5. http://www.osce.org/documents/odihr/2004/06/3193_en.pdf

⁷² OSCE/ODIHR, "Repeat Parliamentary Elections, 28 March 2004," *Georgia OSCE/ODIHR Final Report*, p. 24. http://www.osce.org/documents/odihr/2004/06/3193_en.pdf

⁷³ Irakly Areshidze, *An Opportunity Lost? Constitutional Change in Georgia at the Start of the Saakashvili Presidency*, Center for International Private Enterprise (CIPE), February 2004.

⁷⁴ Molly Corso, "Georgian President Saakashvili's Campaign against Corruption," *EurasiaNet.org*, 22 December 2004. <http://www.eurasianet.org/departments/civilsociety/articles/pp122204.shtml>

⁷⁵ "Ask Georgia's President," *BBC News*, 16 January 2004. Transcript available at:

<http://www.president.gov.ge/?l=E&m=0&sm=7&st=10&id=363>

⁷⁶ "Saakashvili warns Adjara not to turn into a "Heaven for Criminals", January 16, 2004; available at

<http://civil.ge/eng/article.php?id=6037&search=Saakashvili>

arrested in Batumi, the capital of Adjara Autonomous Republic.⁷⁷ On 17 January former Energy Minister Davit Mirtskhulava was arrested in a Tbilisi hospital. In February 2004 Saakashvili closed down Omega Group, a powerful corporate conglomerate linked to the authoritarian leadership in the semi-autonomous region of Adjara. A raid was conducted against an Omega-owned television station. On 20 February former president Eduard Shevardnadze's son-in-law was arrested aboard a plane scheduled to leave Tbilisi for Paris. Footage of the arrest was repeatedly aired on TV. On 4 March three policemen, one alleged car hijacker and one by-passer died in a clash between police and criminals in Georgia's second biggest city, Kutaisi.⁷⁸ March 12 saw the violent arrest of Basili Mkalavishvili, an excommunicated Orthodox priest who had repeatedly led assaults on religious minorities.⁷⁹ Several dozen people were injured by heavily armed police using batons and tear gas. Finally, on 31 March Shevardnadze's former minister of agriculture, David Kirvalidze, was summoned by the General Prosecutor's office.

The arrests were accompanied by bellicose rhetoric. Challenged on the decision to raid the Omega TV station, Saakashvili responded that "people are objecting to tactics – that's not the most substantial thing. Look, at what we are doing: we are putting people in jail who have stolen millions."⁸⁰ At a news conference in Tbilisi on 12 January 2004 Saakashvili vowed to take a tough line against prisoners preparing to riot in support of criminal bosses.

"We will shoot down the rioters. We will not spare bullets against them. I know that the criminal world will resist. But we are not afraid."⁸¹

In March, Saakashvili used the funeral for the policemen killed in the gunfight in Kutaisi to declare "war on criminals" and to send them the following warning: "Do not shoot these [policemen]. Shoot me if you can, because I order [them] to shoot you."

On 12 January Saakashvili nominated one of his most trusted associates at the time, Irakli Okruashvili, as Prosecutor General. On 27 January he presented a draft law "simplifying the procedures of arresting those officials suspected in corruption" to the Georgian parliament. "There is too much evidence for too many cases," Okruashvili later told journalists. "We could arrest everyone."⁸² On 5 April 2004 the new Prosecutor General announced that his goal was "to make corrupted officials reimburse the funds they have stolen."⁸³ Thanks to such a policy, he noted, over 20 million Lari had already been paid into the Georgian budget.⁸⁴

Another immediate objective was to transform the key law enforcement institutions, starting with the police. Within the state apparatus, one of the most corrupt and predatory government bodies was the ministry of internal affairs. Giorgi Baramidze, Georgia's first post-Rose Revolution minister of internal affairs, noted in 2004:

⁷⁷ "Ex-railway chief arrested in Batumi", January 16, 2004; available at

<http://civil.ge/eng/article.php?id=6035&search=Saakashvili>

⁷⁸ "Saakashvili: 'I declare war to Criminals'" March 11, 2004; available at

<http://civil.ge/eng/article.php?id=6403&search=Saakashvili>

⁷⁹ Giorgi Sepashvili, "Assailant Ex-Priest Arrested," *Civil Georgia*, 13 March 2004.

<http://www.civil.ge/eng/article.php?id=6415>

⁸⁰ Ilan Greenberg, *The not-so-velvet Revolution*, New York Times, 30 May 2004

⁸¹ "Saakashvili wants new chief prosecutor vows to crackdown on criminals", January 12, 2004; available at

<http://civil.ge/eng/article.php?id=6000&search=rose%20revolution>

⁸² Ilan Greenberg, *The not-so-velvet Revolution*, 30 May 2004.

⁸³ "Ex-officials suspected in corruption reimbursed USD 10 million", April 5, 2004, available at

<http://civil.ge/eng/article.php?id=6619&search=Akaki%20Chkhaidze>

⁸⁴ Ex Officials Suspected in Corruption pay 10 million USD, 5 April 2004,

<http://www.civil.ge/eng/article.php?id=6619&search=okruashvili>

“Every single relationship inside this ministry and all relations between the ministry and the public were based on corruption ... the Ministry was involved in the drug business, weapons smuggling, protecting criminals, extortion, kidnapping.”⁸⁵

It was a situation of enormous risk, calling for extraordinary measures:

“we have to realise this is a real war ... once you start the real fight against mob people, criminals, there is a huge danger you will be killed.”⁸⁶

Almost immediately, Baramidze raised police officers’ salaries, provided them with modern equipment, and began to go after the hitherto untouchable crime bosses, the so-called “thieves-in-law”. At the same time downsizing of the staff in the ministry of interior started. Baramidze also sent a circular to local police chiefs warning them that they would be fired if there were still thieves-in-law in their regions one month later: “everybody in Georgia knew who they were.”⁸⁷

In December 2005 a law entered into force making it a criminal offence, punishable by prison and confiscation of assets, to declare oneself to be a thief-in-law.⁸⁸ The criminal code was amended in September 2006 with a new article on “membership of the community of thieves in law”. 214 people were arrested as “thieves.”⁸⁹ A prison riot in March 2006 in Tbilisi was also suppressed with force, resulting in the death of 7 inmates.⁹⁰ Human rights groups raised questions and demanded an investigation, but the government was unapologetic. As Saakashvili told parliament, following this crackdown: “The backbone of the system of crime bosses has been broken.”⁹¹

In the summer of 2004, the government implemented one of its best-known and most popular reforms, the complete dismantling of the corruption-ridden traffic police. Some 15,000 officers were fired. In total, according to data provided by the Ministry of Interior, about 30,000 officers from the Ministry of Internal Affairs were dismissed in 2004-2005.⁹² This reduced the number of police officers per population from 1:89 to 1:214.⁹³ Soon trust in the police increased sharply in different surveys. People have fallen in love with law-enforcers, Saakashvili declared in February 2005:

⁸⁵ Ken Stier, “Behind a Desk, Georgian Official Promises War on Corruption,” *EurasiaNet.org*, 19 December 2003. <http://www.eurasianet.org/departments/qanda/articles/eav121903.shtml>

⁸⁶ Ken Stier, “Behind a Desk, Georgian Official Promises War on Corruption,” *EurasiaNet.org*, 19 December 2003. <http://www.eurasianet.org/departments/qanda/articles/eav121903.shtml>

⁸⁷ ESI interviews with Giorgi Baramidze, October 2009, January 2010.

⁸⁸ See: <http://www.civil.ge/eng/article.php?id=11432>.

⁸⁹ A movie produced by the Ministry of Interior on the crack-down on thieves-in-law is on their website: <http://www.police.ge/index.php?m=225> (in Georgian). A good article by Lili di Puppo from March 2006 is here: http://www.caucas.com/home_eng/breve_contenu.php?id=232

⁹⁰ For more on this see: <http://www.rferl.org/content/article/1067203.html>

⁹¹ Mikheil Saakashvili, State of the Nation address, 15 March 2007.

⁹² Information from the Ministry of Interior sent to ESI, February 2010, Annex 1.

⁹³ Zoran Krunic and George Siradze, “The Ministry of Internal Affairs of Georgia - Report on the Current Situation with the Recommendations for the Reform” (Jan. 2005), p. 54. Krunic and Siradze note that “in democratic countries a usual ratio is between 1:250 and 1:400.” http://www.delgeo.ec.europa.eu/en/press/REPORT_ON_MOIA_January-2005.pdf

“In Georgia and the former Soviet Union nobody thought that people could trust and love a police force. We thought it was true only in the US. We could never imagine that one day it could happen here.”⁹⁴

Public investment in policing continued to rise along with salaries of police officers. A new Police Academy was created, mandatory exams and training for all officers set up and more modern equipment, from cars to laboratories, purchased. Only public spending on the penitentiary system grew from 200,000 Lari in 2003 to 67 million Lari (US\$ 38 million) in 2007 as prisons were modernised.⁹⁵

At the same time new, draconian provisions of the penal code were adapted. Stealing a mobile phone could send somebody to prison for many years. Petty corruption was treated like a serious crime, warranting years in jail. In July 2008 a law lowered the minimum age of criminal responsibility from 14 to 12. The Georgian prison population increased from around 6,200 people in 2003 to 18,500 in 2008. This resulted in continued massive problems of overcrowding, despite the fact that new modern prisons were built.⁹⁶ It also earned Georgia the distinction of having the highest per capita prison population in Europe after Russia and Belarus.⁹⁷

Table: The Rose Revolution and Georgia's prison population 2003 - 2008⁹⁸

	Women	Juvenile	Total
2003	158	79	6,274
2004	184	84	6,654
2005	283	115	9,051
2006	660	324	15,464
2007	799	322	18,310
2008	764	279	18,491

At the same time rates of convictions for people charged with a crime now approached 99 percent. In 2007 a total of 21,170 people were convicted (and only 30 acquitted). The first six months of 2009 saw 8,780 convictions and only 7 acquittals.⁹⁹ This was also the highest rate of convictions in Europe.¹⁰⁰

The government's fourth immediate priority in the spring of 2004 was to assert its authority in the small Black Sea province of Adjara. Adjara had been both semi-separatists and a local

⁹⁴ “President Saakashvili's annual address to the Parliament,” 24 February 2005, *Official website of the President of Georgia*. <http://president.gov.ge/?l=E&m=0&sm=3&st=200&id=108>

⁹⁵ UN Special Rapporteur on Torture Follow Up Report, p. 51, http://www.univie.ac.at/bimtor/dateien/georgia_unsrt_2008_followup.pdf

⁹⁶ For different estimates of the prison population see: UN Special Rapporteur on Torture, Follow Up Report (2008), p. 50. http://www.univie.ac.at/bimtor/dateien/georgia_unsrt_2008_followup.pdf. For a recent critique of overcrowding in Georgian prisons: Human Rights Watch, Statement issued in April 2009: “overcrowding persists in almost all of Georgia's penitentiary facilities, leading to many human rights violations, including inadequate medical care and lack of exercise and family visits.”

