

Imamali, Samadli; Aslanov, Etibar; Veliyeva, Narmin

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Kontakt/Contact

ZBW – Leibniz-Informationszentrum Wirtschaft/Leibniz Information Centre for Economics
Düsternbrooker Weg 120
24105 Kiel (Germany)
E-Mail: [rights\[at\]zbw.eu](mailto:rights[at]zbw.eu)
<https://www.zbw.eu/>

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Fiscal Policy Implementation in Georgia Before, During and After Saakashvili Period

Samadli Imamali¹, Etibar Aslanov², Narmin Veliyeva³

^{1,2,3}International School of Economics, Azerbaijan State University of Economics, Azerbaijan,

¹E-mail: isamadli.ac@gmail.com, ²E-mail: etibaras53@gmail.com, ³E-mail: nerminveliyeva85@gmail.com

Abstract

The main purpose of this paper is the review of implications of Georgian fiscal policy and discusses the changes before (until 2004), during (2004-2013) and post Saakashvili (after 2013) period. It is observed that the expansion of fiscal policy was slight prior to Saakashvili's election, however, it demonstrates highly expansionary work during Saakashvili period which started with decisive role of Rose Revolution in 2003. Since the 2003 Rose Revolution, the Georgian government implemented a number of major institutional reforms which have succeeded in modernizing Georgia's state institutions, reducing corruption and 'formalizing' the fiscal policy. Increased public expenditures, cuts in number of taxes along with increased amount of governmental debts for reconstruction purposes illustrates Saakashvili's period. What about after Saakashvili? This study helps understand the current and near-term fiscal policy challenges in Georgia.

Keywords

Fiscal policy; budget expenditures; tax policy; Georgia; Saakashvili

JEL Codes: E62, H6, K34

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1. Introduction

The most of the economists of the last centuries pointed the role and importance of governments in the economy from different approaches. The two basic policies for governments are fiscal and monetary ones. In short, fiscal policy refers to the use of government spending and tax policies to make an impact on the economic conditions, containing demand for goods and services, employment, economic growth and inflation. Georgia – a developing country in South Caucasus region left the centrally planned economic system after the collapse of Soviet Union in 1991. Note that 1991-1995 was recession period for Georgian economy due to civil war and losing ties with the economies of former Soviet countries, which led the economy to the downturn. There have been key leaders in Georgian history. Mikheil Saakashvili, Zurab Zhvania and Nino Burjanadze waived to build upon inherited power networks but rushed to create a new base of cadres (Timm, 2010"). As a starting point of fiscal policy analysis of Georgia, 1995 could be optimal choice for current research, when the war was over and Eduard Shevardnadze elected as the president. The second milestone in Georgia's economic history can be considered as the successful Rose revolution in 2004 as a result of which Saakashvili became the president. This was the launch of new era until 2013.

