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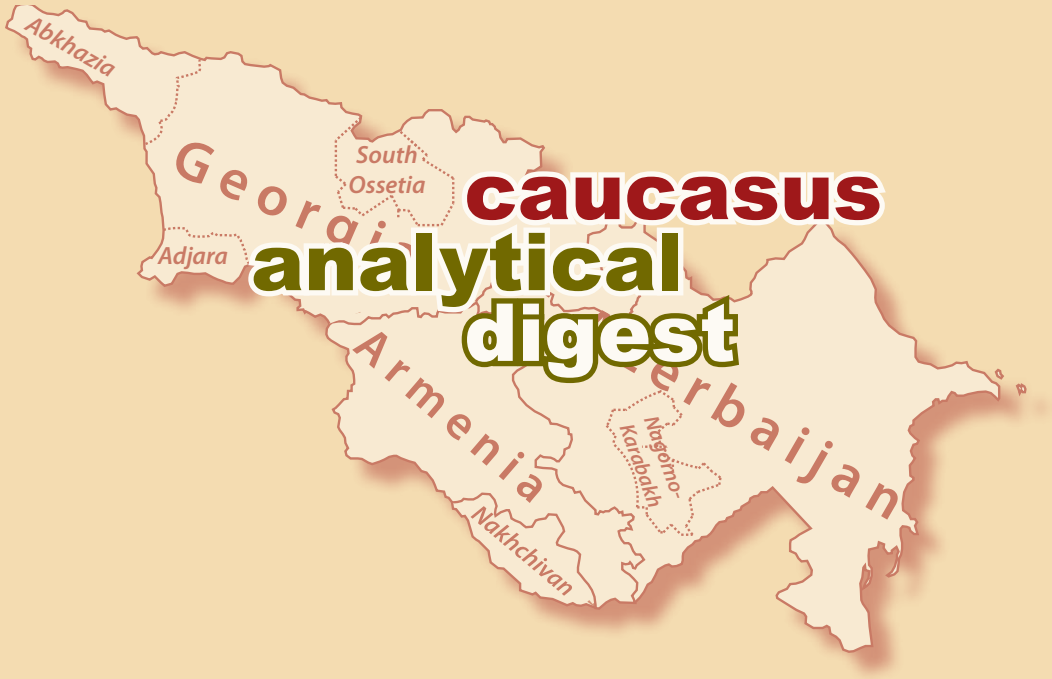

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ANTI-CORRUPTION REFORMS IN GEORGIA

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Similar Events, Different Outcomes: Accounting for Diverging Corruption Patterns in Post-Revolution Georgia and Ukraine

By Alexander Kupatadze, Washington

Abstract

The Coloured Revolutions in post-Soviet Eurasia—the 2003 Rose Revolution in Georgia and the 2004 Orange Revolution in Ukraine—followed rigged elections that triggered public discontent. These "revolutions" can also be regarded as declarations of mass frustration with rampant corruption and state capture by criminal groups. Both events involved active youth groups ("Pora" in Ukraine and "Kmara" in Georgia) and resulted in some elite changes. However, the implications for combating corruption have been different. Georgia has made rapid progress and quickly improved on various indices measuring the extent of corruption and rule of law while little, if any change took place in Ukraine in this regard. The failure of the Orange leaders to address corruption was also a significant factor leading to the reversal of the "revolution" and re-installation of Old Guard with the election of Viktor Yanukovych. This article tries to explain why Georgia was relatively successful in fighting petty bribery and what prevented a similar outcome in Ukraine.

Corruption Trends in Georgia and Ukraine

In the immediate aftermath of the Rose Revolution, anti-corruption efforts mainly targeted corrupt officials in the Shevardnadze government and the wealthy business tycoons closely associated with the previous regime. However, to avoid accusations of a one-sided anti-corruption policy, the new authorities also prosecuted some of their own inner circle. According to Georgia's Justice Ministry in 2003–2010, roughly 1,000 public officials faced charges of corruption, including 6 MPs, 15 deputy ministers and 31 deputy chairpersons of city councils. At the forefront of this effort is new anti-corruption legislation, a zero-tolerance policy, and reforms of key institutions central to combating corruption, such as the police force and prosecutor's office. General economic liberalization policies have reduced red tape and eliminated many opportunities for bribery. For instance, the government cut the number of taxes from 21 to six and the number of required permits from 600 to 50; property registration, trade regimes and customs procedures have been simplified. Furthermore, reforms have cut the bureaucracy dramatically. The number of public sector employees dropped by almost 50 percent while the salaries of the remaining civil servants increased roughly 15-fold. As a consequence, corruption has been substantially reduced in the sectors where citizens interact with the state most frequently, including registering property, licensing businesses, and tax administration. According to the 2008–9 economic survey of the EBRD, only 14 percent of companies report that they are expected to pay bribes to public officials for "getting things done" compared to 31 percent in Ukraine and 39 percent in Russia. Georgia ranked as the "number one reformer" in the World Bank's Doing Business Report last year.

On the negative side, the government used the anti-corruption campaign as an excuse for legitimizing its arbitrary use of state authority and the establishment of an overly centralized police force with excessive and unchecked power. While even government critics agree that petty bribery decreased dramatically, allegations of high-level corruption remain despite fervent denials from government officials. The first major evidence confirming such allegations came with the arrest of ex-Defence Minister Irakli Okruashvili, a former associate of Mikheil Saakashvili who was prosecuted on corruption charges after he made a political comeback in 2007. The investigation into his case revealed the existence of corruption in the highest ranks of the Defence Ministry, including manipulation of state funds for the benefit of "friendly" companies—the very practices that the authorities claimed to have eradicated. Further, without reference to elite-level corruption, it would be impossible to explain how some former high ranking officials emerged as wealthy businessmen, for instance the former minister of one of the so-called power ministries and close friend of Saakashvili now owns official and unofficial stakes in a number of companies that exercise near-monopolies in their respective markets. In short, corruption in Georgia evolved from rampant bribery encompassing all spheres of public life to the more clientelistic system described by Mungiu-Pippidi as the "discretionary distribution of public services by the state to the benefit of particular groups or individuals." Hence the ruling regime allocates resources in order to generate the loyalty and support it needs to stay in power. This practice is also important in the Ukrainian context where the divisions between regionally based clans can be overcome by the incumbents' use of corruption to co-opt and accommodate diverging interests and thus maintain political control.

In a similar vein, both governments practice the use of corruption as *compromat*, albeit to different degrees.

Most recently a Georgian businessman was blackmailed by high-ranking law enforcement officials to give testimony that former Prime Minister Zurab Nogaideli, who is now the leader of one of the opposition political parties, accepted a large bribe. In Ukraine, the anti-corruption battle has focused predominantly on the opposition to President Yanukovich.

In Ukraine the initial success in fighting corruption immediately after the Orange Revolution was undermined by political infighting among the Orange elites and the "pacted" or "negotiated" transition that led to the continued influence of reform spoilers from the *ancien régime.* The government became dysfunctional as a consequence of the continuous political rivalry between President Viktor Yuschenko and Prime Minister Yulia Tymoshenko and the permanent efforts of Kuchma elites to undermine the change. Hence Ukraine lacked any significant anti-corruption reform. The failure to address corruption was one of the factors leading to popular frustration with the Orange leaders, the reversal of the Orange revolution and return of Viktor Yanukovich to power in 2010.

Since Yanukovich's comeback, he has used "anti-corruption efforts" mainly to target his political competitors. The authorities hired the American law firm of Trout Cacheris to launch an investigation into public expenditures during Tymoshekno's 2008 tenure as prime minister and produced a report revealing "evidence of the misapplication of state funds and fraud." Transparency International ridiculed the audit as a "witch hunt" aimed at discrediting the previous government rather than a thorough and independent investigation. The US State Department issued a statement that "while corruption should be pursued, prosecution should not be selective or politically motivated." These efforts culminated in a number of high-ranking arrests from Tymoshenko's camp. While there is a high probability that some of the misspending allegations are true, it does not mean that there was no corruption under other Ukrainian governments. Although some acting officials have also been detained on charges of bribery, such as a mid-level official of the Presidential administration and a Deputy Environment Minister, the anti-corruption campaign still disproportionally affects Yanukovich's political competitors. In the meantime, non-transparent dealings are growing to "unprecedented levels," according to the *Financial Times*, and corruption remains a national curse. As many as 77 per cent of Ukrainians are strongly or somewhat dissatisfied with Yanukovich's handling of official corruption, and 91 per cent think that corruption is very or somewhat common, according to a 2010 IEFES survey. Little, if anything has changed for Ukrainian citizens: traffic police, tax authorities and customs remain notoriously corrupt.