<http://www.hrw.org/en/news/2009/04/22/human-rights-watch-concerns-and-recommendations-georgia>

⁹⁷ See: World Prison Population 8th edition (2009)

http://www.kcl.ac.uk/depsta/law/research/icps/downloads/wppl-8th_41.pdf

⁹⁸ Ministry of Correction and Legal Assistance of Georgia, <http://www.dep.gov.ge/5.php?lang=2>

⁹⁹ Supreme Court of Georgia website, subsection: “Statistical data on hearing criminal cases” (sorted by year) http://www.supremecourt.ge/default.aspx?sec_id=130&lang=2

¹⁰⁰ See also: http://book.coe.int/EN/ficheouvrage.php?PAGEID=36&lang=EN&produit_aliasid=2341

tyranny run by the family of one man, Aslan Abashidze.¹⁰¹ It had also drained the Georgian budget of resources, keeping the revenues from Batumi port and the most important customs points with Turkey.¹⁰² The new government was unwilling to accept this and mounted increasing pressures. The Georgian army organised an exercise in April 2004. Popular protests were organised in Batumi, the capital of Adjara. Former supporters of Abashidze defected and on 6 May he fled to Russia.¹⁰³

Table: Georgia's prison population in context (2008)¹⁰⁴

	per 100,000 people
Sweden	74
Germany	89
Italy	92
Canada	116
Spain	160
Poland	221
Estonia	259
Georgia	415
Belarus	468
Russia	629
USA	756

For political scientist Gia Nodia this was the biggest success of Saakashvili in his first year in office. The Adjara experience suggested that by taking risks it was possible to restore the control of the Tbilisi government. A problem that had appeared insurmountable for 13 years was overcome within weeks. The conviction was growing among Georgia's new leaders that they could walk on water. In early 2005 Saakashvili proudly summed up his first year in office. "For the first time in modern history Georgia has become a proper state," he proclaimed.¹⁰⁵

"I suggest we recall what Georgia was like a year ago. Georgia was a failed state - disintegrated, demoralized and humiliated. It was a country that had lost all attributes of statehood; a country where corruption, lawlessness and injustice reigned supreme; a country where ordinary citizens were routinely cheated by the state; a country where the state and its representatives were constantly extorting money from ordinary citizens; a country that had no budget and that never fulfilled social pledges to its citizens; a country where human rights were blatantly violated; a country that had no defence capabilities, not a single working tank or enough ammunition to last for just an hour in battle."¹⁰⁶

There were some who raised doubts about the way these reforms were implemented. In October 2004 a group of 14 notable Georgian civil society representatives voiced their

¹⁰¹ Radio Free Europe/Radio Liberty, *Georgia: Analyst Ghia Nodia Assesses Saakashvili's Attempts to Transform Country*, June 2005.

¹⁰² Nino Khusidze, *Adjara Boosts Government's Financial Hopes*, Civil Georgia, 8 May 2004

¹⁰³ For a good account available online see: ICG, *Saakashvili's Adjara Success: Repeatable elsewhere in Georgia?*, 18 August 2004.

¹⁰⁴ See: World Prison Population 8th edition (2009)

http://www.kcl.ac.uk/depsta/law/research/icps/downloads/wppl-8th_41.pdf

¹⁰⁵ Lincoln A. Mitchell, *Uncertain Democracy*, 2009, p. 6.

¹⁰⁶ "President Mikheil Saakashvili's annual report to Parliament," 10 February 2005, Official website of the President of Georgia. <http://www.president.gov.ge/?l=E&m=0&sm=6&st=0&id=1491>

concerns about “alarming developments in Georgian politics,” citing restrictions on freedom of speech and the lack of political pluralism in an open letter addressed to Saakashvili.¹⁰⁷ In October 2004 Jaba Devdariani, writing in *Eurasia Insight*, complained that

“the state is governed more by the law of the ruler, rather than by the rule of law. A lack of transparency in the government’s operations is, likewise, prompting people to believe that instead of cleaning up corruption, the government is merely redistributing the loot.”¹⁰⁸

Paradoxically, argued Jonathan Wheatley, the very reforms that sought to clean up Georgia threatened to undermine its democracy. “While attempting to eliminate bureaucratic pluralism from within state structures,” he warned, “the new government made little effort to forge any meaningful links with society or to foster democratic pluralism.”¹⁰⁹ By early 2006, following the murder of a bank employee by members of the Ministry of Interior, following an altercation in a Tbilisi restaurant, protests by civil society grew even louder.¹¹⁰

The US administration of George W. Bush did not entertain any concerns, however. The US view, according to Lincoln Mitchell, was that Rose Revolution had “transformed Georgia from a kleptocratic, weak, semi-democratic regime into a consolidated democracy in a period of weeks.”¹¹¹ On the day of Saakashvili’s inauguration, US Secretary of State Colin Powell gave the new government a hearty endorsement.

“I was very impressed by the President and the members of his new Cabinet that I met ... they are absolutely committed to moving this nation ahead in a very aggressive way to fix the problems that has beset the nation in recent years.”¹¹²

One and a half years later, the American president himself would address the biggest crowd in the modern history of Georgia. Before tens of thousands of people gathered in Tbilisi’s Freedom Square, President Bush proclaimed:

“You are making many important contributions to freedom’s cause, but your most important contribution is your example. In recent months, the world has marvelled at the hopeful changes taking place from Baghdad to Beirut to Bishkek. ... As you watch free people gathering in squares like this across the world, waving their nations’ flags and demanding their God given rights, you can take pride in this fact: they have been inspired by your example, and they take hope in your success.”¹¹³

Such praise, appealing to the Georgian sense of mission and coming on top of the government’s achievements during its first year in power, was not likely to induce caution or humility among Georgia’s young leaders.

¹⁰⁷ Paata Zakareishvili, Irakli Melashvili, Gia Nodia et al, “To His Excellency, the President of Georgia, Mr. Mikheil Saakashvili,” Full text of the open letter, *Civil Georgia*, 18 October 2004.

<http://www.civil.ge/eng/article.php?id=8100>

¹⁰⁸ Jaba Devdariani, “Georgia’s Rose Revolution Grapples with Dilemma: Do Ends Justify Means,” *Eurasia Insight*, 26 October 2004. <http://www.eurasianet.org/departments/insight/articles/eav102604.shtml>

¹⁰⁹ p. 226

¹¹⁰ <http://www.eurasianet.org/departments/civilsociety/articles/eav070706.shtml>

¹¹¹ Lincoln A. Mitchell, *Uncertain Democracy*, 2009, p. 6.

¹¹² Civil.ge, Press Briefing of Georgian President Elect – Mikheil Saakashvili and US Secretary of State Colin Powell, 26 January 2004, Tbilisi

<http://www.civil.ge/eng/article.php?id=6101&search=saakashvili\\%27s%20inauguration%202004> (find the State Department source of this press conference).

¹¹³ “Text: Bush’s Speech in Georgia,” *BBC*, 10 May 2005, <http://news.bbc.co.uk/2/hi/europe/4534267.stm>

3. “Nothing to lose”

Mikheil Saakashvili had risen to power on the promise to fight corruption, not on a free-market platform. In fact, in 2002 *EurasiaNet* described Saakashvili as having a “centre-left, pro-government ideology.”¹¹⁴ In 2003, Saakashvili’s National Movement Party had opposed the privatisation of strategic companies, including the Ferro Alloy Plant in Zestaponi, the port in Poti and electricity distribution companies.¹¹⁵ Observers have noted that, in 2004, Saakashvili’s primary focus was to consolidate power and root out corruption, while delegating economic matters “first to Prime Minister Zhvania and subsequently to State Minister Bendukidze.”¹¹⁶ His inspiration, as he repeatedly told Western journalists, was heroic state-builders in the mold of Mustafa Kemal Atatürk. Kakha Bendukidze told ESI that in his view the Rose Revolution government initially had a “leftist” agenda.¹¹⁷ All this was soon to change, however.

In summer 2004, shortly before leaving Moscow to take up his post as Georgia’s new Minister of Economy, Kakha Bendukidze gave another long interview to the Russian paper *Vedomosti*. He explained that he did not possess a “detailed knowledge” of the Georgian economy. He also noted that this was unnecessary: “The knowledge of fundamental principles easily compensates for not knowing some specifics.”¹¹⁸ Since the prescriptions for good economic policies were universal, there was no need for special expertise to turn around the Georgian economy. All that was required was courage, conviction, revolutionary enthusiasm and a team of highly motivated associates working together in different parts of the Georgian government.

Kakha Bendukidze’s ability to provide a vision of economic development dovetailed perfectly with Saakashvili’s anti-corruption and state-building agenda, placing him at the centre of power from the moment of his arrival in Georgia. His first argument was non-controversial: Georgia’s economic situation was disastrous and recent trends deeply worrying. As he kept repeating, unlike Russia Georgia was not “a rich country that had its own source of revenues which allows it not to think about tomorrow.”¹¹⁹ Georgians had “nothing to lose.”¹²⁰ From this, it followed that Georgia was ripe for economic radicalism:

“If Georgia implements a standard medium-liberal policy, as happened in the Czech Republic, Hungary and partly in Russia, it will grow at 4 percent annually, maybe even faster in the beginning due to the effect of hidden capacity. However, this means that the existing gap between Hungary and Georgia will remain forever.”¹²¹

The country was too poor to resort to anything but radical liberalisation. And by embracing radical reforms, Georgia could do more than merely copy the experience of others: it could strike out and break new ground. This was also the expectation of many of Bendukidze’s

¹¹⁴ Irakly Areshidze, “Early Review of Georgia’s Local Elections”, *Eurasia Insight*, 6 June 2002.

<http://www.eurasianet.org/departments/insight/articles/eav060602.shtml>

¹¹⁵ “National Movement Calls for Nationalization of Strategic Facilities,” *Civil Georgia*, 2 August 2003.

¹¹⁶ Rukhadze and Hauf, “The Georgian Economy Under Saakashvili”, *The Financial*, 21 April 2009.

¹¹⁷ ESI Interview with Kakha Bendukidze, 25 January 2009.

¹¹⁸ Alexander Bekker, “Interview: Kakha Bendukidze, the Minister of Economy of Georgia: ‘Georgia Has Nothing to Lose’” (in Russian), *Vedomosti* 93 (1133), 2 June 2004.

<http://www.vedomosti.ru/newspaper/article/2004/06/02/76569>

¹¹⁹ Alexander Bekker, “Interview: Kakha Bendukidze, the Minister of Economy of Georgia: ‘Georgia Has Nothing to Lose’” (in Russian), *Vedomosti* 93 (1133), 2 June 2004.

<http://www.vedomosti.ru/newspaper/article/2004/06/02/76569>.

¹²⁰ Ibid.

¹²¹ Ibid.

admirers in Russia upon hearing of his appointment in Tbilisi. As Vitaliy Tretyakov wrote in June 2004 under the title “Bendukidze’s Mission” (*Rossiiskaya Gazeta*), Bendukidze’s new position in Georgia offered the chance for a historic experiment:

“we all will shortly witness a highly interesting social experiment. The first goal is to prove the possibility of building an absolutely liberal economy in a given country in the post-Soviet space. The second goal is to prove the effectiveness of economic liberalism in transforming one of the poorest (despite its mountains, sea and fruits) countries of the Commonwealth of Independent States (CIS) into a prosperous one. And, in addition, to demonstrate the capacity of liberalism for building a new economy and maybe a new modern industry virtually from scratch.”¹²²

Soon Bendukidze would articulate his ambition to create a “Hong Kong on the Black Sea.” This involved first and foremost a new understanding of the role of government. For Georgia to grow faster than former communist countries in Central Europe, it had to go further than they did in reducing the role and regulatory powers of the state. At a June 2004 press conference in Moscow, Bendukidze was unequivocal:

“Any economic policy should have maximum deregulation of the economy as its priority. In Georgia, this should take the form of ultra-liberalism, since if Georgia wants to build a normal country, its economy has to grow at very high rates.”¹²³

In this view, a *liberal* economic policy brought growth, and an *ultraliberal* policy brought high growth. The main responsibility of the state was to get out of the way of business:

“To catch up with someone, you have to do something better. Only business can do something better. Only business can create the material basis for existence. In order for business in Georgia to work more effectively than in Hungary, it has to be freed from its entanglements. And I think this is exactly the recipe for a poor country. There is simply no other recipe for a poor country.”¹²⁴

This view – its radicalism, sense of historic mission and can-do optimism – was bound to appeal to a Rose Revolutionary government in search of an economic strategy. To catch up, said Bendukidze, Georgia had to grow at double-digit rates.¹²⁵ In 2003, he pointed out, Russian President Vladimir Putin promised to double Russia’s GDP within ten years. Georgia should be even more ambitious. Citing such historical precedents as Taiwan and Japan, Bendukidze argued that Georgia should try to “triple [its] GDP within 10 years.”¹²⁶ Ultra-liberal reforms, he later pledged, would help the economy grow at 12 percent annually by 2007.¹²⁷

¹²² Vitaliy Tretyakov, “Bendukidze’s Mission” (in Russian), *Rossiiskaya Gazeta*, no. 3492, 3 June 2004. <http://www.rg.ru/2004/06/03/bendukidze.html>

¹²³ “Kakha Bendukidze Promised Ultraliberal Reforms for Georgia” (in Russian), *Polit.Ru*, 2 June 2004. <http://www.polit.ru/news/2004/06/02/benduk.html>

¹²⁴ Ibid.

