

AT THE HARRIMAN INSTITUTE

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Kakha Bendukidze Analyzes Georgia's Economic Strategy: How Georgia Handled Its Economy After the War and the Economic Crisis

Kakha Bendukidze, a former Russian oligarch who served as State Minister on Reforms Coordination in Georgia from 2004 to 2008, and then the Head of the Chancellery of Georgia until 2009, spoke at the Harriman Institute on March 29, 2010, about the state of Georgia's economy. Bendukidze left Georgia after he graduated from the Department of Biology at Tbilisi State University and made his fortune in Russia during perestroika. He returned to his homeland in 2004, after President Mikheil Saakashvili asked him to reform the Georgian economy. Bendukidze is known for his rampant privatization efforts, having famously stated that Georgia "should sell everything except its conscience." Opponents criticize him for selling too many of Georgia's national assets to Russia, while supporters praise him for orchestrating "Georgia's Economic Miracle."

The "miracle," resulted from Bendukidze's campaign to reduce the bureaucracy, cut taxes and minimize government intervention in the economy. The Gross Domestic Product (GDP) rose from \$5.1 billion to \$12.8 between 2004 and 2008. Despite this healthy growth, the gap between GDP and overall economic growth was vast—privatization caused a sharp increase in unemployment and the quickly shrinking government left its citizens without a safety net.

In August 2008, the war with Russia and the global economic crisis dealt a serious blow to Georgia's economy. "From an economic perspective these two events hit simultaneously," explained Bendukidze, adding that Georgia's GDP had been expected to grow by 12% that year. Instead, Georgia experienced a 3% decline after the war, and a 3.9% decline the following year. "This year we expect close to 3% growth," Bendukidze optimistically projected. "I think that it was possible for us not to decline last year, but due to mistakes in economic and general policies after the war and the crisis, we declined."

Bendukidze enlightened that there were two schools of thought "fighting each other" after the double economic hit in 2008. One was Keynesian in nature—increased government spending,

foreign aid, and the development of infrastructure. He admitted that parts of this proposed reform could have helped, "but parts could not." Bendukidze supported the other school, in favor of a large devaluation of currency, the reduction of taxes and a significant cut to the state budget. "As usually happens in politics, we landed somewhere in the middle." The Georgian government modestly devalued the currency, cut taxes "quite significantly, but not to the levels that we were advocating," and did not reduce the budget. "As a result, we had the 3.9% decline."

Considering the circumstances, Bendukidze thinks that Georgia's economy has done fairly well. Last year, the level of Foreign Direct Investment (FDI) to GDP was at about 4%. "Four percent is much higher than other post-Soviet countries," he said, adding that Russia and Azerbaijan—post-Soviet countries with the highest FDIs, are both below 4%. Georgia was able to attract investment even during the crisis by reducing risk factors for investors. "We created an economically low-risk situation for local and international investors by reducing taxes and interest rates."

As a small economy, Georgia requires relatively low investment. "In order to keep the economy growing, if we are talking about investment-promoted growth, we need something like \$1.5 billion in annual investments—finding \$1.5 billion in investments is not rocket science." Bendukidze explained that Georgian officials managed the crisis by continuing the basic principles of its economic policy. "There was no nationalization, no capturing of the financial sector by the government."

Bendukidze praised Georgia's diverse investment sector, "there is no single sector that attracts all of the investment—communication, transportation, processing, mining, energy, we've had investment in all of them." When asked by a member of the audience, which sectors he thinks investors could find the best opportunities, Bendukidze replied, "to define the best investment opportunity you need to be very close to god."

Bendukidze defended his well-known conviction that he does not recognize the concept of strategic assets—the idea that certain national assets are strategically important for Georgia’s government. “From an economic point of view I cannot understand what a strategic asset means,” he said, voicing the opinion that there is no way to differentiate between what is and is not strategic. “Look at the United States, look at any developed nation before the socialists take power, what is the difference between a power station and a coal mine?” Bendukidze continued with the hypothetical comparisons, “Or a coal mine and a nursery? I don’t know the difference between a nursery and a field of potatoes, or a potato supply company and a water supply company. I listen very carefully and try to understand it, but I don’t.”

Harriman Institute Professor Alexander Cooley asked Bendukidze about his views on the U.S. aid and reconstruction package provided to Georgia after the war, in particular the direct budgetary support, “the one-time injection of \$250 million into the Georgian budget.” Bendukidze replied that the aid served its purpose immediately after the war and during the Russian occupation. There was a widespread national decline in tax payments. “Part of the country was in a blockade, Gori was occupied, and it was nearly impossible to move from East to West Georgia. The aid was quite significant during this time and a very good decision on the part of the U.S. administration. I was a part of the negotiations with the U.S. Treasury.”

