

Political Economy Under Georgian Dream: Factors, Policies and Consequences

Bill Harney

Executive Summary

1. Political Economy from Gamsakhurdia to Saakashvili
2. Economic Performance under Georgian Dream: Macroeconomic Indicators and Trade Relations
 - 2.1 Monetary Policy
 - 2.3 Fiscal Policy
 - 2.4 Trade Relations
3. Political Factors Conditioning Economic Policy: Motivations, Results, and Consequences
 - 3.1 Domestic Political Environment: Popular and Elite Support
 - Political Motivation
 - Economic Policies
 - Consequences
 - 3.2 Russia: Balancing Security Threats and Economic Opportunity
 - Political Motivation
 - Economic Policies
 - Consequences
 - 3.3 Euro-Atlantic Institutions: Integration and Ascension
 - Political Motivation
 - Economic Policies
 - Consequences
 - 3.4 The South Caucasus: Transit & Conflict
 - Political Motivation
 - Economic Policies
 - Consequences
4. Concluding Perspective: Political and Economic Stability Going Forward

Executive Summary

The purpose of this report is to establish and analyze how political objectives and economic policy have interacted under the leadership of Georgian Dream from 2012-2018. This report finds that the overriding political objective of the Georgian Dream is to ensure a peaceful and stable environment for the business interests of ruling elites. This objective is then broken into four sub-objectives: the continued control of the domestic political environment by Georgian Dream; de-escalation of tensions with Russia and a renewal of economic links; closer integration with Western institutions, specifically the European Union and NATO; and the deepening of regional and extra-regional projects to develop a South Caucasian economic corridor. The conclusion of this report is that Georgian Dream's economic policies have been moderately successful in the four sub-objectives but, as a result, have failed to address medium- and long-term structural problems in the Georgian economy related to high external debt and a lack of comprehensive inclusive growth strategies.

The first section of the report traces the political economy of Georgia from independence in 1991 to the present. The second section outlines the performance of the Georgian economy under Georgian Dream and contains three subsections highlighting fiscal policy, monetary policy, and trade relations. The third section addresses Georgian Dream's political objectives and how they affect economic policy and performance. This section is broken into four subsections, which each address one of the four main political dynamics factoring into the ruling coalitions' calculus. These subsections cover the continued control of the domestic political environment by Georgian Dream party; the de-escalation of tensions with Russia and a renewal of economic links; closer integration with Western institutions, specifically the European Union and NATO; and the deepening of regional and extra-regional projects to develop a South Caucasian economic corridor. Each subsection discusses why Georgian Dream is motivated to achieve this political objective; which policies Georgian Dream has implemented in pursuit of the objective; and lastly, the positive and negative consequences this objective may have on Georgia's political and economic climate. The fifth section summarizes the main conclusions and underlines the main risks facing Georgia going forward.

1. Political Economy from Gamsakhurdia to Georgian Dream

With the fall of the Soviet Union in 1991, newly independent Georgia underwent a period of severe economic crisis, political unrest, and internal conflict. Economically, Georgia witnessed a dizzying drop in production and a collapse of the monetary system as GDP fell by 65% between 1991-93 and inflation rose to 7000% by 1994.¹ Politically, the country descended into war when the democratically elected government under Zviad Gamsakhurdia responded with military force to local elites' positioning for greater power in Abkhazia and South Ossetia; at the same time, however, state authority dissipated as political power fragmented into the hands of elites presiding over quasi-parliamentary, criminal groups.²

By 1995, however, a modicum of stability returned as Eduard Shevardnadze was able to establish political authority by neutralizing key challengers, consolidating a significant coercive capacity within the state, and enacting an economic program aimed at "macroeconomic stabilization and systematic change."³ The economic programme was conducted in close consultation with the IMF and involved the shift from the Russian rouble-based coupon system to the independent Georgian lari, price and trade liberalization, bank privatization, and the restructuring of foreign debts. The policies successfully resulted in monetary stability (exchange rate stabilization and low inflation) and positive GDP growth for the first time since independence. However, Shevardnadze's administration was also marked by rampant corruption and an inefficient tax code that contributed to huge budget deficits, unpaid social services, and national poverty levels reaching 52%.⁴