¹²⁵ Alexander Bekker, “Interview: Kakha Bendukidze, the Minister of Economy of Georgia: ‘Georgia Has Nothing to Lose’” (in Russian), *Vedomosti* 93 (1133), 2 June 2004. <http://www.vedomosti.ru/newspaper/article/2004/06/02/76569>

¹²⁶ Ibid.

¹²⁷ “Economy Minister Outlines Privatization Policy,” *Civil Georgia*, 10 June 2004. <http://civil.ge/eng/article.php?id=7103>

Bendukidze's libertarianism also helped to justify some policy decisions already taken. In his speeches he would often cite the disbanding of the Georgian traffic police in 2004 to illustrate the central tenets of his reform philosophy.

“We had a road police which was doing nothing apart from taking bribes. So one day all these policemen were fired. For three weeks there were no policemen in Georgia. People asked ‘ah what will happen?’ Well nothing happens because it is a dysfunctional institution. If I switch off the light in the room with no light, nothing will happen. There was no light before and no light after.”¹²⁸

Abolishing the traffic police had been an emblematic and popular part of an anti-corruption campaign in summer 2004. For Bendukidze, however, it was also a model development strategy since growth was a function of scrapping ineffective public institutions. There were many such institutions in Georgia: ministries, agencies, inspectorates. “If you have institutions which do not work, why keep them?” Bendukidze told ESI. “My personal opinion is that most of these institutions are not needed as they do not create any public good.”¹²⁹

In a country where the state was corrupt and unable to perform most of its functions, where citizens had to pay out of their own pockets for supposed public services like health care, disbanding state institutions was easier than reforming them. Abolishing public institutions not only saved money and reduced corruption; it was also a driver of development. With this in mind Bendukidze, began to assemble a team of people to implement his vision. People such as Vakhtang Lezhava, who in August 2004 became Deputy Minister of Economic Development¹³⁰; or Tamar Kovziridze, another deputy of his.¹³¹ Bendukidze was also on the lookout for young people who shared his vision and were not “tainted” by the communist mentality.¹³² Some associates he found among the young members of the New Economic School of Georgia (NESG), a non-profit libertarian organisation based in Tbilisi. The founders of NESG had been inspired by the libertarian Mises Institute in Alabama in 2001. For some years they translated and disseminated key libertarian texts. They also worked with like-minded libertarian think-tanks elsewhere, including the CATO Institute, the Heritage Foundation and the Atlas Foundation in the US.¹³³ Nino Gorgadze, a project manager at the NESG, remembers:

“After Bendukidze came in to conduct the reforms, he asked Paata Sheshelidze, the founder of NESG, for good young people who can help him. We selected fifteen people from NESG, and after interviews eight started working with Bendukidze in 2004.”¹³⁴

They were all in their early twenties. Gorgadze herself was twenty when she started working with Bendukidze in October 2004. Soon she was formulating policy on the energy sector,

¹²⁸ Bendukidze's speech at Cato Institute's Policy Forum “Georgia's Transformation into a Modern Market Democracy”, Washington DC, 13 May 2008. <http://www.cato.org/event.php?eventid=4646>

¹²⁹ ESI Interview with Bendukidze, January 2009.

¹³⁰ Government of Georgia, “Vakhtang Lezhava,” http://www.government.gov.ge/index.php?lang_id=ENG&sec_id=134&info_id=29640

¹³¹ Government of Georgia, “Tamar Kovziridze,” http://www.government.gov.ge/index.php?lang_id=ENG&sec_id=103&info_id=1882. She was then appointed chief advisor for foreign economic affairs of the prime minister and is now in charge of negotiations with the EU on trade issues.

¹³² ESI Interview with Nino Gorgadze, Project Manager at the New Economic School of Georgia, Tbilisi, 18 June 2009.

¹³³ ESI interview with Paata Sheshelidze and Gia Jandieri, 2008.

¹³⁴ ESI Interview with Nino Gorgadze, Project Manager at the New Economic School of Georgia, Tbilisi, 18 June 2009.

licensing and permits, food safety, reform of regulatory institutions and anti-monopoly regulation.¹³⁵ As she put it:

“Bendukidze insisted on working with young people. He believed that they are the only ones not tainted with a communist mentality. Only very few in our team were older than 30. Kakha also does not believe that people require a specific expertise to be able to do a certain job. He thought that if you talk to people for a few hours and explain things, and then you give them tasks to do, they have a free mind to decide how to do the tasks given. You either are creative or you are not.”¹³⁶

2004 saw the launch of an aggressive privatisation campaign. A new tax code was adopted, effective from 1 January 2005.¹³⁷ It featured a 12 percent flat income tax rate (the lowest in Europe) and reduction in the number and rates of other taxes. In November 2004, Bendukidze presented a “concept economic strategy” whose central tenet was the importance of shrinking the role of the state. It was not made public but accepted by the prime minister. When, at the end of 2004, Bendukidze became minister of state in charge of coordinating reform, he embraced a new flagship project that came to represent this revolutionary approach: the drafting of a new law on licences and permits.

Licensing regulations had long beset Georgia due to their huge number, impracticality and the potential for corruption. Obtaining a construction permit for a warehouse in Georgia’s capital required “18 different procedures, including 9 approvals of as many agencies.”¹³⁸ In 2004 “only 207 of the 484 ongoing construction projects in Tbilisi had permits.”¹³⁹ The transportation sector provided another example of a particularly arcane and burdensome licensing system.¹⁴⁰ Every small business was familiar with the experience of health and food safety inspectors preying on them to extort money. Every car owner was aware of the utter uselessness of certifications of cars.

The goal of Bendukidze’s licence reform was revolutionary: to cut the number of licences and permits to the absolute minimum and dramatically simplify licensing procedures. The actual reform process only took three months. Lili Begiashvili, then Bendukidze’s deputy, described it as follows:

“When we started the reform in February 2005 we brought representatives of all Ministries to the table. We created an intergovernmental commission to work on the issue... We sat down together and went through all the permits and licences that were issued by the various state agencies and we gave them the timeframe to figure out what licenses they should abolish, what will happen if they abolish them and to provide us with arguments for those they wanted to keep. Everyone at the higher lever was involved. Can you imagine, we went through all the licenses one by one!”¹⁴¹

¹³⁵ ESI Interview with Nino Gorgadze, Project Manager at the New Economic School of Georgia, Tbilisi, 18 June 2009.

¹³⁶ ESI Interview with Nino Gorgadze, Project Manager at the New Economic School of Georgia, Tbilisi, 18 June 2009.

¹³⁷ “New Tax Code Approved”, *Civil Georgia*, 22 December 2004. <http://civil.ge/eng/article.php?id=8637>

¹³⁸ Svetlana Bagaudinova, Dana Omran and Umar Shavurov, “Licensing 159 Activities, Not 909,” in *Celebrating Reform 2007: Doing Business Case Studies* (2007), International Finance Corporation, World Bank, USAID (Washington): p. 23.

¹³⁹ Svetlana Bagaudinova, Dana Omran and Umar Shavurov, “Licensing 159 Activities, Not 909,” in *Celebrating Reform 2007: Doing Business Case Studies* (2007), International Finance Corporation, World Bank, USAID (Washington): p. 23.

¹⁴⁰ World Bank, *Georgia: Reform in the Food and Agriculture Sector*, Washington, DC, 1996, p. 10.

¹⁴¹ ESI Interview with Lili Begiashvili, Former Deputy Minister of Reform (under Bendukidze) and former Deputy Minister of Agriculture, 1 May 2009.

The reform team met with each line ministry, asked questions if certain licences were useful and listened to counterarguments to keep them. It studied the experience of other countries, from Sweden to New Zealand. The new law introduced new principles designed to simplify procedures, such as “silence is consent”: “if a license/permit is not issued within the timeframe set by the law, the license/permit shall be deemed granted.”¹⁴² The law set a 30-day limit for issuing licenses and a 20-day limit for issuing permits. It also listed all the licensing requirements. It was a revolutionary reform by any standard: only 10 out of 30 OECD countries had then even done a full count of their existing licenses and permits.¹⁴³ The Netherlands had listed over 1,100 various types of licenses in 2005. After a reform, their number was reduced by 22 percent.¹⁴⁴ In Georgia the number of activities requiring a business license fell from 909 to 159¹⁴⁵ and then further to 137.¹⁴⁶ No other OECD reformer had ever abolished as many licences: an 85 percent reduction. The licence reform was signed into law in June 2005.¹⁴⁷

Hand in hand with these reforms came government restructuring and streamlining of institutions. As Lili Begiashvili, who served as Bendukidze’s deputy minister for reform coordination, told ESI,

“The license reform went in line with structural reform. The idea behind these reforms was to give commercial and service functions to the private sector and thus remove them from the state. That is why people were dismissed from their jobs at the state agencies. Some agencies we just had to close as the state had no business in offering those commercial services. There are different figures about how many people were dismissed I read somewhere that after these reforms that the number of people working at the state agencies was decreased from 120,000 to 50,000, but I am not sure. I can say for sure that in the Ministry of Agriculture worked 3,424 people and only 600 remained.”¹⁴⁸

Of 90 licences and permits issued by the Ministry of Agriculture only 9 remained. Only two licences remained in place concerning food production (concerning baby food production and packaging). Although a modern food safety law (based on advisors funded by USAID and the European Commission) was passed in summer 2005, it did not enter into force. An EU-funded report proposed to introduce at least two new licences: for companies which “produce, pack, store products of animal origin for human consumption for exports” and for companies “producing high risk production for the domestic market” (animal feeds, nuts, low acid canned foods). Neither was done. A new Food Safety Agency was set up in 2005 but then, after one year, most of the newly hired inspectors were fired again. At the end of 2006 the total number of food inspectors in the country was 19. They did not have the authority to actually investigate producers. They had no budget for serious controls. There was no effort

¹⁴² International Financial Corporation, “Georgia: After Three Years of Licensing Reform,” 2008, p. 3.

¹⁴³ OECD, Regulatory Policy Committee, “Indicators of Regulatory Management Systems,” 2009, p. 77 (Fig. 37). <http://www.oecd.org/dataoecd/44/37/44294427.pdf>

¹⁴⁴ OECD, “Better Regulation in Europe: An Assessment of Regulatory Capacity in 15 Member States of the European Union”: “Better Regulation in the Netherlands”, 2009, p. 68. <http://www.oecd.org/dataoecd/0/13/43307757.pdf>

¹⁴⁵ Svetlana Bagaudinova, Dana Omran and Umar Shavurov, “Licensing 159 Activities, Not 909,” in *Celebrating Reform 2007: Doing Business Case Studies* (2007), International Finance Corporation, World Bank, USAID (Washington): p. 23.

¹⁴⁶ International Financial Corporation, “Georgia: After Three Years of Licensing Reform,” 2008, p. 3.

¹⁴⁷ Parliament of Georgia, “Legislation – 2005”, http://www.parliament.ge/index.php?lang_id=ENG&sec_id=69&info_id=16088.