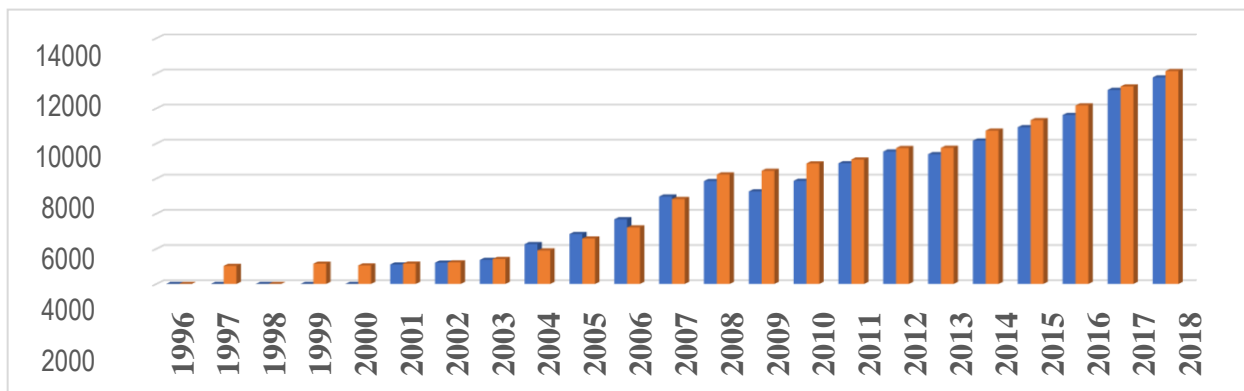
In this perspective paper examine fiscal policy of Georgia in three periods, before, during and after Saakashvili presidency. The years between 1995-2003 represent the period before Saakashvili which ended with resignation of Shevardnadze from office as a result of bloodless Rose Revolution that was led by Saakashvili. Subsequent to Rose Revolution Saakashvili became president in 2004, which characterized as a reconstruction period, when reforms were launched to empower Georgia's military and economic capability, and decrease the rate of corruption. The reforms he made included mass deregulation, privatization and liberalization of the economy, which made it much more easier to do (international) business in the country and acquire (state) property. Corruption was swiftly dealt with, in thanks to measures such as reforming the traffic police, introducing an education reform and tackling bribery, among others. These reforms show its outcome in a short period, as the state budget is increased by 300% within three years and unprecedented economic growth gained. Georgia was named as the leading economic reformer by the World Bank and also, the country ranked 8th in terms of ease of doing business. Because of the economic reforms, Georgia's economy grew 70% between 2003-2013 and per capita income roughly tripled, however, poverty only marginally declined. Also, over the last several years Georgia has been ranked by the Transparency International Corruption Perception Index as the least corrupt country among other non-Baltic former Soviet states (Aliyev, 2014).

The most important problem of Saakashvili period was Russo-Georgian war, which started in 2008 as a result of escalated tensions between Georgia and Russia and ended with the defeat of the former. The war damaged Georgia's economic and

military capabilities and government forced to increase military spending which lowered spending on other fields. Also, the war affected Saakashvili's reputation in a negative way. Georgian Dream-Democratic Georgia coalition won the elections of 2012 and Saakashvili left the president office. Analyzing the fiscal policy changes during the periods is both interesting on its own and crucial to predicting the policy's economic consequences.

2. Government budget

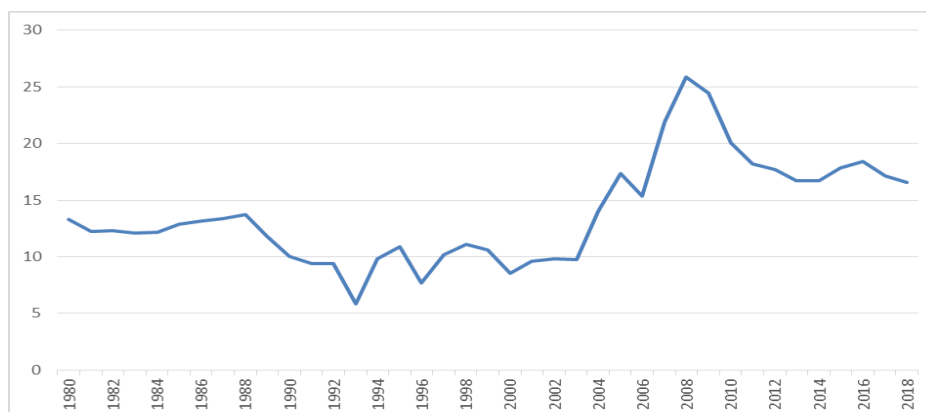
After the collapse of Soviet Union, Georgia has declared its independency and the country's standard of living significantly declined in 1991. The economic crises of the 1990s, massive unemployment, as well as the devastating effects of separatist conflicts in Abkhazia and South Ossetia were further exacerbated by the absence of reforms and the continuity of Soviet era forms of governance (Aliyev, 2014). During initial years of independence, along with common problems of newly-created countries, different factors such as wars, insufficient capital, absence of foreign relations and other internal intrigues affected the economy in a negative way. The first financial support provided by in 1995, when the World Bank and International Monetary Fund granted Georgia a credit of US\$206 million and Germany granted DM (Deutsche mark) 50 million, only four years after getting independence. Because of such factors, the economy met with recession and could not grow, as public revenues and expenditures did not exceed \$2 billion until 2004 year, when Saakashvili elected as a president. Therefore, fiscal policy implementation in Georgia has been slight expansionary during-before Saakashvili period.