Capitalizing on popular discontent caused by the economic situation and motivated by the power vacuum created by Shevardnadze's decision not to run for re-election in 2004, Mikheil Saakashvili was able to position himself as the key opposition figure and theatrically swept into power through the 2003 Rose Revolution.⁵ Once in power, Saakashvili's United National Movement (UNM) carried out a twin-platform of state-building and neoliberal reforms.⁶ UNM's state-building model was based on the party's consolidation of power and the closure of the political space, the reintegration of Abkhazia and South Ossetia, and tackling corruption⁷. While unable to regain state control of the separatist regions and suffering losses in the 2008 Russo-Georgian War, the UNM was able to successfully centralize power, implement reforms, and severely reduce the rampant corruption facing ordinary citizens. The UNM's economic model focused on boosting revenue

¹ World Bank. *Georgia - Systematic Country Diagnostic: From Reformer to Performer (English)*. Washington, D.C. : World Bank Group, 2018. <http://documents.worldbank.org/curated/en/496731525097717444/Georgia-Systematic-Country-Diagnostic-from-reformer-to-performer>

² Waal, Thomas de. *The Caucasus: An Introduction*. 1 edition. Oxford ; New York: Oxford University Press, 2010.

³ Papava, Vladimer. *Economic Reforms in Post-Communist Georgia : Twenty Years After..* New York, Nova Science Publishers, 2013, pp. 10-14.

⁴ *Ibid*, p. 43.

⁵ Hale, Henry E. *Patronal Politics: Eurasian Regime Dynamics in Comparative Perspective*. New York, NY: Cambridge University Press, 2014.

⁶ Waal, *The Caucasus*.

⁷ Papava, Vladimer. The Political Economy of Georgia's Rose Revolution. *Orbis. A Journal of World Affairs*, 2006, Vol. 50, No. 4, Fall.

through a simplified tax code and state-led reacquisition of funds from corrupt business elite; preferential access to economic opportunities for loyal elites; and improving the climate for business and FDI through relaxed labor codes and simplified business licensing laws.⁸ As a result, during UNM's tenure from 2003-2012, Georgia underwent strong GDP growth, increased foreign direct investment, and an impressive recovery from the dual-shocks of the 2008 war and financial crisis.⁹

Georgian Dream (GD) came in power after the 2012 presidential elections on the back of popular opposition to UNM's authoritarian behavior and aggressive policing, which was crystallized by a widely publicized prison abuse scandal directly before the election. GD's formal, and at times informal, center of gravity has been Bidzina Ivanishvili, Georgia's richest man with a personal wealth equal to a third of the country's GDP.¹⁰ GD has outlined medium- and long-term goals with broad popular support but has pursued policies with short-term appeal that are not fully congruent with the stated goals. This contradictory development strategy aims at continuing Euro-Atlantic integration while repairing relations with Russia, maintaining macroeconomic stability while increasing fiscal spending, and spurring long-term economic growth without significant investment in building human capital.¹¹

2. Economic Performance Under Georgian Dream: Macroeconomic Indicators and Trade Relations

2.1 Monetary Policy: Floating Exchange Rates and De-Dollarization Efforts

The stability of the Georgian lari from 2012-2018 has been highly dependent on the market stability of its major regional trading partners (Russia, Turkey, and Azerbaijan). In 2014, a drop in global oil prices, regional political instability (specifically, the War in Ukraine, Western sanctions on Russia, and political unrest in Turkey) and a reduction in Chinese investments combined to significantly reduce demand for Georgian exports and lower the value of remittances.^{12 13} Because of Georgia's significant deficit in the current account balance, the drop in exports, investments, and remittances exerted depreciatory pressures on the lari. The National Bank of Georgia (NBG) chose to resist spending foreign currency reserves and allowed the lari to depreciate, culminating in a 50% depreciation against the dollar from 2015-17.^{14 15} Fuelled by revenues from tourism and

⁸ Papava, *Economic Reforms in Post-Communist Georgia: Twenty Years After*, pp. 46-49.