¹⁴⁸ ESI Interview with Lili Begiashvili, Former Deputy Minister of Reform (under Bendukidze) and former Deputy Minister of Agriculture, 1 May 2009.

to train inspectors. Nor were any efforts made to check on the quality of food imports. De facto, Georgia became the only place in Europe without any food safety system at all. All of this was a matter of pride for Bendukidze, as he proudly told the Financial Times that it was the job of the market to regulate food producers.

In the summer of 2004, the government also began firing public servants. For legal reasons, abolishing entire agencies and ministries proved to be an even easier way to accomplish large-scale dismissals. The number of ministries was reduced. According to the consolidated government budget documents, the number of civil servants declined from 102,593 in 2004 to 74,790 in 2005. Some dismissals did not take place in accordance with the relevant laws:

“Unfortunately, there were a lot of irregularities and bad practice in firing public servants. There were some cases when civil servants were forced to sign resignation letters. It happened right after the Rose Revolution. I have to say that I asked all my employees not to sign such letters.”¹⁴⁹

Bendukidze also pushed for Georgia’s economy to open up completely to the outside world - to abolish visas, reduce trade restrictions and make it as easy as possible for foreign investors to operate in Georgia. Georgia unilaterally abolished visa requirements for citizens of many high- and middle-income countries, which former Prime Minister Gurgenzidze defined as having a nominal GDP per capita exceeding US\$10,000.¹⁵⁰ The government cut import duties down to three basic rates of zero, five and 12 per cent – the second lowest worldwide, according to the Georgian Ministry of Foreign Affairs – as compared to the sixteen different tariff rates, ranging up to 30 percent, that had previously been in force.¹⁵¹ All quotas on imports and exports were removed.¹⁵² As Bendukidze proudly stated, Georgia’s customs regime was one of the most liberal anywhere, on a par with Singapore, Hong Kong, and Macau.¹⁵³

Georgia had had a privatisation policy since the 1990s. It was, according to Bendukidze, a sham. “What happened in Georgia [before the Rose Revolution] is not called privatisation,” Bendukidze said in 2004. “It is called giving away the assets to the good boys.”¹⁵⁴ As far as he was concerned, “genuine privatisation” was something altogether different.

“The sale for money, as much money as possible, without any agreements on the transfer of management rights, without any conditional ownership, without any kind of 10-year lease agreements – these are all tricks of the devil and we must get rid of them.”¹⁵⁵

Many Georgian politicians were skeptical about selling strategic enterprises and anxious about the influx of Russian capital.¹⁵⁶ Bendukidze did not share their concern. He summed

¹⁴⁹ ESI Interview with Lili Begiashvili, Former Deputy Minister of Reform (under Bendukidze) and former Deputy Minister of Agriculture, 1 May 2009.

¹⁵⁰ Milken Institute, “A Conversation With Lado Gurgenzidze, Former Prime Minister of Georgia,” 28 April 2009. <http://www.milkeninstitute.org/events/gcprogram.taf?function=detail&eventid=GC09&EvID=1923>

¹⁵¹ Georgian Ministry of Foreign Affairs, “Trade: Overview”, http://www.mfa.gov.ge/index.php?sec_id=74&lang_id=ENG

¹⁵² Ibid.

¹⁵³ CATO Institute, “Georgia's Transformation into a Modern Market Democracy,” Policy Forum, 13 May 2008. <http://www.cato.org/event.php?eventid=4646>

¹⁵⁴ Justin Burke, “Georgian Economics Minister Designate Discusses Privatization Plans,” *Georgia Daily Digest - EurasiaNet*, 10 June 2004. <http://www.eurasianet.org/resource/georgia/hypermail/200406/0029.shtml>

¹⁵⁵ Ibid.

¹⁵⁶ Giorgi Sepashvili, “Bendukidze – State Minister with Big Mandate to Reform,” *Civil Georgia*, 16 December 2004. <http://www.civil.ge/eng/article.php?id=8589>

up his approach to privatisation in an instantly famous remark: “Everything can be sold, except conscience.”¹⁵⁷ He saw “good prospects” for Russian investors in such areas as “the privatisation of the Batumi Sea Port, oil and gas pipelines.”¹⁵⁸ A special webpage, www.privatization.ge listed all enterprises and assets put up for sale. These included so-called strategic assets such as the Batumi and Poti ports, the Chiatura manganese mining company and a metallurgical plant in Rustavi.

The results of the new policies were striking. Before 2004, receipts from privatisation had been meagre. Annual reports produced by the National Bank of Georgia deplored the gap between expected revenues and actual receipts. In 2000 privatization revenues added approximately US\$9.4 million to the Georgian budget.¹⁵⁹ In 2006, by contrast, they amounted to \$547 million. Privatised objects included a large number of Georgia’s hydropower stations, in addition to many of its major industrial and mining companies.

Table: Privatisation receipts (2004-2009)¹⁶⁰

Year	Amount (USD)
2004	75,831,017
2005	195,221,568
2006	547,053,941
2007	465,610,151
2008	65,324,601
2009 (until 22 July)	3,806,975

The experience of working on these path-breaking reforms produced an intense sense of loyalty among the new team which Bendukidze had brought together. Lili Begiashvili described working with him as “great”:

“He is so highly educated. He loves working at night and I had a lot of sleepless nights particularly when we worked on licensing reform. For three years I was not asleep before 3 AM. Kakha was coming at the office in the evening and stayed there the entire night and I was supposed to be there all that time. He was a great manager; he did not like intrigues and did not buy into them. He was the only man who had enough capacity to make the reforms, who else could do that? The reforms he pushed through were amazing.”¹⁶¹

The flat income tax, low custom rates, open visa regime and law on licences and permits: all these were only the beginning of Georgia’s libertarian revolution, however.

¹⁵⁷ Ibid.

¹⁵⁸ Alexander Bekker, Aleksey Nikolskii, “Georgia Borrowed Bendukidze” (in Russian), *Vedomosti* 93 (1133), 2 June 2004. <http://www.vedomosti.ru/newspaper/article/2004/06/02/76580>

¹⁵⁹ National Bank of Georgia, “Annual Report 2000”, p. 16.

<http://www.nbg.gov.ge/uploads/publications/annualreport/2003/nbg7.2annualreport2000eng.pdf>

¹⁶⁰ Source: www.privatization.ge. The website only gives individual privatization deals, no annual totals. Some deals are not on the website.

¹⁶¹ ESI Interview with Lili Begiashvili, former Deputy Minister for Reforms Coordination, Tbilisi, 1 May 2009.

4. Rebranding a country

By early 2005, the 49-year-old former businessman was put in charge of a whole range of diverse initiatives as State Minister of Reform. This included a new anti-corruption strategy, the privatisation of state-owned agricultural land, public administration reform, a new competition policy, policy on managing forests and health care reform. It also included one of the most important tasks for the government: changing its international image among investors. Despite its early reforms, Georgia still faced a huge image problem among potential investors. An October 2005 article in *Forbes* was a case-in-point:

“Georgia ranks 128 out of 133 countries surveyed for corruption by Transparency International. Half of Georgia lives at or below the poverty level. Justice-starved courts hew to a political agenda. Kidnappings for ransom also occur. After spending \$275 million over four years on modernizing Tbilisi's electricity distribution plant, AES Corp. pulled out of Georgia in 2003 after its financial manager there was slain following electricity tariff increases.”¹⁶²

Bendukidze quickly identified a way to anchor the performance of his economic reform team and address the issue of Georgia's poor investment image. He linked his efforts to the criteria defined in international ranking systems - particular the Ease of Doing Business index (EDBI), a new index which had published its first ever report in 2004. Rising in these rankings now became a national policy priority, closely monitored by president Saakashvili; achieving this was soon seen as another major success of Bendukidze.

The EDBI is based on the idea that there is one global best practice model of (minimalist) business regulation. It is also based on the assumption that reform can be achieved through discreet reforms independent of the wider policy and institutional context. As Sam Schueth writes in a fascinating article soon to be published, the authors of the index operate on the basis that

“the state with the fewest separate taxes and separate payments, lowest tax rates, and fastest (electronic) payment system will score highest on the paying taxes indicator. States that score the highest on the employing workers indicator have the least regulation of hiring and firing decisions.”¹⁶³

One of the main Georgian reforms in this context was the passage of a new employer-friendly labour code in May 2006.¹⁶⁴ The explicit goal of the new law was to make hiring and firing procedures as flexible as possible. It left employees with little legal protection, while easing many procedures for employers. It stipulated that virtually all aspects of the employer-employee relationship were to be regulated on a contractual basis. It permits such general grounds for terminating employment contracts that, as trade union representatives argue, they amount to “firing people without a reason.”¹⁶⁵ It provides for one-month severance pay as the only benefit for workers dismissed by their employers.¹⁶⁶

¹⁶² Matthew Swibel, “Reform, Caucasus-Style,” *Forbes*, 1 October 2005.

http://members.forbes.com/forbes/2005/0110/078_2.html

¹⁶³ Sam Schueth, “Assembling International Competitiveness: Georgia, USAID, and the Doing Business Project”, *Journal of Economic Geography*, Clark University (forthcoming).

¹⁶⁴ Parliament of Georgia, “Legislation – 2006.”

http://www.parliament.ge/index.php?lang_id=ENG&sec_id=69&info_id=16089

¹⁶⁵ Paul Rimple, “Georgia: Unions Push for Labor Law Reform,” *EurasiaNet*, 18 November 2009.

<http://www.eurasianet.org/departments/insight/articles/pp111809.shtml>

¹⁶⁶ Georgia's Labour Code (2005), Article 37, section 3.

In October 2008, speaking at a reception organized by the European Resource Bank in Tbilisi, Georgia’s libertarian Prime Minister Lado Gurgenzidze lauded the Labour Code as an “entrepreneurial revolution.” For Georgia’s ranking in the World Bank’s ”Doing Business 2007” index, it was also a very positive development. Soon Georgia was ranked the 6th most employer-friendly country in the world with respect to labour regulations, and Georgia’s labour code was declared one of the three “boldest reforms” carried out anywhere in the world in the 2005/2006 period.¹⁶⁷

Table: Ease of Doing Business, Georgia and the Employment Indicator (EBDI), 2006 – 2010

Employment Indicator	2006	2007	2008	2009	2010
Georgia’s global rank with regard to the Employing Workers indicator	-	6	4	5	9
Difficulty of hiring index (0-100)	0	0	0	0	0
Rigidity of hours (0-100)	60	20	20	20	20
Difficulty of redundancy (0-100)	70	0	0	0	0
Rigidity of employment index (0-100)	43	7	7	7	7
Redundancy cost (weeks of salary)	4	4	4	4	4

Later, addressing criticisms in 2008, Bendukidze stated:

“Maybe it is difficult to explain in the USA, as the USA does not have a labour code or someone dictating how can I be hired or fired and that is the difference to all other countries, especially Europe where contractual agreements between employer and employee are practically not allowed. Why was it controversial? Not because of how it was done but because there is now huge pressure from EU trade unions to reverse the situation.”¹⁶⁸

Gia Jandieri, founder of the libertarian think tank NESG, argued that trade unions were impositions by Western interests not needed in Georgia.¹⁶⁹ He also wrote in his blog (echoing Ayn Rand):

“Like in very many situations everybody tries to forget that the main source of all of our wealth and opportunities is the entrepreneur - businessman, who creates everything and there is no other money from nowhere and nobody ... So if we want employment, if we want services and goods, if we want to live – let’s not make obstacles for entrepreneurs, let’s give them freedom of choice.”¹⁷⁰

This was not the only reform undertaken to engineer a rise in the EDBI rankings. In its 2007 report, EBDI declared Georgia to be the best reformer worldwide, citing improvements in the “minimum capital required to start a new business,” the rise in the number of business registrations, simplification of border procedures, and shorter times for resolving “simple commercial disputes.”¹⁷¹ The EDBI report listed a number of other reforms:

¹⁶⁷ World Bank/IFC, Doing Business 2007, p. 3,

http://www.doingbusiness.org/documents/DoingBusiness2007_FullReport.pdf.

