

# BTI 2010 | Georgia Country Report

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This report is part of the Transformation Index (BTI) 2010. The BTI is a global ranking of transition processes in which the state of democracy and market economic systems as well as the quality of political management in 128 transformation and developing countries are evaluated.

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## Key Indicators

Population	mn.	4.4	HDI	0.78	GDP p.c.	\$	4662
Pop. growth	% p.a.	-0.8	HDI rank of 182	89	Gini Index		40.8
Life expectancy	years	71	UN Education Index	0.92	Poverty <sup>2</sup>	%	30.4
Urban population	%	52.7	Gender equality <sup>1</sup>	0.40	Aid per capita	\$	86.9

Sources: UNDP, Human Development Report 2009 | The World Bank, World Development Indicators 2009.

Footnotes: (1) Gender Empowerment Measure (GEM). (2) Percentage of population living on less than \$2 a day.

## Executive Summary

In the period under review, serious setbacks marked Georgia's process of political and economic transformation. Recent developments confirmed external and internal observers' growing concerns about the Saakashvili administration's increasingly authoritarian tendencies. Evidence of this trend include a violent crackdown on mass demonstrations in November 2007, substantial interference with media freedom, executive pressure on the judiciary and substantial deviation from the principles of fair elections. In contrast to previous years, an increasingly unified opposition significantly gained in organizational capacities. At the apex of its strength in the fall of 2007, it succeeded in mobilizing more than 50,000 protestors and successfully pushed through preterm presidential and parliamentary elections. At the same time, President Saakashvili and his ruling United National Movement (UNM) proved unable to come up with solutions to the internal crisis. Although the ruling elite managed to secure its political survival – Saakashvili was re-elected to a second term in January 2008 and the UNM gained 119 seats in the May 2008 elections to a new 150 seat parliament – they did so at the expense of further undermining their democratic credentials. Voter turnout was extremely low in the presidential election (56%) and Saakashvili gained the lowest share of the vote (53.47) for president ever in the short history of post-soviet Georgia. After the parliamentary elections 16 out of 30 oppositional MPs refused to take up their mandates on the grounds that they believed the elections were rigged. Moreover, some observers believe that the weakness of democratic institutions and political pluralism contributed heavily to the ill-conceived decision to launch a military attack against South Ossetia in August 2008, which escalated into a full-fledged war against neighboring Russia. The damage inflicted on a still fragile Georgian economy in the course of four days of war was enormous. Growth rates are expected to fall from 12.5% in 2007 and 8.5 % in the first half of 2008 to 2.5% in 2009. The double burden of the global financial crisis and the consequences of the war, which include the creation of thousands of refugees and the destruction of substantial parts of public infrastructure, will weigh heavily on a shrinking state budget.

## History and Characteristics of Transformation

A series of dramatic ups and downs have characterized Georgia's political and economic transformation. After the dissolution of the Soviet Union, Georgia faced the difficult task of managing a post-independence transition that involved not only democratization and the institutionalization of a market economy but state-building and nation-building as well. The development of the republic, which from the outset was hampered by the heavy burden of two unresolved ethnic conflicts and a sharp economic decline (aggravated by pervasive corruption), can be roughly divided into five phases.

1. The first breakthrough to a democratic political regime in Georgia was accomplished with the parliamentary elections of October 1990. The election brought to power a heterogeneous umbrella movement under the leadership of the former dissident Zviad Gamsakhurdia. Despite his landslide victory in the May 1991 presidential elections, he failed to consolidate his rule, which mainly rested on charismatic mobilization. As a result, he was easily driven out of office by a violent coup d'état at the beginning of 1992.

2. The brief interlude of chaos that ensued after the ouster of Gamsakhurdia ended with the return of former party head Eduard Shevardnadze. In the first three years of his rule, Shevardnadze tried to get rid of the competing gangs of criminals that had originally placed him in power. The adoption of a constitution and the successful organization of elections signaled a fragile consolidation. Notwithstanding quite impressive achievements in terms of ending violence and introducing the formal requisites of democratic statehood, and despite massive international assistance, Shevardnadze did not succeed in building stable governing institutions. His political survival depended on the application of two strategies. First, he used access to administrative resources and international development funds as a means to consolidate fluid clientelistic networks. The government thus never acted as a coherent team. Severely weakened by frequent reshuffles, it gained notoriety for the fierce competition between different ministries over the distribution of spoils. Secondly, Shevardnadze manipulated and frequently changed procedural norms regulating access to power. The only continuous feature was a clear dominance of the executive. In contrast, the shape of the parliament was adapted to varying needs. Until 1995, the abolishment of any kind of threshold ensured a highly fragmented legislature. After the creation of the Civic Union of Georgia (CUG) in 1993, which was designed to serve as Shevardnadze's party of power, the introduction of a barrier resulted in a stable majority for the CUG. Pluralism was mainly confined to intra-elite competition inside the ruling party, which was composed of former Soviet apparatchiks and a group of young reformers.

3. These two strategies ceased to function effectively after 2001. The distribution of official fiefdoms among the different cliques of the elite severely hampered economic growth and gave rise to popular unrest. As the international donor community became aware of the increasing gap between legal fiction and corrupt practices, it demonstrated a growing reluctance to continue

funding assistance programs. Confronted with a decline in its authority, the ruling party was compelled to adopt authoritarian measures, a move that provoked an internal split. The attempt to crack down on the independent TV station Rustavi 2 in October 2001 became a turning point. Prominent representatives of the wing of young reformers inside the CUG, headed by Saakashvili, Zhvania and Burjanadze, formed a new opposition that assumed power in the aftermath of popular protests against the rigging of parliamentary elections in November 2003. The relative ease with which Shevardnadze was overthrown during what was to be called the Rose Revolution can be explained partly by the existence of democratic facades erected under his rule. A dense network of NGOs, which had mushroomed during the 1990s, carried out parallel vote counts and organized public protests. Independent media outlets, which had never experienced serious threats to their existence, supported popular mobilization by providing uncensored information. An independent judiciary, established under the influence of the young reformers, canceled the officially announced results.

4. After the accomplishment of the peaceful revolution, the victorious triumvirate of Saakashvili, Burjanadze and Zhvania rushed to stabilize the situation. In a wise move, they joined together in creating a new party named the United National Movement – Democrats. This move put an end to early speculations about internal rivalry. With more than 96% of the popular vote, the charismatic leader Saakashvili gained an overwhelming victory in the presidential elections in January 2004. The newly created party won more than two-thirds of the mandates in the March 2004 parliamentary elections. The new elite was thus awarded with a more than comfortable starting point. Control over the executive and legislative branch of the government made the implementation of a far-reaching structural reform agenda a much easier job. As a result, the government achieved outstanding results in terms of curbing corruption, streamlining an inefficient administration, improving the extraction capabilities of the Georgian state and providing public goods for an economy that experienced a significant upsurge. Despite these impressive results, critics of the new elite pointed at serious deficits and even setbacks in terms of institutionalizing checks and balances. First, the adoption of far reaching amendments to the constitution further weakened a legislative body, which due to the stable majority for the ruling party, was hardly able to exercise its oversight functions. Secondly, the new government stopped short of respecting the independence of the judiciary and was constantly suspected of exercising undue influence over judges. Thirdly, many concerns were raised with regard to state interventions into the independence of the media.

5. Since the fall of 2007, these growing authoritarian tendencies as well as the inability of the ruling elite to translate dynamic economic growth into a significant improvement of living standards for a majority of impoverished citizens gave rise to a series of popular protests and contributed to a deep political polarization. Although there is still no political actor in sight capable of posing a real threat to the ruling elite, a significant slowdown of economic growth caused not only by the global financial crisis but by a serious deterioration of the overall investment climate in the aftermath of the war waged against Russia in 2008 can be expected to contribute to a further undermining of stability.