⁹ MacFarlane, S. Neil. "Post-Revolutionary Georgia on the Edge?" Briefing Paper. Chatham House, March 2011. <https://www.chathamhouse.org/node/6159>.

¹⁰ Nechepurenko, Ivan. "Georgia's Prime Minister Resigns After Protests and Party Infighting." *The New York Times*, June 14, 2018, sec. World. <https://www.nytimes.com/2018/06/13/world/europe/georgia-prime-minister-resigns.html>.

¹¹ World Bank. *Georgia - Systematic Country Diagnostic: From Reformer to Performer (English)*.

¹² "Georgian Economic Outlook 2015-2016: External Shock and Internal Challenges." Economic Policy Research Center (EPRC), May 2016. https://www.eprc.ge/admin/editor/uploads/files/Report_ENG_WEB.pdf.

¹³ World Bank. *Georgia - Systematic Country Diagnostic: From Reformer to Performer (English)*.

¹⁴ Ibid.

¹⁵ EPRC, "Georgian Economic Outlook 2015-2016: External Shock and Internal Challenges."

increase in the export of goods caused by the regional economic recovery, the Georgian economy rebounded with growth rates of 5% in 2017 and has continued to show positive indicators for 2018.

In January 2017, the NBG implemented a larization project in order to “ease the increased debt service burden caused by the exchange rate fluctuation” and increase the efficacy of NBG’s monetary transmission mechanisms.^{16 17}

2.2 Fiscal Policy: Social Spending and the Estonian Model

Since coming to power, GD has continued UNM’s economic policies aimed at maintaining macroeconomic stability and providing conditions conducive to foreign direct investment (FDI).¹⁸ In contrast to UNM, GD has expanded social spending through universal health care and increased expenditures on education, which — in combination with tax cuts for reinvested corporate profits, transfers, and lending to state-owned enterprises — has weakened the country’s fiscal position. This has resulted in an increase of social spending by 2.9% of GDP from 2012 to 2017.¹⁹ GD has sought to offset these expenditures through an excise tax on fuel and tobacco and a reduction in government wages.

Year	2012	2013	2014	2015	2016	2017
GDP (USD in billions)	13.271	13.721	14.355	14.769	15.190	15.947
GDP Growth	6.4%	3.4%	4.6%	2.9%	2.8%	5.0%
Current Account (% of GDP)	-11.9%	-5.9%	-10.8%	-12.1%	-12.9%	-8.6%
Central Government Debt, total (% of GDP)	32.5%	33.9%	35.4%	41.3%	44.4%	--
Inflation, consumer prices (annual %)	-0.9%	-0.5%	3.1%	4.0%	2.1%	--
Real Interest Rates	13.6%	14.5%	7.8%	6.2%	8.1%	4.7%
Nominal Exchange Rate: Lari to USD ¹	1.65	1.66	1.77	2.27	2.37	2.51
Real Effective Exchange Rate ²	111.14	107.82	107.11	99.9	100.06	98.47
Unemployment Rate (% of Total Labor Force)	15%	14.6%	12.4%	12%	11.8%	11.5%
Poverty Rate (% of Population Below National Poverty Line)	28.9%	25.6%	22.4%	20.8%	21.3%	--

¹ Domestic Currency per U.S. Dollar, Period Average
² Real Effective Exchange Rate, based on Consumer Price Index
Source: *The World Bank and International Monetary Fund*

GD has sought to stimulate economic growth by removing corporate taxes on profits that are reinvested into the firm. The purpose of this tax model, referred to as the Estonian Model, is to incentivize firms to increase their productive capacity. This is a blanket policy that applies to the service industry as well the industrial and agriculture sectors. In 2019 it will include the financial sector as well. It is unclear if this policy, which reduces tax revenue from a tourism-focused service

¹⁶ “Monetary Policy Report: February.” National Bank of Georgia, February 2017.

https://www.nbg.gov.ge/uploads/publications/inflationreport/2017/150217publish_MPR_February.pdf.