Source: <https://www.ceicdata.com/en/indicator/georgia>

Figure 1. Governmental Budget Balance (1996-2018)

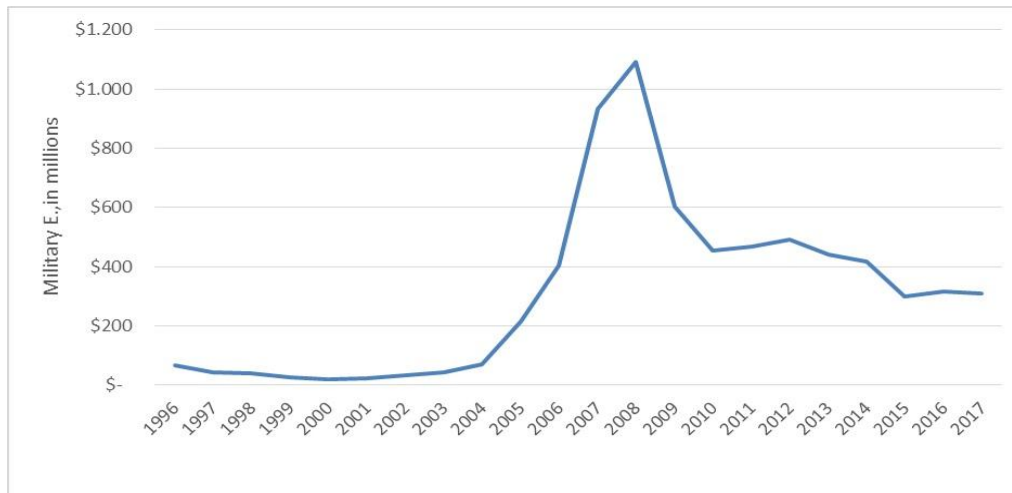
After that year the government revenues and expenditures rose significantly as a result of Saakashvili's government's reforms, and budget deficit replaced with surplus. Budget surplus was actual until 2008, but due to the war with Russian backed internal separators, the government increased expenditures in order to rebuild economy and mobilize its army. Hence, there was large deficit of approximately \$1.177 millions in 2009 and \$998 millions in 2010. It is remarkable note that main spending went to modernization of army, lasted nearly three years. Following that year the budget deficit shrank in comparison to 2009 and 2010. But, still there is a stable budget deficit in the economy of Georgia in the following years of post Saakashvili period.



Source: https://www.theglobaleconomy.com/Georgia/Government_size/

Figure 2. General Government Expenditure (% of GDP) 1980-2018

According to Figure 2, government size in the economy had been stable before independence, expenditure – GDP ratio was fluctuating within 10-15%. After gaining independence, in 1993, the ratio of general government expenditure to total GDP to 6%, the lowest level during independence. Until early 2000s the indicator had displayed volatility with ups and downs and around 10%. However, after 2003 it demonstrated significant rise and reached the highest point in 2009, as more than 25% of the GDP due to increasing general government expenditure in post-war period, mostly for modernization of army and reconstruction of the economy that suffered from Russo-Georgian war. Subsequent to 2010, general government expenditure to GDP ratio fell again to 16-17%, which is still more compared to other similar post-Soviet republics.



