

Georgian Reform - Success Stories

December 2009

Driving Force Behind The Reforms

- **The rule of law & property rights**
- **Minimal state fiscal footprint**
 - Few, low and flat taxes
 - Minimal social security burden on businesses
- **Lean and efficient civil service sector – providing value for taxpayers' money**
- **Limited government**
 - Deep de-regulation
 - Dramatically minimized and simplified licensing
 - Aggressive privatisation
- **Flexible labour market, with minimal state interference in employer-employee relations**
- **Sound money - inflation targeting**
- **Means-tested, focused state assistance to the poor**
- **Free trade, no customs tariffs or non-tariff barriers**

Few, Flat Taxes Only

- **Prior to reforms, 26 various taxes with different rates**
 - + Bribe tax
- **Complicated regulations**
- **Ineffective administration**
- **Low-paid and corrupted tax inspectors**

Before

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- **New Tax Code introduced**
 - **Dramatic reduction in ineffective taxes**
 - **Only 6 low, flat taxes**
 - **Streamlining administration**

Reform

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- **Forbes Tax Misery Index: fourth least tax-burdensome countries in the world**

Result

Pipeline of Consecutive Tax Reforms

	'04A	'05A	'06A	'07A	'08A	'09A	'10F	'11F	'12F	'13F
Number of Taxes	21	7	7	7	6	6	6	6	6	6
VAT	20%	20%	18%	18%	18%	18%	18%	18%	18%	18%
Income Tax	12-20%	12% flat	12% flat	12% flat	Social Tax + Income Tax 32%	Social Tax + Income Tax 25%	20%	18%	15%	15%
Social Tax	33%	20%	20%	20%	-	-	-	-	-	-
Corporate Profit Tax	20%	20%	20%	20%	15%	15%	15%	15%	15%	15%
Dividend & Interest Income Tax	10%	10%	10%	10%	10%	5%	5%	3%	0%	0%

- No payroll tax or social insurance tax
- No capital gains tax
- No wealth tax, inheritance tax or stamp duty
- Foreign-source income of individuals fully exempted
- Tax rates reduction timetable has been further accelerated in 2008

Combating Corruption

- **Systemic corruption was a natural occurrence until new government took the commitment to deal with it**
 - Highly corrupted public sector
 - Artificially augmented, low-paid beurocracy
- **Transparency International ranked Georgia 127 out of 133 in 2003**
- **IFC Enterprise Survey 2002 indicates that more than 70% of firms expected to pay bribes to get things done**

Before

- **Exemplary cases under the new Anti-Corruption Strategy**
- **Public Sector Reform**
 - Maximum elimination of unnecessary interactions between public and private sectors
 - Number of line ministries and government agencies dramatically reduced
 - Number of public sector employees reduced by 50%, salaries of civil servants increased
- **Education System**
 - New system, where merit matters and not payoffs
 - The former school-based admission exams replaced by competitive national testing
 - Finance system restructured - voucher system introduced
- **Traffic Police Reform**
 - Police officers dismissed and recruited through an open competition
 - Salaries were raised ten-fold, training and equipment

Reform

- **Small and effective public sector with competitive compensations**
- **Merit based national exams that ensures the competitiveness of our work force**
 - High competition among educational institutions owing to vouchers
- **Georgian drivers free from roadside shakedowns by corrupt cops demanding bribes**
- **Transparency International ranked Georgia 66 out of 180 in 2009**
- **IFC Enterprise Survey 2008 indicates that only 4% of firms expected to pay bribes to get things done**

Result

Dramatic Decrease and Simplification in Licenses and Permits

- **Beforehand, 300 licenses and 600 permits existed**
- **Licenses and permits seen as source for grafting**
- **High entry barriers and corrupt practices**



- **New Law on Licenses and Permits introduced**
- **Number of ineffective licenses and permits dramatically reduced**
- **70% cut in licenses (↘92) and 90% in permits (↘52)**
 - No sub-categories in the licensing activity
 - Legislative restriction on additional license inductions
 - No exclusive licenses – nondiscrimination applied
- **One-stop-shop in most government agencies**
- **Silence is Consent adopted**
 - 30 days for license and 20 days for permit