## Transformation Status

### I. Democracy

#### 1 | Stateness

The period under review saw a sharp decline in the current government's capability of exercising control over the country's entire territory. Already in winter 2007, one could observe a steady rise in violent incidents around the conflict zones in South Ossetia and Abkhazia. Georgian settlements were bombed, regular explosions occurred in the border regions, which caused mounting death tolls; Russian airplanes violating the Georgian air space; Georgian police forces were involved in the killing of Russian service men; and Georgian soldiers were being taken as hostages. In August 2008, the defeat of the Georgian army in a full-fledged war with Russia paved the way for a further loosening of the Georgian authorities' grip on the territories officially under their jurisdiction.

Monopoly on the  
use of force

During the war, Russian troops occupied large parts of Georgia proper, expelled representatives of Georgian power structures from the Upper Kodori valley in Abkhazia and the Akhagori district in South Ossetia. The Russian forces displaced more than 30,000 individuals from formerly Georgian-controlled villages that now found themselves under Russian control. These refugees are unlikely to return to their homes in the near future. In the Gori region on the border with South Ossetia, the Russian military effectively created a no-man's land by denying the Georgian police access to the territory. As a consequence, looting and killing loomed large. In sum, the Georgian government's performance in terms of state-building appears to be quite negative. At the same time, the sheer fact that the Georgian statehood could have been preserved despite an almost deadly confrontation with neighboring Russia, which seems to have pursued an increasingly assertive and neo-imperialist agenda of restoring its former spheres of influence in the South Caucasus, gives evidence to a certain capacity at survival. It points to the fact that notwithstanding obvious weaknesses, Georgia has passed a critical test to its existence – a test it might have easily failed some years ago.

In the territory controlled by the Georgian state, all citizens share the same civil rights. No legal provisions discriminate against ethnic minorities, which represent 16% of the population. At the same time, the significant Armenian and Azeri minorities are still heavily underrepresented in state structures at all levels. Responding to this critical situation, the government established a public administration institute to train minority representatives and started to implement a civic integration program. Critics, however, claim that besides investment in roads and infrastructure rehabilitation in areas of minority settlement, efforts are mainly directed at improving facilities for the teaching of the Georgian language. At the same time, measures aimed at satisfying the specific cultural and linguistic needs of national minorities are still underdeveloped.

State identity

Though the Orthodox Church of Georgia still enjoys some special privileges, other religious communities do not experience any obstacles to their activities.

No interference of religious dogmas

Despite further improvement in terms of fighting corruption and increasing the salaries for state officials, administrative structures still suffer from a number of crucial weaknesses. To a certain extent, the government's strategy of fighting corruption by implementing institutional reforms and sanctions against officials suspected of violating rules has partly contributed to deficits in efficiency and hindered long-term capacity building. In certain branches of the administration, frequent rotation of officials jeopardizes the establishment of institutionalized routine. In 2007, for example, the much-politicized conflict between the Chamber of Control and the Ministry of Education resulted in the firing of almost 400 officials in the former. Regular reshuffles, especially at the level of local administration, continue to undermine capacity. At the same time, the abolition of allegedly dysfunctional institutions like the Hygienic Food Agency has created some potentially dangerous voids.

Basic administration

## 2 | Political Participation

Since the Rose Revolution, the government has significantly improved the legal and procedural norms governing the electoral process. In the last two years, however, further progress in some areas contrasted with serious setbacks in others (the government failed to remove some legal provisions that had reduced effective political competition in previous times). Representatives of seven qualified parties were added into election administration on the national level as well as on the level of precincts. The threshold in parliamentary elections was lowered from seven to five percent. At the same time, the authorities consistently refused to restructure election commissions on the district level. In an obvious attempt to give undue advantage to the ruling party, the legislature enacted an amendment to the constitution, which increased the number of majoritarian MPs in parliament from 50 to 75, whereas the number of MPs elected through the proportional party list system

Free and fair elections

went down from 100 to 75. To make things worse, the election code does not specify that single-mandate constituencies have to be of comparable size in order to guarantee the equality of the vote. As a result, the number of voters ranges from around 6,000 to 140,000. Local and international observers raised substantial concerns in the aftermath of the 2008 presidential and parliamentary elections, although they stopped short of endorsing the opposition's demands for a recount or annulment of the results. Allegations of irregularities ranged from discrepancies between protocols signed by precinct commissions and those issued by district commissions, unbalanced and biased coverage of candidates and parties in public media outlets, a lack of transparency in handling complaints on almost all levels of election administration, intimidation of voters and election officials, and the use of state resources in favor of the ruling party. Although it is hard to determine whether these irregularities heavily influenced results, they contributed to undermining popular trust in the authorities' commitment to electoral fairness.

The capability of elected rulers to exercise effective power is not constrained by veto powers. Highly successful efforts at curbing corruption since the Rose Revolution have imposed discipline on formerly powerful economic actors, who are no longer able to manipulate the state to their advantage. The military never acted as an independent force and is under firm civilian control.

Effective power to govern

Georgian law guarantees freedom of association and assembly. However, the reaction of the authorities to rising political tensions and actions of mass protest in November 2007 has raised serious concerns with regard to the implementation of these legal principles. International and local observers have criticized the state's excessive use of force, its imposition of a state of emergency and its ongoing campaign of accusing opposition figures of being traitors.

Association / assembly rights

Though guaranteed in the constitution and supported by a series of more specific laws, the freedom of expression was severely restricted in the last two years. This refers not only to individuals, who during the November 2007 demonstrations ran a good chance at being treated with tear gas and water cannons by law enforcement agencies just to find themselves deprived of any opportunity to express their opinion in public during the nine-day state of emergency imposed thereafter. Much more serious and systematic setbacks occurred with regard to media freedom. The November 2007 events, in fact, became a catalyst for a drastic change in the media landscape.

Freedom of expression

For a long time, the outspoken political partisanship of media outlets has been a problem. Almost all independent TV stations take the side of either the government or the opposition at the clear expense of professional journalism. With political tension rising in 2007, the antagonism culminated in a kind of television war. In the wake of the forceful dispersal of public protests in November 2007, the authorities started to openly interfere with media freedom. The government's restrictive

measures during the nine days of emergency included suspending the broadcasting of all independent TV channels and using riot police to raid the most popular TV station (Imedi TV). Some of the restrictions were clearly not of an exceptional and temporary nature. After the government officially lifted the state of emergency, Imedi TV was forced to remain closed under the charge of being involved in an anti-government conspiracy allegedly organized by its owner, media tycoon Badri Patarkatsishvili. Even after Patarkatsishvili's death, Imedi TV continued to be a target of state interference. Though it resumed broadcasting in March 2008, it still refrains from airing political news programs. This is widely perceived to be an outcome of severe government intervention into ownership disputes after Patarkatsishvili's death. Joseph Kay, a distant relative of Patarkatsishvili, owed his success in establishing himself as the current owner of Imedi TV to a considerable degree to massive administrative support. Probably in an attempt to repay for these services, he turned a channel that had been prominent for its critical talk shows into a station broadcasting almost exclusively soap operas.

As a result of all these processes, media pluralism, which was for many years mainly ensured through a diverse ownership structure, has been reduced almost to zero. In his report on the freedom of media, presented in November 2008, the Public Defender Sozar Subari concluded that editorial policies of all nationwide television stations are now fully controlled by the authorities. There is, however, one reason to hope for a new quality of media freedom based on totally different foundations. In recent months, the state-financed public broadcasting company, which is governed by an increasingly neutral board of trustees, has significantly enhanced its public reputation as a source of balanced and objective information.

