Georgia's Succesful Public Sector: Background and Lessons

*
GIA
JANDIERI

Georgia became independent in 1991 after the country cut economic ties with Russia. It immediately eliminated the market for produced goods and caused the limitation or stoppage of more than 900 state-owned factories and thousands of collective farms. However, the privatization of land, apartments, houses, and factories did not help immediately. Post-Soviet Georgia, though being one of the most privately (though illegally) run economies, needed a better business environment and business skills and environment. Nevertheless, that development had to "wait" until the political situation was ripe for true and comprehensive free market reforms after the Rose Revolution in November 2003 and the presidential and parliamentary elections of 2004.

> IN THE 2000S, GEORGIA ATTEMPTED A SECOND STAGE OF PRIVATIZATION. YET SOME OF THE BIG COMPANIES (LIKE GEORGIAN RAILWAYS) REMAINED UNDER STATE OWNERSHIP

HIGHLIGHTS OF REAL PRIVATIZATION[1]

"Voucher privatization" did not achieve the desired outcome. Factories with outdated technologies, producing low-quality goods, were unable to attract foreign investments and suffered from a Russian energy blockade. That significantly slowed down the privatization process. In the 2000s, Georgia attempted a second stage of privatization. Yet some of the big companies (like Georgian Railways) remained under state ownership. A significant part of arable lands remains under public ownership, and most private land needs registration.

The indexes of economic freedom, by the Fraser Institute and the Heritage Foundation, clearly indicate that there are private property protection problems in almost all post-communist countries. Georgia, though not an outsider on those lists, still lags behind developed Western nations.

After two waves of privatization, the state still keeps several hundred public companies (however, most of them are not in operation). Although almost all clinics are private in the health care system, a huge majority of high schools are state-owned. The efficiency of state-owned institutions remains very low — they either

[1] Georgia's privatization was legally outlined as early as 1991 by the Law on the Privatization of State-owned Enterprises in the Republic of Georgia. The voucher scheme occurred between January 1992 and July 1994. It did not work for many reasons, but the main one was that loss-making entities (the vast majority of state-owned firms) were not liquidated. The new "reform" was attempted by the 1997 Law on State-Owned Property Privatization, but that failed too. The "seller" (the Ministry of State Property) was bound by approvals, there were more than 20 exemptions from privatization, and there was a myriad of employee privileges for the post-privatization period. All those hurdles were resolved by the 2004 privatization program (spearheaded by Kakha Bendukidze), which was based on a simple principle: SOEs go those individuals or organization that paid top price.

operate with subsidies or stagnate and waste the scarce resources of the poor country.

Privatization, however, is not only a sale of government-owned properties: It is first and foremost a process of separating the government from intervention in many other areas, not just the economy. Georgia is a positive example, and an almost unique exception in this respect.

Georgia ended the taxpayer-funded welfare system in 2008 after eliminating the social taxes and the state funds managing their distribution. The decision was long in the making by events happening before and since the collapse of the Soviet Union. It made Georgia's fiscal system one of the cleanest and the most sustainable. It has no official social obligations or liabilities toward its citizens, who were incentivized to take care of their own fate in old age and health[2].

In 2011, Georgia adopted a special amendment to the constitution which restricted government spending and taxation powers. While restrictions on the public debt and fiscal deficit are similar to the Maastricht Criteria, the others imposed a 30% public spending to GDP ratio, and a nation-wide referendum requirement for a tax rate increase or new tax. In this respect, Georgia is unique.

> THE STATE OF THE ECONOMY BEFORE THE FORCEFUL INCORPORATION OF GEORGIA INTO THE SOVIET UNION WAS A TREMENDOUS SETBACK IN GEORGIA'S ECONOMIC AND POLITICAL DEVELOPMENT

Obviously, the constitutional provisions presuppose that there will be less pressure on the government for tax increases. That would make the country's economic future more predictable and advantageous. It can be said with great certainty that those important reforms have already saved Georgia's economy from problems after populist promises were given during the 2012 general election[3].