- **Doing Business rank #10 worldwide in dealing with construction permits**
- **Over 2000 construction permits were granted just in 2008, five-fold higher comparing to 2003, for around 2.5 mln sq. m. space in Tbilisi**



Property Registration – Exemplary Worldwide

- Prior to the reform undertaken in the public registry, the large share of property was not registered
- No intensive to encourage investment and access to formal credit markets
- Complicated and interminable procedures
- Only around 26,000 total registrations in 2000

Before

- Refined and simplified registration procedures
- Number of steps reduced from 6 ↘ 3 and days from 9 ↘ 2
- Electronic property registration introduced
- No restriction on foreign ownership of property and land
- Dispositional rights for both sides in mortgage execution

Reform

- Exemplary in the world – transparent and swift process
- Doing Business ranked Georgia 2nd in the world in ease of registering property
- About 300,000 total registrations just in 2007

Result

Fundamental Change in Policy - Monetary Privatisation

- **Former policy - project based privatisation**
- **The most property transferred left as it is or sold in fractions**
- **Only GEL 24 mln in privatisation proceeds in 2003**

Before

- **Fundamental change in policy drift**
- **Monetary privatisation, mostly auctioning, on competitive base becomes priority**

Reform

- **Total of GEL 2 bln proceeds from privatisation during the last 4 years**
- **GEL 551 mln in 2008 – 20 times higher than in 2003**
- **Major assets sold: Poti Port, HPPs, hotels, water and sewage companies, telecommunications, hospitals, etc**

Result

Liberal Labour Market

- **Soviet type labour regulation, adopted in 1973, was full of twists and turns making it difficult for employers to hire/fire staff**
- **Irrational benefits causing costly labour movement**
- **Laws mainly “protecting” only one side – workers, and disregarding interests of employers, which resulted in high shadow employment rates**

Before

- **2006 new Labour Code established freedom of parties to negotiate employment provisions**
 - Simple contractual relations between employers and employees
- **Low costs of hiring and firing workers**
- **Basic working conditions guaranteed**
 - Only specific circumstances, in line with ILO prerequisites, regulated (health safety, pregnancy, minors, dispute settlement, freedoms and rights of workers)

Reform

- **Doing Business ranked Georgia 5th in the world in ease of employing workers**

Result

Cross-Border Trade Liberalisation

- Complex procedures until 2006
- 52 days to import and 54 days to export
- 16 different tariffs applied

Before

- Simplified customs procedures since 2006
- Reducing paper work by more than half
- Slashed time requirements ↘ 4 days for import and ↘ 5 days for export
- Permits applying to only limited numbers of product groups
- One-stop-shop principle for issuance of certificates of origin
- 0% customs tariff on 95% good items and rates reduced ↘ 3 (0%, 5% and 12%)
- No quantitative restrictions, export, re-export or transit tariffs
- Risk management system and Gold List in place at customs

Reform

- Export increased by more than three-fold and import by more than 5.5 times comparing to 2003
- Doing Business rank #30 worldwide in trading across borders

Result

Aiming High to Serve the Poor - Targeted Social Assistance

- **Before 2006, social assistance was given only to particular categories of the Georgian population**
- **Before TSA program, only quintile of extreme poor were getting social assistance**

Before

- **Aiming high to serve the poor - Georgia's new TSA program launched in July 2006**
 - 18 months of intense preparation
 - Team of national experts appointed to develop a targeting mechanism
- **A “proxy means test” (complementing data on income with information of possession of durables, quality of the dwelling, education level of the household, and so on) was selected**
 - It combines both objective (measurable) variables and subjective assessment of the household situation by social workers
 - The formula accommodates differences in consumption across geographical locations
- **The database processing is done centrally**
 - Including information verification and cross-checks, as well the assignment of the proxy score
- **The entire process is automated to assure objectivity and minimize the risk of bribery**

Reform

- **3/4 of state healthcare budget is diverted to poorest quintile**
 - The rest 1/3 to the poor and 0.5% to non-poor
- **Insurance vouchers for 26% of population**
 - Unbound choice of insurance company
- **Cash benefits for 13.7% of population**