### 3 | Rule of Law

Under the current constitution, the executive still enjoys almost unrivaled power. The ability of the legislative body to act as an effective counterweight is severely restricted by the excessive legal competences of the president, who possesses the right to dissolve the parliament if legislators either fail to approve the state budget in three successive votes or refuse to deliver a confidence vote to the new cabinet after three attempts. This rather imbalanced system of separating powers has more than once aggravated political conflicts, because the opposition sees no viable option other than to take to extra-institutional ways of articulating dissent by organizing street protests or hunger strikes.

After the defeat in the August war with Russia in 2008, which has further undermined the legitimacy of the ruling elite, the authorities have demonstrated some readiness to change the situation. The parliament has been discussing a draft of constitutional amendments which would cut at least some of the presidential powers by strengthening the role of the parliament and judicial independence. The

Separation of  
powers

proposed amendments will also introduce a new rule according to which the president can use his power to dissolve the parliament only once during the term in office. In order to resort to this right a second time, he would need to conduct a nationwide referendum.

Despite some far reaching reform measures, which include new rules for the appointment of judges by a non-political body of professionals and significant increases in judges' salaries, the judiciary has been unable to earn itself the reputation of an independent institution. According to a 2007 poll, people perceive the juridical branch to be one of the least trusted institutions with only 22% of the respondents presenting a favorable view.

Independent  
judiciary

In the wake of the November 2007 crisis, public doubts about the apolitical nature of the legal system were to a certain degree confirmed by the course of events. In some cases, prosecutors started to investigate the involvement of members of the opposition in an anti-government plot without much evidence. At the same time, the excessive use of force during the dispersal of the November 2007 demonstrations – including the beating of Public Defender Sozar Subari – did not become an issue of scrupulous investigation. In March 2008, the decision of the Tbilisi City Court to sentence the ex-Defense Minister Okruashvili in absentia to 11 years in prison gave rise to serious suspicions. In opposition circles, this ruling was perceived as being motivated by the aim to block Okruashvili from participating in the May parliamentary elections. On the other hand, crisis management after the defeat in the August war led to some improvements – including the appointment of judges for life and allowing opposition representation in the Supreme Council of Justice.

During the last two years, the arrest of high-ranking officials (ministers, tax and custom officers, policemen and heads of local government) continued to be a prominent element in the official fight against corruption. At the same time, the government has always been suspected of using corruption charges to advance its political agenda. The case of Irakli Okruashvili, a long-time ally of Saakashvili, provides a telling example of the complex issues involved. In fall 2007, the former minister of defense, who quit office in 2006 under less than transparent circumstances, reentered Georgian politics in a dramatic though short-lived comeback. After he had made a series of blatant accusations against the incumbent president and he declared his intentions to launch a new party, he was immediately detained by the authorities under charges of extortion, money laundering and abuse of office. Because these allegations were never properly investigated and because his arrest was set against the backdrop of rumors that he was planning to stand as a candidate in forthcoming presidential elections, this incident nurtured widespread suspicions that anti-corruption policies have become an instrument in the ruling elite's fight against potentially dangerous rivals.

Prosecution of  
office abuse

Violations of civil rights still occur in selected areas. The period under review saw a reappearance or reinforcement of malpractices. First, the physical abuse of suspects and prisoners by law enforcement officers continues to be a problem. With an increase in the prison population from 6,500 in 2005 to more than 20,000 in 2007, the situation can be expected to have worsened. Secondly, with the acceleration of city reconstruction in recent times the violation of property rights also increased in scale. In some cases, the state destroyed private property based on the allegation that it had been acquired illegally or did not comply with the architectural image of the city without giving due attention to question of procedural legitimacy. Thirdly, in the fall of 2007 the excessive use of police force during the dispersal of demonstrations turned out to be a serious issue of concern.

Civil rights

#### 4 | Stability of Democratic Institutions

The process of consolidating democratic institution is still far from complete. Heading the list of major problems is the lack of a proper functioning system of checks and balances. Because of the weakness of highly fragmented opposition parties, the ruling party enjoys a clear hegemony in parliament with more than two-thirds of the seats. As a result, decisions are usually taken without due consideration of their possible consequences. The way the Georgian authorities provoked the August war with Russia in 2008 provides just one telling illustration of the problem. In addition, regular government reshuffles mean that key institutions fail to establish routine procedures in handling challenges. In fact, frequent interventions by the president in the working of other governmental branches actually prevent them from gaining the independence they would need to develop the features of really autonomous institutions. Recent debates about the chamber of control reveal that the overall institutional framework is not consolidated. Never-ending controversies around the election code and the constitution seem to confirm this impression. Upon a closer look, one could take these discussions as a sign of the authorities' growing awareness that the survival of crisis ridden Georgia in the future depends on the initiation of genuine democratic reforms.

Performance of democratic institutions

On a rather general level, all relevant political and social actors demonstrate their commitment to democratic institutions. With regard to the authorities, several occurrences undermine the credibility of their commitment. These include their violent crackdown on peaceful demonstrators in November 2007, heavy executive interference with the work of other branches of government and their manipulation of key rules, like the election code, in order to assure their survival.

Commitment to democratic institutions

The opposition's commitment to democratic institutions is also not beyond doubt. At closer look, the reluctance of leading opposition parties to accept their defeat in democratic competition in the course of the two successive elections in 2008 appears to be motivated not only by legitimate concerns over the violation of

election rules. Opposition groups organize street protests, lead hunger strikes and boycott the parliament in order to compensate for their weakness in relation to the ruling party.

## 5 | Political and Social Integration

No obstacles exist in Georgia to creating and forming political parties. With 180 registered parties, the party system reveals a high degree of fragmentation and fluidity. The United National Movement, the current party in power, continues an old tradition dating back to the Round Table Coalition of former president Zviad Gamsakhurdia and the Civic Union of Eduard Shevardnadze. So far, it lacks a clear-cut political program and ideological platform. Claiming to represent the interests of the whole nation, it is rather to be understood as the voice of the bureaucratic administration. Beneath the surface of purported unity, the ruling party has many internal conflicts. Because these conflicts are not aired in open processes of negotiation, they have led to the defection of many MPs, some of whom became founders of new parties. Recent examples of this phenomenon include former Parliamentary Speaker Nino Burjanadze, who once played a crucial role in the Rose Revolution but left the party in May 2008 over disagreements concerning the list for the parliamentary elections, and Zurab Nogaideli, who served as prime minister between 2005 and 2007 but was dismissed in the aftermath of the violent crackdown of the November 2007 demonstrations and openly criticized president Saakashvili for having provoked the August war with Russia in 2008. The opposition, which mainly consists of 10 parties, still suffers from fragmentation, an insurmountable divide between radicals and moderates, and vigorous infighting, which prevails over common interests. Though the period under review initially saw an upsurge in unity following the November 2007 unrest, this advantage did not coalesce into victory in the 2008 elections and quickly dissipated. Obviously, none of the opposition parties had a backup plan after they failed to triumph at the polls. Unable to formulate a clear strategy about how to enter into a constructive dialogue with the ruling party, the opposition was mainly preoccupied with trading mutual accusations of political treachery.

Party system

The influence of social interest groups is close to zero. Trade unions do exist, but they are hardly visible. This is primarily due to high rates of unemployment and self-employment. The overall weakness of trade unions is reflected by the fact that the adoption of a very flexible and liberal labor code was criticized by the European Neighborhood Policy (ENP) assessment report but was hardly noticed by internal social actors. Though NGOs form a dense network, their capability to act as mediators between the state and society is still severely constrained by their lack of social rooting. Their activities seem to be mainly addressed to international organizations on which they are financially dependent.