---

[2] The reforms were fiercely criticized. See Simon Gabritchidze, An Analysis of Recent Health System Reforms in Georgia: Future Implications of Mass Privatization and Increasing the Role of Private Health Market, Institute of Public Affairs, Warsaw, Fellowship Program for Georgian Public Policy Analysts Policy Papers 06/07. Later, critics recognized "some success": Kate Schecter, The Privatization of the Georgian Healthcare System, Anthropology of East Europe Review 29(1) Spring 2011, pp. 16-22. A more detailed account of the outcome may be found in: Frederik C. Roeder, Andria Urushadze, Kakha Bendukize, Michael D. Tanner, and Casey Given, Healthcare Reform in the Republic of Georgia: A Healthcare Reform Roadmap for Post-Semashko Countries and Beyond, April 6, 2014. A more contextual review of Georgia's privatization may be found in: Larisa Burakova, Robert Lawson, Georgia´s Rose Revolution: How One Country Beat the Odds, Transformed Its Economy, and Provided a Model for Reformers Everywhere, Guatemala, Universidad Francisco Marroquín, 2014, and: Лариса Буракова. Почему и Грузии получилось. Москва, Альпина Бизнес букс, 2011, especially chapter 5.

[3] The Georgian Dream coalition of billionaire business-

The other systemic achievements of Georgia's public-sector reforms are the minor improvement of core government services, like public registers of citizens and properties (and issuance of respective documents), taxation, and government procurement.

Those reforms made Georgia's public sector very efficient and transparent. For instance, any person in the world who has internet access can observe, participate, protest, block, and dispute the purchasing activities of government bodies in Georgia. A similar system is being designed for Ukraine, but its implementation has been delayed[4].

THE PRINCIPAL SOVIET LEGACY

The state of the economy before the forceful incorporation of Georgia into the Soviet Union was a tremendous setback in Georgia's economic and political development. The Bolsheviks did everything in their power to destroy the economy of Russia and the forced members of the Soviet state. They eradicated trade ties, specialization, working and business ethics, and (physically) human capital. A centrally planned economy is based on strict commands and, therefore, cannot accept private owners' opposition to these orders. Understanding the difficulty, the Bolsheviks exterminated the owners as a potential opposition power to their dictatorship[5].

The elimination of private property and their owners created a new atmosphere where nobody wanted to work because of a lack of incentives. The situation resulted in waste of the resources.

In a "normal" country where private ownership is dominant, people tend to keep their strong property rights attitudes – "that's not mine, therefore it is somebody else's (maybe public), and so I need to show respect to expect the same attitude from others". Making everything belong to the government eliminated the need for such kind of cooperation. And the dispersed ownership of companies and their resources kept the owners – citizens – distanced and (rationally) ignorant to their rights to control the assets.

In some republics like Georgia, private initiatives appeared in the 1950s during times of moderate softening of the regime. Private tutors, direct (but hidden) payments to physicians, and factories used for underground production of goods in demand (like fruit juices) became an essential part of life in Georgia. Simultaneously, collective farmers would sell all of their products they received in their tiny land parcels. The productivity in their own (so-called "individual property") space could be several

man Bidzina Ivanishvili won a majority of seats, but besides the promises, it was not successful in reversing the reforms (although it seeks new options to revoke those constitutional arrangements).

[4] The reform's core institution is the Public Service Houses (PSH), or Houses of Justice. It was launched in 2009 and finalized by mid-2011, was coordinated by the Ministry of Justice, and supported by the EU (Human Dynamics Program) and USAID (the U.S.-based company "Senteo" was involved in service-area planning and interior design). PSH provide 250 services to citizens. In 2012, Georgia ranked globally as follows: 1st place in property registration, 4th place in construction permits, 7th place in ease of starting a business, 16th place in doing business. See: Fighting Corruption in Public Services, Chronicling Georgia's Reforms, Washington D.C., World Bank, 2012.

[5] It is often forgotten that the first task of the infamous Cheka (short for "All-Russia Extraordinary Commission to Combat Counterrevolution, Speculation, and Sabotage") was, except for punishing opponents of Bolsheviks in the constitutional elections of November 11, 1917 (in which 75% of the vote was against them and they won 125 of 707 seats), to deal with the general strike (it erupted on the 13th day of the "Revolution") of all industrial trade unions, and invade the private banks and confiscate the savings of the population. The same "policy" was applied, in a more efficient manner, in all newly forced members of the Soviet Union and post-war Eastern Europe.