Accounting for Diverging Patterns

It is now widely recognised in the academic literature that political leadership is crucial for anti-corruption reform. The political will of a committed leadership is viewed as the key to success for any anti-corruption campaign. Hence Heller asks the most important question: "What motivates elites and leaders to undertake or shy away from the tough anti-corruption reforms?" Several factors are discussed below that arguably explain the varying motivation of the incumbents in Georgia and Ukraine to fight petty bribery.

First, Saakashvili's project of building a strong state would not tolerate the existence of corruption that undermines the legitimacy of the ruling regime and works to distort the political system. The key element of Saakashvili's state building project was fighting corruption while Viktor Yushchenko focused on democratization and Viktor Yanukovich is emphasizing the more vague "stability." Yanukovich's understanding of stability means centralized power without political squabbles at the top rather than the absence of rent-seeking. Anti-corruption policies were not consistently pursued by the incapable and constrained leadership in post-Orange revolution in Ukraine, while the Yanukovich government has the necessary capacity but lacks the willingness to do so. As Anders Aslund points out, fighting corruption "is not a priority for him [Yanukovich]." The government has indefinitely postponed endorsing an anti-corruption legislative package leading Drago Kos, the head of the Group of European Countries against Corruption (GRECO), to comment that "Ukraine has shown the least will to fight corruption compared with other countries."

Second, there was a clear understanding among the Georgian leadership that the country, lacking valuable natural resources or large industrial enterprises, was in desperate need of foreign investment that could boost the economy. Attracting investment was a major task for the Saakashvili government and the absence of the added cost of bribery for doing business is frequently pointed out by government officials as a significant element of an investment-friendly environment. Notably, foreign direct investment increased from 340 million USD in 2003 to 1.56 billion in 2008. On the other hand, the oligarchs in Ukraine successfully blocked foreign competition through various informal and illicit means, such as erecting discriminatory bureaucratic barriers. Ukraine, an industrially developed state with a large resource base, produced a group of powerful and super-rich individuals who influence state policies. Oligarchic capital has played less of a role in economically weaker Georgia.

Third, the external environment is crucial. Western actors, such as the EU, brought influence to bear in post-

Soviet Eurasia through conditionality and discourse, for instance by monitoring anti-corruption progress. Successfully implementing recommendations is frequently portrayed as an issue of international prestige. Hence the "pro-Western" leaders are largely concerned with their image as "anti-corruption crusaders."

"The West" has been a factor of allure for Georgia and it was widely understood that the rule of law is a prerequisite for conforming to Western and European social and legal standards. Becoming part of the European Union is a clear-cut goal for Georgia and serves as a major "push" and "pull" factor for the country. Further, despite lots of criticism of Saakashvili for adopting Putin-like authoritarian means, Georgia's leadership is working to build Georgia as an "alternative model of development in the post-Soviet space," meaning a government marked by low levels of corruption, in contrast with the way Russia functions. The rapprochement with the EU also ranks high on Ukraine's political agenda, but importantly some parts of the country, especially the East, favor Russia and significant part of Ukraine's ruling elite view Russia as a more applicable governance model.

This leads to the most important variable: the different political cultures of the ruling elites which accounts for the diverging attitudes toward corruption. Ukraine is now ruled by the so-called "Donetsk clan," a group of individuals who made their careers in the Donbas, the industrial heartland of the Soviet Union. Like the clans of other industrially developed regions, the post-Soviet practice of securing and developing businesses through informal, and sometimes illicit, deals produced tightly-knit networks of politicians, entrepreneurs and criminals in Donetsk. The Donetsk style of governance is based on authoritarianism and rent-seeking, described by van Zon, a researcher of Ukrainian politics, as "the merging of political and economic power with total suppression of dissent and unbridled corruption." In a revealing speech in 2009, Prime Minister Mykola Azarov recounted that when working as finance minister (2002–04 and 2006–07) he told the ministers "Have a conscience. [Steal] 5 per cent and the hell with you because there is no way you can track this money down, but please, don't steal 50 per cent. Show some conscience." This clearly shows that governance, as understood by the highest ranking politicians, easily accommodates corruption.

As in Ukraine there is no clear public-private dichotomy in Georgia, however in stark contrast, many members of Saakashvili's team have a civil society background (for instance Interior Minister Ivane Merabishvili, Secretary of the Security Council Giga Bokeria and Tbilisi Mayor Gigi Ugulava), graduated from Western educational institutions and have a different outlook compared to traditional Soviet cadres. Furthermore, the government succeeded in attracting young educated personnel with competitive salaries. Many of these mid-ranking young bureaucrats in their 20s and 30s are highly motivated, full of new ideas and, most importantly, zealously committed to personal honesty and a belief in institutional integrity.

These and other developments have given birth to the official rhetoric of a "mental" or "cultural" revolution in Georgia. However this societal transformation has not been consolidated yet and remains a long-term perspective. For instance, nepotism is considered a moral obligation among relatives, friends and family rather than an illicit act. Certainly changes in informal institutions take time, and mental transformation cannot be an immediate outcome of any type of revolution.

About the Author:
Alexander Kupatadze is currently the Hoffman Post-Doctoral Fellow in Eurasian Studies at the Institute for European, Russian, and Eurasian Studies of The George Washington University's Elliott School of International Affairs.

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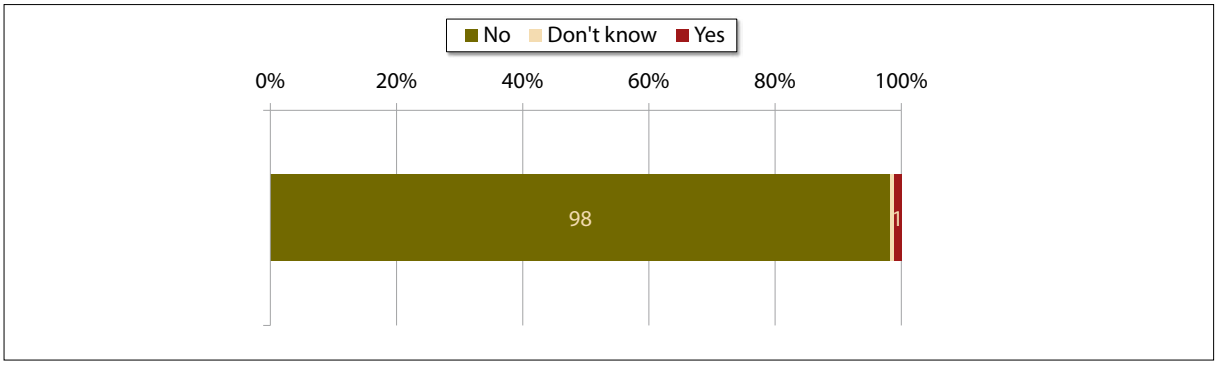
OPINION POLL

Georgians on Corruption

Figure 1: Have you or any member of your household been in a situation during the last 12 months when you/they had to pay a bribe in order to get a service or to obtain preferential treatment or consideration? (%)



Source: representative opinion polls by the Caucasus Research Resource Centers. 2010 "Caucasus Barometer". Retrieved from http://www.crrccenters.org/caucasusbarometer/ *on 13.04.2011.*

The State on the Streets: the Changing Landscape of Policing in Georgia

By Gavin Slade, Oxford

Abstract

After the Rose Revolution of 2003, public negativity towards the police, the revolutionary popularity of the government, and the lack of vested interests in a developed private security market gave Mikheil Saakashvili free rein to completely overhaul state policing. This article presents data showing that the Georgian reform has been successful in terms of public opinion. Perhaps it has even contributed to a call for the ongoing police reform in Russia. However, Georgia faces a future in which policing will become more fragmented and pluralized.

