Economic Liberalism in Georgia

A Challenge for EU Convergence and Trade Unions

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- Two decades after the end of real existing socialism in Georgia, ideology has again become a problem – this time emanating from the far right. Important economic policy makers subscribe to a radical libertarianism. They fundamentally reject intervention in the economy, and provision of public goods such as education and health care by the state.

- The government's anti-regulatory economic policy slows down the country's convergence with the EU. The refusal to strengthen economic regulatory authorities is directly at odds with the need to adopt European standards and regulatory procedures.

- Georgia passed a new Labour Code in 2006 that is widely regarded as one of the world's most unfavourable towards employees. The dismantling of employee and trade union rights in the wake of this law brings Georgia into conflict with ILO core labour standards and the European Social Charter. Instead of a reform of the Labour Code, the country's trade unions are systematically put under pressure.

- Anyone opting for a libertarian experiment such as the one in Georgia also opts for an authoritarian government style. The drastic structural adjustments would not be enforceable in any other way. The ideology-bound economic policy is therefore directly linked to the country's deficit in terms of democracy.

1. When Ideology Becomes a Problem

The majority of international observers writing about Georgia's economy take a positive view. The general consensus is that, since the 2003 »Revolution of Roses«, the country is on the right path, economically, and that it has developed into an attractive investment location, thanks to the fast and extensive privatization of state assets and the liberalization of foreign trade, the labour market and important economic sectors. There is some evidence supporting this view: high, frequently two-digit growth rates between 2004 and 2008, foreign direct investments doubling in the same period, a tenfold increase of the total budget between 2004 and 2009, and favourable positions in international rankings including, for example, 11th place in the World Bank's 2010 »Doing-Business Report«, or 26th place in the »Index of Economic Freedom« compiled by the American Heritage Foundation.

These statistical effects are impressive, but not surprising. They set in, as countries like Poland, Estonia or Latvia have shown, after a slight delay following the market economy's initial structural adjustments, once the sale of state assets and liberalization of important markets brings liquid cash into the country and its household coffers.

There is no panacea for the question of how to proceed after such first incremental reforms. Eastern European countries that have successfully transformed themselves created a regulatory framework that allowed better market functionality and introduced higher standards, thus controlling the ongoing process of liberalization and privatization. The failure to create such a framework can be an indication that liberalization and privatization have become an end to a means for decision-makers, which they cling to even long after current economic and social needs dictate another direction.

Georgia appears to be just such a case. Important economic policy decision-makers subscribe to a radical libertarianism. Supporters of this anti-state school of thought want to leave as many areas of society as possible down to individual personal responsibility or market forces. They regard state intervention in the economy and the provision of public goods such as education and health care by the state as a disenfranchising and inefficient evil. Or, as Lasha Bendukidze, the spiritus rector of Georgia's economic reforms, puts it: »To ask the government for help is like trusting a drunk to do surgery on your brain.«[1]

Many of the reforms Georgia's libertarian camp has implemented since 2004 have been guided by this spirit. There is not much left of the regulatory framework of institutionalized rules and processes through which the state enables orderly and free competition. The labour market has been deregulated to such an extent that both the International Labour Organization (ILO) and the EU have noted fundamental violations against ILO core labour and social standards. Labour inspections for the monitoring of compliance with health regulations at the workplace have been abolished. Food safety inspections had been suspended for years and a new food safety strategy has only been developed in 2010 after massive pressure from the EU. Anti-monopoly laws and competition authorities have been replaced by a system which no longer allows the state to fight monopolies and ensure fair competition. A new competition strategy developed to meet EU requirements for starting negotiations on a Deep and Comprehensive Free Trade Agreement (DCFTA) has not yet let to legislative changes.

In October 2009, the president announced his intention to prohibit the creation of new supervisory authorities, and to oblige the state to have future tax increases approved by the majority of the population in referendums. Indeed, these referendums became binding for the government in December 2010 when the parliament adopted the respective constitutional amendment. According to the president, these and other measures are aimed at »preventing the government executive from changing course away from economic libertarianism«, and at turning the country into a »real flagship of worldwide economic liberalisation«.[2] However, even this is not enough for some of the Libertarian think-tanks in the country. They demand a complete abolishment of all regulatory authorities, constraints and licensing procedures in the economy.

