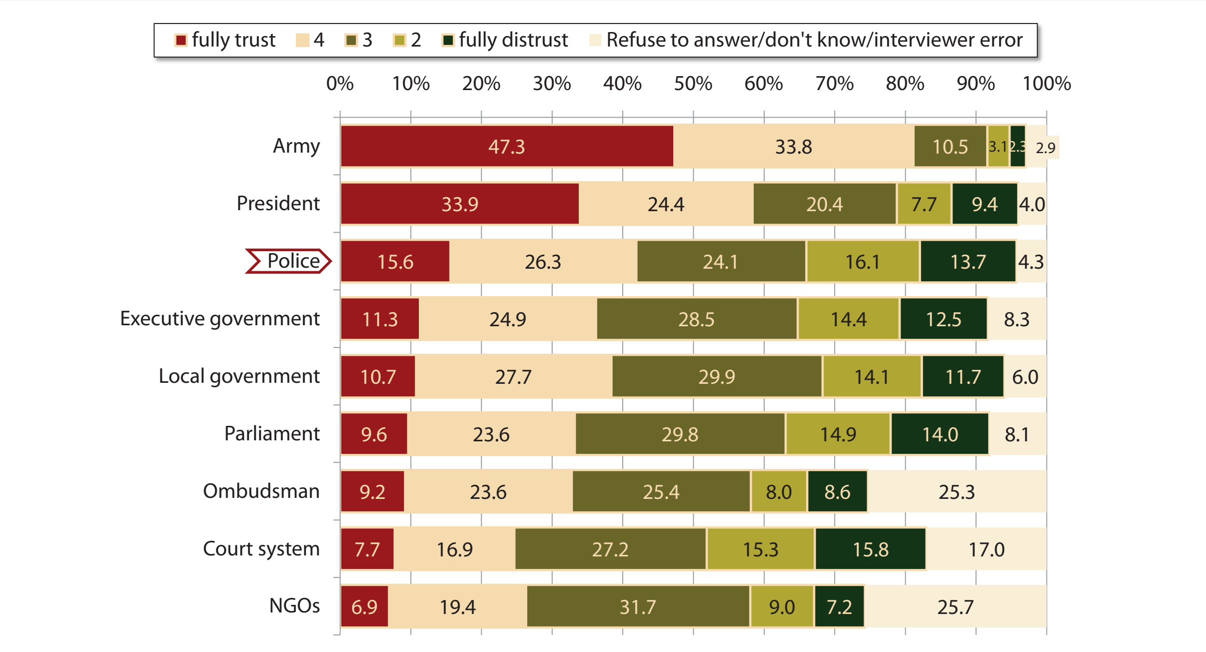
OPINION POLL

Trust in Institutions

Figure 1: Please assess your level of trust toward each social institution on a 5-point scale, where '1' means "Fully distrust", and '5' means "Fully trust".



Source: representative opinion polls by the Caucasus Research Resource Centers. 2010 "Caucasus Barometer". Retrieved from http://www.crrccenters.org/caucasusbarometer/ *on {13.04.2011}.*

The Business Climate and Anti-Corruption Measures in Georgia

By Molly Corso, Tbilisi

Abstract:
When Georgian President Mikheil Saakashvili came to power following the Rose Revolution, the Georgian economy was in shatters. A pervasive shadow economy had grown up in the chaos and corruption of Edward Shevardnadze's rule. The government received a fraction of the tax revenue it was owed. Foreign investment was nearly non-existent, limited largely to oil pipelines. Saakashvili's anti-corruption and pro-business reforms have had a huge impact improving investment and business confidence—although concerns over the government's use of the tax authorities and judicial system persist.

Building for Business

It is hard to underestimate the Georgian government's commitment to creating a friendly environment for investors. While this task is nominally the prime minister's job, Saakashvili himself has become the face of business policy. He frequently goes on live television to single out ministers who have let corruption flourish and fires bureaucrats who allow investors to slip away.