Source: <https://data.worldbank.org/indicator/MS.MIL.XPND.CD?locations=GE>

Figure 3. Military expenditure (current USD) 1996-2017

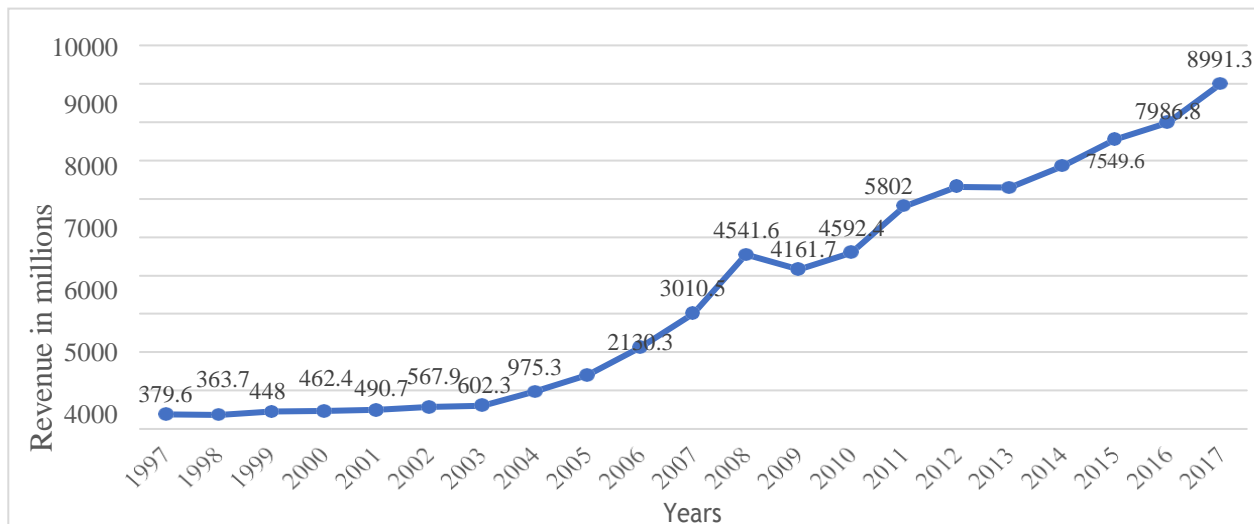
Due to low level of government revenues until 2003, Georgian government could not spend enough amount of money to the military sector. From the figure 3, as the income of the country gets larger, government started to increase the military spending in order to improve capability and capacity of its army, and huge amount of money spent for purchasing military technology abroad. Saakashvili reinstated government control over the Adjara region after forcing autocrat Aslan Abashidze to leave the region in May 2004. Afterward, Russia withdraws its troops from Georgia in 2007 (apart from South-Ossetia and Abkhazia). All these actions went along with sizable military spending, which can be seen in the Figure 3. The military spending peaked in 2008 with the amount of approximately \$1.1 billion because of Russo-Georgian war. Following years showed stable military spending except 2009, when the military expenditure was \$600 million USD. Expenditures for post Saakashvili period is not bigger than \$500 million. Government trying to keep military budget high enough to meet NATO criteria which requires to spend at least 2 percent of GDP for military expenditures, due to latest relations with NATO.

Therefore, it can be summarized that in terms of the change in public expenditures, fiscal policy implementation has been very slight expansionary during pre-Saakashvili period while became substantially expansionary during-and-after Saakashvili.

3. Tax policy

The government tax revenue refers to compulsory transfers to the central government for public purposes. Certain compulsory transfers such as fines, penalties, and most social security contributions are excluded. Refunds and corrections of erroneously collected tax revenue are treated as negative revenue. The central challenge of Eduard Shevardnadze's early presidency was the restoration of rule and order (Christian Timm, "Neopatrimonialism in Various World Regions"). In the early 1990ies, formal state structures of the newly independent Georgian state had been either suborned by paramilitary and mafia groups or had ceased to exist (Wheatley 2005a: 108).