From Collapse to Reform

The Georgian police currently enjoy public confidence and a great deal of government investment in salaries, stations, cars and equipment. However, it was not always like that. In the 1990s, the police were demoralised and weak. This weakness led directly from the legacy of 'unprecedented state collapse' (Zurcher 2006) and an economic decline incomparably worse than any other former Soviet republic following independence. Security provision became fragmented as separatist wars with South Ossetia (1989–1992) and Abkhazia (1992–1993) created a proliferation of violent entrepreneurs. A mass prison breakout in 1991 after the return of some of the most dangerous Georgian recidivists from Russia on the political demand of President Zviad Gamsakhurdia contributed to the increase of criminals at large in society. In the early 1990s, armed groups that took on features of paramilitaries, militias, and extortionist mafias operated throughout Georgia. Many of the newly armed groups were state-sponsored and obtained weapons from stashes belonging to the Soviet Army.

Most famously, Mkhedrioni and the National Guard were paramilitary groups that operated nationally. The former was headed by a renowned criminal, Djaba Ioseliani. Often groups operating across the country under the name Mkhedrioni did not take their command from any centralised structure and instead resembled roving bandits. The National Guard was also ill-disciplined and headed by a convicted criminal, Tengiz Kitovani. By 1993, and with the conflicts now 'frozen', these groups

eventually found themselves merging with state structures. For example, President Eduard Shevardnadze promoted Mkhedrioni to the status of a security force in the Ministry of the Interior and appointed Temur Khachishvili, a member of this armed group, as Minister of the Interior, though Mkhedrioni itself was *de facto* abolished.

In the case of 1990s Georgia, security and policing, to the extent that these public goods were produced at all, came to be provided by demoralised law enforcement institutions reinforced by the bottom-up integration of violent formations, and collusion with overtly criminal groups that negotiated an untouchable autonomy in various regions of Georgia. In this regard, the prominence and influence of career criminals that formed something like a mafia network, so-called 'thieves-in-law', was particularly marked in Georgia compared to elsewhere. The corruption and demoralisation of policing structures brought about the debasement of recruitment and training processes and by 2003 the police to civilian ratio was 1:78 (Kupatadze et al. 2007: 94)—for comparison, in the later Soviet period this ratio stood at 1:450.

Policing in Georgia was ripe for reform by the time of the peaceful ouster of President Eduard Shevardnadze in 2003's Rose Revolution. Mikheil Saakashvili was swept to power with over 90% of the vote and the United National Movement landed a majority in parliament in relatively free and fair elections. With a strong mandate the new government had a window of opportunity to overcome entrenched interest groups and carry out far-reaching reforms and policing was top of the agenda.

Beginning immediately in 2004 Saakashvili carried out reform of the police with international assistance from Europe and America. Amongst others, the OSCE's Police Assistance Program, the EU's Rule of Law Mission, the Police and Human Rights Program of the Council of Europe and the embassies of the US, Germany and France supported the reform (Boda & Kakachia 2006). The main structural changes were within the Ministry of the Interior. Overall, the Ministry was reduced in size from 40,000 employees to approximately 17,000 (Hiscock 2006). Around 15,000 old police personnel were fired; this was over half the nation's police (Kukhianidze 2006). The infamously corrupt Soviet era institution of the Traffic Police, which numbered some 2,700 men, was disbanded. A new Patrol Police replaced them. This new force took on responsibilities for order on the streets as well as traffic control. They were given new German cars and Israeli guns and investment was made in police stations, equipment and information technology.

A competitive recruitment system brought in new people to replace the old police as reformers overhauled the police academy. A six week training program verses new recruits in criminal law and the criminal procedural code as well as administrative and physical training. Officers were given new uniforms and their salaries raised significantly. The police now number 14,500 with a police to civilian ratio of 1:324.

The 'shock therapy' in laying-off so many policemen, sometimes with no clear reason given, shifted a critical mass of those trained in violence from the state into society once again. Fears that ex-policemen would turn to crime, appears, with some exceptions, not to have materialised. Instead, the rapid changes created a ripple in the private security sector with many new private security firms registered and presumably employing ex-policemen (Hiscock 2006).

Though Georgia has still not seen the explosion in private security firms that was seen in the 1990s in places like Bulgaria, Ukraine or Russia, conditions now make this growth likely. Market liberalisation has brought stronger economic growth, as well as increasing inequality and insecurity, creating a demand for extra security provision and security products that the turnover of personnel from law enforcement bodies can meet. The lack of legislation means that the private security industry in Georgia is difficult to estimate and numbers vary, but it may include around 250–300 private security companies of which only 10 are particularly large (Hiscock 2006). Some state security structures perform market functions as well however, such as the Protection Police—a security force that protects important politicians and buildings.

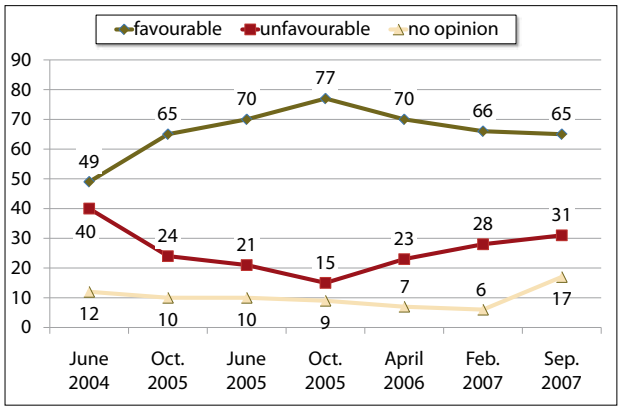
The Georgian government needs to regulate and monitor these developments very carefully. Where Georgia's police reform may offer some lessons to other countries such as Russia, the Russian experience of privatising security functions in an unregulated and scandal-ridden grey area between the state and the market should provide clear lessons about the ways in which unregulated private security providers can undermine feelings of security and indirectly harm the reputation of state institutions.

Public Opinion Regarding the Police in Georgia

Public opinion towards the police can rarely have been so positive in Georgia. Figure 1 shows the jump in the Georgian police's favourability rating once the reforms began. Prior to the 2004 reforms, national voter survey results showed only 49% in favour of the police, while following the reforms this figure increases dramatically, peaking at 77% in October 2005. Police popularity declined somewhat in the following years as the novelty of the reforms wore off and the police became embroiled in a series of scandals, most notably the killing of the banker Sandro Girgvliani by

members of the Interior Ministry in a fight following an argument.

Figure 1. Attitudes to the Georgian police over time.



Source: International Republican Institute (IRI 2004–2007) Georgian National Voter Surveys.

Today, a range of public opinion surveys from a variety of organisations show that the police maintain a good reputation in Georgian society. The Georgian crime survey conducted in concert with the International Crime Victimization Survey (ICVS), independent Dutch criminologists and the Ministry of Justice, finds that in 2010 a combined 66% of Georgians were either 'very confident' or 'confident' in the police, higher than for courts (47%) or prosecutors (49%). These results are even more impressive for the Patrol Police taken on its own, which has a combined confidence rating of 81%. Importantly, perceived levels of corruption have been lowered: 80% thought the police corrupt in 2000 compared to just 24.6% in 2006. Moreover, levels of victimization have reduced radically since the 1990s. Indeed, comparing Gerber and Mendelson's (2008) study of police misconduct in Russia (see below) and ICVS findings in Georgia shows you are more likely to be victim of physical abuse specifically by the police in Russia than to suffer any physical abuse at all in Georgia.

However, the ICVS shows that this confidence does not translate fully into trust: compared to other countries in the study, Georgians significantly underreport all types of crime, preferring privacy and self-reliance. Furthermore, when surveys ask about trust rather than confidence or favourability, different results obtain. The Caucasus Research Resource Centers' independent Caucasus Barometer Survey for 2009 show that only around 50% of Georgians claim to either 'fully trust' or 'rather trust' the police with 30% neither trusting nor distrusting and 13% reporting distrustfulness. Furthermore, negative attitudes most likely increase when disaggregated to those who have actually used police services (see also the corresponding Caucasus Barometer figures for 2010 in this issue (Trust in Institutions, p. 10)).

Still, these figures for Georgia are more in line with Western Europe and higher than the Central and Eastern Europe area which has a median 32% satisfaction level with the police (Caparini & Marenin 2005). The effects then of the Georgian reforms are evident and suggest a model for other countries to follow in which policing is professionalized, civilianised and, most importantly, re-conceptualised. Certainly, such reforms can bolster political capital: data from the IRI surveys in 2005 show that with the exception of providing electricity and smoother roads, police reforms were the aspect Georgians were most pleased with in the performance of the government.