Result

From Daily Black-outs to Net Electricity Exporter

- Daily black-outs prior to reform
- All TPPs and 3 out of 12 main HPPs were idle
- Deeply state regulated electricity production/supply
- Minimum collection rates: 15% – 25%
- Rampant corruption

Before

- New Energy Policy document adapted in 2006
- Complete rehabilitation of all HPPs and transmission lines
- Privatisation of almost all HPPs and retail electricity distribution companies
- Newly built HPPs are fully deregulated from electricity generation tariffs
 - Only three permits for new HPP construction
 - No licence to export the electricity and no tariff set
- Wholesale generation tariffs are fully liberalised
- Small HPPs (less than 13 MW capacity) can sell electricity at unregulated tariffs

Reform

- In 2008, HPPs supplied 80% of total electricity consumption of Georgia
- Collection rate: 95%
- Georgia became a net exporter of electricity in all four neighboring countries for the first time in its history
- Only 18% of the total prospective hydro capacity is utilised
 - Objective: maximum utilisation of hydro resources and evolution into a major regional exporter of electricity
- About 80 greenfield HPP sites have been identified and offered with small and medium scale capacity
- Three new transmission lines to Turkey are underway
 - Total transmission capacity will reach 1,500 MW - more than 10 times bigger than current capacity

Result

No Market Entry Barriers for Pharmaceuticals

- **Excessive market entry barriers for pharmaceuticals before the reform**
- **One regime for all new sort of medicaments to be placed in Georgian market**
 - 2 month for registration (administrative and science research)
- **Parallel import restricted – few companies with unchallenging market power**

Before

- **Light touch regulation for those pharmaceuticals that are approved by OECD/EU respective authorities on their markets**
 - Registration days down from 60 ↘ 7 days
- **Parallel import allowed**
 - For those pharmaceuticals already registered on Georgian market and entering with different labeling, only notice regime applies
- **Lifting restrictions on OTC medicaments to be sold in supermarkets/retail stores**

Reform

- **No market entry barriers for pharmaceuticals**
- **High competition on the market resulting in competitive prices**
- **Increased assortment of pharmaceutical products**

Result

No Technical Barriers to Trade

- **Until reform, technical regulations inherited from the Soviet Era**
 - Soviet GOST system with no voluntary standards
 - Unreasonable number of visits per year allowed
 - Irrationally high and complicated standards
- **Technical regulations as a source of bribery**

Before

- **Technical regulations only for activities that have direct influence on life safety of consumers**
 - Limited audit visits per year and no impediments in entrepreneurship activities
 - Respective (mutual) responsibilities for infringers and providers of entitlement
 - Voluntary standards in place
 - Recognition of EU and OECD technical regulations

Reform

- **Business is free from unreasonable and irrational technical regulations**
- **Easy, fast and low-cost export-import procedures for products under sanitary/phytosanitary control**
- **Voluntary standards (i.e. excluding safety concerns) allow businesses to operate without excessive investment conditions**
- **No technical barriers to trade**

Result

Ensuring No Policy Drift – Liberty Act

- The government intends to submit to Parliament the constitutional Law on Economic Liberty, Opportunity and Dignity (**the Liberty Act**)
- The Liberty Act will contain a coherent package of bold measures to constitutionally enshrine our basic policies, reassuring investors that no policy reversal or policy drift is possible
- Returning to citizens the power to tax – **no new taxes or tax rate increases without a nationwide referendum**
- **Fiscal responsibility**
 - Government expenditure capped at 30% of GDP
 - Budget deficit capped at 3% of GDP
 - Government debt capped at 60% of GDP
 - No budget earmarks
- **No restrictions on currency convertibility or repatriation of capital & profit**
- **Ban on state ownership of banks and on the imposition of price controls**
- **Ban on an increase in the number of licenses and permits**
- **Ban on an increase in the number of state or independent regulators**
- **Means-tested assistance rendered through vouchers and other ways that empower citizens and give them choice (in healthcare, education, etc), rather than by funding directly state-owned service providers**