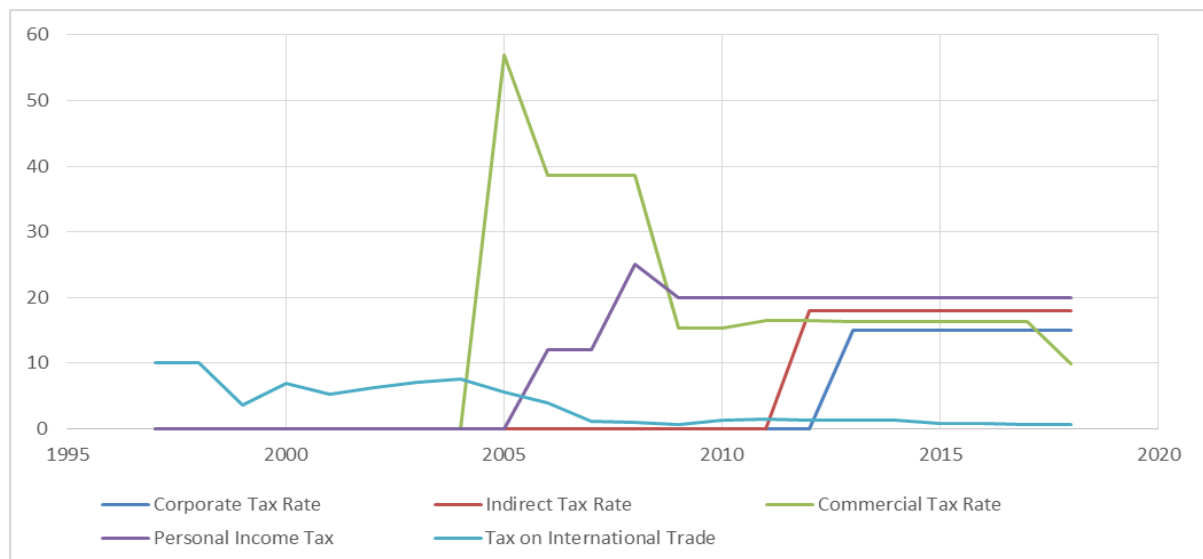
Georgia is a country with low tax rates and transparent tax system. Tax and customs legislation are unified under one tax code and the collection of taxes and supervision of the tax environment is provided by Georgia Revenue Service. Tax revenue represents a certain portion of fiscal revenues in Georgia. While the taxes amount was only 8.3% of GDP in 1997, it demonstrates an increase up to 23.7% according to 2017 data. During these years some fluctuations have been observed in the proportion of GDP. In 2003 tax revenue was only 7% of GDP, however it has went up 23.8% (2008) in 5 years. Additionally, some fluctuations have happened till 2017, but there is no big difference among them.



Source: <https://data.worldbank.org/indicator/GC.TAX.TOTL.CN>

Figure 4. Total tax revenues in Georgia (1997-2017)

Georgia is a country with low tax rates and transparent tax system. Tax and customs legislation are unified under one tax code and the collection of taxes and supervision of the tax environment is provided by Georgia Revenue Service. Tax revenue represents a certain portion of fiscal revenues in Georgia. While the taxes amount was only 8.3% of GDP in 1997, it demonstrates an increase up to 23.7% according to 2017 data. During these years some fluctuations have been observed in the proportion of GDP. In 2003 tax revenue was only 7% of GDP, however it has went up 23.8% (2008) in 5 years. Additionally, some fluctuations have happened till 2017, but there is no big difference among them. Georgia government has obtained nearly 379.6 million revenue from the tax in 1997. Comparing with 2017 the huge difference has been noticed from Figure 2. It is not coincidence that the government has increased the amount of tax revenue implementing the stable tax policy. In 2017 it rose up to nearly 8991.3 million.



Source: https://www.theglobaleconomy.com/Georgia/Government_size/

Figure 5. Dynamics of main types of taxes in Georgia (1997-2018)

The five main taxes that take the most shares in the Georgian budget are given in Figure 5 within 20 years period between 1997 and 2018. Prior to Saakashvili's presidency, in other words, between 1997 and 2004, indirect tax rate, commercial tax rate, personal income tax and taxes on international trade were not implemented.