Interest groups

General support for democracy seems to be quite high in Georgia. A closer look at the results of a public opinion poll conducted in October 2008, however, raises some concerns. More than 40% of the respondents did not consider collecting signatures and legal demonstrations to be acceptable forms of social protest; 54% disapproved of legal strikes. Although one can assume that these answers are to a certain degree reflective of the special circumstances of the time – Georgia had just recently survived a war with Russia and a whole year of ceaseless confrontations between the government and the opposition – they also seem to point to a general weariness with regard to legitimate means of articulating protest. As a consequence, stability appears to be the most important goal, whereas competition and debate – indispensable to functioning democracy – are still seen in exclusively negative terms.

Consent to  
democratic norms

Despite official efforts at fighting networks of patronage, widespread distrust still severely impedes the emergence of authentic forms of social self-organization. The existence of NGOs does not in and of itself dispel this common perception, as their emergence is mainly donor driven. Moreover, most NGOs resemble advocacy groups staffed by urban intellectuals whose bonds to the interests of those they claim to represent are quite loose.

Associational  
activities

## II. Market Economy

### 6 | Level of Socioeconomic Development

A slight drop in the GINI coefficient points to a very moderate decline in the level of inequality. Large parts of the population still remain excluded from enjoying the benefits of economic growth. World Bank figures even suggest that absolute poverty has increased, rising from 24% in 2004 to 31% in 2007. The same holds true for unemployment, which went up from 11.5 in 2004 to 13.3% in 2007. Combined with high inflationary pressure on consumer prices and especially on food prices, these figures explain why, according to the results of public opinion polls, the majority of people do not feel the impact of macroeconomic stabilization on their lives. At first glance, urban and rural areas seem to be comparably affected. Villages suffer mainly from underdevelopment and output decline in the agricultural sector, whose share in GDP has fallen from 19.3% in 2003 to 9.7% in 2007. This shrinking in relative terms is accompanied by a decline in absolute terms. As a result, 60% of Georgia's poor dwell in the countryside. At the same time, cities and towns struggle with unemployment rates that are five times higher

Socioeconomic  
barriers

than in the countryside. Upon closer inspection, however, poverty and unemployment reveal a typical rural-urban imbalance. Officially, agriculture employs 55% of the population. As most of these farmers have only small plots and mainly engage in a very limited form of subsistence production, these figures actually conceal a much higher rate of factual unemployment. At the same time, citizens in rural areas still lack access to services like potable water, health care and qualified education, which were significantly improved for inhabitants of urban zones in recent time.

Economic indicators		2004	2005	2006	2007
GDP	\$ mn.	5125.8	6411.1	7761.9	<b>10175.5</b>
Growth of GDP	%	5.9	9.6	9.4	<b>12.4</b>
Inflation (CPI)	%	5.7	8.2	9.2	<b>9.2</b>
Unemployment	%	12.6	13.8	13.6	<b>13.3</b>
Foreign direct investment	% of GDP	9.6	7.1	13.7	<b>17.0</b>
Export growth	%	4.6	4.8	16.3	<b>9.8</b>
Import growth	%	8.3	5.0	19.5	<b>22.2</b>
Current account balance	\$ mn.	-353.6	-709.5	-1174.6	<b>-2008.7</b>
Public debt	\$ mn.	1593.1	1494.4	1466.0	<b>1543.2</b>
External debt	\$ mn.	2064.3	1910.7	1972.6	<b>2292.4</b>
Total debt service	% of GNI	4.5	2.9	3.4	<b>1.8</b>
Cash surplus or deficit	% of GDP	0.5	1.5	1.6	<b>0.8</b>
Tax Revenue	% of GDP	9.9	12.1	15.4	<b>17.7</b>
Government consumption	% of GDP	14.0	17.3	15.3	<b>21.9</b>
Public expnd. on edu.	% of GDP	2.9	2.5	3.0	<b>2.7</b>
Public expnd. on health	% of GDP	1.3	1.7	1.8	-
R&D expenditure	% of GDP	0.2	0.2	-	-
Military expenditure	% of GDP	1.4	3.3	5.2	<b>9.2</b>

Sources: The World Bank, World Development Indicators 2009 | UNESCO Institute for Statistics | International Labour Organization, Key Indicators of the Labour Market Database | Stockholm International Peace Research Institute (SIPRI), Yearbook: Armaments, Disarmament and International Security.

## 7 | Organization of the Market and Competition

Since the Rose Revolution, the Georgian authorities generally succeeded in creating a solid legal and institutional framework for a competitive market economy. This was mainly achieved by lifting dense regulations, easing business registration, reducing the number of licenses, simplifying the tax code and removing labor protection regulations. This policy was informed by two motives. First, the government aimed at encouraging private economic activity and attracting urgently needed foreign investments. Secondly, the political elite intended to enhance the regulatory capacity of the state and thus to provide all economic actors with the same degree of predictability by enacting only those regulations the state is actually capable of enforcing. Significant progress on both levels is beyond doubt. Remarkable improvements are reflected in the rank Georgia achieved in the World Bank's Ease of Doing Business Index. It moved from 112th place in 2006 to 18th place in 2008. In addition, the fact that the share of the informal economy was significantly reduced points to the efficiency of state-led efforts to ensure market-based competition.

Market-based  
competition

One convincing indicator illustrates how successful the project of expanding the formal economy actually was. Despite a sharp decline in the number of taxes and in the rates charged, tax revenues increased by 172% between 2003 and 2007. At the same time, two major weaknesses persist. On the one hand, Georgia still suffers from a certain gap between legal norm and every-day practice. As was explicitly mentioned in the Human Development Report published by UNDP in 2008, Georgia's positive ranking mainly refers to legislative reforms. When it comes to assessing the implementation of legal norms in practice, the picture is different. For example, some reports point to the fact that getting taxes paid may turn out to be quite time consuming. On the other hand, agriculture, which is by far the largest employer, is still very much underdeveloped. With very few exceptions, the agricultural sector is not integrated in the market economy. In 2007, it attracted only 1% of FDI.

Solid anti-monopoly legislation is in place. Whereas in former times implementation was hampered by the widespread practice of granting all sorts of privileges to politically influential entrepreneurs, the emergence of monopolies is nowadays no longer a real problem for the Georgian economy with its high degree of openness to international trade and business. Some concerns remain with regard to equal access to export opportunities.

Anti-monopoly  
policy

Consistent reforms aimed at reducing the number of custom control institutions, lowering import duties and simplifying procedures for custom clearance have created a very liberal foreign trade regime. In 2007, the government made further progress by uniting the institutions of tax and customs in a single State Revenue

Liberalization of  
foreign trade

Service. By actively seeking involvement in international trade regimes and by concluding bilateral agreements with the United States, Japan, Norway, Canada, Switzerland and the European Union, which offered Georgia a Generalized System of Preferences (GSP), the Georgian government has significantly contributed to facilitating greater access of Georgian goods to external markets. It was precisely this policy that helped Georgia survive the exogenous shock caused by the imposition of the Russian trade embargo.

In the last years, Georgia has experienced a significant expansion of its financial sector with assets growing by 60% and deposits by 55% on annual average between 2005 and 2007. Having laid the legal and institutional foundations for the development of a properly managed and prudently controlled banking system already years ago, the country has thus taken important steps to expanding its formerly very much underdeveloped credit market. Starting from a low base, credit growth accelerated rapidly until 2008.

Banking system

At the same time, the National Bank of Georgia has successfully assumed a supervisory role and is – to name just one example – applying prudential limits for foreign currency borrowing by commercial banks. Despite impressive progress so far, however, access to credit is sometimes still quite limited. Whereas credit is mainly concentrated in the retail trade and construction sector, agriculture is still underserved. Fairly high credit rates, which started to rise again under the double burden of the global financial crisis and the consequences of the war with Russia in 2008, limits the availability of needed capital injections to small and medium sized enterprises (SMEs). Part of the problem is rooted in the lack of collaterals and time-consuming procedures of risk assessment. Moreover, since 2008 the deterioration of the investment climate has led to a significant increase in banking risks.

