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## Privatization in Georgia and Its Challenges

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**Abstract:** Post-socialist countries have gone through a difficult path of institutional transformation, and some of them are still in the process. For Georgia, 70 years of Soviet experience was associated with the disappearance of pre-Soviet institutional memory, and consequently, the institutional transformations of this country were much more difficult than those of the countries that spent less time in the union. The characteristics of the institutional transformation of the transition to a market economy are the establishment of the private sector, the establishment of market relations, the legalization of the state guarantee in free competition, the transfer of state ownership to private ownership.

This process leads to the formation of market forces in various sectors of economic systems, which, above all, is beneficial to consumers, as a result, we get improved efficiency, which offers consumers a cheaper product and also the right to free choice.

Also, privatization significantly increases investment opportunities, which allows for lower prices and guarantees increased labor productivity.

By transferring property to private ownership, the state's costs of maintaining and financing the property it owns are significantly reduced to zero. Therefore, the alienation of shares and assets of privatization companies leads to an increase in profits for the state.

As we see privatization is quite a difficult process in the sense that its ultimate goal is to increase efficiency for the country's economy. The privatization process in Georgia turned out to be less effective because the social problems of the population could not be solved, the middle class could not be formed and the level of production is in an unfavorable condition. Consequently, there are stagnant enterprises that need a new privatization plan to bring the necessary conditions for economic development.

The following are ineffective examples from modern Georgia and present solutions that will overcome the "trap" of privatization and move the country on a healthy trajectory of development.

**Key Word:** Privatization; effective institutions; reforms, developing country, stock market development, Georgia

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### I. Introduction

The private sector is the mainstay of the capitalist economy, which is essential for entrepreneurs. After the collapse of the Soviet Union, the issue of privatization was on the agenda, which meant the introduction of new institutions in the economy. It is widely acknowledged that countries, where the private sector has played a dominant role, have achieved great economic success. Consequently, the countries representing classical capitalism developed much more than the countries where the level of state involvement in economic relations was higher.

The main reasons for the need for private sector development are inefficiency inherent in state-owned enterprises, the demand for private property, the objective necessity for the development of a market economy.

The benefits of privatization can be an increase in productivity in the country, relatively increased competition, and multiple positive effects. This will ultimately lead to the growth of economic indicators in the state and the liberation of the market from the monopolistic influence of the state.

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### II. Existing Problems and Prospects

As it is known, 3 types of privatization were typical for the countries of the former Soviet Union: moderately radical, radical, and evolutionary.<sup>1</sup>

Examples of moderately radical types of privatization are found in Slovakia, the Czech Republic, Bulgaria, and Hungary. Two tasks were important here: with the rapid implementation of privatization, the focus was on attracting investment and modernizing technologies. One of the best examples is the Czechoslovakian coupon privatization, which began in 1991. Coupon books were distributed to all adult citizens of the country, which could not be bought or sold. Their owners could buy a package of shares with a nominal value of SEK 70,000 (approximately the equivalent of US \$ 2,800) through investment funds. Coupon privatization allows the property to be dispersed among the population. This prevents the emergence of a class of owners and avoids the criminalization of large privatizations.<sup>2</sup>

The best result of privatization in terms of economic efficiency was revealed in Poland, which was characterized by a type of radical privatization by selling state property to investors. Out of 8000 enterprises existing in the early 90s, only 1150 enterprises were privatized. The remaining 5,000 enterprises were transferred to the privatization agency, which sanctioned itself with its funds and aimed to carry out the next stages of privatization at higher prices. Shares of these enterprises have been sold in stages since 1995, initially, 413 shares of the enterprise were sold. The shares were sold for privatization certificates or cash. The remaining 2,000 enterprises closed quickly due to a lack of prospects for their development, which in turn led to a sharp rise in unemployment. Therefore, the privatization process is considered ineffective by experts in terms of social equality for Poland. However, it facilitated the actual accumulation of capital, which ensured that the crisis caused by the ongoing changes in the country was quickly overcome.<sup>3</sup>

The privatization process in Georgia was most similar to the Russian privatization. That is why it is important to discuss the Russian experience to better understand the Georgian reality.

Russia was characterized by radical privatization, but it also had its peculiarities. Initially, part of the small enterprises was sold. Large enterprises, for the most part, were transferred to private ownership free of charge, mostly with vouchers (issued for privatization). They were initially transformed into joint-stock companies and then sold on vouchers. Besides, the benefits were enjoyed by the workers of the enterprise who acquired the shares of these enterprises free of charge or at a reduced price.<sup>4</sup>

The next wave of privatization began in 1994. During this period, shares of enterprises could be bought only with money, although the population had less purchasing power of anything and, an enterprise; That is why the process was delayed. As a result, the middle class could not be formed due to the transfer of small enterprises to the population. This problem is still visible for the Russian economy, because unemployment is still a topical issue here, and in the experience of successful countries, it can be overcome only through the development of small businesses.