¹⁶⁸ CATO Institute, “Georgia’s Transformation into a Modern Market Democracy”, CATO Policy Forum, 13 May 2008, Washington, DC. <http://www.cato.org/event.php?eventid=4646>

¹⁶⁹ Gia Jandieri, “Labor Market, Unions and the New Labor Code,” personal blog (giajandieri.blogspot.com), 12 May 2006. <http://giajandieri.blogspot.com/2006/05/labor-market-unions-and-new-labor-code.html>

¹⁷⁰ Gia Jandieri, “Labor Market, Unions and the New Labor Code,” personal blog (giajandieri.blogspot.com), 12 May 2006. <http://giajandieri.blogspot.com/2006/05/labor-market-unions-and-new-labor-code.html>

¹⁷¹ World Bank/IFC, Doing Business 2007, Overview, p. 1,

http://www.doingbusiness.org/documents/DoingBusiness2007_FullReport.pdf.

“The social security contributions paid by businesses decreased from 31 percent of wages to 20 percent, making it easier for employers to hire new workers. Better collection of corporate taxes, which shot up by 300 percent, more than made up for the loss in revenues.”¹⁷²

The World Bank’s Simeon Djankov, the mastermind of the EDBI, spoke about the Georgian reforms as path breaking:

“I believe that after 10 years you will invite me to Georgia not for presentation of Georgia as the number one reformer worldwide but for presentation of Georgia as the country with the number one economy.”¹⁷³

Further reforms undertaken in Georgia in 2006/2007 took place in five areas relevant to the EBDI: starting a business, dealing with licences, registering property, obtaining credits and protecting investors. As a result, Georgia rose to 18th in the Doing Business report 2008,¹⁷⁴ from 100th only two years before. And Djankov, who now met with Bendukidze regularly, lent a helping hand to the process (as Sam Schueth noted, he and Bendukidze co-drafted the 2007 bankruptcy law) - later describing the reforms as “unprecedented” and bound to lead to prosperity within 8-12 years!

¹⁷² World Bank/IFC, Doing Business 2007, Overview, p. 1,

http://www.doingbusiness.org/documents/DoingBusiness2007_FullReport.pdf.

¹⁷³ Press Center of the Chancellery of the Government of Georgia, “Presentation of Research Results of Financial Corporation”, http://www.government.gov.ge/index.php?lang_id=ENG&sec_id=105&info_id=1846

¹⁷⁴ World Bank/IFC, Doing Business 2008,

http://www.doingbusiness.org/documents/FullReport/2008/DB08_Full_Report.pdf.

Georgia's rise in the Ease of Doing Business Index						
Doing Business report ¹⁷⁵	2005 ¹⁷⁶ (covering 2003/2004)	2006 ¹⁷⁷ (covering 2004/2005)	2007 ¹⁷⁸ (covering 2005/2006)	2008 ¹⁷⁹ (covering 2006/2007)	2009 ¹⁸⁰ (covering 2007/2008)	2010 ¹⁸¹ (covering 2008/2009)
Ease of Doing Business rank	137	100	37	18	15	11
Recalculated Rank ¹⁸²	-	112 ¹⁸³	-	21 ¹⁸⁴	16 ¹⁸⁵	-
Number of reform areas			6	5	4	2

Following another meeting with Bendukidze on 6 August 2007 to consider the new solvency law, Simeon Djankov announced:

“It’s notable that Georgia is one of the quickest reformer countries in the world, so that it’s hardly possible to find any precedent to it. Obviously, such reforms are instrumental in enhancing the attraction of the country to direct foreign investment; they facilitate the tempo of economic growth and assist in creating new jobs.”¹⁸⁶

The Georgian reformers understandably prided themselves on the results they achieved. When the Doing Business report 2008 was issued, Georgia’s Prime Minister Zurab Noghaideli declared:

“Georgia is already ranking 18th and thus we have kept our promise. It is notable that making business in Georgia has become easier than in Belgium, Netherlands, Austria, France and other countries, not to say anything of the post-Soviet countries; only Estonia is ahead of us among the post-Soviet countries.”¹⁸⁷

¹⁷⁵ Each report covers the first half of the preceding year and the second half of the year before.

¹⁷⁶ Simeon Djankov, “Top Reformer Wins Election in Georgia”, 7 January 2008, <http://blog.doingbusiness.org/2008/01/top-reformer-wi.html>.

¹⁷⁷ World Bank/IFC, Doing Business in 2006, http://www.doingbusiness.org/documents/DoingBusiness2006_fullreport.pdf.

¹⁷⁸ World Bank/IFC, Doing Business 2007, http://www.doingbusiness.org/documents/DoingBusiness2007_FullReport.pdf.

¹⁷⁹ World Bank/IFC, Doing Business 2008, http://www.doingbusiness.org/documents/fullreport/2008/DB08_Overview.pdf.

¹⁸⁰ World Bank/IFC, Doing Business 2009, http://www.doingbusiness.org/Documents/FullReport/2009/DB_2009_English.pdf.

¹⁸¹ World Bank/IFC, Doing Business 2010, <http://www.doingbusiness.org/documents/fullreport/2010/DB10-full-report.pdf>.

¹⁸² The ranks were recalculated to reflect the addition of new countries and changes in the methodology.

¹⁸³ World Bank/IFC, Doing Business 2007, http://www.doingbusiness.org/documents/DoingBusiness2007_FullReport.pdf.

¹⁸⁴ World Bank/IFC, Doing Business 2009, http://www.doingbusiness.org/Documents/FullReport/2009/DB_2009_English.pdf.

¹⁸⁵ World Bank/IFC, Doing Business 2010, <http://www.doingbusiness.org/documents/fullreport/2010/DB10-full-report.pdf>.

¹⁸⁶ Website of the Government of Georgia, Press conference at the Chancellery of the Government of Georgia, 5 October 2007, http://www.government.gov.ge/index.php?lang_id=ENG&sec_id=35&info_id=588.

¹⁸⁷ Website of the Government of Georgia, Press conference at the Chancellery of the Government of Georgia, 5 October 2007,

5. And the Winner is... Georgia?

In October 2006, libertarians from 28 countries around the world gathered in Tbilisi to discuss liberal reforms they had implemented in their respective countries and to share lessons learned. The event was organized and financed by libertarian think tanks including the Cato Institute, New Economic School of Georgia (NESG), the Atlas Economic Research Foundation, the Heritage Foundation and others. Andrei Illarionov, former Kremlin adviser and current Cato senior fellow was there. So was Mart Laar, former Estonian prime minister.¹⁸⁸ Dan Mitchell, Director of the Heritage Foundation, explained:

“governments are inefficient in redistributing the money they collect; government spending displaces money from the private sector; government programs discourage economically desirable decisions, such as saving, since people do not save any more after the government has subsidized pensions and health care; welfare programs encourage people to choose leisure over work; unemployment insurance programs provide an incentive to stay unemployed; government programs interfere with competitive markets; government programs inhibit innovation....”¹⁸⁹

Therefore, he concluded, governments should be limited to offering only the basic services of “national defense, legal system, and public safety... so people can enjoy freedom.”¹⁹⁰ This was John Galt’s vision, now coming to life not in Colorado but in mountainous Georgia.

In 2007, the Georgian government hired the international advertising agency M&C Saatchi. Its international rankings in EDBI were now put at the heart of an international marketing campaign in 2007. On CNN, in the Economist, in the Financial Times a global audience came across the slogan: “And the Winner is: GEORGIA.”¹⁹¹ The message was straightforward, comparing Georgia to other major countries in the world economy:

Georgia vs. Germany: Germany, a byword for economic prosperity, does all it can to encourage entrepreneurs... No, the real surprise is that in the latest tables the nation of Georgia ranks even higher. Oh, and the summers are warmer in Georgia too.

Georgia vs. China: In the league table of the world's most reformed economies, China comes an excellent fourth. But who comes first? That would be Georgia. We may never be as big as China, but we've always punched above our weight.”

Georgia vs. Holland: Situated on the Black Sea, we're at the crossroads of Europe and Central Asia. Transit links, whether by sea, road or air, are superb. And for the past five years our growth rate has exceeded that of most countries in the world. Including Holland.”¹⁹²

http://www.government.gov.ge/index.php?lang_id=ENG&sec_id=35&info_id=588.

¹⁸⁸ For more information on the event and the speakers please visit the website of the Cato Institute:

<http://www.cato.org/events/tbilisiconf2006/index.html>.

¹⁸⁹ Dan Mitchell (Heritage Foundation), “Why Government Spending Hinders Economic Growth”, Conference papers and presentations, 25-27 October 2006, Tbilisi <http://www.cato.org/events/tbilisiconf2006/papers.html>, p. 10-14

¹⁹⁰ Dan Mitchell (Heritage Foundation), “Why Government Spending Hinders Economic Growth”, Conference papers and presentations, 25-27 October 2006, Tbilisi. <http://www.cato.org/events/tbilisiconf2006/papers.html>, p. 15.

¹⁹¹ View a campaign video “Georgia vs. Germany” at: Invest in Georgia, http://www.investingorgia.org/about_us/videos/view/286.

¹⁹² Invest in Georgia, “Winner Is Georgia Ad Campaign”, http://www.investingorgia.org/about_us/winner_is_georgia_ad_campaign.

Georgian officials travelled to investor forums hosted by The Economist, The Financial Times and Dow Jones. And at the end of 2007 Bendukidze was joined in the Georgian government by another confirmed libertarian: Lado Gurgidze. Born in 1970, a dual Georgian-UK citizen with an MBA from a US business school, he now became Georgian prime minister. Having left Georgia in 1990 to pursue studies abroad, Gurgidze had made a career in finance in Europe. He returned to Georgia in 2004, taking the position of the CEO of the privately owned Bank of Georgia.¹⁹³ He managed to turn the bank around and make it one of Georgia's leading financial institutions. Like Bendukidze, he saw himself as a “technocrat, not a politician.”¹⁹⁴ An open admirer of Ayn Rand, Gurgidze named his company Galt & Taggart Securities after the names of the main characters in Rand's novel *Atlas Shrugged*.

Like Bendukidze, Gurgidze was convinced that Georgia, being a small and poor country in a difficult geopolitical environment, needed to become “better than others” in order to succeed and that half measures did not work. The “recipe for Georgia's success” that Gurgidze outlined in an interview at CATO Institute in October 2008 was libertarianism:

“Low and flat taxes; Commitment on a legislative level to reduce the government's fiscal footprint; Deregulation and cutting the red tape; Unilateral free trade; Very flexible labour legislation; No sector or industrial policy of any kind; No market-distorting practices such as subsidies, preferences, or exemptions; No currency or capital controls; A ‘hawkish’ anti-inflationary stance, and ‘aggressive’ privatization.”¹⁹⁵

In an April 2009 presentation at the Milken Institute in California Gurgidze spoke of “unilateral liberalization, deregulation and privatization” as the key reform principles. In addition, he emphasized the need to make reforms “succession-proof.”¹⁹⁶ On 8 April 2008, on Gurgidze's initiative, the Georgian government floated a US\$500 million Eurobond issue, which was an “instant success,” with demand for the bonds greatly exceeding the supply.¹⁹⁷

In May 2008 Kakha Bendukidze, now the head of the Georgian presidential administration, was invited to present Georgia's economic success story at the CATO Institute's Policy forum in Washington DC under the title *Georgia's Transformation into a Modern Market Democracy*.¹⁹⁸ Introduced by Russian economist Andrei Illarionov, now working for CATO, as “the driving force behind Georgia's reforms”, Bendukidze presented the libertarian success story of his country as a victory of self-evident truths. Throughout his speech Bendukidze also makes fun of the love for regulation he sees at work in the rest of Europe:

“Our ideology behind the reforms was making everything private as much as possible... and we decided to liberalize our market and open our society unilaterally, which means that we are not waiting for other countries when they decided to reduce for example customs duties. If they want to torture their citizens it is their business.”

