

**A Conversation With
Lado Gurgенidze, Former Prime Minister of Georgia**

Georgia in Search of Economic Liberty
A Blueprint for Reform in Low and Lower Middle Income Economies

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Interviewer Michael Intriligator, Senior Fellow, Milken Institute; Professor of Economics,
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Georgia: Key Facts

Area:	69,700 sq km
Population:	4.5 million
Life expectancy:	76.51 years
Official language:	Georgian
Literacy rate:	100%
Capital:	Tbilisi
Currency (code):	Lari (GEL)
GDP (2008):	US\$12.80 billion
GDP - per capita 2008E (PPP):	US\$4,851
Inflation rate 2008 (e-o-p):	5.5%
External debt to GDP 2008:	21.4%



Source: Department of Statistics of Georgia

Georgia in Search of Economic Liberty *Lado Gurguenidze*

1989-2003

- Civil war 1991-1993, loss of effective control of two breakaway provinces
- Uninspired leadership, endemic corruption
- Inconsistent reforms
 - The few bright spots included:
 - Land/housing stock privatisation
 - Banking sector privatisation by 1995
 - No currency or capital controls since 1997
- High tax rates, poor administration
- Cumulative real GDP decline by 60%+: 2003 GDP c. US\$4 bn
- Negligible exports and investment inflows
- External public debt c. 56% of GDP, two Paris Club restructurings
- Banking sector assets c. US\$600 mln (c.16% of GDP)
- Few public sector institutions functioning by 2003
- Crumbling infrastructure after 15 years of neglect
- **Essentially, a failed state by 2003**

Transformation since the Rose Revolution

- GDP real growth rates of 8.5% or higher in 2004-1H 2008
- Nominal GDP grew from approximately US\$4 billion to almost US\$13 billion
- Massive private foreign capital inflows
 - 2007: US\$2.3 billion (approximately 23% of GDP)
 - 2008: US\$2.15 billion (approximately 17% of GDP)
- C. 300 institutional investors invested in Georgian debt & equities
- Exports CAGR of 20%+
- YE 2008 external public debt 21.4% of GDP, debut sovereign Eurobond
- Banking sector assets US\$5.4 bn at YE 2008
- Massive infrastructure upgrades & public sector reform
- Rapidly expanding middle class, entrepreneurial revolution

Key reforms: rising economic liberty & retreat of the state

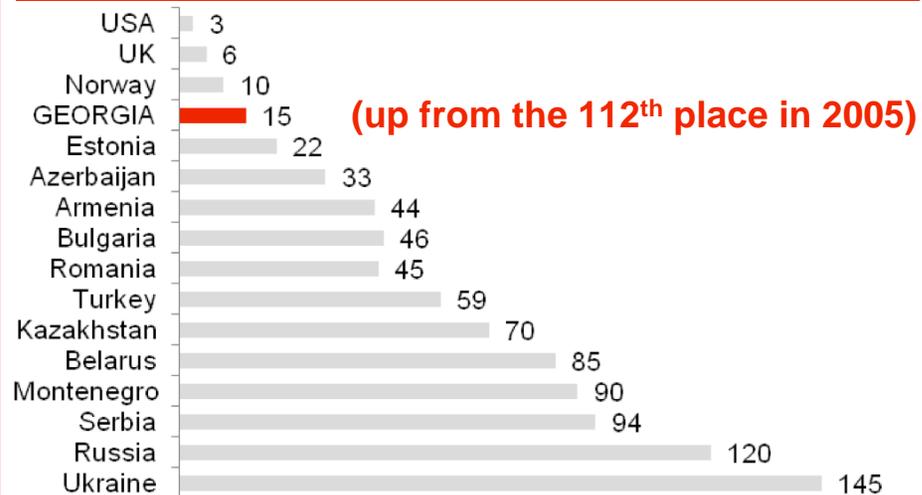
Policies	Outcomes
<p>Low, flat taxes No exemptions, credits etc DTT with 24 countries Government's fiscal footprint capped at 25% of GDP</p>	<p>GDP growth $\geq 9\%$ p.a. (2005-1H 2008) Riding the Laffer curve: Fiscal revenue up c. 500%</p>
<p>Inflation targeting No currency or capital controls, FX managed float, Light-touch, risk-based financial services sector regulation</p>	<p>Inflation, at 5.5%, one of the lowest in CEE Banking sector assets grew from \$900 mln to over \$5 bn (availability of credit) Sky-high private capital inflows (5-year cumulative $>40\%$ of GDP)</p>
<p>Unilateral abolition of import tariffs</p>	<p>No market distortions, elimination of corruption at customs</p>
<p>Unilateral abolition of visas, work permits, simplified residency rules</p>	<p>Foreign visitors up 300% (1 mln in 2007)</p>
<p>Flexible labour code</p>	<p>Growth of formal employment & emergence of a bankable middle class</p>
<p>Ease of starting up a business</p>	<p>$> 50,000$ new business registrations p.a., year after year</p>
<p>Massive de-regulation & outsourced regulation</p>	<p>Suppressed corruption, improved business climate Ranked as the 15th freest economy in the world</p>
<p>Aggressive privatisation</p>	<p>Improved efficiency and capital deployment</p>

Public sector reform

- Modernisation of the state & civil service
 - Police
 - Armed forces
 - Public sector financial management
 - Efficient, leaner state bodies
 - Permits and licenses – single window & silence is consent
 - Transparency and accountability + minimising bureaucratic discretion + low, flat taxes = suppression of corruption
- Education & healthcare: fiscal funding of the poorest citizens rather than institutions
 - Education reform – school choice nationwide, unified nat'l exams
 - Healthcare reform – private service provision, the poorest 1 mln receive health insurance vouchers
- Welfare reform – means-tested basis
- Judicial reform
- Environment
 - 88% of energy from hydro power
 - Volume of standing forest per capita three times the European average

One of the freest economies in the world

Ease of Doing Business, 2009



Source: World Bank (Rank out of 181 countries).

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One of the best tax jurisdictions in the world

- Flat personal income tax of 20% decreasing to 15% by 2012
- Corporate income tax of 15%
- VAT of 18%
- Property tax of up to 1% on the self-assessed value of property
- Interest income and dividend tax rates of 5% decreasing to 0% by 2012
 - 0% dividend income tax on dividends from publicly-traded equities
 - 0% tax on interest income from bank deposits and publicly-traded debt securities
- No separate capital gains tax
- Foreign-source income fully exempt for resident individuals
- Assets held over two years fully exempt for individuals
- No social insurance, PAYE or other payroll taxes
- No inheritance tax
- No wealth tax
- No stamp duty or other transaction-based taxes or levies
- DTTs with 24 countries, several more to follow
- FIZs, Free Warehouse Regime, IFCs etc

Sustainability of reforms

- Reforms & policies that are easy to sustain when the pendulum swings the other way have the following characteristics:
 - Pervasive (rather than targeting specific demographic groups or industries)
 - Permanent (rather than in effect for a fixed period of time and then phased out)
 - Quantifiable (and as such easy to communicate to the public and monitor)
 - Tangibly affecting everyday lives of citizens
- In Georgia, key sustainable policies include the following
 - Low, flat taxes/fiscal policy
 - Inflation targeting
 - Zero import tariffs
 - Ease of starting up a business
- Reforms & policies typically at risk when the pendulum swings the other way have the following characteristics
 - Niche/focused on a particular sector/demographic group
 - Complex/esoteric
 - Non-quantifiable
 - Not having a tangible everyday effect on people's lives

Thank you for your attention



- Q&A