The process of privatization of large enterprises turned out to be even more complex. They were sold at a small, non-market price, which led to the state budget refusing large sums of money. Thus, privatization in Russia was carried out as symbolic sums, due to which the accumulation of real budget capital could not take place and, consequently, the process could not contribute to economic growth.

Also very interesting is the experience of China, where evolutionary privatization took place. Initially, enterprises moved to self-government and self-financing to maintain state ownership. They could not trade in resources and means of production, although alternative forms of ownership were later established, in particular, they used alternative sources of investment, such as the creation of new enterprises. China has focused not on changing the form of ownership, but on increasing production and investment. The result of achieving these goals was an increase in production. This experience is partially in line with the economic criteria of the reform, such as increasing production efficiency, accelerating the pace of scientific and technological progress, increasing living standards.

The selection of types of privatization is not as important as taking into account the social, economic, and political characteristics of the country and taking them into account in the process of transferring property to private ownership. To get a positive result, it is inevitable for privatization to organically merge with the current macroeconomic changes in the state. If they are not balanced, the desired result will remain unachieved.<sup>5</sup>

Although Georgian governments' have shown their political will to support the effectiveness of the privatization institution, there are still some inconsistencies. Because of them, the private sector often falls into an inequitable competition and raises suspicions of elite corruption, which is objectively seen as an institutional „trap“.

Privatization is one of the most important events for the development of the economy in Georgia. This process is regulated by various normative acts. The Law of Georgia on Privatization of State Property defines privatization as the purchase of ownership of state property. The law provides a clear list of objects that cannot be

privatized. The above list includes the electricity sector dispatching services. However, it is still unclear on what basis this sector was alienated.<sup>6</sup>

Among the forms of privatization is lease-redemption, according to which the lessee is given the right to use and own the territorial value for the independent implementation of the activity until they redeem the leased property. The transfer of state property by the lease-redemption method is done according to the rules of competition.<sup>7</sup>

For a country in the intermediate stage of a market economy, a key factor in the strength of the economy is the successful conduct of privatization processes. Therefore, a policy should be pursued so that the course of work with territorial authorities is focused on optimal decentralization, which implies an increase in the role of local self-government and territorial units.

Among other important duties, one of the main activities of the territorial units is to monitor the fulfillment of the terms of the lease and redemption of objects transferred to private ownership in the form of competition, as well as property transferred in the forms defined by the Civil Code to tenants and buyers.

However, in addition to monitoring the payment of the amount stipulated in the contract concluded with the buyers of the privatized property of the territorial units, it is also regulated to monitor the fulfillment of the competitive conditions stipulated in the contract.

To improve the control mechanism and to solve the above-mentioned issue, it is necessary to plan thematic and complex inspections of the activities of territorial units, where attention will also be paid to the control over the implementation of other normative acts in the activities of territorial units.

One of the most important issues is the actual implementation of anti-corruption measures in the territorial units. In this regard, it can be said that it is necessary to tighten control over the activities of territorial units, but we must not forget that this is only one side, and working in this direction alone will not bring significant results in practice.

To reduce fraud, it is also essential to plan changes in the legislative space to remove existing contradictions that help under the current legislation or may assist certain transactions in the privatization process. At the same time, it is necessary to increase the remuneration of the employee. This must be done in cooperation with local authorities.

Before we adopt property reform legislation, particular scrutiny is needed to examine the impact of this reform on quality and the criminalization of the economy and society.

Privatization itself is an anti-corruption tool. For example, when transferring the enterprise to private ownership, vicious events such as embezzlement, theft, concealment of income, embezzlement, incompetence, correspondence, superficial attitude to work, unprofessionalism, etc. are lost.

In Georgia, according to the legislation, by-laws and orders are used to regulate the privatization process. It would be better to incorporate the by-laws into the basic laws or to create a completely new law in which all the norms that were spelled out in the by-laws will be defined.

### **III. What Do We Need To Succeed?!**

If we want privatization to succeed, we need to have stability in the country, both in legislation and in politics. We need to know how much the state can implement the policies developed in real life and how stable is the government in the country.

The excitement and social tensions disrupt the normal pace of production processes and limit the key to the production process, all of which create an unfavorable environment for investors. Based on this, due to the high risk in the country, they leave the region. The precondition for entrepreneurial activity is the stability of democratic transformations in the state.