He personally opens small and medium size factories around the country, quizzing new CEOs about employment rates, conditions and salaries.

The country has received numerous awards and accolades from the World Bank and Freedom House for its pro-business reforms: largely efforts to streamline government regulation and reduce government interference. The oft-cited statistics—open a business in just a day, no minimum salary, the absence of bribes—have become the mantra for government efforts to attract investment.

And, to a noticeable extent, the message has worked: in March when Donald Trump signed a deal with the Silk Road Group, led by Georgian businessman George Ramishvili, to develop new luxury properties in Georgia, he started his speech by listing off Georgia's many awards. The Donald joked, in fact, that America would be so lucky to rank as high as Georgia in the fight to ease obstacles for business.

But even as the Trump deal bolsters Georgia's image as a place to do business, it also raises questions about why big names like Trump opt for branding or licensing deals rather than direct investment.

Foreign Direct Investment (FDI)—a vital source of revenue for the government budget—improved from just under $500 million in 2004 to $2 billion in 2007, before suffering from the double hit of the August 2008 war and the global financial crisis. In 2008, inflows dropped to $1.5 billion and the figures continue to slip in subsequent years. In 2010 it fell a further 16 percent from 2009 to just $533 million.

The reasons for the lack of investment are many and complex. In the global economy today, investment is lower than it was before the 2008 crisis, so Georgia is competing against many more countries for fewer dollars. Georgia's small market and overall economy lack the spending power of its neighbors. Access to Georgia is an additional issue: despite new agreements with the European Union on air links and more airline carriers offering flights to Georgia, it is still difficult and expensive to fly into Tbilisi or Batumi.

The government's laissez-faire policy has also had its downside: the lack of food safety regulations and anti-monopoly laws feed into fears that the market may be too unruly for businesses used to a more structured environment. For example, bakeries have complained that unscrupulous competitors are using inferior ingredients to make products they sell at prices that undercut high quality bread. In March, Georgian television aired a report accusing bakeries of adding dye to bread to make it black or brown—and selling it as wheat or rye at a higher price. Without regulation, companies that follow substandard health and sanitary standards are able to produce and sell products for a fraction of the price as companies that follow stringent international standards—in direct violation of fair competition.

Other issues could also play a role, including perceptions about the country's security—concerns about a replay of the 2008 mini-war linger—and years of complaints against the authorities' use of tax audits and the judiciary for political purposes.

Tax Audits, Financial Police and Other Worries

In 2004, when Saakashvili and his government welcomed prominent Russian tycoon Kakha Bendukidze to guide the country's laissez-faire economic reforms, wiping out corruption was synonymous with improving the business climate. Corruption in all its forms—unnecessary licenses, unwieldy legislation, illegal shadow trading and epidemic tax fraud—was strangling the state and cutting into business profits.

Televised scenes showing intimidating men in masks with big guns arresting corrupt business owners—usually the friends and relatives of disgraced politicians—became a symbol of Saakashvili's strength in the face of corruption, the deadly cancer Shevadnadze had been too weak to eradicate.

But then the fight against tax evasion continued to evolve, targeting other, less obvious businesses and public opinion began to change. Small and medium-sized business owners were quickly disenchanted, especially when the government began requiring cash registers and receipts to document cash sales. These measures sought to bring all sales into the open, but high fines and unclear laws caused confusion among merchants who were already suspicious that the tax authorities were working against them. Large companies, with accountants and extensive contacts among government officials, complained more quietly that tax officials were poorly trained—or simply too afraid to make decisions in favor of business.

The government took heed of popular concerns. Work on improving the tax and customs code continued, while the financial police were "decriminalized" and demoted to being just one more department of the newly created Revenue Services in 2006.

Of course, not all efforts proved to be popular. A string of evictions targeting restaurants and kiosks in 2007 and a controversial decision to tear down a residential building officials claimed was illegally constructed all added to the mass street protests against the Saakashvili government in November 2007.