> THE CORE PROBLEM WITH STATE-OWNED ENTERPRISES (SOEs) WAS THAT STATE OWNERSHIP DESTROYED INCENTIVES TO USE RESOURCES IN A PROPER AND EFFICIENT WAY

times higher than in the collective lands. The leaders of the companies and the collective farms could feel themselves as *quasi* owners of them, as they could get some self-satisfaction and illegal financial (or in-kind) benefits.

The core problem with state-owned enterprises (SOEs) was, therefore, that state ownership destroyed incentives to use resources in a proper and efficient way. Factories also lacked any incentive to improve quality, use better technologies, and economize their resources. The central planning authorities were to decide who needs to produce what, who buys it, and at what price. There was no competition and no motivation to do something better than others – consumers had no choice, and the government decided everything.

Any initiative by company leaders could be dangerous – they would prefer to avoid any responsibility in regard to the quality of the produced goods. Locally initiated changes to the shapes, colors, materials, or quantities of produced goods would shift responsibilities to their level. Punishment would be very severe. Simultaneously, those managers would lose their opportunities to steal the resources, use them for illegal productive activities, and use the factory space for other initiatives.

THE LOGIC OF THE COLLAPSE AND TRANSITION TO THE MARKET ECONOMY

Most post-communist nations quickly reintroduced private property. The formal act had different scales of impact in the countries. The reasons for this diverse success can be the environment in each country and how long a country lacked private property. Most of the countries (or, rather, their political establishments) have kept many companies in state ownership in the name of social welfare, retaining former "profitability" and "market" shares at home or abroad, or fearing unemployment. The real fear was of losing votes and opportunities to appoint friends to SOE boards of directors.

The principal questions to ask are:

- If an enterprise is a normal company, and can make a profit, then why should it stay in the public sector when it can operate in the private sector?

- If it is losing public funds, can the government risk public money? Clearly, the State Audit Office must be very unhappy about such a risky and inappropriate use of public resources;

- What is the strategic end: to lose or save public resources, to make people better off or worse off, and who benefits and who loses from such "strategies"?

- How can an SOE decide independently on its prices if a government or political establishment is granted the opportunity to use the price as a reason to attack (or use a social argument as an excuse for intervention in price setting, industrial design, management, or personnel decisions)?

A tacit answer to those questions and related matters is to be found in the laws and rules that try to regulate SOEs. There is a need for a closer look at SOEs and their functions.

GOVERNMENT INTERVENTIONS

Traditional explanations by economists for why we need to use government intervention into the market process (or private life) can vary from monopolies to non-excludability, and all these theories tend to argue for one assumption: The private sector is inefficient in supplying some goods and services with good prices and quality. (There is an issue in this assumption itself – it cannot define what is "good".)

The free market position for this is simple and effective – good prices and qualities mean market-competitive prices and qualities which are accepted by consumers. In other words, any ideas of necessary government interventions are strongly limited with the opposing principle of economic efficiency.

Cost-benefit analysis can ask us to consider the political costs and benefits of state intervention. Here we can talk of the consequences of unlimited government action and unlimited majority power in a democratic system. It is not easy to calculate if all the contributors to public finances are the equal beneficiaries too. However, public finance now plays a redistribution function rather than a productive one. The state-run pension, health care, transportation, and educational organizations spend a major part of the public budgets of nations, but not so much in Georgia.

Thus, for instance, any taxpayer who contributes to publicly operated roads can be one who rarely uses the roads. But a taxi driver who drives thousands of kilometers per month contributes less than they benefit from the same roads.

Cost-benefit analysis can clearly indicate that, in pure economic calculations, any government intervention can be economic failure, and these costs can be only politically justified and financed. The beneficiaries of such redistribution are the incumbent politicians and bureaucracy, who promote the use of the democratic system for justifying state interventions. Their intention is to please (usually in an illusionary manner) the majority of voters at the expense of others for whom the costs are much higher than the benefits[6].

When is governmental intervention unavoidable? When politicians have no other choice and need to spend money to get additional votes? And if not getting such powers, they threaten bigger political turbulences which could bring more economic failure?

In the era of declining economic growth among wealthy nations when their governments reached their highest level of public debts and liabilities, their choices for improving growth with better policies are strongly limited. Getting out of the mess requires time — a longer period of time that last beyond one or two peaceful political cycles.