This clearly shows: two decades after the demise of real existing socialism, ideology has once more become a problem in Georgia – this time emanating from the far right.

1. Quoted from ESI (2010): »Georgia's Libertarian Revolution. Part 1: Georgia as a model« p. 10. European Stability Initiative: Brussels.

2. See »Saakashvili Lays Out „Act on Economic Freedom"« Civil Georgia, Tbilisi. 6 Oct. 2009. www.civil.ge.

2. Singapore of the Caucasus?

Believing that the market can regulate things better than the state does not constitute an economic policy concept as such. The anti-state approach used to tackle most economic policy issues says very little about which role model the country's economy is actually supposed to follow.

One good example for the absence of an actual economic policy model is the agriculture sector. As Georgia's resource situation favours an agrarian economy, one would expect the government to focus on developing the agricultural sector. However, this sector's yields continue to dwindle from one year to the next. Although over 55 per cent of the labour force are employed in agriculture, it accounts for only 12 per cent of GDP. The sector's unproductiveness reflected by these figures has also led to growing foreign trade deficits. Whilst the import of agricultural products has more than doubled between 2004 and 2008, there has been a decline in exports over this period. This deficit is hardly surprising, given the fact that important export goods such as wine, oranges, lemons and tea continue to be produced by small family-run businesses. Ninety-nine per cent of the 2009 citrus fruit harvest, and more than 90 per cent of grapes come from family-owned micro-enterprises.[3] These businesses lack the capital required for investments and productivity increase, neither do they have access to loans. Yet, the government has so far failed to develop a policy for supporting Small- and Medium Enterprises (SMEs).

Without state intervention, government incentives and regulations, the agricultural potential will continue to remain untapped. An unwillingness to regulate the market, however, is a hindrance to agricultural export sector development. The growing hardships experienced by a rural population faced with double-digit inflation rates may have motivated the president's March 2011 announcement to allow state intervention in the primary sector. Whether this announcement will actually lead to a turnaround in agricultural policy remains to be seen. Without such a turnaround, Georgia will not be able to increase its EU exports in the foreseeable future. Currently, hazelnuts account for 71.6 per cent of these exports.

Nevertheless, Georgia's president thinks it is realistic to assume that the country will be on par with the Gulf emirate Dubai in five to seven years. Apart from this Gulf state, government representatives regularly cite Singapore and Hong Kong as Georgia's role models – regardless of the fact that none of these countries can pride themselves on high democratic standards, they are renowned mostly for the protection of declared sectors and state-controlled development of new industry branches during their economic boom periods in the 1960s and 70s. Singapore and Hong Kong never came anywhere near the deregulation and state abstinence exercised by the Georgian government.

3. EU Convergence at Risk?

The government's anti-regulatory economic policy slows down Georgia's harmonization with the EU. Although the country is making headway in the implementation of the ENP action plan and the harmonization with European standards in many areas, economic, labour and social policies are not included. As far as those are concerned, the decision-makers' belief in a free market blocks the necessary reforms. The unwillingness to empower supervisory authorities to regulate important sectors is directly at odds with the need to adopt European standards and regulatory procedures. Stefan Füle, the European Commissioner for Enlargement and European Neighbourhood Policy, therefore lamented, when introducing the latest ENP progress report in May 2010, that the »ultra-liberal economic environment« in Georgia were not in line with the „pillars" of EU-Georgia future partnership.[4] The Georgian president, known for his self-confidence, turned the tables, holding out the prospect of EU harmonization with Georgia instead: »The global economic crisis hit a powerful blow to the project of social Europe. I think Europe will make more steps towards free economy and we will eventually meet somewhere in midway.«[5]

The brunt of this policy is borne by consumers, employees and small-scale entrepreneurs. Important markets such as the pharmaceutical market or the energy sector are controlled by monopoly enterprises. The number

3. See Deutsche Wirtschaftsvereinigung Georgien. DWVG Newsletter July 2010.

4. Quoted from »Saakashvili: Act of Economic Liberty Planned in Autumn.« Civil Georgia, Tbilisi, 21 September 2010. www.civil.ge.

