

Challenges of Economic of Georgia: Good and Bad Economic Growth

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Abstract

The Georgian economy has been undergoing serious transformations over the years. The reforms carried out by the government affected all spheres of the economy - health care, education, industry, the military-technical complex, etc. The annual growth of the economy is approximately 4.8%. The EU, partner developed countries and donor international organizations allocate huge financial resources for the implementation of the changes planned by the government. Despite this, the economy of Georgia is in a difficult situation. The reason of economic stagnation in which the country has been for years is an extensive vector of development of the national economy. Investment projects carried out in the country in recent years are extensive in most cases. These projects are aimed at increasing current profits. They mostly are not oriented to long-term perspective. Intensification projects based on scientific and technical progress that are capable to change the level of production qualitatively are few. Despite the lack of an innovative scientific and technical background the economic indicators are increasing. However, the analysis of the indicators' growth factors shows the lack of development of the national economic system. The data does not reflect the real economic statement and point to an extensive (so-called bad growth) growth of the national economy and will lead to economic and political crisis. The intensive and extensive factors of economic growth is discussed and analyzed in the paper. The recommendations and measures are developed by the authors for improving the economy through the intensification of production processes.

Keywords: Economic growth; intensive and extensive growth; bad and good growth; innovation development; scientific and technical progress.

Introduction

Since the 90s, the Georgian economy has been experiencing a difficult transformation. Reforms touched upon all fields and spheres of economy. The introduction of market mechanisms in economy are considered as the starting point of socio-economic transformation. The start of the reforms has negatively impacted the development rate of economy. Along with the collapse of the Soviet Union, practically the production machineries were stopped. The crisis has touched all the fields of economy, from where the country is trying to come.

The incomplete list of problems that have not lost their sensitivity till today and from where the country is still trying to escape looks like this: (Kasradze Tea, 2013); (Kasradze Tea; Zarnadze Nino, 2018)

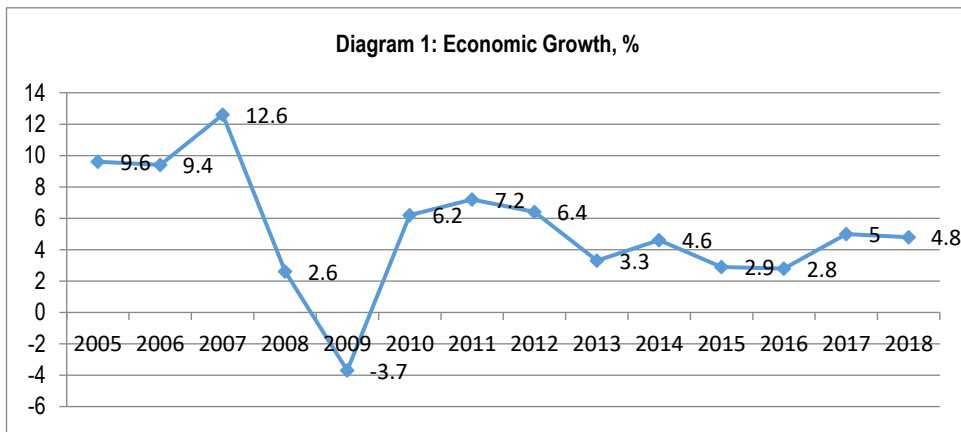
- An increasing demand for public goods and services, utility services, transportation system, medicine, telecommunications, education and safety (not only military security is meant here, but safety in energy, health care, ecological, food security, etc);
- A high rate of physical and moral aging of major funds (outdated residential funds, water-sewerage and gas cables, etc.) The outdated infrastructure not only stops/hinders the development of production, but it is a threat to people's lives too;
- Irrational use of natural resources;
- Low rate of employment;
- Low level of population life standard;
- low quality of education and its availability;
- Low quality of health care and its availability;
- High rate of inflation;

- Devalued national currency;
- Severe ecological condition;
- Low rate of scientific-technical progress and innovative activity;
- And others.

The solution is the growth and development of the economy, which is achieved through a reasonable, balanced cooperation between the state and the private sector. The private sector creates economic wealth and fills the budget (**Kasradze Tea, 2012**). According to Geostat data, nowadays 90% of the taxes are currently paid by 13% of the population employed in the private sector. According to experts, in order to change the social and economic situation in the country for better, it is necessary at least to double this indicator in which the partnership between the state and the private sector can play a big role.

Economic growth of Georgia – data and reality

Since 2005 Georgia's economy has been characterized by a growing tendency (if we don't count 2009), where the private sector plays a leading role.