## 8 | Currency and Price Stability

Like in former years, the Georgian economy is still suffering from fairly high – and to make things worse – volatile inflation rates, which reached 11.7% in 2007 before declining to below 6% in 2008. Volatility mainly points to the government's incapacity to control inflation. The Georgian economy is thus highly exposed to externally-driven shocks. Upward trends reflect a rising domestic demand, partly rooted in a steady rise in energy prices, a rapid growth of the money supply and the expansion in net foreign assets. In addition, increasing volumes of imports are still not matched by a corresponding growth in exports. Although the resulting negative trade balance is by and large compensated for by FDI inflows, the overall deficit, which rose from \$578 million in 2003 to \$2.2 billion in 2007, continues to raise substantial concern. Critics blame the authorities for not using taxation as an instrument to cut demand in imported goods.

Anti-inflation /  
forex policy

Until recently, high growth rates and prudent reform policy ensured a high degree of macroeconomic stability. Above all, this stability resulted from impressive achievements in terms of consolidating public finances. Major fiscal reforms referred to the revenue side as well as to the expenditure side. The adoption of a simplified tax code and the introduction of a flat rate income tax led to a significant rise in budgetary revenues from 15.1% of GDP in 2002 to 28% in 2008. At the same time, the introduction of a medium-term expenditure framework in 2006 ensured for coherent and prioritized public spending. On the one hand, increased public investment in the provision of public goods and in the rehabilitation of infrastructure contributed heavily to economic growth. On the other hand, a prudent debt management strategy allowed for a significant improvement of Georgia's debt outlook. Against the backdrop of this impressive success story, minor shortcomings like a widening current account deficit and a persistently high rate of inflation do not seem to pose a real danger to stability. Although the gap between exports and imports has increased by 2.8 times between 2005 and 2007 and exceeded \$2 billion in 2008, the constant inflow of foreign capital offered a viable compensation for quite a time. However, the combined effect of the global finance crisis and the August war with Russia in 2008 present daunting challenges to future stability.

Macrostability

## 9 | Private Property

The legal basis for the protection of property rights has improved since the Rose Revolution. Amendments to the laws on the registration of immovable property, the status of state-owned land and ownership enforcement procedures closed important gaps in the legal environment. When it comes to applying legal norms to every-day practice, some major shortcomings persist. Since 2007, Public Defender Sozar Subari has accused the government of voluntarily depriving property owners of their rights, referring mainly to the demolition of privately owned shops and kiosks as well as to several cases of businessmen who had been forced to "donate" their land to the state. According to critical remarks made by representatives of international organizations, a wave of police-led seizures of private property reflects severe institutional weaknesses in the tax administration and judiciary, both of which are quite vulnerable to executive interference and tend to ignore norms of procedural justice. The Tbilisi city government, a key ally of President Saakashvili, stood in the middle of a hot controversy concerning private property. Amid a real estate boom in the Georgian capital, many tenants were evicted from their houses in order to clear the way for profitable deals with new investors.

Property rights

Due to a large-scale program launched by the government immediately after the Rose Revolution in 2004, privatization is now almost complete. Major shortcomings, however, can still be observed on two levels. First, the entire process of privatization is still governed by less than fully transparent rules. Though the sale

Private enterprise

of state assets is mainly conducted by auctions, which should ensure a high degree of transparency, the criteria for selecting the most successful bidder are not always clear. In addition, there had been cases in which the financial value of the bid was renegotiated after the bidding contest had been completed. Secondly, the private sector is still dominated by formerly state-owned enterprises, whose net job creation rate is quite low, in part because they are still occupied with the difficult task of restructuring. New private enterprises, which are as a rule a source of labor demand, still constitute a relatively small but growing share of the private sector.

## 10 | Welfare Regime

The last years have seen significant efforts by the Georgian government to improve the existing welfare regime, which is, however, still far removed from satisfying existential needs. Although in absolute terms public social spending rose from \$47 million in 2003 to \$466 million in 2007, the increase in relative terms remained quite modest. Whereas social spending accounted for 11% of budgetary expenditure in 2003, its share amounted to 15% of the overall budget in 2007. Pensioners, whose monthly income went up from \$6.5 in 2003 to \$41.1 in 2007, benefited most from enhanced welfare spending. At the same time, the government cancelled all unemployment benefits in 2006, which were replaced by a unified support program reaching out to roughly 135,000 families by 2008. On average, these families received not more than \$35 a month, hardly enough to cover even basic needs in the face of rising inflationary pressure. As a result, rising social unrest is said to have contributed heavily to anti-government demonstrations in 2007. So far, the war on poverty declared by the government in response to the social unrest has not delivered tangible results. It remains to be seen what consequences are to be expected from a probable drop in state revenues caused by the combined effect of the global finance crisis and the August war with Russia in 2008.

Social safety nets

Georgia is still far removed from ensuring equal opportunity to all its citizens. Significant differences still exist in access to infrastructure services between rural and urban areas and between the poorer and more developed regions of the country. Efforts to attract qualified teachers to areas of minority settlement by offering them crucial increases in salary failed almost completely because of an outspoken dislike to move to poorly developed settlements. In addition, gender inequality remains an issue of concern. Though progress had been reached in education with enrollment rates showing no difference between female and male students, gender gaps are evident in labor force participation and remuneration. In 2006, only 45.4% of females were employed compared to 59.3% of males. To make things worse, the majority of women reported as employed are self-employed – a significant proportion of them in agriculture. As a consequence, women earn on average less than half of men's salary.

Equal opportunity

## 11 | Economic Performance

Until recently, the Georgian economy had been growing strongly with accelerated GDP growth rates touching 12% in 2007. Part of the success story was the ability to attract foreign direct investment, which still appears to be the main driving force of economic development. At first glance, dependence on external capital seems to point to a continuation of old strategies, which might increase the country's vulnerability to external shocks. A closer look reveals some structural innovation. Whereas between 2002 and 2005 the lion share of FDI inflow was for pipeline construction, in recent years investment has increasingly gone to other sectors, particularly banking, manufacturing and tourism. This trend reflects the achievements of a generally prudent macroeconomic management and a coherent set of structural reforms. It remains to be seen how sustainable this trend will be in the face of the global financial crisis and the deterioration of the overall investment climate caused by the August war against Russia in 2008. In 2008, construction and trade companies already experienced a notable drop in sales. According to pessimistic estimates, GDP growth rate will reach only 2.5% instead of the targeted 9% in 2008. Some ongoing investment projects have already been suspended, others postponed. Given the fact that the Georgian economy's recent boom was accompanied by a significant current account deficit, which was mainly compensated for by a constant inflow of foreign capital, further development prospects appear quite gloomy.