During the reconstruction period of Saakashvili's cabinet, these taxes passed and commercial tax rate showed a significant rise up to 57 percent in 2005, but then tend to fall and declined to 38.6 percent in 2006, and remained until 2009, when the rate fell to 15.3 percent. Following that year, the rate did not show substantial change except 2018 when indicator declined

to 9.9 percent, the lowest after 2005. Coming to corporate tax rate, it applied in 2013 at fixed 15 percent rate. Taxes on international trade were 10 percent in 1997 and fluctuated between 1-10 percent among 1997-2007, following it fell below the 1 percent rate. Indirect taxes applied in 2011, and similar to corporate tax, government set fixed amount of indirect taxes at the level of 18 percent. Personal income tax placed in 2006. Although it started at the level of 12 percent and rose to 25 percent in 2008, it was fixed at 20 percent rate afterwards. Value-added tax (VAT) is collected at a flat rate of 18%. There is few exceptions granted, nearly all goods and services are subject to VAT. Medical care, exports and education are exempt from VAT. Regardless of turnover a taxpayer have to register for VAT if it produces or imports goods. Turnovers of less than 100,00 GEL is exempt.

In conclusion, it is seen from the figure that, although the taxes were different from each other in the time when they first placed, government reforms bring them to nearly the same level, especially after 2012. The amount of income tax according to the income is given in the table below with four divided income categories and tax rates accordance with them.

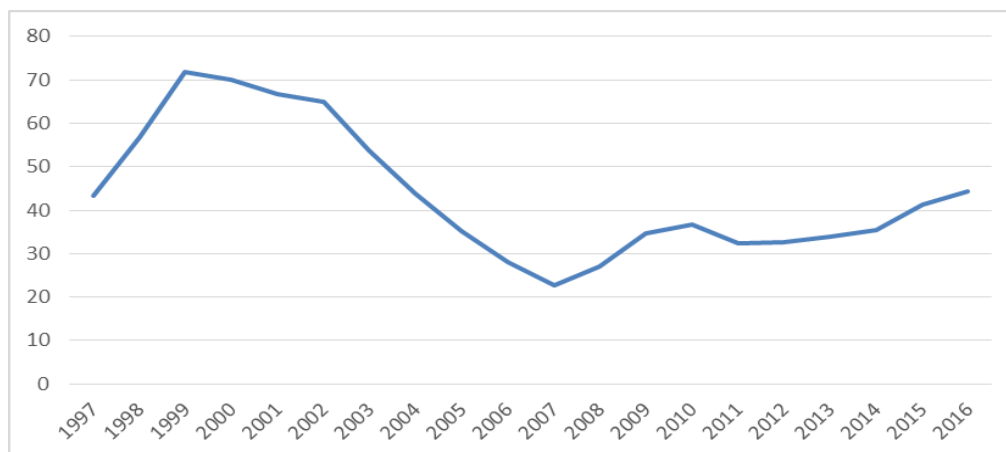
Table 1. Amount of income tax

	Amount of gross taxable income during a year	Tax rate
1	up to 200 lari	12% of the amount of taxable income
2	201 to 350 lari	24 lari + 15% of the amount in excess of 200 lari
3	351 to 600 lari	46.5 lari + 17% of the amount in excess of 350 lari
4	from 601 lari	89 ari + 20% of the amount in excess of 600 lari

4. How effective is fiscal policy?

The effectiveness of fiscal policy tools can be investigated by analyzing their contributions to primary macroeconomic indicators. For small-economy countries, like Georgia, high level of fiscal policy implementation is very important.

The notion of infinite debt is theorized by Deleuze and Guattari (1983/1972:192e199, 217; 1987/1980:113,442e444) and also developed by Giorgio Agamben (1998/1995) in his uptake of Schmitt's (1985/1922) conceptualization of state power as founded on sovereign exception from legal order (Samuel Schueth, Apparatus of capture: Fiscal state formation in the republic of Georgia). The organic law on "Economic Freedom" in 2011 is the main indicator on this development. After the implementation of this law tax revenue has a significant role on the amount of total revenue. Specially, the economic rights and freedoms have been estimated on the adoption of organic law. Such changes have affected to the whole tax system based on these rules. The government mainly focused on expenditure, debt and balance issue. According to the new laws, the ratio of sum of the consolidated budget expenses and the growth of non-financial assets to the GDP must not be more than 30% (Expenditure Rule, 2011). Also, the consolidated budget deficit's ratio to the gross domestic product must not be over 3% (Balance Rule, 2011). Here one of the main rules is related to state debt which's ratio to Gross Domestic Product cannot exceed 60% although the ratio is nearly more than 60 percent since 2011.