Source: Ministry of Finance of Georgia, www.mof.ge

In recent years, the economic activity in the private sector has increased significantly, not only the increasing number of newly registered enterprises from year to year, but also the number of jobs increased from year to year and the volume of investments made (Kasradze Tea, 2014).

"The state supporting programs greatly contributed to the growth of economic activity, creation of new enterprises and expansion of existing ones. 374 enterprises were financed within the program "Produce in Georgia", 921 million GEL was invested and supported to create more than 14 900 new job vacancies. 467 million GEL was invested in creating new enterprises and 340 million GEL - for the expansion of the existing enterprises. At the same time, the total amount of investments made within the component of availability of real estate is 97 million GEL."¹

Despite the development of the private sector of economy and significant support of the state in this development, it can be easily said that real partnership between the state and the private sector has not been made in Georgia yet. There is no single balanced partnership strategy. Therefore, often the actions of the state and business are not only consistent, but often even contradictory (**Kasradze Tea, 2014**).

In recent years, the growth of national economy has caused unprecedented demand for infrastructural services. It is necessary not only to maintain, supply and distribute goods and services, but also to improve and create new ones. Since (budgetary) funding based on traditional sources of infrastructure projects in most countries is far less than it is necessary,

¹ Current economic trends, the Ministry of Economy and Sustainable Development, http://www.economy.ge/uploads/publications/economy_17469715bb1eb317db9e9.6799101

the private sector's interest and involvement of their finances and know-how is very important in this case (**Kasradze Tea, 2012**).

Effective management of the work is favorable for both the state and the private sector. Directly or indirectly, the outcome of their activities will be reflected on the country's economy and, respectively, on well-being of the society (**Gulua, Ekaterine, 2012**); (**Gulua, Ekaterine, 2011**).

The market economy gives the possibility of a fruitful partnership between the state and the private sector. Such a practice has already been introduced/approved in the world. According to the World Bank data, from 1990 to 2016 7132 PPP projects were implemented worldwide with 2.6 trillion US dollars. Only in Europe in 2016 12 billion-euro-PPP projects were implemented. In this regard, the United Kingdom is a leader with 3.8 billion-euro-projects, respectively, the 2nd and 3rd places are shared between France and Turkey. The partnership is mainly implemented in infrastructural projects. The number of successful projects implemented in the field of transport by countries is as follows:

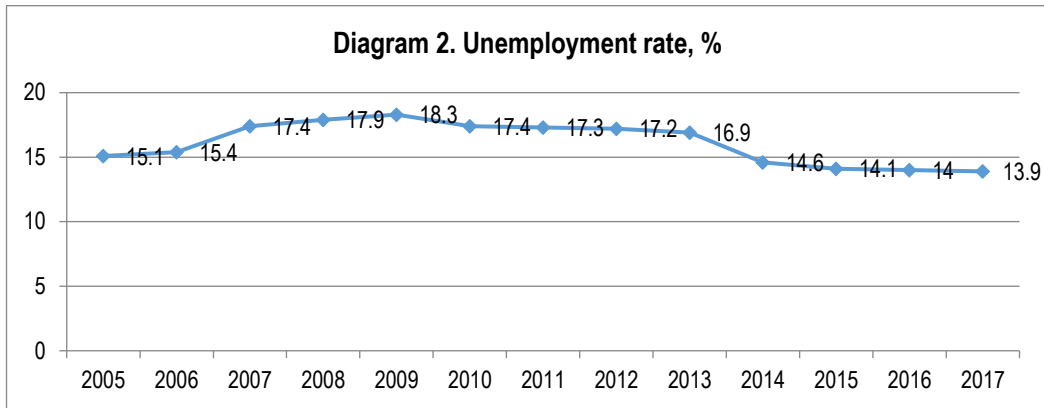
Table 1: The cases in Best Practice on PPP projects by economy

Economy	The number of projects	Transportation mode			
		Land (road)	Land (rail)	Maritime	Air
Australia	2	2	0	0	0
Brunei	0	0	0	0	0
Canada	3	1	1	0	1
Chile	3	2	0	0	1
China	0	0	0	0	0
Hong Kong, China	0	0	0	0	0
Indonesia	9	3	4	1	1
Japan	9	1	3	0	5
Korea	2	1	1	0	0
Malaysia	4	1	2	0	1
Mexico	3	1	0	1	1
New Zealand	1	1	0	0	0
Papua New Guinea	1	0	0	0	1
Peru	0	0	0	0	0
The Philippines	8	2	2	1	3
The Russian Federation	3	1	2	0	0
Singapore	0	0	0	0	0
Chinese Taipei	3	1	1	1	0
Thailand	5	2	2	1	0
The United States	2	1	1	0	0
Viet Nam	5	3	0	1	1
Total	63	23	19	6	15

Source: PPP Best Practice, Asia-Pacific Economic Cooperation, 2016.