¹⁹³ Lado Gurgidze: “London Can Do Without Me, Much Work in Georgian Banking.” Interview with General Director of Bank of Georgia. *24 Hours*, no. 202 (31), 24 February 2005.

<http://www.24hours.ge/index.php?n=202&r=1&id=1031>

¹⁹⁴ Milken Institute, “A Conversation with Lado Gurgidze, Former Prime Minister of Georgia,” 28 April 2009. <http://www.milkeninstitute.org/events/gcprogram.taf?function=detail&eventid=GC09&EvID=1923>

¹⁹⁵ Emmanuel Martin, “Interview with Lado Gurgidze,” *YouTube*, October 2008.

<http://www.youtube.com/watch?v=-BMSjuRckqw>

¹⁹⁶ Milken Institute, “A Conversation with Lado Gurgidze, Former Prime Minister of Georgia,” 28 April 2009. <http://www.milkeninstitute.org/events/gcprogram.taf?function=detail&eventid=GC09&EvID=1923>

¹⁹⁷ Nino Patsuria, “Georgia: A Sign of Change? Georgia Floats Its First International Bonds,” *Eurasia Insight*, 29 April 2008. <http://www.eurasianet.org/departments/insight/articles/eav042908a.shtml>

¹⁹⁸ CATO Institute, “Georgia's Transformation into a Modern Market Democracy,” Policy Forum, 13 May 2008. <http://www.cato.org/event.php?eventid=4646>

“Licensing, actually there is an idea somewhere born, I don’t know, in Germany or where normal person cannot conduct activity without having special licence and there was huge amount of licenses. That is unfortunately usual for many countries. We have reduced the number of licences 85 percent so now we have 6 times less licences and permits than we had before, and we simplified the licensing. I think that this year we can make another big leap and reduce maybe twice or three times.”

“So why is privatization important for developing countries? First there is no culture of managing state owned enterprises, anywhere but especially in developing countries. Second, there are many different types of corruption so it was my personal goal to privatize as much as possible because I think that in a country like Georgia corruption is one of the biggest potential problems. So we privatized all international airports, perhaps the railway in a few years, all sea ports, generation and distribution of energy, gas supplies, agricultural land – this will happen quite soon – and as I mentioned we have this quasi privatization of natural resources through tradable licences.”¹⁹⁹

It was a confident performance: Georgia faced a bright future, and so did the libertarian principles, which had made its economic miracle possible. Bendukidze’s prophecy of a 12 percent growth rate came true: in 2007, the real GDP growth rate reached 12.4 percent.²⁰⁰ Thus Georgia proved that, by following the prescriptions of the Ease of Doing Business indicators, a country could change its image, attract investment and grow fast. Or so, at least, it appeared to those who had designed the EBDI and helped Georgia rise in its ranks. As the mastermind behind Georgia’s aggressive reform drive, Bendukidze enjoyed the full support of both the EBDI team and USAID in Georgia. Any criticisms were drowned in the praises of Washington-based think tanks. The Heritage Foundation, whose Georgian partner was none other than the NESG, also saw Georgia rise rapidly in its index of economic freedom. And in 2009 a report by the US Agency for International Development noted that:

“Perhaps the most telling indicator of what has been accomplished is the new status that Georgia has gained as an investment destination, after the broadest, deepest, fastest business climate reforms of any country in the last 50 years.”²⁰¹

¹⁹⁹ Watch the full video of Bendukidze’s presentation at: CATO Institute, “Georgia’s Transformation into a Modern Market Democracy,” Policy Forum, 13 May 2008. <http://www.cato.org/event.php?eventid=4646>

²⁰⁰ [National Bank of Georgia, Annual Report 2007](http://www.nbg.gov.ge/uploads/publications/annualreport/tsliuri_angarishi_2007_eng_bolo_internetistvis.pdf), p. 11.

²⁰¹ USAID, *Georgia: Opened for Business. Georgia Business Climate Reform Final Report*, September 2009, p. 3. http://pdf.usaid.gov/pdf_docs/PDACN591.pdf

6. Bendukidze and Russian economic imperialism

On 22 January 2006, in the midst of a cold winter, two nearly simultaneous explosions wrecked parts of the North Caucasus – Transcaucasus and Tbilisi-Mozdok gas pipelines, cutting Georgia off from gas supplies.²⁰² Most Georgians saw these incidents as Russian sabotage against the background of worsening relations between the two countries and Gazprom's demands to raise the gas price for Georgia. In the aftermath of the blasts, Georgian opposition deputies called on Saakashvili to dismiss Kakha Bendukidze. He was, they suggested, a Russian pawn willing to sacrifice Georgia's security to the Russian interests.²⁰³

It was not the first time that Bendukidze had faced such accusations. Throughout his time in government, one of the most common charges levelled against Bendukidze by Georgian critics was the claim that he represented Russian economic interests – and that his libertarian policies would lead, intentionally or not, to the inclusion of Georgia within a Russian “liberal Empire”.

The concept of “liberal empire” had entered the Russian debate in 2003 thanks to Anatoly Chubais, the father of Russia's mass privatization scheme. In an article on Russia's strategy for the 21st century, Chubais suggested that the Kremlin should make it its task to “facilitate the expansion of Russian business in neighbouring countries both in the area of trade and in the purchase and development of assets”, thereby creating a zone of economic influence in its neighbourhood.²⁰⁴ Energy would be a crucial part of the equation, tying the members of the CIS together, increasing Russian leverage and paving the way for the realisation of Russia's historic mission in the Caucasus and Central Asia.

It is easy to understand why the idea of Bendukidze as an instrument of Russian economic influence seemed plausible to Georgians concerned about the influence of the former colonial power. The Russian press itself, after all, had seen Bendukidze's June 2004 return from Moscow to Tbilisi as positive for Russian interests. *Rossiiskaya Gazeta* columnist Tretyakov wrote that part of Bendukidze's mission in Georgia was “to prove the possibility of a non-antagonistic coexistence of Russian economic and political interests in the Caucasus with the political and economic interests of the United States.”²⁰⁵ Speaking on Russian TV in *Vesti Nedeli*, anchor Viktor Dyatlikovich said,

“Bendukidze is back in Georgia... Here, however, it is not clear which verb to use: was Bendukidze invited by Tbilisi or, rather, was he sent from Moscow? Perhaps both are partly true. And there are already some discussions on trade-offs such as: we give you Bendukidze and you give us the Batumi port.”²⁰⁶

²⁰² “Pipeline Blast in Russia Cuts Gas to Georgia”, *Civil Georgia*, 22 January 2006.

<http://civil.ge/eng/article.php?id=11560>

²⁰³ Diana Petriashvili, “As Georgia Loses Gas, Rancor at Russia on the Rise”, *Eurasia Insight*, 23 January 2006.

<http://www.eurasianet.org/departments/insight/articles/eav012306b.shtml>

²⁰⁴ Anatoliy Chubais, “Russia's Mission in the 21st Century” (in Russian), *Nezavisimaya Gazeta*, 10 January 2003. http://www.ng.ru/ideas/2003-10-01/1_mission.html

²⁰⁵ Vitaliy Tretyakov, “Bendukidze's Mission” (in Russian), *Rossiiskaya Gazeta* (Federal issue), no. 3492, Jun. 3, 2004. <http://www.rg.ru/printable/2004/06/03/bendukidze.html>

²⁰⁶ Viktor Dyatlikovich, “Bendukidze is back to Georgia” (in Russian), on Russia 1, *Vesti Nedeli* 06 June 2004, <http://www.vesti7.ru/news?id=4593>.

Bendukidze had been one of the most influential business figures in Russia for over a decade. He had given advice to Russia's highest-level policymakers, including President Putin. The May 2004 offer to join Saakashvili's government came after Bendukidze arrived in Tbilisi – for a Russian-Georgian investment forum – as part of a Russian delegation. Bendukidze also asked Saakashvili to enlist Putin's support for his ministerial appointment.²⁰⁷ Bendukidze argued that “money has no nationality” and that all investors were welcome in Georgia. Announcing his privatization programme, he stated:

“It makes no difference who will buy Georgian state-run facilities – Russians, Americans or others. The important thing is to receive as much money as possible from the privatization of these enterprises.”²⁰⁸

Bendukidze stressed that even the energy sector was no “holy cow.”²⁰⁹ As Russian business daily *Vedomosti* reported, he saw “good prospects” for Russian investors in such areas as “the privatization of the Batumi Sea Port, oil and gas pipelines, and the implementation of projects in the energy and tourism sectors.”²¹⁰

One of the most sophisticated critics of Bendukidze's “all's for sale” approach was Vladimir Papava, a prominent economist, economy minister under Shevardnadze and an MP in Saakashvili's National Movement Party from 2004 to 2008. Papava supported many of the early reforms after the Rose Revolution.²¹¹ In 2006, however, he warned that by overexposing Georgia to Russian capital, Bendukidze was bringing the country back into the Russian orbit.²¹² The sale of major electricity assets to Russian electricity monopoly RAO (its chairman none other than Anatoly Chubais); the sale of Georgia's biggest gold and copper mines to Russian companies; the acquisition of the Georgian United Bank by a Russian state-controlled bank; as well as attempts by Russian gas monopolist Gazprom to seize control of Georgia's gas distribution network - all of these, Papava noted in a 2007 article, were evidence of Russia's “snaring Georgia in the Liberal Empire's net.”²¹³

Criticism of Bendukidze and his policies gained more currency as relations between Tbilisi and Moscow began to deteriorate dramatically after 2005. How was it possible for somebody with such close ties to Moscow's economic and political elite to remain so influential within a government whose anti-Russian rhetoric became increasingly strident? To find the answer, one needs to take a closer look at the actual evolution of Russian-Georgian relations after 2004 – and at the real impact of Bendukidze's economic reforms.

²⁰⁷ Alexander Bekker, “Interview: Kakha Bendukidze, the Minister of Economy of Georgia: ‘Georgia Has Nothing to Lose’” (in Russian), *Vedomosti* 93 (1133), 2 June 2004.

<http://www.vedomosti.ru/newspaper/article/2004/06/02/76569>; also available at:

<http://www.alpha.perm.ru/iaproject/txt.php?n=5631>

²⁰⁸ “Georgia Open to Privatization,” *Civil Georgia*, 15 June 2004. <http://civil.ge/eng/article.php?id=7134>

²⁰⁹ Viktor Dyatlikovich, “Bendukidze Went back to Georgia” (in Russian, “Бендукидзе вернулся в грузины”), *Vesti Nedeli*, 6 June 2004. <http://www.vesti7.ru/news?id=4593>

²¹⁰ Alexandr Bekker, Aleksey Nikolskii, “Georgia Borrowed Bendukidze” (in Russian), *Vedomosti* 93 (1133), Jun. 2, 2004. <http://www.vedomosti.ru/newspaper/article/2004/06/02/76580>

²¹¹ “Vladimer Papava: Curriculum Vitae,” Vladimer Papava's personal website, http://www.papava.info/docs/Vladimer_PAPAVA_CV.pdf

²¹² Vladimer Papava, “The Political Economy of Georgia's Rose Revolution,” *East European Democratization*, Fall 2006, p. 664. http://www.papava.info/publications/Papava_Rose_Revolution.pdf

²¹³ Vladimer Papava, “On the Essence of Economic Reforms in Georgia, or How European is the European Choice of Post-Revolution Georgia?”, p. 3-4.

http://www.tepav.org.tr/tur/admin/dosyabul/upload/Karadeniz%20makale_Papava.doc

When Bendukidze joined the Georgian government in June 2004, relations between Russia and Georgia seemed to be on the mend. The newly elected Mikheil Saakashvili, although clearly pro-Western, had chosen Moscow as his first visit abroad in February 2004. Having met Vladimir Putin, he publicly stated that he intended to improve bilateral relations. The Russian Prime Minister at the time, a liberal economist named Mikhail Kasyanov, was eager to discuss opportunities for economic cooperation with Georgia.²¹⁴ A friend of Bendukidze and fellow libertarian, Andrei Illarionov, was Putin's chief economic advisor.