Despite the ruling party's electoral success in 2008 and 2010, the perception that the authorities were willing to use the all-encompassing accusation of corruption to vindicate decisions against private business interests persisted. The decision to reinstate the financial police—renamed the Investigation Service—in 2009 compounded fears that the government was turning to business to make ends meet after state coffers were hit by the war and global financial crisis.

Concern grew to the point that complaints against the tax authorities had an impact on a 2009 International Finance Corporation report on Georgia's competitiveness. Businesses of all sizes continued to have the impression that the government's fight against corruption had turned against the very entities it was supposed to protect. A noisy case against a large electronics chain in August 2009 crystallized the fear that the government was willing to sacrifice businesses for short term tax profits regardless of the risk of long term damage to the country's reputation. Until 2011, in fact, simple mistakes in tax returns were subject to jail time if the error was worth more than 25 thousand lari (€10.3 thousand).

Judicial reform has faltered and lawyers complain that judges routinely rule in favor of the government. The recent case against two Israeli businessmen found guilty of attempting to bribe a government official is the latest example. While there appears to be substantial evidence that the two men were not opposed to paying a bribe, there is a lingering question of who initiated discussions about the bribe—and for what purpose.

And, despite the fact that the Ministry of Finance established an arbitration commission to determine if cases against tax payers were fair, lawyers and associations continued to complain that tax authorities were punitive and aggressive.

While Georgia has continued to score highly as a business-friendly country according to international indexes, by 2010 there was a growing sense that there was a gap between the scores and reality. The World Bank report and others measure how laws impact areas that affect business, not perceptions or confidence—important indicators that can influence investors' decisions.

While the government has claimed those fears are largely unfounded, they stubbornly cast a shadow over attempts to elevate business concerns. The U.S. government's latest, $40 million, four-year program to help bolster business in Georgia is a good indication that outsiders still find it difficult to do business in the county. After the heyday of breaking down barriers for business and changing laws—when the stroke of a pen could radically change Georgia's image as a potential investment destination—today attention is focused on how the laws are being implemented on the ground. Ultimately the effectiveness of the US program will be determined by Georgia's future ranking in relation to other countries as a place that welcomes business.

A New "Partnership"

In December 2010, Saakashvili announced a new stage in the "partnership" between the government and the business community. His comments, which came after a period of intense negotiations between business groups and the government over changes to the tax and customs code, focused on restoring trust between local business and the state.

Beyond reaching out to local business, officials adopted other measures to reassure the foreign business community. Prime Minister Nika Gilauri met with influential Georgian and foreign CEOs and business leaders to consult on who should be appointed as the country's new tax ombudsman, and Parliament Speaker Davit Bakradze agreed to chair a business committee with representatives of the opposition, the finance committee and major business associations. In addition, the Ministry of Finance replaced the head of the Revenue Services as a prelude to a massive restructuring of the tax and customs administrations. Further lines of communication between business and the government are planned through the tax ombudsman's office, including a commission to evaluate tax authority decisions. Also, the Prime Minister's office is working on a new competition law to address some concerns about the potential for monopolies in the market.

Conclusion

The Georgian government has clearly made business a priority for the country. A small country with limited resources, Georgia relies on investment—foreign and local—to balance its trade deficit and create employment. The fight against corruption the government initiated nearly eight years ago is a central aspect of its policy to create an environment that is friendly and attractive for business.

Saakashvili's government has made fighting corruption a pillar of the state he created—and it is an important battle to ensure businesses have the ability to grow and prosper. Creating a culture in which individuals pay their taxes has not been a simple task, but the government is succeeding.

But after so many years of reforms, problems—underscored by the perception that officials are eager to fine first, ask questions later—cast a shadow on their success. The new policy of more communication with businesses and a new "partnership" between the business community and the government is a good start to resolve those issues. It will take time, however, to strengthen trust between authorities and entrepreneurs.

About the Author

Molly Corso is a freelance journalist based in Tbilisi. She is also the editor of Investor.ge, the business magazine published by the American Chamber of Commerce in Georgia.