¹⁷ World Bank. *Georgia - Systematic Country Diagnostic: From Reformer to Performer (English)*.

¹⁸ “2018 Article IV Consultation, Second Review Under the Extended Fund Facility Arrangement, And Request for Modification of a Quantative Performance Criterion - Press Releases; Staff Report; and Statement by the Executive Director for Georgia.” IMF Country Report No. 18/198. International Monetary Fund, June 28, 2018. <http://www.imf.org/en/Publications/CR/Issues/2018/06/28/Georgia-2018-Article-IV-Consultation-Second-Review-under-the-Extended-Fund-Facility-46036>.

¹⁹ World Bank. *Georgia - Systematic Country Diagnostic: From Reformer to Performer (English)*.

sector that has thrived so far without protective government policies, will stimulate targeted growth in the industrial and agricultural sectors.²⁰

2.3 International Trade and Investment: Free Trade Agreements, Tourism & a Trade Deficit

From 2012 to 2017, Georgia's annual trade deficit in goods and services dropped from 3.1 billion USD to 1.8 billion USD and the current account balance as a percentage of GDP dropped from -11.9% to -8.6%. In that period, however, Georgia has continued to import more than twice as many goods (in terms of value) as it exports, maintaining an annual trade deficit in goods of roughly \$4 billion. The improvement in the trade deficit and current account balance has largely been caused by growth in the tourism and transport sectors. From 2012 to 2016, the receipt from tourism grew from 26% of total exports to 38% while the transport of goods and services through Georgia continued to play a significant role in service exports.²¹ This is congruent with GD's economic policy, which has emphasized growth through the tourism and transport sectors.

Georgia's largest exports are copper ore, ferroalloys, nut products, gold, and wine.²² Georgia's largest imports are petroleum products and packaged medicaments.²³ Georgia's largest trading partners are the EU, Russia, Azerbaijan, and Turkey; while Georgia also conducts significant trade with China, Armenia, the United States and Ukraine.²⁴ ²⁵ Georgia has free trade agreements with the EU, China, and Turkey. It is the only country to have FTAs with both China and the EU.

From 2012 to 2017, the net inflow of FDI into Georgia has risen from 6% of

Table 2 - Georgian Exports and Imports with Major Partners

Major Partners	Value of Exports in 2017 (Share of Total Exports)	Primary Exports*	Value of Imports in 2017 (Share of Total Imports)	Primary Imports*	% Change in Total Trade Turnover Between 2012 and 2017
European Union	\$646 mln (23.7%)	copper ore, nitrogenous fertilizers, nuts	\$2,198 mln (27.6%)	diverse portfolio	+2.2%
Russia	\$397 mln (14.5%)	wine, water, ferroalloys, cars, citrus products	\$799 mln (10%)	wheat, refined petroleum, petroleum gas, foodstuffs	+128.4%
Turkey	\$216 mln (7.9%)	ferroalloys, iron products, textiles	\$1,375 mln (17.2%)	diverse portfolio	-1.2%
China	\$207 mln (7.6%)	copper ore, scrap copper, wine	\$732 mln (9.2%)	appliances, electronics, textiles	+46.80%
USA	\$121 mln (4.4%)	ferroalloys, nitrogenous fertilizers	\$268 mln (3.4%)	cars, industrial machinery, poultry	-11.40%
Azerbaijan	\$272 mln (10%)	cars, raw iron, packaged medicaments	\$573 mln (7.2%)	refined petroleum, petroleum gas	-36.50%
Armenia	\$209 mln (7.7%)	cars, nitrogenous fertilizers	\$281 mln (3.5%)	copper ore, tobacco, hard liquor, glass bottles	+49.10%
Ukraine	\$124 mln (4.5%)	water, hard liquor, wine, ferroalloys	\$445 mln (5.6%)	foodstuffs, seed oil, iron products, coke	-24.50%