It could well be possible then that Georgia's northern neighbour, Russia, has being paying attention to the Georgian reforms. As of December 2009, Russian President Dmitri Medvedev demanded reform of the country's scandal-plagued and costly police. As well as firing 17 top police commissioners, Medvedev called for a reduction in the police force by 20% by 2012, greater independence for internal investigations carried out by the Ministry of the Interior, the renaming of the *militsia* to *politsia,* the raising of wages to combat corruption and a new Law on the Police which has already passed through parliament.

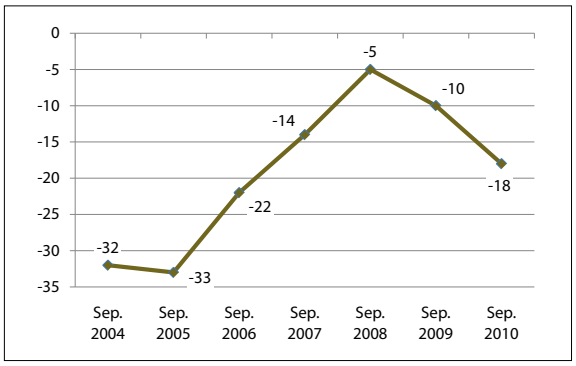
These reforms have yet to impact public opinion in Russia: data from April 2011 from the Russian Levada Centre shows that 59.9% of Russians still do not trust the police. Data from the state-controlled polling firm VTsIOM[1] paint a similarly negative picture over the last decade. Figure 2 shows that the negative ratings of law enforcement have consistently outweighed positive ones proportionately (0 = no difference between positive and negative responses, i.e. 50% approval vs. 50% disapproval) (see Figure 2 overleaf).

These results are unsurprising when we consider that three waves of representative surveys on police misconduct from 2002 to 2004 across Russia found that in that period '5.2 percent of Russian adults [were] victimized by police violence in any two- to three-year period, 6.3 percent by corruption, and 13.8 percent by some form of misconduct directly or via family.' '[This] translate[s] into roughly 6.2, 7.6, and 16.4 million acts of police misconduct. These numbers are staggering' (Gerber & Mendelson 2008: 17). Russia's police desperately need Georgian-style reform. Yet, while Medvedev's reforms

1 The Russian state used its ownership of VTsIOM to take over the firm in 2003. All the key researchers at VTsIOM then went to work for the newly created Levada Center, which is now considered the main independent polling firm in Russia.

are welcome, they are hasty, and compromised by the weight of embedded interests in a security sector that by some estimates employs in total 10 million people—many in private security companies, who have no interest in seeing a strong state competitor in the shape of a reformed police.

Figure 2. (Dis)approval Rating for Russian Law Enforcement



Source: Vserossiiskii tsentr izucheniya obshchestvennogo mneniya (VTsIOM) Available at: http://wciom.ru/index.php?id=173

Conclusion

The data show that Georgia's police reforms have been successful in terms of gaining public confidence. Possibly, the reforms have even indirectly influenced calls for reform in other countries in the region such as Russia. However, unlike in Russia, conditions in Georgia were favourable to making real headway with police reform. After the Rose Revolution, public negativity towards the police, the revolutionary popularity of the government, its willingness to take on international assistance, and the lack of vested interests in a developed private security market gave Mikheil Saakashvili the grounds to completely overhaul state policing. However, the situation is already changing. It is likely that Georgia will see a deepening of Russia-esque processes of privatisation of policing—which the government should aim to tightly regulate. These processes are especially likely as the economy slows, aid dries up, national debt increases and the government finds it harder to maintain the costs of providing security in an increasingly unequal society.

About the Author

Gavin Slade is a graduate student at the Centre for Criminology, Oxford University.

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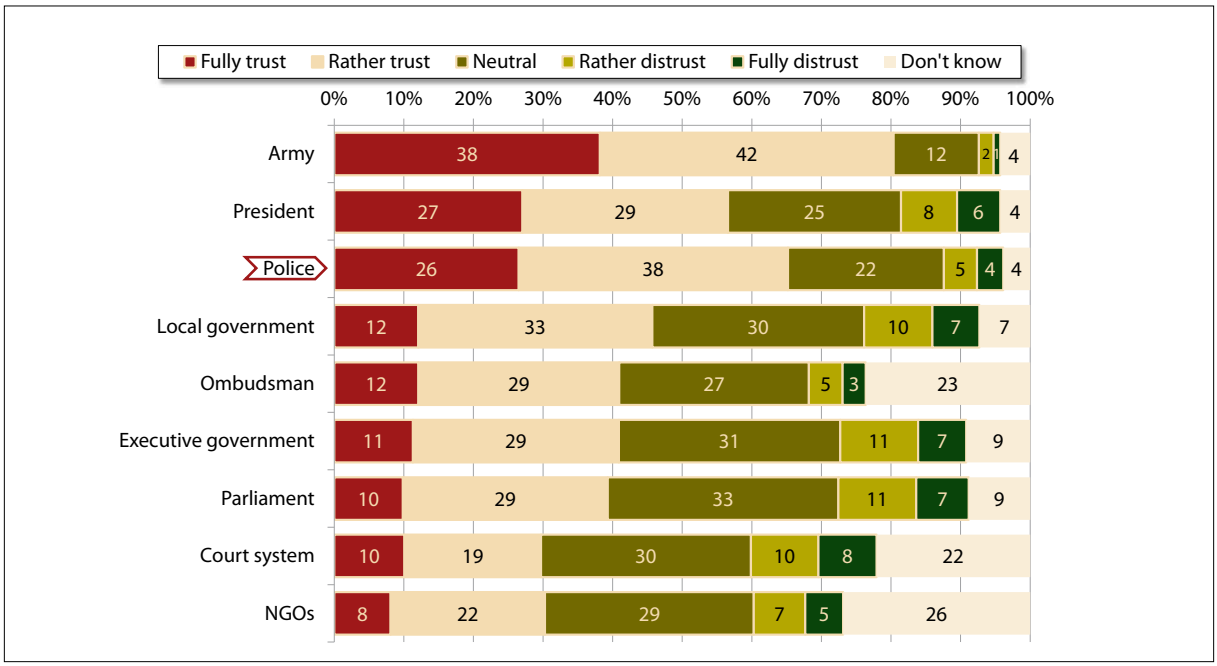
OPINION POLL

Trust in Institutions

Figure 1: Please assess your level of trust toward each social institution on a 5-point scale.



Source: representative opinion polls by the Caucasus Research Resource Centers. 2010 "Caucasus Barometer". Retrieved from http://www.crrccenters.org/caucasusbarometer/ *on 13.04.2011.*

NB: This file is a slightly revised and corrected edition of the original issue.

The Business Climate and Anti-Corruption Measures in Georgia

By Molly Corso, Tbilisi

Abstract:
When Georgian President Mikheil Saakashvili came to power following the Rose Revolution, the Georgian economy was in shatters. A pervasive shadow economy had grown up in the chaos and corruption of Edward Shevardnadze's rule. The government received a fraction of the tax revenue it was owed. Foreign investment was nearly non-existent, limited largely to oil pipelines. Saakashvili's anti-corruption and pro-business reforms have had a huge impact improving investment and business confidence—although concerns over the government's use of the tax authorities and judicial system persist.

Building for Business

It is hard to underestimate the Georgian government's commitment to creating a friendly environment for investors. While this task is nominally the prime minister's job, Saakashvili himself has become the face of business policy. He frequently goes on live television to single out ministers who have let corruption flourish and fires bureaucrats who allow investors to slip away.

He personally opens small and medium size factories around the country, quizzing new CEOs about employment rates, conditions and salaries.

The country has received numerous awards and accolades from the World Bank and Freedom House for its pro-business reforms: largely efforts to streamline government regulation and reduce government interference. The oft-cited statistics—open a business in just a day, no minimum salary, the absence of bribes—have become the mantra for government efforts to attract investment.

And, to a noticeable extent, the message has worked: in March when Donald Trump signed a deal with the Silk Road Group, led by Georgian businessman George Ramishvili, to develop new luxury properties in Georgia, he started his speech by listing off Georgia's many awards. The Donald joked, in fact, that America would be so lucky to rank as high as Georgia in the fight to ease obstacles for business.

But even as the Trump deal bolsters Georgia's image as a place to do business, it also raises questions about why big names like Trump opt for branding or licensing deals rather than direct investment.