<https://www.apec.org/Publications/2016/04/Public-Private-Partnership-Best-Practices>

The hard social-economic background in Georgia directly indicates that the state does not have sufficient financial resources or potential to solve these problems. The problems that have accumulated over the years require an effective private-public partnership. Problems that have accumulated over the years require an effective private-public partnership. Despite the fact that the economy has had an average growth of 4.8% over the years, this is not reflected on the welfare of the society (the unemployment rate is still high, a large number of population is beyond the poverty line, the inflation rate is high, a large number of people is in debt and cannot escape from it, a loan interest rate is very high, it is unstable, in the last 3 years, the Lari rate has been devaluated by 70%, which very badly touched the population who has income in Lari and loans in a foreign currency) (**Kasradze Tea, 2018**).



Source: Ministry of Finance of Georgia, www.mof.ge

In this situation, the importance of a private-public partnership is high, as the large investments provide an implementation of large-scale projects; updating material-technical base; renewal of an entrepreneurial fund; introduction of new technologies. While these projects have a long period of redemption, their effects have a great impact on the development of the economy and the well-being of the society (Kasradze Tea, 2014).

Today there is a visible contradiction between the state and business interests. The main motivation of private enterprises in the market economy is to get the maximal gain in a minimum timeframe. In the countries with developing economies the impact of the above factors is so big on the private sector that the business becomes focused on maximization of the current profit, on a high rentability of a project, on rapid repurchasing of the expenses, on the capital cost minimization, on paying the minimum taxes, on giving low salaries and on the extensive growth of production scales (Petr Wawrosz, Jiri Mihola, 2013).

However, it is obvious that realization of large-scale projects that have the potential to change the quality of the business and the economy in total is not limited to the short term period of repurchasing and high incomes at the initial stage of implementation of the project. As is known, large-scale projects such as construction of roads and bridges, construction of large production, introduction of innovations, constructing schools, hospitals, kindergartens, gasification and electrification, water supply and so on together with large funding require long periods of time to the point of profit. At the initial stage of such projects, additional investments may be required, but their realization effects have a strategic importance for the development of the country (Gulua, Ekaterine, 2014); (Gulua, Ekaterine, 2013).

Thus, the interests of the state include increasing a high efficiency of enterprise capacities, development of high-tech fields, realization of large-scale projects, ensuring the safe environment for production, renewal of physically outdated production facilities and implementation of projects **based on intensification**.

An increase in economic growth caused by more efficient use of inputs (increased productivity of labor, physical capital, energy or materials) is referred to as *intensive growth*. GDP growth caused only by increases in the amount of inputs available for use (increased population, new territory) is called *extensive growth* (Bjork, 1999).

Intensification - this is a system development process based on scientific and technical progress through the introduction of innovations. Such projects require large investments and a long period of redemption, and exactly this is the resistance between the state and the private business.

For the success of the public-private partnership, existence of the proper institutions, effective procedures, transparent, accountable public and private sectors is important, which is a problem in many countries (especially in developing ones). Exactly for this purpose UNECE guidelines were created for politicians, public and private officials. Effective partnership standards, conditions for its achievement, mutual cooperation rules, possible liabilities and responsibilities of the state and business are determined in it. The guideline aims to increase the capacity of governments at all levels to implement PPPs successfully. (United Nations Economic Commission for Europe, 2008); (Asian Development Bank, 2006)

For the successful realization of the PPP concept existence of an independent, impartial institution in the country, which by balancing the interests of both parties (public and private) will support and monitor the implementation of PPP projects. This institute is a mediator between the private sector and the state that controls the performance quality of the commitments of the parties involved. For example, the obligations undertaken by the state may be the following: ensuring a healthy competition, creating a liberal tax environment; transfer of lease of land and other state property (lease, leasing, usufruct, etc.), in case of necessity issuance of licenses (permissions), protection of private property, availability of impartial court, etc (**Kasradze Tea, 2015**); (Kasradze Tea, 2016); (**Zarnadze Nino, 2018**)

In its turn, the business may undertake the obligation to invest; high quality of goods and service, safe working environment, introduction of innovative technologies, the use of scientific-technological potential, activation of researches and funding to achieve the economic growth through intensification.

