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GEORGIA IN THE PROCESS OF TRANSITION FROM PLANNED TO MARKET ECONOMY

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Abstract

The last two decades of the 20th century was marked with the most noteworthy proceedings in modern economy that has been the socialist countries' transition from the Soviet-type planned economy to a market economy. The collapse of Soviet Union was a "geopolitical tremor" that profoundly transformed the entire political landscape, revolving the globe on five continents and leaving fifteen independent nations on the place of one single state. The crumple of communism finalized the millenarian politics and the era of planned economy. Newly emerging democracies of Europe had to overcome political and economic obstacles along the way. Market economy and economic systems are highly researched topics. Nevertheless, there are scarcity of researches that explores knowledge, convictions and expectations that people and government officials have held toward change. The purpose of this paper is to identify the challenges and prospects that Georgia had faced in the transition process and to scrutinize the strategies of overcoming the problems. It shall address the following issues: forming a market and market prices via privatization, establishing monetary and financial systems, developing state institutions and fiscal roles of state. This research shall take a closer look at region's geopolitical dynamics and shall explore the complex nature of transition process. It shall investigate the competing interests, challenges and opportunities during the conversion process. Research paper reveals that changing an economic system through mere economic factors, such as prices and privatization is not enough. People's philosophy must follow and sustain that change for success. Change must obviously have a clear destination and goal. Consequently, people must become more cognizant why these changes are necessary and why this is happening in order to steep them actively in the process of transition.

Keywords: Transition Process, Market Economy, Soviet System, Privatization, Economic Systems

JEL Classifications: M00, L33, M19, P2, P30, P40

1. Introduction

The crumple of communism finalized the millenarian politics and the era of planned economy (Wolf, 2009). The effects of transition process varied among and across nations and countries, their new direction and brand-new operations had altered the lives of various people and the

consequence described as losers and winners varied greatly among transition nations (EBRD, 2007). Leaving behind the socialist model shaped troubles for countries and solving these problems appeared to be the major challenge to integrity of newly emerging democracies of Europe (Cornia and Sipos, 1991). The vast majority of observers consider the collapse of the Soviet-type economies to have been rooted in its failure to increase the standards of living and to endorse democratic order (Boyer and Hollingsworth, 1997). The collapse of the Soviet Union as a political and economic entity forced the former Soviet republics to recognize the need of restructuring their economic systems.

The process of transition was painful for transition countries in many cases (Dicken, 2003) which also played a great role in shaping the perception of social, political and economic problems and new strategies to overcome it (Dahms, 2000). New strategies and reforms called to be effective and efficient as the process of transition could have been degenerated not only by external surrounding but by impenetrable internal economic policies as well (Flassbeck *et al.* 1999). It seemed like, liberty derived from democracy and prosperity gained through free markets has won (Wolf, 2009), but the further happening demonstrated that the process of transition in various countries has been allied to sharpening the poverty, unemployment and human suffering (EBRD, 2007). At the beginning of the transition period, it appeared that small open economies, compared to other transition economies, had undergone the deeper and longer declines and the transition countries timid healing in the mid-1990s was hindered by the Russian financial crisis in 1998. Market economy and capitalism and associated emerging profit prospects, and the allotment of scarce resources have straightforward influence on change in the society and on social order (Dahms, 2000), whereas capitalism tends to be the necessary condition for democracy (Kornai, 2000). The sense of private enterprise in socialist economy, with a very few exclusions, was barred (Hanson, 2003). Therefore, privatization was regarded as an opportunity to deprive the property from the state and generate a new class of capitalism and entrepreneurs (Lavigne, 1999). The process of privatization was as well referred to as a behavior that could stimulate and maximize profits and could achieve economic progress and general welfare (Roland, 2000).

The rest of the paper is structured as follows. Section 2 explains the general context and the collapse of Soviet Union and the consequences it has had over former member states, especially for Georgia, whereas Section 3 addresses the key challenges that countries have faced after the crumple of planned economy. Section 4 points out the opportunities and possibilities created within the process. Also, it pinpoints the benefits and advantages that countries have reaped as a result. Finally, Section 5 concludes the paper.

2. General context - Georgia

The Soviet system created the ideology within people, a set of norms and codes of behavior acceptable and non-acceptable for social order. The norms were established by the authorities and people had no interaction and right to participate in defining and establishing them (Lavigne, 1999). Consequently, the collapse of the system and the transition period paved a way to openness and novel thinking. Somehow, ordinary citizens had limited knowledge regarding economic systems, institutions and overall transition process (Aslund, 1995). During the Soviet System, one single party controlled and coordinated economic life and state ownership was a norm (Lavigne, 1999). All through the transition process, the state ownership paved a way to private ownership via privatization, coordination by a single party was no longer the case and the principles of market economy prevailed. The collapse of the Soviet Union demonstrated that abandoning the socialist model solely is not a mere answer to the problems and that the major challenge is to solve the problems generated through it and its latent paybacks were huge and have widen beyond the population of the countries (Cornia and Sipos, 1991).