* Based on the value of goods traded between 2012 and 2016
Source: *Observatory of Economic Complexity* and adapted from *GeoStat*

²⁰ Papava, Vladimer. "Georgia's Economy: From Optimism to Primitivism." GFSIS, Expert Opinion, No. 75, 2017, pp. 7- 8, <https://www.gfsis.org/files/library/opinion-papers/75-expert-opinion-eng.pdf> .

²¹ World Bank. *World Development Indicators*. Distributed by The World Bank: DataBank . <http://databank.worldbank.org/data/source/world-development-indicators#>

²² National Statistics Office of Georgia. *Dataset: External Trade - Georgian Exports by commodity groups (HS 6 digit level)*. Distributed by National Statistics Office of Georgia. http://www.geostat.ge/index.php?action=page&p_id=134&lang=eng

²³ National Statistics Office of Georgia. *Dataset: External Trade - Georgian Imports by Commodity Groups (HS 6 digit level)*. Distributed by National Statistics Office of Georgia. http://www.geostat.ge/index.php?action=page&p_id=134&lang=eng

²⁴ National Statistics Office of Georgia. *Dataset: External Trade - Georgian Exports by Country*. Distributed by National Statistics Office of Georgia. http://www.geostat.ge/index.php?action=page&p_id=134&lang=eng

²⁵ National Statistics Office of Georgia. *Dataset: External Trade - Georgian Imports by Country*. Distributed by National Statistics Office of Georgia. http://www.geostat.ge/index.php?action=page&p_id=134&lang=eng

GDP to 11.9%.²⁶ Within roughly that period, 24% of that FDI has gone to the transport & communication sector, 13% to both the construction and the financial sectors, 12% to the energy sector, 10% to manufacturing, 7% to real estate, and 1% to agriculture.²⁷ In 2017, the largest FDI flows were from Turkey and Azerbaijan with significant investment from the EU, China, U.S. and the United Arab Emirates.²⁸

3. Political Factors Influencing Economic Policy: Motivations, Results, and Consequences

This report identifies the overarching political objective of Georgian Dream (GD) is to ensure a peaceful and stable environment for the ruling network, centered around Bidzina Ivanishvili, to protect their existing business interests and to enjoy privileged access to economic opportunity and investment. This interpretation of GD's political objectives does not presume the coalition to be a unitary actor but rather sees it as a collection of interests aggregated into a patronal network consistent with Henry Hale's definition.²⁹ As such, the behavior of the ruling network, formalized as GD, over the past six years has displayed patterns that can be broken into the pursuit of four, broad sub-objectives. In reality, the sub-objectives interpenetrate each other but, for the sake of clarity, they are presented in isolation.

3.1 Domestic Political Environment: Popular and Elite Support

GD has maintained control over the domestic arena by co-opting the interests of business elites, reducing the perception of the state as intrusive, and boosting social spending. This has resulted in a populist economic policy prioritizing the tourism industry over long-term growth strategies.