---

[6] On fiscal illusions, see: James Buchanan, Public Finance in Democratic Process: Fiscal Institutions and Individual Choice, chapter 10, James Bucanan, Collected Works, vol. 4.

> A BUREAUCRATIC VERSION OF PRICE DETERMINATION CANNOT MAKE MUCH SENSE, ESPECIALLY IN DYNAMIC AND COMPETITIVE MARKETS

PRACTICAL APPROACHES TO SOE POLICY

The first idea for SOE policy can be limiting SOEs' risky operations while simultaneously giving it the highest level of autonomy. But such autonomy entails the risk of being eliminated for one political reason or another, while the pressure to bail out public companies or intervene with its management remain strong and omnipresent.

In addition to the theoretical problems related to the state ownership of properties and companies, there are practical macroeconomic problems that make SOEs ineffective:

1. Difficulty of maintaining price

Any attempt by an SOE to calculate prices on their goods and services can become an excuse for periodic or permanent accusations of wrong-doing and a demand for auditing.

It is obvious that a bureaucratic version of price determination cannot make much sense, especially in dynamic and competitive markets. A bureaucrat or an SOE leader cannot avoid mistakes in a permanently changing economic situation.

Even if SOE leaders find very precise prices in the market and put them on their goods and services, politically motivated people would still argue that there were better choices.

The issue can become insoluble when a change of a government happens. The new government would be interested in maintaining its control over an SOE and will try to find mismanagement by the current managers.

If it appears that SOEs had lower market prices, it can become a reason to attack it because it wastes state resources. Even if the prices were higher than market ones and people were not eager to pay them, it can again be counted as wasting the resources and dissatisfying people.

> FOR SOEs, NOTHING IS GUARANTEED BUT GOVERNMENT AND TREASURY BACKING WITH PROTECTION, SUBSIDIES, AND BAILOUTS

> ANY SOE WHICH ENTERS THE MARKET WITH SPECIAL PRIVILEGES (TAX RELIEF, DISCOUNTED ACCESS TO SCARCE RESOURCES, REGULATIONS THAT ARE TAILORED TO FIT SOEs) CAN EVENTUALLY BE CONVERTED INTO A GOVERNMENT MONOPOLY, WHICH ALLOWS THEM TO FORGET ABOUT EFFICIENCY

Moreover, as market prices permanently change, a SOE can be accused of simultaneously underestimating and overestimating the prices. That is especially easy after some years from the moment when prices were used. It can be difficult to prove what the market prices were, and somebody can still label the differences between market and SOE prices as huge (or claim that the prices were bad for customers).

In fact, accusing the prices of being wrong is easier and more frequent. Quality claims require a higher expertise, but accusations of wrong quality or design can be much easier, though more difficult to prove.

2. Risk-taking

SOEs are ordinary companies and they operate in a competitive environment. Although they sometimes operate in sectors with few or no direct competitors, consumers can always look for alternatives. Therefore, for SOEs, nothing is guaranteed but government and treasury backing with protection, subsidies, and bailouts.

The two sources of risks SOE managers undertake in seeking closer relationships with the government, rather than trying to please customers, are bribery and political corruption in exchange for special privileges.

3. SOE as a monopoly

Any SOE which enters the market with special privileges (tax relief, discounted access to scarce resources, regulations that are tailored to fit SOEs) can eventually be converted into a government monopoly, which allows them to forget about efficiency.

Governments attempt to defend their policies (including maintaining SOEs) with many arguments. They try to invent different reasons for the importance of SOEs and introduce special legislation to save them from competition.

One of the examples of such interventions are so-called “natural monopolies”. It is believed that there are some market sectors where there cannot be any substitutes for customers. Even though governments long hindered the private sector from creating alternatives, most of the "natural monopoly" sectors are now operated by private companies without problems for customers. Moreover, government regulations are mostly to blame for still-existing artificial problems (like mobile connection roaming prices).

”

GOVERNMENT INTERVENTION CAN HINDER MARKET COMPETITION AND CREATE ARTIFICIAL MONOPOLIES

Government intervention can hinder market competition and create artificial monopolies. Moreover, any attempt to remedy this problem with the same government interventions only deepens the problem. Only government intervention can create and save long-lasting monopolies. In contrast, a monopoly in the private market process can be an outcome of the efficient use of resources and successful management, though still controlled by competitive forces (new substitutes, changing preferences).