Located in the landscapes of the Caucasus Region, Georgia is a small but growing market with a population of about 3.7 million. Its strengths include a strategic location between Russia, Turkey, and Central Asia, proximity to markets of the Black Sea region, the Caucasus and Central Asia. Some of the FSU countries had faced greater problems not only with regards to transition but handling the difficulties associated with the disruption of trade (Milanovic *et al.* 2000). Georgia, like many of the former Soviet republics suffered substantial decline beginning in 1991, and faced

several obstacles in the process of transition. During 2001-03, Georgia's annual GDP growth averaged over 6.3 percent (IMF and World Bank, 2004). After the crumple of the Soviet Regime, Georgia faced two major internal challenges: one was the separatist conflicts and the other was eliminating the dominance of corruption and poverty. There is no doubt that the region demonstrated vast opportunities. Nevertheless, unsolved issues between border countries exposed considerable obstacles to the development of co-operation in the Black Sea region. Georgia, though once a prosperous Soviet Republic, found it difficult to recuperate from the economic landslide caused by the disintegration of the Union.

3. Key challenges in the transition process

After the collapse of the Soviet Union, the state lost the role of a provider of machinery, fertilizers, and agricultural products, which in turn caused low productivity within farmers (Green, 2010). In the new era of capitalist system, companies were directing their activities to profit making. The main goal of an act was to maximize financial gain. The process involved the exploitation of the worker, which in turn resulted in tremendous disparity of income (Dahms, 2000). Therefore, as a systematic econometric analysis demonstrates, the size of the output declined more for FSU countries. However, main reason behind this decline was not correlated to the speed of the reform and the size of the initial output decline (Gros and Steinherr, 2004) and after the collapse of the Soviet economic system, the space between the richest and the poorest citizens has been sharpened (Bonnell, 1996).

Ordinary citizens found it difficult to become accustomed with new policies and rules, as they were adjusted to those benefits that the state created for them, one of the cases was within farmers, after the privatization process, they have not only obtained a small portion of the land but they also lacked the supply of the basic inputs, credit facilities and machinery which had previously been insured by the state (Green, 2010). Job protection, which made people feel safe about existing jobs, within the low level of unemployment was abolished (Hanson, 2003). Employers and employees became separate from each other, so that employees only possessed the labor power while employers had the tools of production (Dahms, 2000). New private owners lessened the benefits provided by the state, decreased its role in the economy, low wages were insufficient for maintaining and improving the living standards, and larger share of family budget was dedicated to health, education and basic necessities which were insured by the state in the Soviet period (Bonnell, 1996). The welfare has declined because of the initial fall in the output and modest economic growth. Export activities and import sources of employment have been stagnated particularly in agriculture and in industry. Georgia's annual income per-capita was 56% and unemployment rate was 16% in 2001. Inequality rate also augmented, the indicator of poverty boosted from 14% in 1997 to 23% in 2001. Due to small size of the market, the high growth rate is only achievable through the expansion in export activities and thus concentrating on comparative advantage and creating job opportunities (World Bank, 2003). Abolishing and closing down bankrupt and old factories forced citizens into unemployment and into losing their jobs, hence it made people regret about present and made them appreciate a sense of security feeling that was offered in the past by the system (Bonnell, 1996). Whereas, under the old regime, the state offered some benefits to citizens while assessing services and public utilities, public services were provided cheaply and people had to pay below cost-recovery prices on electricity and gas. The transition in turn, required the huge investment in public infrastructure, which in turn created some problems for poorer people to assess the services (EBRD, 2007). In order to analyze how the country managed to make a transition to the market economy, we should analyze the process of monetary stabilization, which shapes the experience of government and conditions under which foreign assistance is provided (Flassbeck *et al.* 1999). The introduction of independent currencies occurred step by step. Because of shortage of cash in the first half of 1992 several republics started issuing a coupon as currency in parallel with the Ruble. Georgia made its coupon an independent currency on August 2, 1993 (Aslund, 1995). In the transition process, the currency reform was decided unilaterally and International Monetary Fund (IMF) made no involvement in designing the reform (Aslund, 1995). New York Times (1995) reported about the introduction of new currency in the country, entitled the Lari, which circulated in the former Soviet Republic,

Georgia in order to replace a coupon that resisted challenging with the Ruble. The inflation was eliminated by the responsible monetary plan and preserved a stable Dollar/Lari exchange rate of 0.75 in early 1998 (MacPhee, 2001). Citizens found that if several years ago they could not even dream about obtaining a bank loan, the new system gave them a possibility to apply for the bank loan, including mortgages and making the use of new credit and debit cards (EBRD, 2007). Since the planning of allocating the resources was eliminated, liberations of prices resulted from excessive total demand in comparison with supply, caused prices to vary (Dahms, 2000). Since the collapse of the Soviet state regime, socialist economies were characterized by a shortage of consumer goods and a lack of choice in the shops, whereas new system opened new possibilities and options, introducing new consumer goods to people in the region, that at least some of the people could afford purchasing it (EBRD, 2007). However, all these fundamental economic changes and transformations made citizens adjust to out of favor methods being introduced by the government, hence liberation of prices meant positioning some good outside the reach of some citizens because they could not afford paying prices set (Bonnell, 1996).