Output strength

## 12 | Sustainability

As in many other areas, Georgia established a comprehensive legal framework for environment protection in the 1990s. Due to corruption and indifference, however, serious problems occurred with regard to enforcing these legal norms. After the Rose Revolution, the authorities initiated some reforms, which mainly aimed at enhancing the state's monitoring and sanction potential. They pursued a strategy based mainly on two pillars. First, they merged a wide range of competing agencies with overlapping competences under the roof of the Ministry for the Protection of the Environment in order to strengthen oversight capacities. Secondly, they reduced the number of permits in order to remove opportunities for extortion. Critics claim that especially the second element of the overall reform strategy had some fatal consequences. After authorities finished abolishing regulations, oil and gas extraction and construction ceased to be classified as environmentally sensitive activities. Severe environmental problems can be observed in two areas. First, the protection of forests suffers from major shortcomings. Because of persisting corruption, almost 60% of the annual forest harvest (40% of Georgian territory is covered with forest) goes unrecorded. In addition, the situation is worsened by the

Environmental policy

total absence of strategies and resources for a sustainable management of resources. No reliable forest inventories exist. Official leasing contracts are as a rule short-term and do not provide any incentives for a sustainable use of resources. As a consequence, deforestation had reached an alarming degree, increasing the likelihood of soil erosion, landslides and flooding. Secondly, large parts of the Georgian population still suffer from limited access to a supply of clean potable water. In 2005, almost 30% of the population was not connected to water pipelines. In addition, due to infrastructural breakdown, the water in many parts of the country is highly contaminated. The problem is partly caused by corrupt management, partly by a lack of resources and partly by inadequate pricing. Even in 2007, tariffs covered only 30% of the real costs. In recent years, however, Georgia has taken steps to rehabilitate water pipelines and optimize management.

Because education was hit extremely hard by the transformation crisis and by entrenched corruption in the 1990s, educational reform became a priority after the Rose Revolution. Strategies applied can be roughly divided in two. On the one hand, the government introduced new methods of financing, management and quality control. On the other hand, with rising budget revenues government spending on educational needs was increased. As a result, the self-management capacities of educational institutions expanded to a significant degree, centralized tests for university entry were established, the number of universities was significantly reduced in the course of a centrally managed accreditation process, open competition for academic positions was institutionalized and in absolute terms public spending was three times higher in 2007 compared to 2003.

Despite impressive progress, a number of shortcomings remain. In relative terms, budgetary expenditure on education remained fairly stable at 3% of GDP and is very low even in comparison to other post-soviet states. To name just one consequence, despite significant rises in teachers' salaries, which went up from \$63.5 in 2005 to \$132 in 2007, they are still too low to ensure livelihood. As a rule, teachers still need to take additional work. Moreover, with more emphasis given to secondary education in recent years, new problems began to surface. Schools now have more autonomy in financial issues with boards of trustees exercising oversight, but some of them clearly fail to act in a responsible manner. To date, no mechanisms are in place to ensure accountability and independence in decision-making. Finally, according to a poll conducted in 2008, universities continue to suffer from corruption. Whereas formerly students paid bribes in order to get admission, now they pay for grades.

Education policy /  
R&D

# Transformation Management

## I. Level of Difficulty

The level of structural difficulties faced by the political leadership is comparatively high. Soviet legacies, which include an unbalanced economy badly adapted to the pressures of globalization, the lack of autonomous social organizations, a weak civil society and a longstanding tradition of authoritarian rule, are in the case of Georgia further complicated by the burden of two unresolved ethnic conflicts, difficult relations with neighboring Russia and the heritage of pervasive corruption, which contributed to a weakening of state structures and a significant delay of structural reforms under Shevardnadze. Two of the few advantages, a comfortable geographical location at the crossroad of important energy transport lines and the presence of a well-educated labor force, have the potential of triggering economic development. The 2008 war with Russia has demonstrated with utmost clarity that all future plans at sustainable recovery are dependent on a long lasting resolution of ethnic conflict.

Structural  
constraints

Despite the existence of a great number of NGOs, no authentic tradition of civil society has emerged in Georgia. Marked by a long history of foreign domination and a deeply entrenched culture of clientelism, there is a high degree of distrust in public institutions within Georgian society. Although this overall attitude has started to change slightly in the course of successful reforms since the Rose Revolution, a prevailing atmosphere of apathy persists and renders the emergence of a vibrant civil society highly unlikely.

Civil society  
traditions

The period under review saw a significant rise in conflict intensity on two levels. First, ethnic conflict around the two breakaway regions of South Ossetia and Abkhazia, which was for more than 14 years superficially stabilized in a fragile state of no war no peace, exploded into open violence and warfare. Although the war was mainly about a confrontation with Russia as an external actor, unresolved ethnic tensions between ethnic Georgians and ethnic Ossetians and Abkhazians played their role as well. On the one hand, these tensions could have been easily evoked by Russia as a pretext for what they call protective intervention. On the other hand, atrocities committed during the war reinforced these tensions to a significant degree. Secondly, fierce competition between rival factions of the

Conflict intensity

political elite, which are deeply split into opposite political camps, escalated for the first time since the Rose Revolution into violent confrontation between mobilized sections of the population and the authorities. A persistent failure on behalf of the government to integrate large parts of socially excluded and marginalized segments of the society into public life was the driving force behind what at first glance appeared to be a political conflict. Although opposition's efforts to use street politics as a means of competing for power did not produce sustainable results and although the number of those who participated in action of public protest decreased quite significantly after initial success in mobilization, the potential for social unrest is still quite high. As long as the poor and impoverished do not feel represented in democratic institutions, this will continue to pose a latent threat to stability.

## II. Management Performance

### 14 | Steering Capability

The period under review was marked by a significant decline in the political leadership's capacity to maintain strategic priorities. Whereas previously the current government gained widespread internal and external support for pursuing a coherent reform agenda, especially in the realms of strengthening of government structures, combating corruption and improving the overall business climate, it clearly failed to meet rising expectations with regard to the next generation of reforms in the last two years. The government missed chances for improvement in two crucial areas. First, already for quite a long time the international donor community and NGO activists have criticized the authorities for failing to realize genuine democratic reforms. Although the incumbent government was quite aware of its need to address this criticism – among others in order to gain internal support for admission to NATO – it did not live up to repeated promises to bring about changes for the better. Quite the reverse, the violent crackdown on peaceful demonstrators in November 2007 was a serious setback with lasting consequences. As a result, Georgia suffered a serious blow to its international reputation, especially among its European partners.

Prioritization

The Georgian government spent much of its political energy on conflicts with the opposition in order to combat the alarming rise in political polarization, which its harsh repression of the political and social unrest provoked. The ruling elites even took the risk of further undermining their democratic credentials by manipulating electoral rules to their advantage. In the run up to the parliamentary election, they

decided to increase the number of majoritarian mandates from 50 to 75. This move not only contradicted their former declaration of intent to improve the conditions for political competition, it moreover served to further alienate an increasingly stubborn opposition, which did not even accept the results of parliamentary elections in 2008. The resulting deadlock has prevented the achievement of a broad political consensus on crucial issues. Planned constitutional amendments and revisions of the election code have stalled. Secondly, the government did not achieve tangible progress in its self-declared war against poverty, which should have translated the results of economic reform to the level of daily experience. Instead of concentrating scarce public resources on social welfare spending and investment in agriculture, the authorities' decision to wage a war against Russia in order to restore territorial integrity led to an irresponsible waste of urgently needed budgetary revenues and the destruction of large parts of public and private infrastructure. In addition, the ill-conceived move reduced the chance to realize other important goals, like gaining NATO membership, almost to zero. To make things worse, as a consequence of the war progress in resolving ethnic conflicts and in improving the Georgian security environment became ever more distant. All this points to a very poor definition of priorities caused mainly by the absence of institutionalized channels of publicly negotiating policies.

Whereas in previous years the Georgian authorities enjoyed a sterling reputation for being able to implement their far-reaching reform agenda, this positive image was to a certain extent damaged in the recent period. Negative assessments refer again mainly to the areas of democratization and welfare politics. The continuation of democratic reforms suffered mainly from a significant rise in political tension and a concomitant shift in the government's priorities. The government's interest in impressing the international community by further progress was outweighed by its desire to gain an upper hand in the competition with an opposition buttressed by popular anger over growing social hardship. Looked at from this angle, the great majority of setbacks mentioned in this report do not point to implementation failures but rather to a shift in policies.