OPPOSITION TO PRIVATIZATION

The opponents on the political left (though not necessarily from such political parties) tend to explain their interventionist positions with two reasons:

1. Markets can fail to provide certain goods and services if this is not profitable for private companies to produce and sell them.

2. There are poor people who cannot afford some essential goods and services.

Any attempt to solve such problems must be first evaluated on economic efficiency. The opponents of free market solutions need to provide, with measurable data and results, the consequences of state interventions. Or, if someone thinks there is a market failure and the government can solve it, then we need to see short- and long-run measurable outcomes from them. They need to provide us with calculations of improvements they intend to reach, and also how to ensure that the best people are elected and appointed in political and executive positions.

For instance, when someone advocates affordable health care, they need to show how this policy can maintain a better quality of service, being simultaneously free of coercion, and incentivize healthier lifestyles and responsibility.

One of the most popular so-called market failure issues the left propagates is the monopolistic power sometimes appearing due to the efficient use of resources by a successful company (like Google). Many agree that it can become a problem for a short period of time before alternatives appear. But the state intervention alternative is also a monopoly under government protec-

> ANY ATTEMPTS TO REGULATE MARKET FAILURES BY A STATE CREATES PRIVILEGED GROUPS

tion. Moreover, any attempts to regulate market failures by a state creates privileged groups[7].

Oftentimes, any failure of government intervention is excused by the left with one sentence: That was not genuine socialism, there were mistakes in the policies, and there were wrong leaders.

First of all, those mistakes have already taken millions of lives. Still, when they say there can be better policies, we need very precise calculations of how to avoid mismanagement and misuse of resources. When SOEs enjoy real monopolistic powers and their bosses in the government are simultaneously monopolistic in their political powers, they are very short-sighted.

One of the biggest differences between a public company belonging to the state or private owners is that it is much more difficult to abandon ownership of a state company than of a private one. In fact, the abandonment power is one of the most important parts of ownership rights.

Knowing about this problem, SOE management feels much less pressure on them than if the SOE was a private company working in a competitive environment. That invites both inefficiency and less-qualified managers who prefer government privileges to economizing and pleasing consumers. Such managers are addicted to a free lunch and living at the expense of others (See Bastiat).

It is clear that opposing such issues is only possible if someone is only busy with political goals and disregards economic principles (See Sowell). The political goals are easier to achieve with emotional arguments rather than economic ones, as the latter offer mostly long-run solutions. Politicians need tangible outputs immediately. Outcomes like better education quality after 10 years are much less interesting for politicians and voters.

> THE CURRENT POLITICAL SITUATION LEAVES FEW CHANCES TO USE ECONOMIC EFFICIENCY ARGUMENTS

Undoubtedly, the current political situation leaves few chances to use economic efficiency arguments. For instance, it is always hard to oppose paternalistic or protection-

[7] For instance, regulation of communications is technically and economically nonsense, but it has a very important political benefit for governments. Moreover, that is an essential part of their power to control individuals.

”

TO TRY AND KEEP SOME ECONOMIC EFFICIENCY, A NATION NEEDS TO LIMIT AND RESTRICT GOVERNMENT POWERS, INCLUDING SOE EXISTENCE AND FUNCTIONS

ist policies when your neighbors use them — voters would rather vote for politicians who show visible effects and never tell them complicated stories of side-effects that destroy their choices and lives.

But to try and keep some economic efficiency, a nation needs to limit and restrict government powers, including SOE existence and functions. That keeps the chance to improve the level of living conditions for everyone (See Thatcher).

There are two major myths used to justify SOEs and delay privatization:

1. "Strategic importance"

Many supporters of SOEs and privatization opponents claim that, if privatized, some strategically important companies or functions will be used against the nation by its enemies. In fact, those opponents never say what the strategy is, where it was written, or what are its goals. The most important goal any key sector for the economy needs to accomplish is that it works. Someone who is skeptical of privatization and thinks that, in some cases, some important sectors are vulnerable, needs to show how government intervention solves the issue. Asking free market advocates to justify privatization is wrong – private people are served by the government, which is obliged to report to the people.

But if we need a solution for privatizing an important sector, institutions, or functions, then it is simple: Sell only in the transparent market and in a transparent way. Do not allow hidden and political groups to buy the property.