Numerous assessments have been carried out for analyzing the poverty and living standards; however, few researches have been conducted for understanding people's perceptions and attitudes toward transition process (EBRD, 2007). Because of the limited knowledge and experience toward capitalism, economic decline made the inhabitants intolerant with democratic measures that were seen incompetent. This democratic procedure was seen as a way to grab power for special groups. In turn, all these happenings undermined the trust in democratic institutions (Bonnell, 1996). Therefore, making it difficult to implement the participation, the key concept which ensures the proper stage of participation that enables all involved interested stakeholders to be steeped in an obvious process through liberally functioning institutions (Martin, 2000). However, a limited number of citizens could have known that, the "transition" as a word might be misleading, and one might consider it to be "simple" short run policy that requires a few years to be implemented, consequently no one could even predict that the countries engaged in this process can become winning capitalist economies (Roland, 2000).

If we analyze the victims and winners of economic transaction, we will see that the former exceeds the latter. First of all, let's analyze who has suffered from the economic transition and who has benefited the most. The biggest losers tend to be the elderly, who used to have fixed pensions and because of rampant inflation they have been wrinkled. As labor was cheap in the Soviet Union, the companies hired as many workers as they could have afforded, therefore unskilled workers were in the first row to lose their jobs. As these people were not qualified and skilled, they stayed unemployed for a long period of time. Large families, who raised many children also suffered, as living costs became higher and the cost of rising children became considerably high. Homelessness was also a dominant problem and very visible in the large cities. Very few have reaped the benefits of transition process, usually there were people who were actively involved in the communist parties and lived with their ideology, and a portion of the old communist political elite was also able to have political influence on the economic power (Rona-Tas, 1996). As EBRD (2007) indicated, a high level of unhappiness is remarkable across the region especially the high level is noticeable in the Commonwealth of Independent States.

4. Process of transition - opportunities hidden under challenges

After the collapse of the system, new markets have emerged and the focus shifted to markets, while minimizing the role of the government's intervention in it. Numerous countries suffered significant and sometimes very severe reductions in real output (Olson, 1993). As the government reduced subsidies, the consumer prices went up, the unemployment rate increased hugely and new and tight monetary policies had a direct influence upon economic system. Between 1990 and 1995, Georgia passed new laws on "Property of Agriculture Lands" and "Land Property" which implied hastening the land privatization course and relocating state owned lands to individuals without additional fees, but the land size was small with an average of one hectare (Green, 2010). The privatization reform totally changed the established economic system in the country. The process of privatization was considered as a foundation to economic growth and welfare (Government of Georgia, 2004). Meanwhile, it has created some difficulties to individuals coping

with the transition period (Breslauer, 1996). Ordinary citizens were vulnerable to corresponding changes. Therefore, it became harder for ordinary citizens to adjust to the new conditions and regulatory policies. Consequently, some regrets about past life have emerged among them. In many countries, ordinary citizens are nostalgic about the past and argue that their lives were much better in the Soviet system (Heady and Miller, 2006).

The contemporary situation of the country has become better than it was in the previous years. Until mid-2008, the Georgian economy was growing fast, with strong credit growth and increasing foreign direct investments. But the armed conflict with Russia over the disputed region of South Ossetia hampered this development and forced the country to request additional financing from donors (Burke, 2010). However, with the help of democratic direction being implemented by the government, it has transformed into one of the most democratic countries in the region (New York Times, 2009). The foreign exchange market has been stable; deposits have been increasing steadily in the banking system (IMF, 2009). Even though, Georgia's economy shows faltering signs of improvement, according to IMF Resident Representative in Georgia, Edward Gardner, full-fledged revival will hugely depend on positive global environment (Burke, 2010).

5. Conclusion

The success or failure of the transition process from planned to market economy is rooted on both the philosophy of the people and the government officials. That is, since the economy operates with the interaction of individuals, firms and governments, economic performance is vested in peoples' values, ideas and beliefs. Most people act with a set of principles, principles that determine actions and actions that determine a way of life. A government that has a very clear goal and obvious methods to implement the reform is likely to attain the outcome desired, and a government with the well-liked directive to succeed is expected to be more thriving than the government and a society that have no clear objective, no clear directions and have no vision about what they desire and want (Gros and Steinherr, 2004). If we take a glance at the present situation, after so many years behind the collapse of the Soviet system, we will notice that little investigation has been conducted analyzing the effects of the transition process. There is the scarcity of studies that proves that social prosperity was achieved as a result of transition process (EBRD, 2007).

As a small, historically dependent nation, Georgia entered uncharted territory where the prospects of market economy seemed attractive and challenges remained obscure and vague to overcome. Series of historically unprecedented events have brought the attention of the West to the wider Black Sea region. Today, this region is a major crossroads for energy and commerce. Regional co-operation is very closely connected with the region's aspirations towards Euro-Atlantic integration. There is no doubt that the region demonstrates vast opportunities for integration. Nevertheless, unsolved issues between border countries expose considerable obstacles to the development of co-operation in the Black Sea region.

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