Implementation

With regard to welfare policies, a slightly different picture emerges. Although one can rightfully argue that the August war with Russia and the global financial crisis forced the Georgian government to devise new priorities, which thus prevented it from living up to the expectations raised by its self-declared war against poverty, problems with implementing adopted political measures played a limited role as well. This refers first of all to the ambitious plan to replace unemployment benefits with a unified support program for poor families in order to improve the targeting of the vulnerable. Although local administrations should have kept reliable data on those who needed assistance since 2005, evidence from different local areas suggests that local officials successfully circumvented targeting mechanisms and, thus, to a certain degree succeeded in undermining the rationality of the reform.

Under the double stress of a deep internal crisis and an almost deadly confrontation with neighboring Russia, the current government failed to improve its capability at policy learning. At the height of both crises, which were partly caused by an unrealistic appraisal of their own resources and options, the authorities showed, however, some flexibility in applying new policy tools for achieving old aims. However, they stopped short of adopting innovative strategies. In the end, they prevented the worst from happening, but they did so at the clear expense of postponing solutions to pressing problems.

Georgian authorities displayed a quite high degree of flexibility in their conflict with an initially unified opposition, which broke out in the fall of 2007 with a series of mass demonstrations and lingered on in the first half of 2008 just to regain momentum in the aftermath of the August war with Russia in 2008. Whereas in the beginning, they took recourse to a violent crackdown of the unrest and the imposition of a state of emergency, they soon came to realize that the excessive use of force served only to aggravate tension.

Responding to external and internal criticism, they signaled their readiness to enter into a dialogue with the protestors. At the same time, they continued to blame their political rivals of pursuing an agenda of destabilization and of acting on behalf of imperialist Russian interests in toppling the constitutional order. Giving in to some demands like the holding of preterm elections and the changing of some regulations in the disputed election code, they simultaneously refrained from approving anything that could have posed a real danger to their grip to power.

To name just some examples, they allowed for the representation of opposition parties in election commissions on the precinct and central level but preserved their monopolistic control over district election commissions. They lowered the threshold for the representation of parties in parliament from 7% to 5% but simultaneously increased the number of mandates distributed according majoritarian principles (and as a rule gained by the party in power) from 50 to 75. They offered the post of deputy speaker of parliament and a deputy chair on each of the parliament's committees to the opposition but firmly rejected to even debate the opposition's proposal for the direct election of city mayors and regional governors. In terms of political survival, this double strategy proved to be quite successful. By constantly emphasizing their will to compromise, the authorities effectively shifted the blame for the negotiations' failure to the opposition.

By making concessions on some issues while displaying rigidity on others, they placed an apple of discord in the camp of opposition parties, which constantly failed to agree among themselves on a convincing strategy and thus lost in popular support. At the same time, by prioritizing their short-term interest in political survival, the ruling elites missed the chance to bolster their decreasing legitimacy in the eyes of a growing number of citizens. They moreover gambled away the

opportunity to actively involve the opposition in a broad consensus on future reforms, which would have forcing them to share responsibility for the outcomes. These consequences were soon felt when in the aftermath of Georgia's defeat in the August war with Russia people filled the streets again and called for the resignation of Saakashvili. Although the protests were far of attaining the same scale as the unrests one before, it was for the first time in the short history of independent Georgia that people did not shy away from criticizing their government even in the face of a dangerous confrontation with Russia.

It remains to be seen how the authorities will deal with this situation. For the time being, they seem to confine themselves to the old strategy of making minor concessions. This impression is mainly confirmed by the last cabinet reshuffle, which took place in December 2008 and disappointed hopes for the establishment of an all-inclusive anti-crisis government.

## 15 | Resource Efficiency

During the past two years, Georgia has a rather mixed record with regard to enhancing resource efficiency. To begin with, repeated government reshuffles point to an irresponsible exhaustion of personal resources. Beginning with the dismissal of Prime Minister Nogaideli in the aftermath of the November 2007, Georgia has seen four heads of government in 14 months. In 2008 alone, Saakashvili appointed four different foreign ministers – an ill-advised decision in the face of tense relations with neighboring Russia. To make things worse, the rotation of leading members of the executive was not motivated by any long-term strategy. Core supporters of the widely criticized authoritarian trend, like members of the Ministry of Internal Affairs, were not touched by replacements. Such selecting replacements undermined the population's belief in the seriousness of the government's commitment to change and reduced the government's chance of weakening the opposition by ensuring a more pluralistic outlook. In particular, the appointment of Grigol Mgalobishvili, the deeply unpopular former ambassador to Turkey, was either perceived as an indicator of growing helplessness or as proof of the unwillingness of Saakashvili to tolerate anybody with some authentic authority besides him.

Critics have also raised some concerns with regard to the rational and efficient use of financial resources. This refers first of all to significant increases in defense spending, which reached 10% of GDP and is the single largest category of state budget expenditures. In terms of military spending, Georgia ranks second in the world. In addition, the somewhat poor performance of the Georgian army during the August war with Russia has shown that many years of priority spending on defense issue failed to deliver structural and qualitative changes. Welfare spending delineates a second area where the use of available resources was less than efficient.

Efficient use of  
assets

Bearing in mind the government's declaration of intent to improve the targeting of the poor and vulnerable, the fact that pensions still consume the lion's share of all welfare spending appears hardly appropriate. Critics claim that Georgia's single flat rate pension, which does not differentiate between poor and wealthy pensioners, makes country's task of alleviating poverty even more difficult. These allegations appear to be on target when one takes into consideration that the total cash payments made to the extremely poor in 2008 totaled only one-eighth of the amount the government distributed on pensions.

Besides these structural flaws, in the period under review welfare spending suffered from time to time from sheer opportunistic motives. Thus in the fall of 2007, Saakashvili gave orders to distribute one time social welfare payments. Obviously this move aimed mainly at undermining support for the growing opposition movement. In other areas of social welfare spending, one can observe a certain move toward targeting the poor and vulnerable. In 2006, the government cancelled all unemployment benefits in order to replace them with a unified support program for poor families. Increased efforts at reaching the poor were also the driving force behind a shift in health care spending. Whereas previously priority was given to hospital care, public spending now concentrates on primary health care facilities. Because the need for medical treatment often leads to extreme impoverishment, this seems to be a step in the right direction.

Since the Rose Revolution, policy coordination has improved significantly. Ministries do not function any longer as shields for influential circles of economic actors; policy has gained in coherence. Ample space, however, remains for improvement with regard to interagency coordination. Regular interference by the president still represents the single most important means of ensuring cooperation between different parts of the administration. Recent events have highlighted the inherent structural weaknesses of this hierarchical and unpredictable form of policy coordination. The hearings before the parliamentary commission studying the August war, for example, revealed that the Georgian intelligence service forgot to share information with the Ministry of Economy on the willingness of Russian investors to invest into the Georgian energy sector.

Policy  
coordination

Five years after the Rose Revolution, combating corruption is still a priority of the current government. So far, the official anti-corruption plan, which aims at improving the transparency and effectiveness of the civil service, mainly targeted lower and mid-level corruption. As a consequence, Georgia allegedly continues to suffer from corruption on elite levels, a concern which is constantly raised by the opposition. Though it is quite difficult to judge the legitimacy of these claims, one has to bear in mind that at least the opportunities for cronyism and insider deals have grown considerably in recent time due to concentration of power among a small and interwoven circle of individuals. Moreover, the strategies applied so far in the battle against corruption have partly enhanced the opportunities for power

Anti-corruption  
policy

abuse on the elite level. Besides structural reforms, which aimed at deregulation and the simplification of administrative procedures, anti-corruption policies were mainly based on strengthening state capacity by imposing harsh discipline on potentially rule-violating officials. Quite often, this resulted in somewhat arbitrary executive interference with the daily execution of administrative tasks. The emergence of depersonalized institutional routine was thus prevented. One is left with the impression that these anti-corruption mechanisms, which may have been appropriate for making initial progress, may turn out to become obstacles for further progress in the long run.