Foreign Direct Investment (FDI)—a vital source of revenue for the government budget—improved from just under $500 million in 2004 to $2 billion in 2007, before suffering from the double hit of the August 2008 war and the global financial crisis. In 2008, inflows dropped to $1.5 billion and the figures continue to slip in subsequent years. In 2010 it fell a further 16 percent from 2009 to just $533 million.

The reasons for the lack of investment are many and complex. In the global economy today, investment is lower than it was before the 2008 crisis, so Georgia is competing against many more countries for fewer dollars. Georgia's small market and overall economy lack the spending power of its neighbors. Access to Georgia is an additional issue: despite new agreements with the European Union on air links and more airline carriers offering flights to Georgia, it is still difficult and expensive to fly into Tbilisi or Batumi.

The government's laissez-faire policy has also had its downside: the lack of food safety regulations and anti-monopoly laws feed into fears that the market may be too unruly for businesses used to a more structured environment. For example, bakeries have complained that unscrupulous competitors are using inferior ingredients to make products they sell at prices that undercut high quality bread. In March, Georgian television aired a report accusing bakeries of adding dye to bread to make it black or brown—and selling it as wheat or rye at a higher price. Without regulation, companies that follow substandard health and sanitary standards are able to produce and sell products for a fraction of the price as companies that follow stringent international standards—in direct violation of fair competition.

Other issues could also play a role, including perceptions about the country's security—concerns about a replay of the 2008 mini-war linger—and years of complaints against the authorities' use of tax audits and the judiciary for political purposes.

Tax Audits, Financial Police and Other Worries

In 2004, when Saakashvili and his government welcomed prominent Russian tycoon Kakha Bendukidze to guide the country's laissez-faire economic reforms, wiping out corruption was synonymous with improving the business climate. Corruption in all its forms—unnecessary licenses, unwieldy legislation, illegal shadow trading and epidemic tax fraud—was strangling the state and cutting into business profits.

Televised scenes showing intimidating men in masks with big guns arresting corrupt business owners—usually the friends and relatives of disgraced politicians—became a symbol of Saakashvili's strength in the face of corruption, the deadly cancer Shevadnadze had been too weak to eradicate.

But then the fight against tax evasion continued to evolve, targeting other, less obvious businesses and public opinion began to change. Small and medium-sized business owners were quickly disenchanted, especially when the government began requiring cash registers and receipts to document cash sales. These measures sought to bring all sales into the open, but high fines and unclear laws caused confusion among merchants who were already suspicious that the tax authorities were working against them. Large companies, with accountants and extensive contacts among government officials, complained more quietly that tax officials were poorly trained—or simply too afraid to make decisions in favor of business.

The government took heed of popular concerns. Work on improving the tax and customs code continued, while the financial police were "decriminalized" and demoted to being just one more department of the newly created Revenue Services in 2006.

Of course, not all efforts proved to be popular. A string of evictions targeting restaurants and kiosks in 2007 and a controversial decision to tear down a residential building officials claimed was illegally constructed all added to the mass street protests against the Saakashvili government in November 2007.

Despite the ruling party's electoral success in 2008 and 2010, the perception that the authorities were willing to use the all-encompassing accusation of corruption to vindicate decisions against private business interests persisted. The decision to reinstate the financial police—renamed the Investigation Service—in 2009

compounded fears that the government was turning to business to make ends meet after state coffers were hit by the war and global financial crisis.

Concern grew to the point that complaints against the tax authorities had an impact on a 2009 International Finance Corporation report on Georgia's competitiveness. Businesses of all sizes continued to have the impression that the government's fight against corruption had turned against the very entities it was supposed to protect. A noisy case against a large electronics chain in August 2009 crystallized the fear that the government was willing to sacrifice businesses for short term tax profits regardless of the risk of long term damage to the country's reputation. Until 2011, in fact, simple mistakes in tax returns were subject to jail time if the error was worth more than 25 thousand lari (€10.3 thousand).

Judicial reform has faltered and lawyers complain that judges routinely rule in favor of the government. The recent case against two Israeli businessmen found guilty of attempting to bribe a government official is the latest example. While there appears to be substantial evidence that the two men were not opposed to paying a bribe, there is a lingering question of who initiated discussions about the bribe—and for what purpose.

And, despite the fact that the Ministry of Finance established an arbitration commission to determine if cases against tax payers were fair, lawyers and associations continued to complain that tax authorities were punitive and aggressive.

While Georgia has continued to score highly as a business-friendly country according to international indexes, by 2010 there was a growing sense that there was a gap between the scores and reality. The World Bank report and others measure how laws impact areas that affect business, not perceptions or confidence—important indicators that can influence investors' decisions.

While the government has claimed those fears are largely unfounded, they stubbornly cast a shadow over attempts to elevate business concerns. The U.S. government's latest, $40 million, four-year program to help bolster business in Georgia is a good indication that outsiders still find it difficult to do business in the county. After the heyday of breaking down barriers for business and changing laws—when the stroke of a pen could radically change Georgia's image as a potential investment destination—today attention is focused on how the laws are being implemented on the ground. Ultimately the effectiveness of the US program will be determined by Georgia's future ranking in relation to other countries as a place that welcomes business.

A New "Partnership"

In December 2010, Saakashvili announced a new stage in the "partnership" between the government and the business community. His comments, which came after a period of intense negotiations between business groups and the government over changes to the tax and customs code, focused on restoring trust between local business and the state.

Beyond reaching out to local business, officials adopted other measures to reassure the foreign business community. Prime Minister Nika Gilauri met with influential Georgian and foreign CEOs and business leaders to consult on who should be appointed as the country's new tax ombudsman, and Parliament Speaker Davit Bakradze agreed to chair a business committee with representatives of the opposition, the finance committee and major business associations. In addition, the Ministry of Finance replaced the head of the Revenue Services as a prelude to a massive restructuring of the tax and customs administrations. Further lines of communication between business and the government are planned through the tax ombudsman's office, including a commission to evaluate tax authority decisions. Also, the Prime Minister's office is working on a new competition law to address some concerns about the potential for monopolies in the market.

Conclusion

The Georgian government has clearly made business a priority for the country. A small country with limited resources, Georgia relies on investment—foreign and local—to balance its trade deficit and create employment. The fight against corruption the government initiated nearly eight years ago is a central aspect of its policy to create an environment that is friendly and attractive for business.

Saakashvili's government has made fighting corruption a pillar of the state he created—and it is an important battle to ensure businesses have the ability to grow and prosper. Creating a culture in which individuals pay their taxes has not been a simple task, but the government is succeeding.

But after so many years of reforms, problems—underscored by the perception that officials are eager to fine first, ask questions later—cast a shadow on their success. The new policy of more communication with businesses and a new "partnership" between the business community and the government is a good start to resolve those issues. It will take time, however, to strengthen trust between authorities and entrepreneurs.

About the Author

Molly Corso is a freelance journalist based in Tbilisi. She is also the editor of Investor.ge, the business magazine published by the American Chamber of Commerce in Georgia.

DOCUMENTATION

Georgia in Business-Related Country Rankings

Ease of Doing Business

Prepared by: Worldbank
Established: 2003
Frequency: Annual
The data refer to the respective previous year.
Covered countries: at present 183
URL: http://www.doingbusiness.org/economyrankings/

Brief description:
The ease of doing business index ranks economies from 1 to 175. The index is calculated as the ranking on the simple average of country percentile rankings on each of the 10 topics covered. The survey uses a simple business case to ensure comparability across countries and over time—with assumptions about the legal form of the business, its size, its location and the nature of its operations. Surveys are administered through more than 8,000 local experts, including lawyers, business consultants, accountants, government officials and other professionals routinely administering or advising on legal and regulatory requirements.