Before doing so, it is essential for politicians to create certain measurable conditions and procedural rules to determine why something is strategic, what its objectives are, and how to accomplish its goals (these shall apply to ordinary SOEs and government functions in general). The process must also prove that functions can be better performed by the state rather than a private sector. Just imagine what would be the outcome if mobile communications and smartphones were to be supplied by a state company.

"Is this function very important?" That was the typical question Vato Lejava[8], one of the architects of the Georgian reforms, would

[8] Vato (Vahtang) Lejava, as former deputy state minister of reforms coordination, chief adviser to the prime minister, and chief adviser on economic and governance affairs, and deputy minister of finance (from 2005 to 2012) was the principal drafter and implementer of the constitutional Liberty Act mentioned above, and of sector reforms, privatization, international trade liberalization and improvement of investment climate. In those efforts he worked hand-in-hand with the late Kakha Bendukidze and a team of reformers around President Saakashvili; currently he is rector of the Free University

> WHAT IS ALWAYS BEHIND THE NATURAL MONOPOLY ARGUMENT IS THAT THOSE WHO ARE IN POWER OR WISH TO WIN A GOVERNMENT OFFICE THINK ABOUT THE PERSONAL BENEFITS THEY COULD GAIN FROM SOEs

always ask in a discussion on government intentions. Even if justified, we shall take for granted that only competing private companies could be an efficient provider of a service. A government can just ensure disaster in its provision.

It may also be worth mentioning the current "global roaming prices abracadabra": people tend to think this is a problem crated by private companies and are quick to blame them, believing that it was the "nice", user-friendly EU commission that stopped them. In fact, the regulations implemented everywhere are to protect local territorial markets. The local artificial monopolies are very happy with this, at the expense of unhappy customers. Without those regulations, mobile communication would be easy, cheap, quick to improve, and customers would be also using their (home) cell numbers without problems. We can think differently: Mobile phone numbers are the ID numbers, and here we can see that even ID numbers and personal identification can be easily and quickly privatized[9].

2. The myth of natural monopolies

It is sometimes a stronger argument, as some theorists argue (and politicians use this with pleasure), that there are sometimes natural barriers, like putting pipes in the same place where it is already occupied. In fact, the issue is mostly about how much it can cost to lay more pipe, but not abut impossibility. In some sectors (like communication), this type of argument already disappeared. Again, the problem is in the costs of maintenance and has nothing to do with nature. We can observe how man subway lines run under the most important buildings in New York City, London, or Paris. If the costs are justified, there will be no barriers to add new pipes or cables.

But one should not forget about the alternatives. If there is no water and it is too costly to put new pipes, the solution is to find a better place to live where water is not expensive. Or, any monopoly power is limited by:

- competitors who can appear any time, attracted by the high prices;

of Tbilisi and the Agricultural University of Georgia.

[9] This is a proposal of George Zesashvili, a long-standing Deputy Chairman and Chairman of Georgia's Central Election Commission.

- consumer purchasing power;

- the appearance of new technologies which can be accelerated by higher prices set by the monopoly;

- wrong management of the monopoly because of less attention to the market.

In other words, any attempt of the opponents to justify the mythology contradicts their arguments for a natural monopoly if one digs into the microeconomics of the matter[10].

Practically, what is always behind the natural monopoly argument is that those who are in power or wish to win a government office think about the personal benefits they could gain from SOEs or some of the agencies established to perform public functions. Those gains can be access to shares, management posts, control in redistributing public resources, or a chance to appoint relatives or friends to such posts. By the nature of things, politicians hesitate to support privatization and compare its outcomes to the potential personal benefits from maintaining SOEs.

And here a "game of illusions" comes into play: It is easy to massage public emotions and tell the electorate it is unwise to sell Rustavi Metallurgical Plant, a notorious case of outdated technology and loss-making, because "Georgia must be proud" of its history, or because it employs 10,000 workers, and even when privatized, these illusions serve as "justification" for privileges, workforce support schemes, and subsidies[11].

WHAT CAN BE DONE?

Based on the experience of the last 5–7 years, political populism and politicization of economic processes in the current democratic system is unavoidable. Emotions of a different sort could overcome common sense, but we can only expect that this politicization will be limited by economic scarcity. Public debts and other liabilities created by governments can at some point destroy their economies and invite political conflict.