The positive atmosphere went beyond friendly rhetoric. In May 2004 Russia did not intervene when the Georgian government successfully restored control over the semi-autonomous region of Adjara, home to a large Russian military base and a pro-Russian leader, Aslan Abashidze. It was the head of Russia's National Security Council, Igor Ivanov, who flew to Adjara's capital Batumi to convince Abashidze to leave.²¹⁵ Progress was also made on one of the thorniest long-standing issues between Russia and Georgia – the removal of Russian military bases from Georgia. On 30 May 2005, Russian Foreign Minister Sergey Lavrov and Georgian Foreign Minister Salome Zourabichvili issued a joint statement specifying a timeline for closing the bases in Adjara and Akhalkalaki (in the majority-Armenian region of Javakheti in southern Georgia).²¹⁶ The process was to begin immediately and be fully completed by the end of 2008. This represented a diplomatic victory for the Georgian side. Russia had initially insisted on at least 7 years to complete the withdrawal.²¹⁷

However, the tentative improvement in Russian-Georgian relations turned out to be short lived. Tensions started mounting in summer of 2004, when the Georgian government tried to forcibly reassert its control in the breakaway republic of South Ossetia. The effort was led by the Georgian Defence Minister Irakli Okruashvili, known for his hawkish stance against the separatists. Georgia's attempts to take control over the breakaway republics now went hand in hand with its increasingly visible resolve to pursue full NATO membership. Georgia started sending additional troops to join the coalition troops in Iraq. (The first Georgian contingent had been sent by Shevardnadze in 2003).

Russia, already concerned about NATO's March 2004 enlargement into Eastern Europe, including the Baltic States, looked on angrily as Georgia, which Moscow had always perceived as its own sphere of interest, pursued closer ties with the Western alliance and the US. As Putin saw it, Georgia's political manoeuvring would at best weaken Russian influence in the Caucasus, and at worst weaken Russia itself. The success of the Orange Revolution in Ukraine in the fall of 2004, which brought to power the pro-Western candidate Viktor Yushchenko, only heightened Russia's concerns. Kremlin advisors and analysts feared that the "colour revolutions", which they saw as US-orchestrated coups, might eventually arrive in Russia. As pro-government political expert Alexey Zudin wrote in March 2005, "America and Europe are actively participating in the power rotation in Russia's near abroad."²¹⁸

²¹⁴ ESI Interview with Mikhail Kasyanov, October 2009.

²¹⁵ "Russian Security Chief Mediates in Adjara Crisis," *Civil Georgia*, 5 May 2004.
<http://civil.ge/eng/article.php?id=6876>

²¹⁶ Ministry of Foreign Affairs of Russia, "The Joint Statement of the Ministers of Foreign Affairs of the Russian Federation and Georgia" (in Russian), 30 May 2005.

http://www.mid.ru/Brp_4.nsf/arb/62BDD977D27FB959C3257011004E5998?OpenDocument

²¹⁷ Vladimir Novikov and Mikhail Zygar, "Ready for Exit: Russia Agreed to Liquidate Bases in Georgia" (in Russian), *Kommersant*, no. 97 (3181), 31 May 2005.

<http://kommersant.ru/doc.aspx?DocsID=581643&print=true>

²¹⁸ "The Kremlin in an Orange Environment" (in Russian), *Politcom.ru*, 24 March 2005.

<http://politcom.ru/1860.html>

At the same time, Georgia's leaders became increasingly outspoken about Georgia's role as an agent of democratisation in the post-Soviet region. They saw themselves as a vanguard in a new wave of revolutions, which would even include the Kremlin itself. One of Georgia's young revolutionaries, Giorgi Kandelaki, discussed early in 2005 whether "the new wave of democratization" would come to include Russia:

"even a tightly centrist government such as Russia's may be called to account for its actions. As in Tbilisi in 2003 and in Kyiv in 2005, the forecasts of nay-sayers were inevitably proven wrong once voters' eyes were opened to the need for democracy and the bankruptcy of authoritarianism. That realisation will come to the CIS. It's only a question of time."²¹⁹

When George W. Bush came to Tbilisi in May 2005 and spoke about Georgia's Rose Revolution as a democratic inspiration for people "across the Caucasus, in Central Asia and the broader Middle East,"²²⁰ alarm bells rang not only in Minsk and Baku, but also in Moscow.²²¹

By 2006, Georgian-Russian relations had cooled drastically. Georgia's military build-up – now conspicuous – and its growing insistence on reintegrating Abkhazia and South Ossetia were harshly criticized by Russian authorities. Not long after the January 2006 gas pipeline explosions, Russia imposed a ban on Georgian wine and agricultural produce, citing quality concerns.²²² In September, Georgian authorities arrested four Russian military intelligence officers on espionage charges,²²³ which Putin described as "state terrorism with hostage-taking." Russia responded with a full embargo, blocking all air, road, rail and sea links with Georgia, suspending postal communications and money transfers, and organising a crackdown on Georgian illegal immigrants in Russian cities.²²⁴ In November 2006, Gazprom announced its plans to double the price of gas sold to Georgia in 2007. The situation was now very different from 2004, when both sides entertained hopes for a better relationship. "Despite all the political difficulties with Russia," Prime Minister Noghaideli felt it necessary to stress in 2007, "we have excellent relations with Russian investors."²²⁵

Meanwhile, important changes were taking place inside the Kremlin. In February 2004, Putin sacked Prime Minister Kasyanov, who then joined the opposition and prepared to run in the 2008 presidential elections.²²⁶ In December 2005, Kakha Bendukidze's friend Andrei Illarionov resigned from his position as Putin's economic advisor, saying that "there are no more opportunities for a policy of economic freedom in the country."²²⁷ He was soon to become one of the most vocal critics of the Putin regime. The Kremlin of 2006 was not the Kremlin Bendukidze had worked with back in 2003. Bendukidze's own ties to Russia were

²¹⁹ Georgia Kandelaki, "You say you want a revolution?", Eurasianet, 19 January 2005.

²²⁰ "Text: Bush's Speech in Georgia," *BBC News*, 10 May 2005. <http://news.bbc.co.uk/2/hi/europe/4534267.stm>

²²¹ "Text: Bush's Speech in Georgia," *BBC News*, 10 May 2005. <http://news.bbc.co.uk/2/hi/europe/4534267.stm>

²²² Vladimir Socor, "Russia Bans Georgian, Moldovan Wines and Other Products," *Eurasia Daily Monitor*, vol. 3, issue 60, 27 March 2006. [http://www.jamestown.org/single/?no_cache=1&tx_ttnews\[tt_news\]=31523](http://www.jamestown.org/single/?no_cache=1&tx_ttnews[tt_news]=31523)

²²³ "Georgia Arrests Russian 'Intelligence Operatives'", *Civil Georgia*, 27 September 2006. <http://civil.ge/eng/article.php?id=13657>

²²⁴ "How Russia Waged a Cold War with Georgia" (in Russian), *Kommersant*, no. 75 (3651), 4 May 2007. <http://kommersant.ru/doc.aspx?fromsearch=905e8791-c11e-403f-b0d9-72b226169611&docsid=763492>

²²⁵ Isabel Gorst, "Foreign investment: Caucasus is scene of new chapter in the Great Game," *Financial Times*, 31 October 2007. http://us.ft.com/ftgateway/superpage.ft?news_id=fto103120070219501167

²²⁶ Kasyanov submitted his candidacy for presidency but was denied registration, however. See: Mikhail Kasyanov, *Without Putin* (in Russian, *Bez Putina*), Novaya Gazeta, Moscow, 2009.

²²⁷ Irina Granik, "I Didn't Come to Work in Such a State" (in Russian), interview with Andrei Illarionov, *Kommersant* no. 245 (3329), 28 December 2005. <http://kommersant.ru/doc.aspx?fromsearch=475e0e3e-8eb0-4415-9a6a-7bd076b5f61a&docsid=639373>

growing progressively weaker. In November 2005, Bendukidze pulled out of business activities in Russia, selling his share in OMZ to Gazprombank. In May 2006, Mart Laar, a former prime minister of Estonia, an outspoken opponent of Russian neo-authoritarianism and one of Bendukidze's friends in Eastern Europe, became an advisor to the Georgian president. Laar was to work closely with Bendukidze.²²⁸ His circle of friends and colleagues now comprising outspoken critics of the Kremlin, the notion that Bendukidze would pursue a secret agenda of catering to Russian economic interests seemed increasingly implausible.

Contrary to expectations and suspicions, Bendukidze's years in government saw Georgia's growing independence of Russia both in trade and, crucially, energy. While Georgia had little choice but to accept Gazprom's 2006 price hike, it also succeeded in decreasing its reliance on Russian energy imports in 2007 by hammering out deals to purchase natural gas from Turkey and Azerbaijan.²²⁹ Georgia also took measures to decrease the share of gas in its energy mix. Endowed with significant hydropower potential, Georgia increased its domestic production. The government launched infrastructural rehabilitation programmes. The Czech company Energo Pro purchased electricity assets in Georgia at a significantly lower price than its initial offer (US\$132 million versus \$312 million) – but only under the condition that it would invest an additional \$285 million in infrastructure, asset rehabilitation and new capacity.²³⁰ In 2007, for the first time ever, Georgia became a net electricity exporter.²³¹

Bendukidze's critics allege that his aggressive privatisation policy helped transfer important assets into Russian hands, undermining Georgia's security. Yet Russian investors had already been the most important investor group in Georgia *before* the Rose Revolution. Chubais' RAO UES, for example, had purchased electricity assets in Georgia in the summer of 2003, when Bendukidze was still in Russia. The assets in question had previously belonged to an American owner, AES Silk Road. Even prior to the deal with AES, RAO already controlled half of Georgia's power transmission lines.²³²

No other deals of comparable magnitude took place after Bendukidze's return to Tbilisi. The number of post-2004 actual privatisation deals involving Russian investors is not great. One took place in November 2005, when Stanton Equities Corp., a London-based subsidiary of a Russian group called Industrial Investors (Prominvest), purchased Georgia's main gold mine (Madneuli) and a subsidiary. The buyer paid \$35 million for a 97 percent stake in Madneuli and an additional \$16 million to the state budget to cover the company's debts.²³³ The deal accounted for approximately one-fifth of total privatisation revenue in 2005.²³⁴ A smaller sale involved "Azoti", a large mineral fertilizer plant in the city of Rustavi, acquired by the Energy

²²⁸ "Ex-Estonian PM Becomes Saakashvili's Aide for Reforms," *Civil Georgia*, 10 May 2006.

<http://civil.ge/eng/article.php?id=12520>

²²⁹ "Georgia Will Buy Gas from Turkey," *Kommersant*, 24 December 2006.

<http://www.kommersant.ru/news.aspx?DocsID=996584>. And Liz Fuller, "Caucasus: Georgia, Azerbaijan Seek Alternatives to Russian Gas," *RFE/RL*, 5 January 2007. <http://www.rferl.org/content/article/1073826.html>

²³⁰ "Czech Company Takes over Majority of Georgia's Energy Market," *Civil Georgia*, 5 February 2007.