Motivation: Maintain Elite Cohesion and Popular Support

A key motivation of the ruling GD party is the party's continued preeminent position in the domestic political environment. Defined as a hybrid regime by Freedom House, elections under Georgian Dream have been deemed democratic, the media space remains largely open, and civil society exerts democratizing pressure on the political system.³⁰ Thus within this context of moderately democratic conditions, GD, and the patronal networks that animate it, have pursued the political objective of continued leadership — i.e., regime/network security — by aggregating mass support through populist policies and maintaining elite cohesion through a co-optive form of informal governance.³¹

²⁶ World Bank. *Dataset: World Development Indicators*. Distributed by The World Bank: DataBank . <http://databank.worldbank.org/data/source/world-development-indicators#>

²⁷ IMF Country Report No. 18/198. "2018 Article IV Consultation, Second Review Under the Extended Fund Facility Arrangement, And Request for Modification of a Quantative Performance Criterion - Press Releases; Staff Report; and Statement by the Executive Director for Georgia."

²⁸ "2017 FDI USD 1.86 Bln – Preliminary Data." Civil.ge, March 12, 2018. <https://old.civil.ge/eng/article.php?id=30941>.

²⁹ Hale, *Patronal Politics*.

³⁰ "Georgia: Country Report" Nations in Transit 2018. Freedom House, 2018. <https://freedomhouse.org/report/nations-transit/2018/georgia>.

³¹ Bidzina Lebanidze and Kornely Kakachia. "Informal Governance & Electorate Perceptions in Hybrid Regimes: The 2016 Parliamentary Elections in Georgia." *Demokratizatsiya: The Journal of Post-Soviet Democratization* 25, no. 4 (2017): 529-549. <https://muse.jhu.edu/>.

Policies: Less Intrusive State and Increased Social Spending

This political objective, combined with the fact that major economic policy is largely formulated by business figures with managerial (as opposed to economic) backgrounds with professional ties to Ivanishvili's companies, has driven the priorities of economic policy toward simplistic social spending on education, pensions and health care; prioritizing growth in the tourism industry; and maintaining macroeconomic stability.³² The logic goes that social spending serves the purpose of cementing a certain level of public support while the tourism industry and macroeconomic stability provide income and foreign investment for business elites.

In large part, however, Georgian Dream has been able to maintain popular support without instituting any substantive economic policy. The visibly coercive nature of UNM's mode of governance in the economy and society at large has meant that the GD has been able to simply present itself as a contrast to shore up support. This is cemented by the fragmented and ineffectual nature of the opposition.³³

In regards to social spending, a large part of Georgian Dream's appeal in 2012 and now has been simplistic efforts to undo to the aspects of UNM's neoliberal reforms that particularly hurt low-income sections of society. They have done this by raising government spending on social programs by 2.9% of GDP since 2012. This has meant that Georgian Dream has sought to address societal conditions through short-term government-led redistributive policies as opposed to inclusive medium-term growth through human capital development.³⁴ The initial policy programme announced in 2014, for example, provided a comprehensive framework to boost social spending in a manner that was congruent with long-term inclusive growth, i.e. education reform prioritizing knowledge-based labor and innovation and increasing access to healthcare nationwide to boost living standards in rural areas. This plan was replaced, however, with a "primitive" 4-point plan that gave blanket tax breaks to firms (including already massively successful companies in the tourism sector) and scrapped forward-looking social spending reforms based on future demands with plans focused on current demands.³⁵

Additionally, government behavior toward businesses and society at large has been far more moderate than under UNM. Whereas Saakashvili and his network, institutionalized as the UNM, wielded state capacity forcibly against opposition and coerced elites in pursuit of business/economic objectives, Ivanishvili has preferred to occupy informal positions of power and co-opt the interests of elites.³⁶ Though Ivanishvili faced several elite defections in the 2016 elections, the super-majority won by his party in the same election signals his continued capacity to deliver benefits to members of his network.

³² Papava, Vladimer. (Georgian Minister of Economy from 1994-2000), in-person interview with the author, July 20, 2018

³³ Freedom House, "Georgia: Country Report"

³⁴ World Bank. *Georgia - Systematic Country Diagnostic: From Reformer to Performer (English)*.