Institutionally flawed protection of private property rights and an unhealthy court system hinder the effectiveness of privatization. Investors pay great attention to the degree of court objectivity. They must be sure that in the event of a dispute, the authority will decide it objectively and that there is an institution in the country that can protect its interests.

Most large and medium-sized state-owned enterprises are characterized by unprofitability. Rehabilitation, restructuring, or liquidation is necessary to solve this problem. Only then it will become attractive to enterprise investors.

The State Property Management Agency has been operating in Georgia since 2012, which is subordinated to the Georgian Agency for Economy and Sustainable Development, and the privatization of state property is entirely its function. This institution sells a 100% controlling stake in state property to private entities. In other words, the objects to be transferred to private ownership in the stock market are presented in the form of whole

packages. In a country with a relatively low level of securities trading, it would be good to divide this property into shares and sell them in this way. This process will primarily contribute to the development of the stock market, as well as attracting investment, which is essential for the advancement of the country's economy. In addition to these effects, the example of enterprises will give more chances to the production to develop, because the shareholders will generate ideas, transfer knowledge and the activities of the enterprise can become much more efficient. This process will also help to form a middle class in the population and raise the standard of living. In a country where the average monthly expenditure per capita does not exceed GEL 330 (1\$≈3,3GEL) and the average monthly nominal wage is GEL 240, it is difficult to generate the type of investors who will be able to buy the enterprise.<sup>8</sup> However, if these people will be able to afford to buy part of the enterprise they will have more motivation to make savings as the part cost will be more affordable.

Georgia needs a new wave of privatization of state-owned enterprises, which will free the private sector from unhealthy competition from state-owned enterprises. The Security Police, which is subordinated to the Ministry of Internal Affairs of Georgia, has been functioning since 2004.<sup>9</sup> In addition to protecting the strategic facilities of the state, the service also entered the private sector and the list of facilities to be protected was also extended to the services of private and legal entities. Georgian law gives the Security Police the right to carry weapons, which private security companies do not have the right to do. Consequently, the law creates a competitive advantage for the Security Police that is unbeatable for its competitors. Accordingly, it is a leader in the sector, both in terms of protected facilities, employees, and financial indicators. Although the Security Police is financially one of the state-owned enterprises, it is desirable to separate it from the State Security Service. Part of the services of private and legal entities of the security police should be privatized and brought into the same norms as other competitors in this sector. The situation in Georgia is similar in many sectors, which need to be reviewed and privatized. The state should ensure a healthy environment for business, the state should not engage in business.

#### **IV. Conclusion**

Privatization means the sale of government-owned property. This in itself means that the proceeds from the alienation of property go to the country fund, which leads to an increase in government revenues and the budget, that is, a positive fiscal effect. Based on this, the country's economy develops, and new jobs are created, which in itself has a positive impact on the level of employment.

Mass and accelerated privatization are not effective when there is no competition in the state and when it is weak. Privatization at such times is simply a means of redistributing property among a small number of privileged officials.

It is especially important to stimulate small businesses based on private sector self-financing. One of the main causes of the transformation crisis is the inactivity of privately owned enterprises or their low workload.

As a result of transferring property to private ownership, it is desirable to obtain a layer of successful owners, which, in itself, is a prerequisite for the emergence of the middle class. In other situations, this activity loses its meaning and it does not give us the most necessary and desirable result, such as the socio-economic progress of the country. Therefore, privatization is a very useful tool for enhancing the economic development of the state. It is an important and essential event, guiding it at the right course will lead the country forward.

As a result of the increase in productivity, the gross domestic product also increases, all this has a positive impact on the economic growth data. It should be noted that in most cases we adopt a positive fiscal policy, which is manifested in both short-term and long-term, in particular in the form of taxes paid by existing enterprises to the budget.

The main advantage that comes with selling shares of state-owned enterprises is stimulating the formation of the stock market. This is very important for Georgia because the stock market is more or less not functioning here. These factors will inevitably contribute to increased productivity, which is a prerequisite for increasing the level of employment and increasing the gross domestic product. This effect will also be positive for the population, as it will be possible to buy shares in the stock market, from which the dividends received can give them additional income. All of this will ultimately lead to the country's economic growth.

However, we must also point out the downside. When selling shares, the main focus is on the price of the shares and not on the terms offered by the state. This can lead to a conflict of interests between the state and the population.

Effective management of the privatization process ensures both the enrichment of the population and the possibility of accumulating funds for the state. After radical privatization, Georgia needs a new privatization plan that will be effective and will help strengthen the country's economy and ensure sustainable economic development.

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