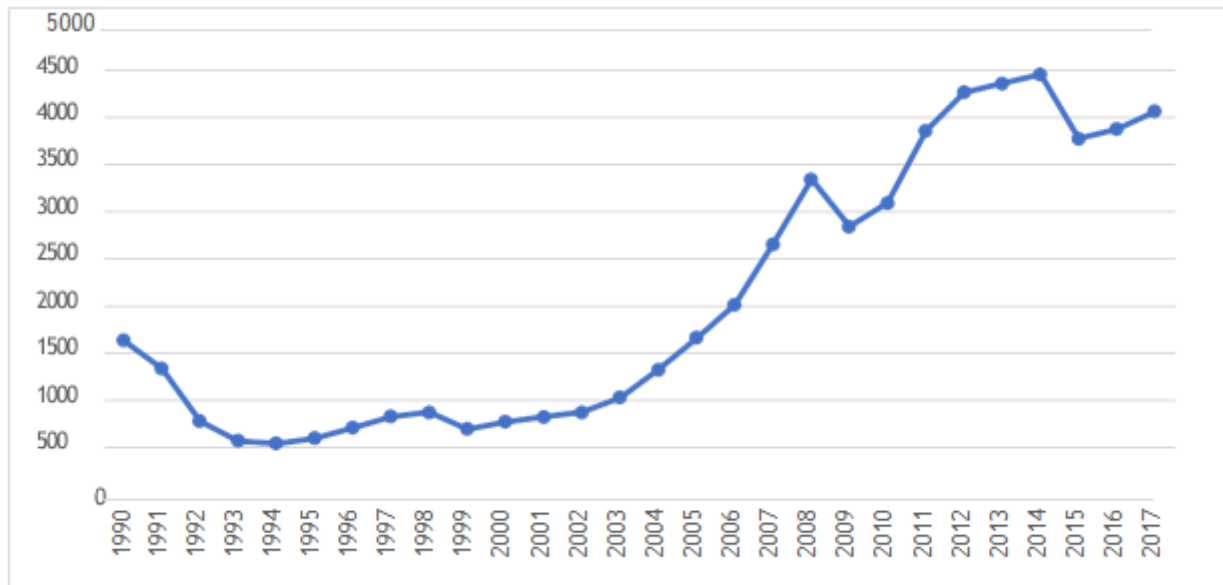


Source: https://www.theglobaleconomy.com/Georgia/Government_size/

Figure 6. Government debt, Total (% of GDP)

As all other post Soviet countries, Georgia experienced declining GDP and GDP per capita after declaring its independence from Soviet Union. As of 1991 year, GDP per capita was \$1314, which decreased to nearly \$500 in 1993 and 1994. The government suffered from low level of GDP per capita till 2003. 10 years period between 1993 and 2003, GDP per capita has been fluctuated around \$500 and \$1000. As in the other fields and indicators of the economy, GDP per capita also