After Georgia overcame the initial shock of the war, the aid was “at best case scenario, useless,” noted Bendukidze. He made an exception in the case of Internally Displaced Persons (IDPs). “We used it to give our refugees (IDPs) permanent homes—small homes that they actually own.” Bendukidze called this decision “one of the most important changes to Georgia’s internal policy.” He has been advocating the integration of IDPs (there were many as a result of the civil war in the 1990s) into Georgian society since he took office in 2004. According to a *New York Times* article from November of that year, IDPs occupied some of Georgia’s most expensive real estate. When he first took office, Bendukidze auctioned a state-owned, IDP-filled hotel in downtown Tbilisi to German investors, providing each IDP family with \$7,000 for an apartment—market rate in another part of Tbilisi.

Previously, “the attitude towards internally displaced persons was close to what is going on in Palestine—putting them in camps with no personal property,” recalled Bendukidze. “During the late 90s and early 2000s there was a feeling that

we should keep refugees as a special tool that would enable us to build up an angry army of returnees to Abkhazia. I think it is impossible to use a part of society as political hostages of crazy ideas.” The inflow of U.S. aid after the war allowed Bendukidze to continue what he had wanted to do in 2004, except this time he was dealing with the fresh wave of IDPs from the 2008 war. “There was some difficult discussion within the government, if we settled fresh refugees from the 2008 war, then questions would arise about why we aren’t providing homes to refugees who came, mainly from Abkhazia, in the early 90s. We went ahead with it anyway, and I am happy we did it.”

Bendukidze urged Georgia to abandon its dependence—except in the case of IDP resettling efforts—on U.S. funds and turn to its own budgetary proceeds. “Otherwise we will create a big distortion—a small economy with a lot of aid.” He took a similar position with Eurobonds, which Georgia borrowed in April 2008. “I opposed this because I think governments of developing weak countries like Georgia should steer clear of debt. By coincidence it happened that this money was able to mitigate the results of the war.” He pointed to the U.S. as a good example of how the bond market can crash an economy.

In October 2006, the Russian Federation imposed an embargo on Georgia, cutting postal and transportation ties, denying visas, and placing restrictions on Georgian exports. Analysts speculate that Russia’s agitation with Georgia’s NATO aspirations, and its pro-Western policies, fueled Russia’s decision. Bendukidze believes that the total impact of the Russian embargo is overestimated. “The immediate effect was below 1% of the GDP. The export to Russia was significant, but not huge, mainly wine and mineral water—part of the damage has been digested.” He reflected that the real problem “is not how it is in reality, but our perceptions, our imaginations, and our emotions.” Bendukidze specified that after the embargo he urged Georgian wine makers to imagine that “Russia is not there at all, just the Northern Ocean after the Caucasus.”

The real barrier to Georgia’s economic development is the failure to develop functioning institutions, reasoned Bendukidze, “a problem quite common for post-Soviet countries.” He emphasized that in order to succeed Georgia needs to develop all types of institutions, not just economic ones. “In general I do not like to separate reforms. Everything is related to the economy and the economy is related to everything.” It is unrealistic to “import institutions by appointing people and writing decrees—that is quite naïve.” Bendukidze insisted that the process

must be organic, and legislation should change “permanently, not quickly.” He speculates that it could take anywhere from 10 to 30 years for real institutions to emerge in Georgia. “Looking at the Baltic states, we can see that even 20 years is not always sufficient.”

In 2004, when Bendukidze’s team began its reforms, market liberalization was at the cornerstone of their efforts. “In order to establish institutions we require much greater economic freedom than is acceptable in Western nations. It’s the only way to build a more or less functioning society, one that does not impede on people’s ability to make decisions.”

After Bendukidze was dismissed from the Georgian government in February 2009, he shifted

his focus back to investment—he is looking into several industries outside of Georgia and Russia. Also the founder of the Free University in Tbilisi, Bendukidze wants to further his efforts in education. “I want to continue to develop a high-level undergraduate university in Georgia. This is very interesting to me; I have never been an educator, so maybe in a few years I will be.” He expressed that in general he does not like to plan the future. “Planning the future is just wasting time. Nobody knows what will happen tomorrow.”

Reported by Masha Udensiva-Brenner