The development of the economy on the basis of production process intensification is the priority of the entire world. According to the data of 2018, the most innovative countries in the world are South Korea, Sweden, Singapore, Germany, Switzerland, Japan, Finland, Denmark, France, Israel, the USA and other developed countries. Innovations have a significant contribution to their GDP growth (**EY, 2015**).

The innovative policy of developed countries aims at forming and developing the scientific and technological potential of the country. The economic growth of these countries is caused by the increase of production capacity, the creation and diversification of new products and services, the introduction of knowledge and advanced technologies in the process of production. As a result of intensification processes, the increased economy (good growth) ensures a long-term growth of GDP and national income, a reduction of inflation, raising the level and quality of living of population. Priority programs in leading countries of the world are the programs of scientific and technological development. In recent years, the expenditure incurred by these countries from state budget for innovations is as follows:

Table 2. R&D expenditure as a share of GDP by countries

Countries	2016	2015	2014	2013
Israel	4,3	4,3	4,2	4,2
South Korea	4,2	4,2	4,3	4,1
Sweden	3,3	3,3	3,1	3,3
Japan	3,1	3,3	3,4	3,3
Austria	3,1	3,0	3,1	3,0
Germany	2,9	2,9	2,9	2,8
USA	2,7	2,7	2,7	2,7
France	2,3	2,2	2,2	2,3
China	2,1	2,1	2,0	2,0

Source: World Data Atlace

https://knoema.com/atlas/topics/Research-and-Development/RandD-Expenditure/RandD-expenditure-as-a-share-of-GDP?origin=knoema.ru&_ga=2.111977284.1304505994.1551078675-776431307.1551078675

Public-Private Cooperation in Georgia:

Georgia's economy is one of the fastest growing economies in the region. The rate of economic growth, GDP growth rate, the number of private enterprises is increasing in comparison with previous years, although the figures of economic growth do not reflect the quality of the situation in the economy. The potential of different fields of economy (agriculture, metallurgy, mechanical engineering, etc.), which previously provided the country's welfare and development, is experiencing a crisis nowadays. Only 15 of 71 enterprises of the agrarian profile existing on the state balance are functioning. In the Metallurgical City (Rustavi) where once the entire population was employed in the metallurgical factory, today unemployment rate is 10% according to the official data and more than 30% by the unofficial data. Mechanical engineering is considered to be in the disappeared fields (**Nino Tsukhishvili, Saba Buadze, 2016**); (**Sophio Chareli, Sulxan Saladze, 2015**).

The state has privatized a part of the enterprises of this sector, but most of them are still in state ownership, most of which are either non-functional or loss-making.

The number of state enterprises in the country in 2012-2013 reached 1129. National Agency of State Property has started to liquidate, bankrupt and merge unprofitable, bankrupted and fictitious (non-functional) enterprises; some enterprises were handed over to private entities with the right to manage, many enterprises were privatized. As a result of these measures, their number decreased significantly by the end of 2013 and reached 373, from which only 13% of enterprises was profitable (Nino Tsukhishvili, Saba Buadze, 2016); (Sophio Chareli, Sulxan Saladze, 2015); (Kasradze Tea, 2017).

By 2014, 344 enterprises were on the state balance. Out of this, 24 enterprises have been transferred to different ministries with the right to manage (18) or to a private investor (6), 10 enterprises – to the joint stock company Partnership Fund. The remaining 310 enterprises, which are on the balance of the Ministry of Economy according to the sectors are distributed as follows:

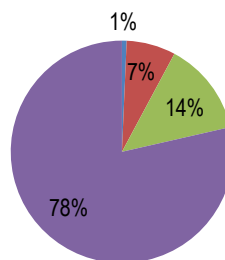
- Medical Services - 88 enterprises;
- Transport, transportation - 16 enterprises;
- Communication - 3 enterprises;
- Water supply - 2 enterprises;
- Construction services - 17 enterprises;
- Tourism - 13 enterprises;
- Out of 71 enterprises of agrarian profile only 15 were functioning;
- and so on. (State Audit Office, 2015)

The diagram 2 shows that only 2 out of 310 state enterprises are in the so-called "good" condition, 21 of them are at the lower level ("notable"), 40 companies are in the "substandard" position, and most of them (231 - approximately 75%) are in the so-called "suspicious" financial position or/and are not engaged in entrepreneurial activity at all.

By 2016 146 enterprises remain in the management of the National Agency of State Property.

Diagram 2. Classification of enterprises entered into the management of the National Agency of State Property according to the financial status.