5. Ibid.

of registered cases of food poisoning rose from 388 to 2035 between 2002 and 2007, although the number of unrecorded cases probably exceeds these figures several times over. Work-related illnesses, as well as serious and often fatal accidents at the workplace, are widespread. There is no longer any statutory health insurance. Instead of investing the scarce resources into the long-term development of social security systems, the social policy pursues a lord-of-the-manor approach: when the hardship becomes too apparent, as in the spring of 2011, when inflation rose above 12 per cent, the government reacts with the distribution of one-off vouchers for food and electricity. From the off, there is no such thing as an employment market policy, as the distribution of the factor labour is seen as the exclusive remit of the market. The EU Commission's ENP progress report for 2010 therefore also concluded: »As regards employment, Georgia has no specific employment strategy in place and no employment implementing agency.«[6]

4. Example Labour Relations: Dismantling of Social Standards and Pressure on Trade Unions

In no other area is the gap between ideological claims and economic necessities as wide as in the field of labour relations. In 2006, Georgia passed a new Labour Code that is widely regarded as one of the world's most unfavourable towards employees. Sections 37 (d) and 38 (3) allow the termination of employee contracts by the employer without just cause. Employers are not even required to observe a notice period (in contrast to the employees) when issuing a termination of contract. All they are obliged to do is pay one month's severance pay. The law does not provide express rights to union participation, representation and collective bargaining. If a company's employees already enjoy union representation, the employer can ignore this, and enter into either individual employment contracts or wage agreements with non-unionized employees. Strikes may not exceed 90 days and need to be preceded by warning strikes. The law does not provide for a right to sympathy strikes in solidarity with other industries or companies. »Illegal« striking is in turn punishable by imprisonment for up to two years. The number of members required to establish a union, one hundred, is disproportionally high in international comparison.

6. See European Commission (2010): Implementation of the European Neighbourhood Policy in 2009: Progress Report Georgia«, Brussels 12/05/2010 Sec (2010) 518. p. 10.

The erosion of employee and union rights in connection with this law soon brought Georgia into conflict with the ILO conventions ratified by its own parliament, and with the European Social Charter, which the country has committed itself to. There are many known cases of employees losing their job because of their trade union activities. These include nine unionized dock workers in Poti, who were sacked on 23.10.2007 after demonstrating for their right to wage negotiations. One employee was fired by power company GSE on 6.3.2008, because she had demanded wage negotiations from the management. On 11.4.2008, nine employees of a Georgian textile company were dismissed after being elected to the company's newly established trade union committee. This list could be continued indefinitely. The International Trade Union Confederation (ITUC) counts at least 30 individual cases where people have been laid off because of their union activities. The Georgian Trade Union Confederation GTUC estimates that it has lost 20,000 members in the wake of the new Labour Code because of intimidation and the dismantling of trade union structures in companies.

Once the Georgian unions publicized these and other, similar cases, Georgia was asked by the International Labour Organization (ILO) to guarantee better protection for core labour standards. The ILO also noted violations of conventions ratified by Georgia, in particular conventions 87 (Right to Organize) and 98 (Collective Bargaining). In June 2010, the case of Georgia was even heard during the ILO general meeting by the committee for monitoring compliance with ILO conventions. In the final statement, the government is called upon to take concrete action for reforming the Labour Code and intensifying social dialogue.

Meanwhile, the violation of core labour and social standards has also caught the attention of the EU Commission. Just like the ILO, the Commission demands a reform of the Code and links this to progress in the negotiations concerning further trade integration between the EU and Georgia as part of the preferential trading agreement GSP+. However: despite this demand, made as long ago as early 2008, the GSP+ agreement was renewed in December 2008 for a further three years, i.e. until 2011. As to whether the EU will actually make the reform of the Labour Code a prerequisite for the new negotiations, therefore introducing conditionality into the proceedings – we can only wait and see. Scepticism seems to be in order as the EU and Georgia are planning negotiations for a Deep and Comprehensive Free Trade Agreement (DCFTA) that goes beyond GPS+. Employment standards will play a role in the preliminary talks but have so far, apparently, not been given much priority by the EU.

The government has so far paid little heed to the demands voiced by the European Commission, ILO and Georgian trade unions. And although a Tripartite Commission on Social Dialogue has been established on the national level in November 2009, this has so far not led to a reform of the Labour Code.