Table 1: Ease of Doing Business. Ranking 2010

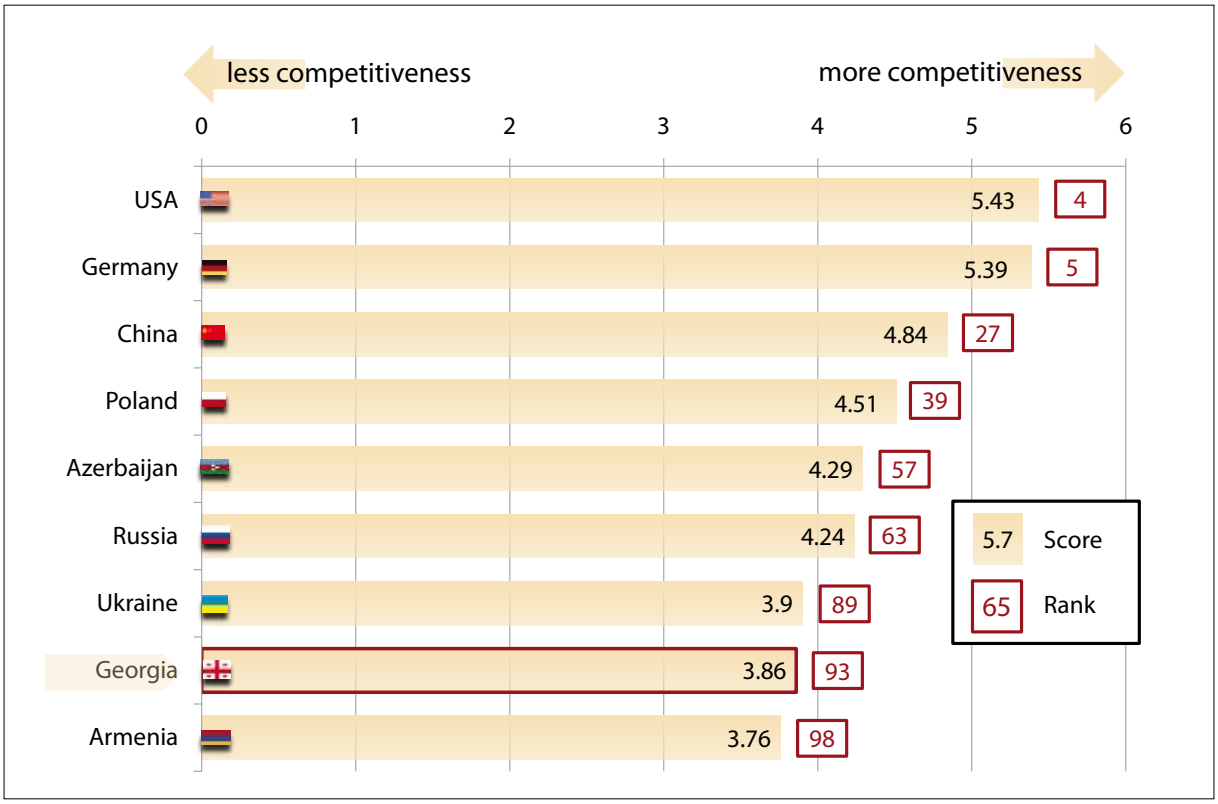
	USA	Georgia	Germany	Armenia	Azerbaijan	China	Russia	Ukraine
Overall rank	*5*	*12*	*22*	*48*	*54*	*79*	*123*	*145*
Starting a Business	9	8	88	22	15	151	108	118
Dealing with Construction Permits	27	7	18	78	160	181	182	179
Registering Property	12	2	67	5	10	38	51	164
Getting Credit	6	15	15	46	46	65	89	32
Protecting Investors	5	20	93	93	20	93	93	109
Paying Taxes	62	61	88	159	103	114	105	181
Trading Across Borders	20	35	14	82	177	50	162	139
Enforcing Contracts	8	41	6	63	27	15	18	43
Closing a Business	14	105	35	54	88	68	103	150

Global Competitiveness Index (GCI)

Prepared by: World Economic Forum
Established: 2005 (2001–2004: Growth Competitive Index)
Frequency: Annual
The data refer to the first year given in the title.
Covered countries: at present 133
URL: http://www.weforum.org/en/initiatives/gcp/Global%20Competitiveness%20Report/index.htm

Brief description:
The GCI assesses the competitiveness of nations and provides a holistic overview of factors that are critical to driving productivity and competitiveness. These factors are grouped into nine pillars with 90 indicators: institutions (property rights, ethics and corruption, undue influence, government inefficiency, security, accountability), infrastructure (infrastructure quality, transport, energy, telecommunications), macroeconomy, health and primary education, higher education and training, market efficiency (competition, distortions, market size, flexibility and efficiency of labor market, sophistication and openness of financial markets), technological readiness, business sophistication, innovation.
The rankings are drawn from a combination of publicly available hard data and the results of the Executive Opinion Survey, a comprehensive annual survey conducted by the World Economic Forum, together with its network of Partner Institutions. By now over 13.000 business leaders are polled in the 133 economies worldwide which are included in the index. The survey questionnaire is designed to capture a broad range of factors affecting an economy›s business climate that are critical determinants of sustained economic growth.

Figure 1: Global Competitiveness Index: Scores and Ranking 2010–2011



Index of Economic Freedom

Prepared by: The Heritage Foundation and Wall Street Journal (USA)
Established: 1995
Frequency: Annual
The data refer to the previous respective year.
Covered countries: at present 183
URL: http://www.heritage.org/Index/Ranking.aspx

Brief description:
The 2007 methodology has been revised to provide an even clearer picture of economic freedom. The index measures 10 specific factors, and averages them equally into a total score. Each one of the 10 freedoms is graded using a scale from 0 to 100, where 100 represents the maximum freedom. A score of 100 signifies an economic environment or set of policies that is most conducive to economic freedom. The ten component freedoms are: Business, Trade and Fiscal Freedom, Freedom from Government, Monetary, Investment and Financial Freedom, Property rights, Freedom form Corruption, Labor Freedom.

Figure 2: Index of Economic Freedom: Score and Ranking 2011

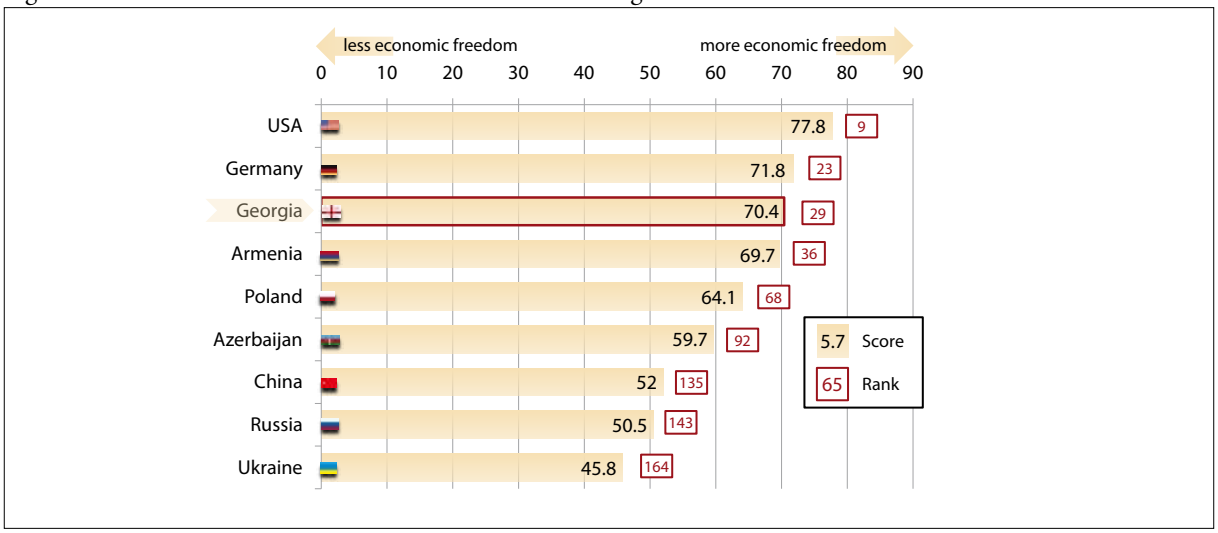
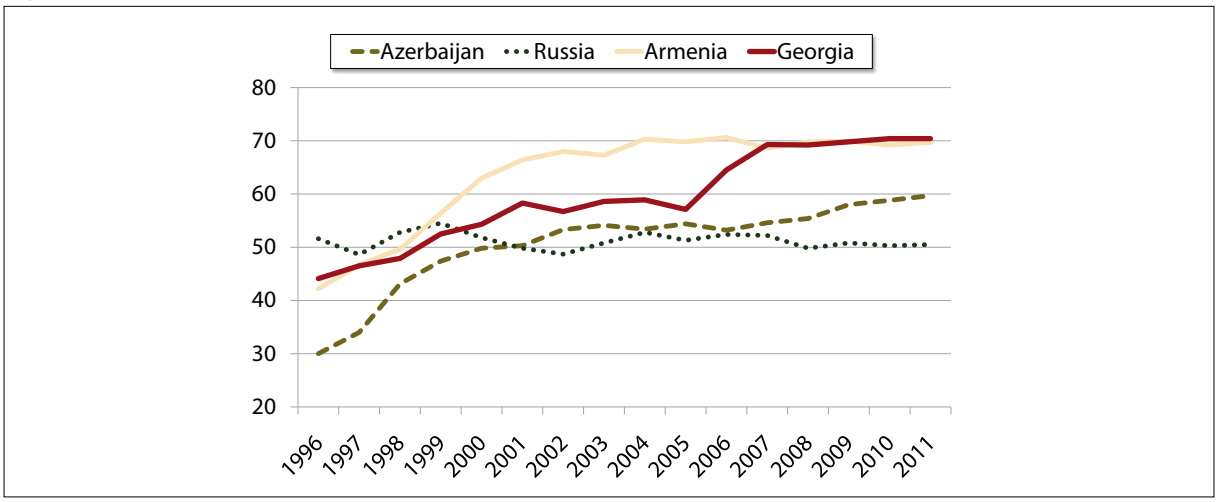