■ Good ■ Notable ■ Substandard ■ Suspicious



In order to overcome the situation in the economy, it is necessary to use the private sector potential. The relationship between the private business and the state should not be limited to only financial relations and in this process the scientific-technical potential, know-how and intellectual capital of the private sector should be involved. For instance, the share of innovative active enterprises in EU countries is 70%. These countries do not only create high indicators of economic growth in the long term, but also in the world market they stand out with the growth of product competitiveness. Today the countries with developed market economy are focused on the creation of high-tech products that will reduce product cost and improve human life quality (Kasradze Tea, 2018); (Zarnadze Nino, 2007).

Certain steps have been made to establish and develop a public-private partnership in Georgia.

On July 1, 2018 a law on public and private cooperation was adopted, which defines the rules and procedures related to elaboration and implementation of the public and private cooperation project, public and private co-operation principles, the relevant institutional system, and also other issues related to public and private cooperation.

The public and private cooperation goals are¹:

- A) to increase the efficiency of projects;
- B) to satisfy a public interest by creating a new public infrastructure and/or providing public services and/or improving existing ones;
- C) to attract private financing;
- D) to increase the spending efficiency of public finances;
- E) to distribute risks between public and private sectors;
- F) to use a private partner's know-how.

The legislative environment may be more or less prepared for the development of a private-public partnership, though the successful examples of this partnership are not many. It is necessary to activate the work in this direction, but the accents should not be made only on the profitability depicted in figures. It is important that a high profitability of production should be based on an intensive growth. In the framework of a partnership the state should request the implementation of the infrastructural changes from the private sector, the modernization of production through the introduction of modern technique and technologies, involvement of the local population in the production process and their training/qualification improvement in case of necessity, keeping ecological standards and caring about the environment, involvement of the scientific potential in the process of production; purchasing raw materials on the local market and so on.

It is necessary to raise awareness about the PPP (its positive and negative sides) in public, especially in the private sector. However, it should be said that the government itself does not know the essence of PPP well. Ministries and public officials do not properly understand the basic idea of PPP. There is a lot of work to be done in this direction.

It is also necessary to involve banks in implementing PPP projects. Banks have a big role in developing the country's economy. They have a large financial resource and they need to be convinced of the efficiency of PPP projects. This trend will increase domestic liquidity and help governments find an alternative financing for smaller PPPs that are not attractive to international investment banks.

A private-public partnership has both advantages and shortcomings, so they should be well-measured before making a contract. In particular, the public sector should clearly define the purpose of the project and the expected benefit for the public in advance and after that hold negotiations and be able to protect the public interests in the contract (**Zarnadze Nino, Narmania Davit, 2009**). If it offers a state partnership to foreign companies, then it should also demand some conditions from them - eg. It should request to hire and train local labor force. In fact foreign companies should not go against it, because local workers are always cheaper. In this respect, the state itself should be concerned about the qualification of local workforce. It should make more investments in the education sector (Gulua, Ekaterine, 2018); (**Gulua, Ekaterine, 2017**); (Gulua, Ekaterine; Kharadze, Natalia, 2018). The higher the skills and knowledge of the local workforce, the more the foreign companies will be interested in using local human resources. In the long term, local workers are always cheaper than those brought from abroad. (Kasradze Tea, 2013); (Kasradze Tea; Zarnadze Nino, 2018); (Kasradze Tea, 2018); (**Kasradze Tea, 2009**); (**Zarnadze Nino, Kasradze Tea, 2016**)

Conclusion:

Market economy creates new opportunities for the development of a production system to improve the well-being of the society (**Kasradze Tea, 2018**). The quality of life in the society can only be increased in case of the overall stable growth of economy. The quantitative increase of economic indicators does not always reflect the quality of the production system and on the whole the real condition of economy. Often the manufacturing system can generate greater returns or high level of profitability, but this growth is only associated with the increase in the cost of producing a large number of products. Such an increase does not reflect the trend of improving production, does not increase the efficiency of the product management system, does not decrease the cost of production, does not improve the quality of the product, does not transfer the production system to a new stage of development. That is why the growth of economy based on the extensification of factors is a "bad" instrument of development (**Zarnadze Nino, 2007**).

The policy of a production intensification should become the basis for economic growth in Georgia. The experience of developed countries that have managed to raise the well-being of the society through the implementation of the innovation policy in a country's economy will help Georgia to increase innovation and investment activities, create a new production

¹ Law of Georgia on Public and Private Cooperation

capacity, increase gross domestic product and national income, reduce inflation and unemployment, create competitive products based on the scientific-technical progress.

In order to achieve the above-mentioned goals, between the state and business a harmonious, balanced, beneficial partnership is necessary for both parties, otherwise the boat in which everyone is rowing in different directions can never reach the shore.

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