<http://www.civil.ge/eng/article.php?id=14566>

²³¹ Government of Georgia, "About the Georgian Power Sector – Press Release", 24 December 2008, p. 2.

http://www.investinggeorgia.org/uploads/file/34_1415_755125_GOVERNMENTOFGEORGIAANNOUNCESTHESALEOF100OFORTACHALAHYDROPOWERPLANTTOENERGO-PROGEORGIA_081222.pdf

²³² "Shevardnadze Dismisses US Criticism, Hails UES Entry", *Civil Georgia*, 4 August 2003.

<http://civil.ge/eng/article.php?id=4701>

²³³ "London-Based Stanton Equities Corp Wins Mining Company," *Civil Georgia*, 1 November 2005.

<http://civil.ge/eng/article.php?id=11080>

²³⁴ Calculations made on the basis of the data available from privatization.ge.

Invest company for \$20 million in September 2005.²³⁵ According to its own website, Energy Invest was founded in 2004 by “Russian and Georgian business groups.”²³⁶ However, Azoti’s largest shareholder since 2002 had been Itera, an independent gas producer from Russia. In 2004 Bendukidze announced that Itera had failed to meet its investment commitments for Azoti. A Rustavi court ruled that the plant was bankrupt, and in the subsequent auction Energy Invest offered \$20 million for the controlling stake in Azoti – a much greater amount than the \$5 million offered by Itera.²³⁷

Among other post-Rose Revolution deals mentioned by Bendukidze’s critics is the takeover of the United Georgian Bank by the Russian state-controlled Vneshtorgbank in 2005. This did not, however, constitute privatisation: the United Georgian Bank had been privatised as early as 1995. The liberalisation of the economy led foreign investors from various countries to buy into Georgian banks or to establish their branches in Georgia. By the end of 2007, out of 20 commercial banks in Georgia, 14 featured the participation of foreign capital from diverse sources. The share of foreign investment in the capital stock of commercial banks was more than 64 percent.²³⁸

Finally, a few proposed privatisation deals involving Russian investors never actually took place. A much-discussed sale of the Chiatura manganese factory to Russia’s industrial group Evrazholding did not materialise, as the potential buyer pulled out of the agreement. Due to the lack of full transparency in the Georgian privatisation process – the government’s website on privatisation contains information on assets and sales, but the list is incomplete and information on buyers is often scarce – rumours circulated that many more enterprises were transferred into Russian hands on the sly. There is no evidence to support such claims, however, when it comes to larger, more visible and strategic transactions. One of Georgia’s most significant privatisation deals took place in 2006. It involved the sale of several hydro power plants and energy distribution companies to the Czech company Energo Pro, which became the leading electricity distributor in Georgia. Some alleged that Energo Pro was acting as a façade for Russian interests.²³⁹ Nothing has come up so far to substantiate such claims, however, as a 75-percent stake in the company is held by Jaromír Tesa, a Czech millionaire.²⁴⁰

Likewise, Gazprom was unable to obtain control over the Georgian gas transportation network in 2005, despite its offer of lower gas prices in exchange for these assets. (This plan had always been strongly opposed by the Georgian opposition, as well as the United States, for fear that it would give Russia too much influence in the Caspian energy sector. In February 2005, Steven Mann, the US State Department’s senior adviser on Caspian Basin energy issues, stated that the sale of Georgia’s gas pipeline “would mean that our chance to

²³⁵ “Interview -Georgian fertiliser firm plans more investment,” *Reuters*, 8 February 2008.

<http://uk.reuters.com/article/idUKANT83705920080208>

²³⁶ Energy Invest, official website. <http://www.energyinvest.ge/eng.html>

²³⁷ “Georgia Sold Azoti” (in Russian), *Kommersant*, no. 173 (3257), 15 September 2005.

<http://kommersant.ru/doc.aspx?fromsearch=278fcb53-5e90-45d0-93fd-76012a207df5&docid=609144>

²³⁸ These foreign investors included the European Bank of Reconstruction and Development (EBRD), International Financial Corporation (IFC), German “Deutsche Investitions und Entwicklungsgesellschaft” (DEG), German “Kreditanstalt fuer Wiederaufbau” (KfW), JSC “Procredit Holding”, German “Kommerzbank”, Russian “Vneshtorgbank”, Kazakh “Bank Turan Alem”, Austrian “Bank Austria Kreditanstalt”, “International Bank of Azerbaijan”, HSBC EUROPE (Netherlands) and others. Source: National Bank of Georgia, *Annual report 2007*, p. 48. Available at

http://www.nbg.gov.ge/uploads/publications/annualreport/tsliuri_angarishi_2007_eng_bolo_internetistvis.pdf

²³⁹ ESI Interview with Gia Khukhashvili, an independent economic expert in Georgia, 3 November 2008.

²⁴⁰ “Svitavy’s Energo-Pro purchases another hydro-electric power plant in Georgia”, *Financninoviny.cz*, 21 December 2008, <http://www.ceb.cz/content/view/1217/95/>

assure independent and alternative energy resources would be lost.”²⁴¹) Another sensitive sale that was discussed – that of the Georgian Railways to Russia – also failed to materialise.²⁴²

Finally, in late December 2008, Russia’s state-owned electricity trader Inter RAO and the Georgian authorities signed a non-binding memorandum on joint management of the Enguri Hydropower Plant, Georgia’s largest. The Georgian Energy Minister announced the news only two weeks later, in January 2009.²⁴³ The opposition protested against the planned deal, saying it undermined Georgia’s energy security.²⁴⁴ The Abkhaz authorities, too, objected to the plan, claiming they were not involved in the negotiations (Enguri HPP’s five generators are located on the territory of Abkhazia).²⁴⁵ Despite attempts by the management of Inter RAO to find a compromise, the plans for joint management eventually fell through and, contrary to the provisions contained in the memorandum, no legally binding contract was signed so far.

At the same time, Bendukidze’s privatisation policy made Georgia more attractive to a growing number of Western investors. Prior to the Rose Revolution, the latter had been few in number. (The only two worth mentioning were British Petroleum, a shareholder in the Baku-Tbilisi-Ceyhan oil pipeline project, and American-based AES, which pulled out of the country in 2003.) By May 2005, however, David Dumbadze, the Chairman of the Russian-Georgian Business Council, could conclude that “today’s investment market in Georgia is dominated by Western investors.”²⁴⁶

While total FDI for 2004-2008 was US\$5.7 billion, the total volume of Russian FDI in Georgia stood at \$232 million. If one includes all Cypriot investment into the overall Russian figure (since it is a common practice for Russian companies to be registered in Cyprus), the figure increases to \$515 million, less than ten percent of total FDI for this period. This is still a substantial amount. However, over the same period \$702 million of FDI came from the UK, \$531 million from the US, \$438 million from the United Arab Emirates, \$444 million from Turkey and \$307 million from Kazakhstan.²⁴⁷

Describing his critics as “a group of idiots, according to whom my mission in the government was to strengthen Russia’s levers here,” Bendukidze has brushed aside the allegations of “selling out Georgia.”²⁴⁸ Consistent with his libertarian principles, he told Russian *Forbes* in 2007:

“Georgia is a country in which it is good to invest not only for Russian companies, but for any companies. By the way, one should note that despite the problems created by Russia, Russian

²⁴¹ Diana Petriashvili, “Georgia: No Gas Pipeline Sale – For Now,” *EurasiaNet.org*, 9 March 2005.

<http://www.eurasianet.org/departments/business/articles/eav030905.shtml>

²⁴² “Georgian Railway Not Being Sold to Russia,” *Messenger Online*, 15 June 2009.

http://www.messenger.com.ge/issues/1875_june_15_2009/1875_econ_one.html

²⁴³ “Russia, Georgia to Jointly Manage Enguri Power Plant,” *Civil Georgia*, 12 January 2009.

<http://www.civil.ge/eng/article.php?id=20257>

²⁴⁴ “Opposition Cries Foul Over Enguri HPP Deal,” *Civil Georgia*, 13 January 2009.

<http://www.civil.ge/eng/article.php?id=20261>

²⁴⁵ “Abkhaz Leader ‘Bewildered’ over Russia-Georgia Enguri HPP,” *Civil Georgia*, 20 January 2009.

<http://www.civil.ge/eng/article.php?id=20292>

²⁴⁶ “Svyato mesto pusto ne byvaet: interview with the Chairman of the Russian-Georgian Business Council, David Dumbadze,” (in Russian), *REGNUM*, 26 May 2005. <http://www.regnum.ru/news/460274.html>

²⁴⁷ All data taken from the Georgian statistical office, www.statistics.ge.

²⁴⁸ Kakha Bendukidze, “Bendukidze On His Dismissal,” *Civil Georgia*, 8 February 2009.

<http://civil.ge/eng/article.php?id=20392>

companies enjoyed the same conditions here as all the rest. No one tried to interfere with them or limit them somehow.”²⁴⁹

In numerous interviews given to the Russian press after he joined the Georgian government, Bendukidze supported the official Georgian stance on issues such as territorial integrity. He argued that the reintegration of the breakaway republics is rightfully a priority for Georgia:

“Our dream, our goal is to restore our territorial integrity and, simultaneously, to turn Georgia into a normal, developed, successful and prosperous state. These goals are not shared [by Russia]. We do not see how you can become a successful country if you have an unresolved territorial problem and we do not understand how you can solve this problem without turning Georgia into a successful country. That is what we want.”²⁵⁰

Commenting on the loss of the Russian market for Georgian wine exporters due to the Russian embargo, Bendukidze scoffed at the “legends circulated in Russia, which said that Russia can bring Georgia to its knees by introducing an embargo.”²⁵¹ Discussing divisive issues with Russia, including NATO membership, was impossible, he argued. After the August 2008 war, Bendukidze noted that Russian policy-makers were ignorant about the true internal developments in Georgia: “I have always said that one of the main problems of Russian authorities is the lack of objective information.”²⁵² According to Bendukidze, Russia had initiated the August 2008 war in order to topple Saakashvili’s regime – and failed.²⁵³

In the end, a closer examination of Bendukidze’s four and a half years of influence in government does not show that Russian business interests in Georgia became significantly stronger. Bendukidze’s privatisation policy and reforms attracted diversified inflows of FDI from multiple sources. In the energy sector, instead of becoming more dependent on Russia, as some had feared, Georgia did just the opposite, on its path to becoming an electricity exporter.

Ironically, if Bendukidze helped isolate Georgia from the EU, and made it more vulnerable to Russian influence, he did not do so by supporting Russian designs for a liberal empire but by importing – from Russia and a handful of conservative US think tanks – a sceptical and dismissive view of the European Union. It is to this, and to the more serious criticism of his libertarian revolution, that we turn next.

²⁴⁹ (in Russian) Kirill Gorskii, “Interview with Kakha Bendukidze: I Am Useful” («Я приношу пользу»), *Forbes*, 15 November 2007. <http://freader.net/archives/14>

²⁵⁰ (In Russian) Boris Dolgin, “Interview with Kakha Bendukidze: There Won’t Be Any Exchange of Political Views on Comfortable Life/ «Обмена политических взглядов на комфортную жизнь не будет», in Russian), *Polit.ru*, 10 October 2006. <http://www.polit.ru/analytics/2006/10/10/bendukidze.html>

²⁵¹ Vladimir Fedorin, “Keynesianism Is a Phlogiston Theory’: interview with Kakha Bendukidze” (in Russian), *empedocl’s LiveJournal blog*, 23 April 2009. <http://empedocl.livejournal.com/56273.html>

²⁵² (in Russian) Dmitry Bykov, “Kakha Bendukidze: Russia Will Change When I Become Slimmer” (Каха Бендукидзе: «Россия изменится, когда я похудею»), *Profile*, no. 4 (607), 9 February 2009. <http://www.profile.ru/items/?item=27982>

²⁵³ (in Russian) Dmitry Bykov, “Kakha Bendukidze: Russia Will Change When I Become Slimmer” (Каха Бендукидзе: «Россия изменится, когда я похудею»), *Profile*, no. 4 (607), 9 February 2009. <http://www.profile.ru/items/?item=27982>

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