But before this happens and everyone accepts that this policy of SOEs is wrong, we can introduce some special rules for SOEs. Again, this does not mean that SOEs are a good idea. We should simply find a way to restrict existing SOEs and limit the creation of new ones.

Given that democracy is about how individuals behave toward one another and not just about how governments are elected and take decisions to direct the lives of individuals, there are several principles that, to some extent, worked in Georgia:

1. The government is a servant, and therefore has no right to hide anything from its citizens. That includes state companies or any organization financed by the state budget. They need to report to the public about any activities, spending plans, purchasing operations, profits, personal salaries, paid taxes, etc.

2. Governments have no right to risk resources. Therefore, it cannot maintain a business plan which contains risks.

---

[10] See: Julian Simon, The Ultimate Resource II: People, Materials, and Environment, Baltimore, University of Maryland at College Park, February 16, 1998, conclusions.

[11] RMP was established in 1948 as the first fully integrated metallurgical facility in that part of USSR. In its heyday, it produced steel, hot-rolled seamless pipes, and pig iron products, aluminum, or iron, and benefited from its supply of seamless pipes to connect the oilfields of Kazakhstan, Azerbaijan, and Turkmenistan to the mainland Soviet market, plus some export to the Middle East. It was privatized in 2005, but the pretense for subsidies and quasi-subsidies remained. It motivated court litigations between the new owners against the government official that privatized the plant and attempted to impose hard budget constraints.

3. Creation of an SOE should be based on concrete principles and goals. Fulfillment of the principles and goals must be strictly controlled. No SOE can be created or operated if there is a private company operating in the sector of its proposed activities. If there is an SOE operating, but a new private company entered the sector, then the SOE has to be privatized by the end of the next year.

4. Any SOE created by one government must be reapproved by the next government. Failure to reapprove automatically puts the SOE on the privatization list.

5. Failure to fulfill the principles and goals by an SOE automatically puts it onto the privatization list. A government can postpone privatization by only one year.

6. SOEs pay taxes and rent land or building space like all private companies.

7. An SOE has no right to plan profit. It can, however, happen that an SOE becomes profitable. In that case, any profits go directly to the state budget. An SOE that became profitable must be put on the privatization list. Again, governments can postpone privatization by only one year.

8. The institution responsible for SOEs is the State Treasury or a state institution similar by function. The head of the Treasury has a personal responsibility for the financial health of SOEs. The head of the executive branch can appoint some members of an SOE board from the stakeholder public institutions.

9. The government or central bank may not subsidize an SOE by more than 10% of its annual turnover. There can be no subsidies in sectors where SOEs have private alternatives.

10. The government must announce three (or five) major goals for why it is demanding to operate an SOE (or a function operated by a state agency). The goals must be clear and concrete with measurable outcomes and monitoring tools. The quarterly reports must indicate fulfillment of the major goals. Failure to report not fulfilling the goals for two consecutive quarters automatically puts the SOE or the government agency function on the privatization list.

Following this set of recommendations, which were successfully implemented in Georgia, might offer a viable alternative to SOEs in a number of country. Those good practices are an important lesson for both governments and citizens, and a source of inspiration for further developments. ●

*

GIA
JANDIERI

Co-founder and vice president of New Economic School – Georgia, a free market think tank. He worked in the State Audit Office, Central Election Commission, the Parliament of Georgia, the Anti-Corruption Agency, and was a board member of Geostat. He is an active member of Economic Freedom, Atlas, 4liberty.eu, and many other free market networks.

MEMBERS OF 4LIBERTY.EU NETWORK

Free Market Foundation (Hungary) is a think tank dedicated to promoting classical liberal values and ideas. The organization's projects focus on advocating a free market economy and fighting racism. The Foundation's activities involve education, activism, and academic research alike, thus reaching out to different people.

Liberální Institut (Prague, Czech Republic) is a non-governmental, non-partisan, non-profit think tank for the development, dissemination, and application of classical liberal ideas and programs based on the principles of classical liberalism. It focuses on three types of activities: education, research, and publication.

Svetilnik (Ljubljana, Slovenia) is a non-profit, non-governmental, and non-political association. Its mission is to enlighten Slovenia with ideas of freedom. The goal of the association is a society where individuals are free to pursue their own interests and are responsible for their actions.