Displeased by the growing international pressure, the Georgian government has adopted a sharper tone towards the country's trade unions. The government, unaccustomed to having to coordinate its decisions with other domestic policy decision-makers, increasingly appears to perceive the rising resurgence of the trade unions as a disruptive factor. By now, yellow trade unions are being given support with the aim of weakening the real unions, both politically and organizationally. This includes the yellow trade union »Educational Professional Syndicate«, which was established in 2008 in the education sector and which enjoys the support of the Ministry of Education. In June 2010, the same Ministry tried to starve the Georgian teachers' union ESFTUG financially by decreeing that the members' dues retained by employers should no longer be forwarded to the union. Since September 2010, the railway workers' union has also been hit by these state-imposed sanctions. Whilst the admissibility of such measures is still being disputed judicially, the border of legality has already been crossed in other areas. By now, leading union officials are also subjected to personal threats and/or put under personal pressure. In the spring of 2011, the chairwoman of the Georgian teachers' union reported an attempt to make her resign from her office, in order to prepare the ground for new elections to make room for a government-loyal candidate. Her failure to do so was apparently followed by threats and intimidation. In March 2011, legal proceedings were then instituted against the education union, in order to enforce a snap election by juridical means. Many international observers see this as a politically motivated trial.

The Georgian government is unnecessarily creating problems for itself through its refusal to subject the Labour Code to a reform, and through its questionable approach to fundamental social and employment rights. Bringing the Labour Code in line with ILO standards would neither deter investors, nor would it destroy jobs. Incidentally, the official unemployment rate has climbed from 13.6 to 16.9 per cent since the Labour Code was introduced, and protection from unfair dismissal abolished. The frequently disproved theory that lax protection from unfair dismissal and few workers' rights boost employment levels also turned out not to hold true in Georgia.

5. Economic Liberalism and Deficient Democracy

The described problems regarding economic policy are closely linked to the state of Georgian democracy. Denying people essential social rights also keeps them from exercising their political civil rights, either at all, or to their full extent. Georgia provides telling examples of this. The country has, for example, been criticized for many years for deficiencies regarding freedom of opinion and freedom of the media. However, one aspect that is rarely made explicit in this context is the link between a limited freedom of opinion and the lack of labour rights for journalists. All the more surprising as it is so obvious: the fact that journalists and creative people working in the media lack protection from unfair dismissal throws the doors open to political censorship. In Georgia, journalists who report or research »disobligingly« can be dismissed without citing reasons for dismissal. This practice is hardly going to change if dismissal protection is not improved, and the interests of media professionals are not properly represented.

Anyone opting for a libertarian experiment like Georgia's also opts for a non-participative and non-consultative style of governing. The drastic structural adjustments would not be enforceable any other way. It is therefore not surprising that neither employers' nor employees' associations were consulted before the Labour Code was passed. However, that is not all: such an experiment also demands that organized interest groups are kept small. The state does not want to risk a watering down of its libertarian agenda by coordinating it with stakeholders and social partners. The above described treatment of trade unions confirms this, as currently, the unions are the only member-based power with growing political influence, owing to the weak opposition.

The treatment accorded to the trade unions is a foretaste of the government style to be expected in this country until the next presidential elections in 2013. More democracy is not likely to be on the agenda. If such a will did exist, it would have resulted in democratic reforms since 2003. As recently as September 2008, president Saakashvili promised a »second Revolution of Roses« with extensive democratic reforms before the UN General Assembly. But despite the governing party's absolute majority in parliament, the promised reforms have still not materialized.

Instead of implementing democratic reforms, it is more likely to be expected that the government will use the time until 2013 for securing its power base. The proceedings against trade unions, described above, appear to confirm this. The constitutional reform currently under discussion also points in this direction. The ruling party intends to enhance the powers of the prime minister and weaken the office of the president by way of a constitutional amendment. The trick: although the changes will already be decided on in the coming weeks, they are not to come into force until 2013, i.e. at the point in time when the current president can no longer run for this office, after two terms. He could then continue to determine the fate of the country as prime minister. The northern neighbour Russia has already demonstrated how such a gambit can come off.

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