Figure 3: Index of Economic Freedom: 1995–2011



Corruption Perceptions Index

Prepared by: Transparency International
Established: 1995
Frequency: Annual
Covered countries: at present 180
URL: http://www.transparency.org/policy_research/surveys_indices/cpi

Brief description:
The Corruption Perceptions Index is a composite index that draws on multiple expert opinion surveys that poll perceptions of public sector corruption in countries around the world. It scores countries on a scale from zero to ten, with zero indicating high levels of perceived corruption and ten indicating low levels of perceived corruption.

Figure 4: Corruption Perceptions Index 2010: Scores and Ranking

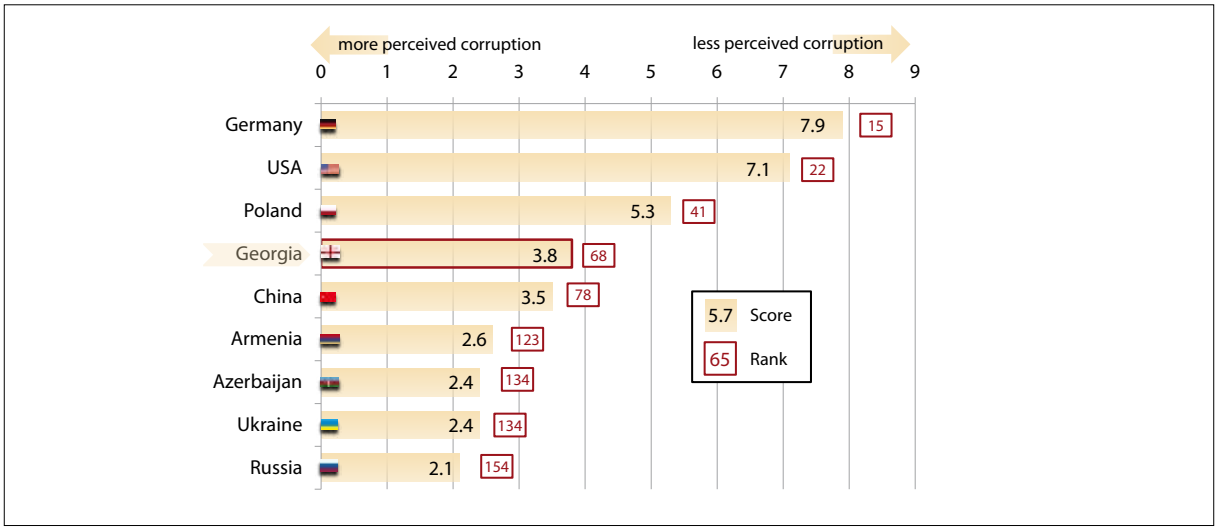
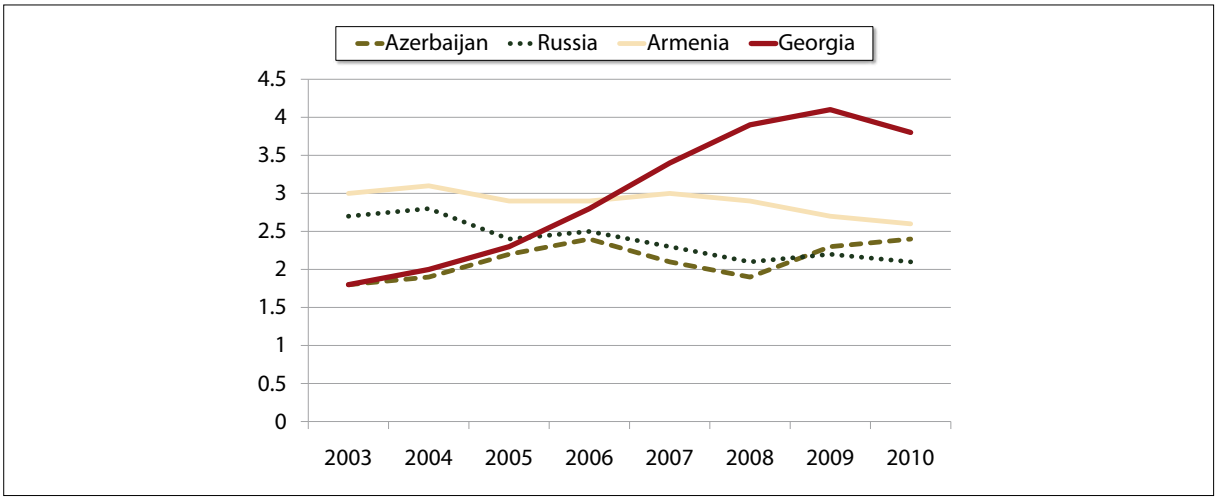


Figure 5: Corruption Perceptions Index 2003–2010

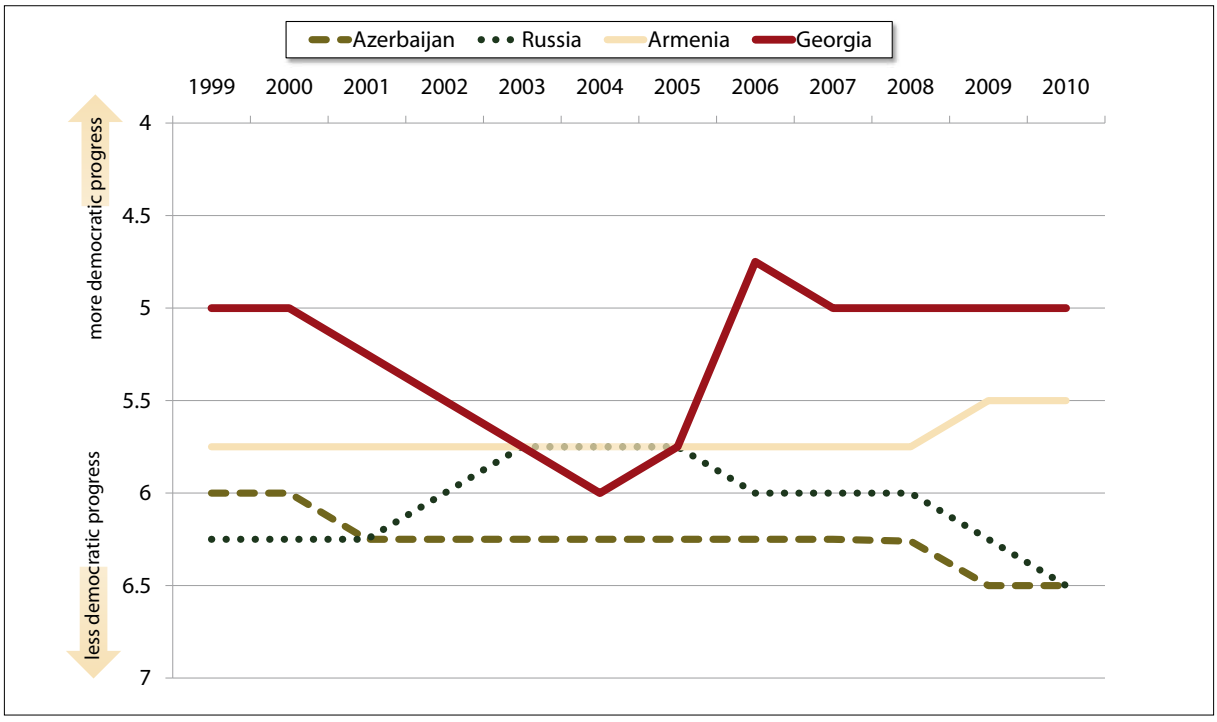


Freedom House: Nations in Transit

Prepared by: Freedom House (Washington, USA)
Established: 1997
Frequency: Annual
The data refer to the respective previous year.
Covered countries: at present 29
URL: http://freedomhouse.org

Brief description:
Nations in Transit measures progress and setbacks in democratization in countries and territories from Central Europe to the Eurasian region of the Former Soviet Union. The rating covers seven categories: electoral process; civil society; independent media; national democratic governance; local democratic governance; judicial framework and independence; and corruption. The ratings are based on a scale of 1 to 7, with 1 representing the highest and 7 the lowest level of democratic progress.