³⁵ Papava, Vladimer. "Georgia's Economy: From Optimism to Primitivism."

³⁶ Bidzina Lebanidze and Kornely Kakachia. "Informal Governance & Electorate Perceptions in Hybrid Regimes: The 2016 Parliamentary Elections in Georgia."

Consequences: Tourism Trap, Fiscal Instability, and Long-Term Growth

As a result of Georgian Dream's policies, the clearest consequences for the Georgian economy in the medium- and long-term will concern the interconnected issues of societal inequality, poverty, and unemployment; low domestic production and high consumption of foreign goods; and macroeconomic vulnerabilities.

The World Bank has argued that in order for Georgia to experience consistent, strong growth in the coming decade, policies must prioritize the development of exports through increased total factor productivity. This, in turn, requires government investment in infrastructure, human capital development through improved education and job training, and increasing the logistical and managerial capacity of local firms.³⁷ While there has been a focus on infrastructure, there has been little substantive attention given to the latter two tenets. Instead, the focus has been placed on tourism as a way to build export revenue and on social spending as a stop-gap solution to structural issues facing society as a whole.³⁸

Since 2012, the tourism industry has shown consistent growth by every index - the volume of tourists, revenue, percentage of total GDP, jobs created, etc.³⁹ The success of the tourism industry can be attributed to existent features, such as the country's natural beauty and unique culture as well as public and private sector initiatives to boost flight connectivity with Europe and raise the country's tourism profile through public relations campaigns. It is clear that growth in the tourism sector has continued and should continue to, but it is unlikely that tourism and government policies to facilitate this sector will translate to societal benefits and economic development. The increased volume of tourists should, for example, increase demand for consumer goods but, at present, Georgia imports roughly 80% of its consumer basket.⁴⁰ This means that as the volume of tourism increases, Georgia's consumerist model will strengthen. Furthermore, the tourism industry does not incentivize growth in knowledge-based sectors of society as it doesn't demand highly-educated labor.

Thus, when looking at Georgia in the medium- and long-term, it is difficult to understand how current policies will address high levels of social inequality and poverty. It seems likely that the real sector of the economy will not see significant growth, imports will continue to significantly outweigh exports, and fiscal spending on social programs will continue to strain the fiscal budget. As such, Georgia's macroeconomic stability will likely experience pressure from continued external imbalance and fiscal deficits.

3.2 Russia: Security Threats and Economic Opportunity

³⁷ World Bank. *Georgia - Systematic Country Diagnostic: From Reformer to Performer (English)*.

³⁸ Papava, Vladimer. (Georgian Minister of Economy from 1994-2000), in-person interview with the author, July 20, 2018

³⁹ "Economic Impact 2018: Georgia." World Travel & Tourism Council (WTTC), March 2018. <https://www.wttc.org/-/media/files/reports/economic-impact-research/countries-2018/georgia2018.pdf>.

⁴⁰ Papava, Vladimer. "Georgia's Economy in a 'Tourist Trap'." *Rondeli Blog, GFSIS*, July 25, 2018. <https://www.gfsis.org/blog/view/854>.

Russia remains the primary security threat facing Georgia and continues to support the independence of Abkhazia and South Ossetia, thereby preventing Georgia's re-acquisition of the breakaway regions. GD, however, has sought to reduce tensions with Russia by resuming economic relations and avoiding provocations that could escalate into crises.

Motivation: Real and Present Danger but Lucrative Economic Benefit

Georgian Dream's decision to pursue economic cooperation with Russia through a more pragmatic approach toward its northern neighbor has been a dramatic shift from Saakashvili's policy of confrontation and escalation. Current policy has been underpinned by a continued recognition that Russia poses a significant threat to Georgian security but that, without concrete security guarantees from Western partners, a willingness for confrontation holds little strategic value.⁴¹ As such, Georgian Dream has adopted a de-escalatory posture aimed at avoiding Russian provocations and building stability through renewing economic links, an area of mutual benefit.