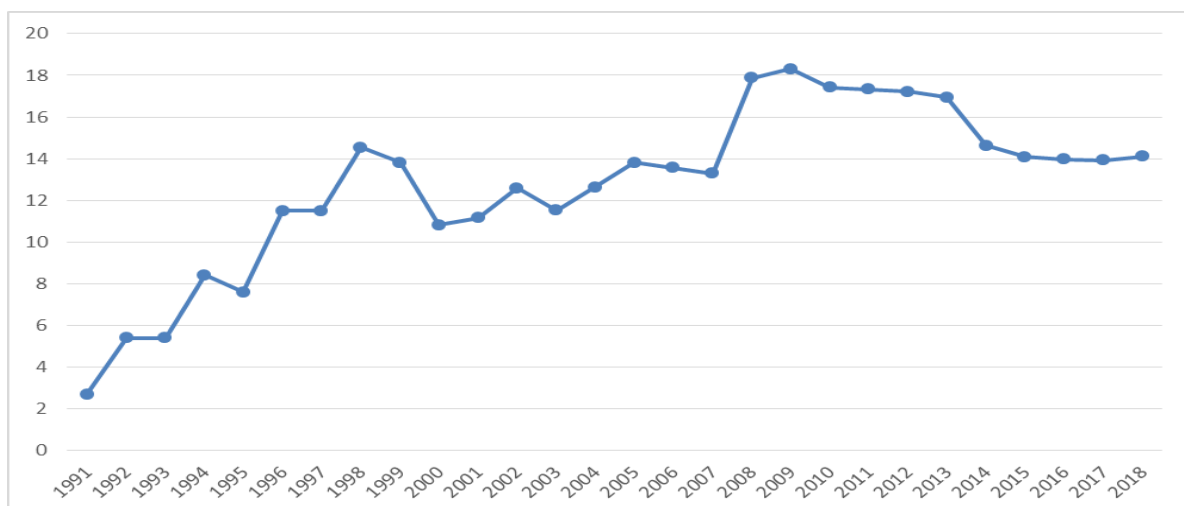
started to rise thanks to Saakashvili's reforms, and reached \$3324 in 2008, however, due to war, it fell below the \$3000. Subsequent to 2015, the amount of GDP per capita has started to increase after fall observed in 2013. Currently, the increase is actual in Georgian economy as well.



Source: <https://data.worldbank.org/indicator/NY.GDP.PCAP.CD?locations=GE>

Figure 7. GDP per capita (current US\$)

Unlike other indicators the unemployment rate was not stable, and the dynamic changes have been noticed each year. Although Georgia was newly emerged country in 1991, it managed to keep the level of unemployment in the low level, however, in following years unemployment level showed increase and peaked with the rate of about 15 percent and it considered the highest rank in the second millennium. Generally, due to the war with the internal separators, the unemployment level reached the highest point after independence in 2009 with the rate of 18 percent. Despite of Saakashvili's success in reducing corruption and increasing government budget as well as solving disputes in the borders of the country, his cabinet could not afford to increase the level of employment. Following 2009, the level of unemployment declined, though it was not significant.



Source: https://www.theglobaleconomy.com/Georgia/Government_size/

Figure 8. Unemployment, total (% of total labor force)

5. Conclusions

This paper has analyzed the progressivity of fiscal policy implementation of Georgia throughout several periods mentioned as before, during and after Saakashvili period. A wide range of fiscal activities were analyzed along with their data and

explained throughout figures, graphs and tables. Main objectives of fiscal policy implementation includes full employment, economic stability and stabilization of the rate of growth, thus our paper is mainly based on these objectives and deeply analyzed all mentioned above. Results mention that, pre Saakashvili period, roughly until 2004 economic indicators demonstrate unstableness and this period is actually recession period for the country. Along with internal conflicts during first years after Soviet's collapse, low amount of GDP per capita, public revenues and expenditures is characteristic, meanwhile, higher amount of unemployment is actual. The first borrow from abroad in 1995, and Rose Revolution (2003) are important comeback dates for first period.

Saakashvili's election in 2004 is start point of the second analyzed period, which contains several reforms in fiscal policy and 2011 organic law on 'Economic Freedoms. Overall, economic growth is characteristic, within several economic indicators along with increased public debts. Important instrument of fiscal policy implementation is taxation issues which is analyzed in detail throughout this article. A steep decrease in amount and number of taxes is characteristic for later periods which were in high numbers in 1990s.

In conclusion, later periods analyzed in this paper indicates stable and successful policy implementation adopting western-developed countries' policy models, which is result of increased rate of international relations. Decreased amount of tax on international trade takes an important part in its implementation.

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