Figure 6: Nations in Transit: Corruption 1999–2010



NB: For 2000 no values were established.

CHRONICLE

From 11 March to 11 April 2011

11 March 2011	The US real estate tycoon Donald Trump signs a deal during a ceremony in New York with the Georgian President Mikheil Saakashvili to develop two towers in Tbilisi and Georgia's sea resort of Batumi with an estimated worth of up to 300 million US dollars.
11 March 2011	Foreign Direct Investments (FDI) in Georgia have declined 16% to 553.1 million US dollars in 2010 according to preliminary figures released by Geostat, the State Statistics Office.
15 March 2011	The leader of the Armenian opposition Zharangutyun (Heritage) party Raffi Hovannisian begins a hunger strike at Yerevan's Liberty Square to demand fresh presidential and parliamentary elections in Armenia.
15 March 2011	OSCE Chairman-in-Office Lithuanian Foreign Minister Audronius Ažubalis visits Georgia and meets with Georgian Foreign Minister Grigol Vashade.
15 March 2011	Georgian President Mikheil Saakashvili meets with General David Petraeus, the commander of the US and NATO forces in Afghanistan, in Washington.
16 March 2011	Azerbaijan threatens to shoot down civilian planes flying to the disputed region of Nagorno Karabakh if the civilian airport in the region reopens as planned.
16 March 2011	Daniel W. Yohannes, the chief executive of the US government foreign aid agency Millennium Challenge Corporation (MCC), reports that the MCC is considering allocating a new aid package of 100–150 million US dollars to Georgia during a House Foreign Affairs Committee hearing.
26 March 2011	Georgia donates 1 million US dollars via the Red Cross to relief efforts for earthquake-hit Japan
28 March 2011	The OSCE condemns an attack on journalist Seymur Haziyev in Azerbaijan
28 March 2011	The breakaway region of Abkhazia releases the preliminary results of a population census
31 March 2011	Swedish Foreign Minister Carl Bildt visits Georgia
31 March 2011	Armenian opposition leader Raffi Hovannisian ends his hunger strike
1 April 2011	The International Court of Justice refuses to hear complaints of alleged human rights abuses committed by Russia in Georgia's breakaway regions of Abkhazia and South Ossetia
1 April 2011	Two Israeli businessmen are found guilty of offering a bribe to the Georgian Deputy Finance Minister and sentenced to jail in Georgia
1 April 2011	RAKIA, a state-owned investment fund from the UAE emirate of Ras Al Khaimah, is in talks to sell 80% of its stake in Georgia's Black Sea Port of Poti to the Hague-based APM Terminals
3 April 2011	Georgian Foreign Minister Grigol Vashadze visits Spain
4 April 2011	Protestors are arrested in front of the Georgian Supreme Court during a campaign for prison inmate's rights
5 April 2011	A new synagogue opens in Azerbaijan's capital of Baku during a ceremony attended by US ambassador Matthew Bryza and envoys from Israel and Turkey, among others.
6 April 2011	Head of the opposition Musavat party youth wing Tural Abbasli is expelled from Baku State University in Azerbaijan
8 April 2011	Armenian opposition leader Levon Ter-Petrosian gives a deadline of three weeks to Armenia's political leadership to start a dialogue with the Armenian National Congress (HAK) and free jailed opposition members during a rally at Yerevan's Liberty Square.
8 April 2011	The Georgian Parliament passes in its final reading amendments to a law on broadcasting containing measures to render media ownership in Georgia more transparent.
8 April 2011	Armenian President Serzh Sarkisian announces during a meeting with business associations in Yerevan that the government is ready to offer tax breaks for companies and entrepreneurs launching innovative manufacturing operations.
8 April 2011	The Israeli defense company Elbit System Ltd. says that it is filing a suit in the High Court of Justice in the United Kingdom against Georgia over its failure to pay approximately 100 million US dollars
11 April 2011	The Russian Foreign Ministry accuses Georgia of "conniving" with criminal groups to destabilize the situation on the border between Georgia and the breakaway region of Abkhazia
11 April 2011	A Yerevan court reversed its decision to freeze the bank accounts of the independent newspaper "Hraparak" charged with libel by former Armenian President Robert Kocharian.

ABOUT THE CAUCASUS ANALYTICAL DIGEST

Editors: Iris Kempe, Matthias Neumann, Robert Orttung, Jeronim Perović, Lili Di Puppo

The Caucasus Analytical Digest (CAD) is a monthly internet publication jointly produced by the Heinrich Böll Foundation in Tbilisi (www.boell.ge), the Research Centre for East European Studies at the University of Bremen (www.forschungsstelle.uni-bremen.de), the Resource Security Institute in Washington, DC (resourcesecurityinstitute.org/) and the Center for Security Studies (CSS) at ETH Zurich (www.css.ethz.ch) with support from the German Association for East European Studies (DGO). The Caucasus Analytical Digest analyzes the political, economic, and social situation in the three South Caucasus states of Armenia, Azerbaijan and Georgia within the context of international and security dimensions of this region's development. CAD is supported by a grant from the Heinrich Boell Foundation.

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Heinrich Böll Foundation

The Heinrich Böll Foundation, affiliated with the Green Party of Germany, is a legally independent political foundation. The regional office for the South Caucasus was opened in 2003. Its main objective is to contribute to the forming of free, fair and tolerant societies in the region. The Foundation supports and facilitates cooperation of individuals and organizations throughout the region who, based on the principle values of human rights, search for the change of undemocratic and intolerant attitudes in societies and politics, for the transformation of ethno-political and territorial conflicts into the direction of fair and non-violent solutions and for the sustainable development of people and communities. The Foundation encourages critical public debate to make processes of decision-making democratic and transparent.

Center for Security Studies (CSS) at ETH Zurich

The Center for Security Studies (CSS) at the Swiss Federal Institute of Technology (ETH Zurich) is a Swiss academic center of competence that specializes in research, teaching, and information services in the fields of international and Swiss security studies. The CSS also acts as a consultant to various political bodies and the general public.

Research Centre for East European Studies at the University of Bremen

Founded in 1982, the Research Centre for East European Studies (Forschungsstelle Osteuropa) at the University of Bremen is dedicated to socialist and post-socialist cultural and societal developments in the countries of Central and Eastern Europe. One of the core missions of the institute is the dissemination of academic knowledge to the interested public. This includes regular e-mail service with nearly 20,000 subscribers in politics, economics and the media.

The Institute for European, Russian and Eurasian Studies, The Elliott School of International Affairs, The George Washington University

The Institute for European, Russian and Eurasian Studies is home to a Master's program in European and Eurasian Studies, faculty members from political science, history, economics, sociology, anthropology, language and literature, and other fields, visiting scholars from around the world, research associates, graduate student fellows, and a rich assortment of brown bag lunches, seminars, public lectures, and conferences.

Resource Security Institute

The Resource Security Institute (RSI) is a non-profit organization devoted to improving understanding about global energy security, particularly as it relates to Eurasia. We do this through collaborating on the publication of electronic newsletters, articles, books and public presentations.

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Research Centre for East European Studies • Publications Department • Klagenfurter Str. 3 • 28359 Bremen •Germany
Phone: +49 421-218-69600 • Telefax: +49 421-218-69607 • e-mail: fsopr@uni-bremen.de • Internet: www.res.ethz.ch/analysis/cad