The Lithuanian Free Market Institute (Vilnius, Lithuania) is a private, non-profit organization established in 1990 to promote the ideas of individual freedom and responsibility, free markets, and limited government. The LFMI's team conducts research on key economic issues, develops conceptual reform packages, drafts and evaluates legislative proposals, and aids government institutions by advising how to better implement the principles of free markets in Lithuania.

The F. A. Hayek Foundation (Bratislava, Slovakia) is an independent and non-political, non-profit organization, founded in 1991, by a group of market-oriented Slovak economists. The core mission of the F. A. Hayek Foundation is to establish a tradition of market-oriented thinking in Slovakia – an approach that had not existed before the 1990s in our region.

IME (Sofia, Bulgaria) is the first and oldest independent economic policy think tank in Bulgaria. Its mission is to elaborate and advocate market-based solutions to challenges faced by Bulgarians and the region face in reforms. This mission has been pursued sine early 1993 when the institute was formally registered a non-profit legal entity.

The Academy of Liberalism (Tallinn, Estonia) was established in the late 1990s. Its aim is to promote a liberal worldview to oppose the emergence of socialist ideas in society.

INESS (Bratislava, Slovakia), the Institute of Economic and Social Studies, began its activities in January 2006. As an independent think tank, INESS monitors the functioning and financing of the public sector, evaluates the effects of legislative changes on the economy and society, and comments on current economic and social issues.

Projekt: Polska (Warsaw, Poland) comprises people who dream of a modern, open, and liberal Poland. It is those to whom a democratic, effective, and citizen-friendly government is a key goal, and who help accomplish this goal while enjoying themselves, forming new friendships, and furthering their own interests.

Liberales Institut (Potsdam, Germany) is the think tank of the Friedrich Naumann Foundation for Freedom dedicated to political issues such as how liberalism can respond to challenges of the contemporary world and how liberal ideas can contribute to shaping the future.

Fundacja Industrial (Lodz, Poland) is a think tank created in Lodz in 2007. Its mission is to promote an open society, liberal economic ideas, and a liberal culture, and to organize a social movement around these ideas. Among the foundation's most recognizable projects are: Liberté!, Freedom Games, and 6. District. The foundation is coordinating the 4liberty.eu project on behalf of Friedrich Naumann Foundation.

Republikon Institute (Budapest, Hungary) is a liberal think tank organization based in Budapest that focuses on analyzing Hungarian and international politics, formulating policy recommendations, and initiating projects that contribute to a more open, democratic, and free society.

Civil Development Forum (FOR) (Warsaw, Poland**)** was founded in March 2007 in Warsaw by Professor Leszek Balcerowicz as a non-profit organization. Its aim is to participate in public debate on economic issues, present reliable ideas, and promote active behavior. FOR's research activity focuses on four areas: less fiscalism and more employment, more market competition, stronger rule of law, and the impact of EU regulations on the economic growth in Poland. FOR presents its findings in the forms of reports, policy briefs, and educational papers. Other projects and activities of FOR include, among others, Public Debt Clock, social campaigns, public debates, lectures, and spring and autumn economic schools.

Visio Institut (Ljubljana, Slovenia) is an independent public policy think tank in Slovenia. Aiming for an open, free, fair, and developed Slovenia, the Visio Institut is publishing an array of publications, while Visio scholars regularly appear in media and at public events.

COOPERATING PARTNERS FROM EASTERN PARTNERSHIP COUNTRIES

The Institute for Economic Research and Policy Consulting (Kiev, Ukraine) is a well-known Ukrainian independent think tank, focusing on economic research and policy consulting. IER was founded in October 1999 by top-ranking Ukrainian politicians and scientists, and a German advisory group on economic reforms in Ukraine, which has been a part of Germany's TRANSFORM program. Its mission is to provide an alternative position on key problems of social and economic development of Ukraine.

New Economic School – Georgia (Tbilisi, Georgia) is a free market think tank, non-profit organization, and NGO. Its main mission is to educate young people in free market ideas. It organizes seminars, workshops, and conferences for education and exchanges of ideas. NESG was founded by Georgian individuals to fill the knowledge gap about the market economy in the country and the lack of good teachers and economics textbooks.