## 16 | Consensus-Building

In principle, all major political actors subscribe to the double goal of establishing a viable market economy and a functioning democracy. However, the overall consensus does not preclude fundamental conflict over the appropriateness of strategies aimed at achieving these goals. The trading of mutual accusations between the government and the opposition point to a deep-rooted culture of mistrust. At the same time, the authorities betray a certain indifference about the growing (although still not politicized) disappointment among those segments of the population that have not felt the impact of reform on their precarious living conditions.

Consensus on goals

To date, the reformers dominate the political arena to such an extent that they are not faced with the challenge of excluding or co-opting anti-democratic veto-actors. As this comfortable situation is mainly rooted in the fact that up to now no political actor was capable of mobilizing the excluded and marginalized segments of the population in any sustainable way, sudden changes cannot be excluded. Cautiousness with regard to the stability of democratic institutions appears justified, as the double burden of the global financial crisis and the defeat in the August war with Russia may easily turn out to confront the reformers with a real threat to their survival in the near future. To date, however, the only real challenge to democracy is the authorities' inclination to sacrifice democratic principles in the name of what they call a strengthening of state capabilities.

Anti-democratic  
veto actors

The ruling elite's capabilities in conflict management appear to be very much underdeveloped. They failed to reach any progress with regard to reconciliation between ethnic groups and did nothing to contribute to a depolarization of the very strained relations with the opposition. While in the past their unrivalled hegemony in the political arena compensated for this weakness, this was no longer the case in the period under review.

Cleavage /  
conflict  
management

With Saakashvili's rise to power, the once vibrant NGO sectors have been weakened by a kind of brain drain. NGOs have become an important pool for the recruitment of government personal. At the same time, especially in the initial stage after the Rose Revolution, the new authorities demonstrated indifference to concerns raised by some NGOs with regard to the hasty adoption of constitutional amendments, bureaucratic harassment of independent media outlets or human right violations. Meanwhile, we observe a more differentiated attitude on behalf of the government towards civil society organizations. Whereas some ministries like the Ministry of Justice and the Ministry of Education take advice from and have regular contact with civil society organizations, others like the Ministry of Interior or the president himself demonstrate a certain reluctance towards close cooperation.

Civil society participation

Memories of past injustices committed by Georgians as well as by Abkhazians and South Ossetians during the secessionist wars of the early 1990s still deeply divide communities in Georgia. The authorities did little to address issues of reconciliation. Quite the reverse, the military attack launched by the Georgian government in August 2008 against South Ossetia deepened mutual distrust. Along with the violent conflict the Georgian authorities waged a war of rhetoric, which created ample space for a renewing of stereotypical reasoning. In putting blame exclusively on Russia, the Georgian authorities and the majority of all relevant political actors do not show any inclination to pay attention to legitimate concerns of either Abkhazians or Ossetians. The prospects for rapprochement between the ethnic groups involved are thus removed to a far future. To date, no political dialogue exists between ethnic groups.

Reconciliation

## 17 | International Cooperation

In the period under review, Georgia continued to receive massive financial aid from multilateral and bilateral donors with the bulk of financial assistance spent on infrastructure projects like the rehabilitation of roads, water pipelines, irrigation systems and the electricity sector as well as on credits to small and medium enterprises. Whereas these projects were largely considered to be highly successful, donor-driven efforts to create a professional civil service were partly blocked by President Saakashvili's habit of rotating ministers and officials. Moreover, many critics claim that aid money was not always spent in ways that helped to strengthen democracy and the rule of law. One has to be cautious, however, about blaming the Georgian authorities for these missed chances, because the donors themselves focused on infrastructure projects and scaled back funding for civil society organizations in order to devote resources to the building up of the central government.

Effective use of support

While in the first years after the Rose Revolution the Georgian authorities earned themselves an unquestionable credibility among the international donor community

Credibility

for pursuing a coherent reform agenda, the strengthening of authoritarian tendencies, especially in the aftermath of the violent crackdown on peaceful demonstration in 2007, has started to cast a shadow of doubt on their reliability. Growing concerns over the restriction of media freedom, executive interference with the autonomy of the judiciary and some irregularities during the elections in 2008 have led to ongoing debates within the international donor community about tying future assistance to stricter conditions. Thus, the international donor conference, which convened in Brussels in October 2008 in order to finalize an assistance package, decided that Georgian government bodies were required to report to donors every six months.

For understandable reasons, Georgian foreign policy was and is mainly focused on the closely interconnected issues of handling strained relations with Russia and gaining admission to NATO. In addition, regional cooperation, which is also fostered in the framework of the European Union's neighborhood policy, continued to be of some importance. The Georgian government strives to retain good relations with Armenia as well as with Azerbaijan and Turkey. Under the burden of still unresolved conflicts in the Caucasus region, these goals are quite difficult to achieve. An agreement reached between Georgia, Turkey and Azerbaijan in 2007 over the construction of a regional railway linking these three countries was met with clear objection by Armenia.

Regional  
cooperation

## Strategic Outlook

Georgia stands at a crossroads. While President Saakashvili's first term was considered highly successful, his second term was marked by authoritarian tendencies, declining growth rates and a serious deterioration of the security environment. In order to prevent the country from sliding back into stagnation and apathy, resolute measures are required in at least three crucial policy dimensions.

The dramatic consequences of Georgia's defeat in the August war of 2008 have once again demonstrated that progress in conflict resolution with South Ossetia and Abkhazia represents the single most important precondition for sustainable development in Georgia. So far, a certain ignorance on behalf of the Georgian authorities with regard to the legitimate concerns of both secessionist republics have played into the hands of a Russian policy based on playing out the ethnic card in order to maintain spheres of influence. Instead of focusing all energies on propaganda war against the Kremlin, which continues to be perceived as the one and only driving force behind secessionist claims, the Georgian government would be well advised to strengthen ties with political and social actors in both Tshinvali and Sukhumi. Especially in Abkhazia, local elites are increasingly concerned about an overly assertive Russian strategy to provide Moscow-based businesses with privileged access to lucrative assets. This situation opens up ample opportunity for Georgian-Abkhazian rapprochement. In order to regain lost trust, Tbilisi should actively support efforts by the international donor community to expand activities in both secessionist republics.

Recently, rising political polarization and street protests have pointed to the vulnerability of democratic institutions, which have increasingly proven to be incapable of mediating popular demands. The combination of rising expectations on behalf of an increasingly mobilized population with still underdeveloped institutional channels for the articulation of diverging social interests may thus pose a serious threat to the sustainability of the democratization process in the near future. The authorities should address these problems by a twofold agenda. First, they should speed up the adoption of constitutional amendments that would allow for a strengthening of the parliament and its prerogatives and would thus give new impulse to party development. Secondly, they should enhance the autonomy and the resource base of local bodies of self-government, which could then gain in authority and would be able to perform the function of mediator between state and society on a level more closely connected to the everyday experience of ordinary citizens.

Under the double burden of the world financial crisis and the damage inflicted by the August war with Russia in 2008, the economy is in danger of falling into recession. Declining growth rates and the suspension of many investment projects will lead to a drop in state revenues. In this context, the government needs to redefine its priorities with regard to spending. A significant downscaling of extraordinary high defense spending should be a matter of urgency. Moreover,

the government should give preference to better-targeted welfare spending and investment in labor-intensive economic branches like agriculture. Donors would be well advised to tie the provision of assistance to appropriate conditions. This would require the creation of reliable mechanisms of accountability.