Policies: Lifted Embargo and De-Escalatory Posture

The resumption of economic relations between the two former Soviet republics has strongly affected the Georgian economy by significantly increasing trade turnover between the countries, contributing to a rise in Russian tourists, and opening the door to greater Russian investment. From 2012 to 2017, for example, trade between the countries increased by 128%; Russia has become Georgia's second largest export market;^{42 43} the annual number of Russian tourists has increased from roughly 400,000 to 1.1 million, a sixth of total foreign tourists;⁴⁴ and, according to local and Western experts, investment has increased, though numerical details remain murky.^{45 46 47}

Since the fall of the Soviet Union, Russia has actively pursued its interests in former Soviet republics, including Georgia. Since as early as 2002 under Shevardnadze, Georgia has sought NATO accession as a way to limit Russian interference in internal matters. Russia, however, has consistently opposed Georgia's path to NATO and experts argue that the war in 2008 was provoked in order to demonstrate their resolve to the West that such overtures would be met with force. Against this backdrop, Georgia has continued to seek closer ties with NATO but the realization of these goals remain distant. As such, GD has sought to counter the threat of Russian kinetic force through bolstering strategic defense capabilities while avoiding an escalatory posture, which could be manipulated by Russian informational measures to frame Georgia as an aggressor and legitimize Russian military operations.⁴⁸

⁴¹ "National Security Concept of Georgia." Ministry of Foreign Affairs of Georgia, 2018. <https://mod.gov.ge/uploads/2018/pdf/NSC-ENG.pdf>.

⁴² National Statistics Office of Georgia. *Dataset: External Trade - Georgian Imports by Country*. Distributed by National Statistics Office of Georgia. http://www.geostat.ge/index.php?action=page&p_id=134&lang=eng

⁴³ National Statistics Office of Georgia. *Dataset: External Trade - Georgian Exports by Country*. Distributed by National Statistics Office of Georgia. http://www.geostat.ge/index.php?action=page&p_id=134&lang=eng

⁴⁴ Georgian National Tourism Administration. *Dataset: International Travel by Months (Residence) (2011-2017)*. Distributed by Georgian National Tourism Administration. <https://gnta.ge/statistics/>

⁴⁵ Stronski, Paul, and Alexandra Vreeman. "Georgia at Twenty-Five: In a Difficult Spot." *Carnegie Endowment for International Peace*, May 25, 2017, 16.

⁴⁶ Smith, David. (former Chief Negotiator for Defense and Space for the US State Department), stated in lecture attended by author, July 16, 2018

⁴⁷ Papava, Vladimer. (Georgian Minister of Economy from 1994-2000), in-person interview with the author, July 20, 2018

⁴⁸ Stronski and Vreeman, "Georgia at Twenty-Five: In a Difficult Spot."

Consequences: Peace under the Threat of Cross-Domain Coercion

GD's economic policy toward Russia has drawn opposition from segments of society concerned that Russian involvement, or in this interpretation *penetration*, in the Georgian economy can be operationalized by Russia to achieve political objectives. Others, however, recognize that Georgia, being a poor country, has much to benefit from the dramatic increase in Russian trade, investment, and tourists since 2012. The agricultural sector, for example, which accounts for only 10% of the GDP but employs 50% of the population, exports primarily to Russia, providing an important opportunity for large segments of the Georgian populace.⁴⁹ While Russian trade and tourism provide a valuable source of foreign currency.⁵⁰

Those who argue that de-escalation and the resumption of economic links with Russia are dangerous to Georgian security point to the vulnerabilities that emerge from economic reliance, an opening of public space to Russian informational sources, and perceived informal relationships between Georgian elites and the Kremlin. This view of the situation is congruent with an interpretation of Russian military operations aimed toward cross-domain coercion. This operational methodology, initially outlined in the Gerasimov Doctrine but expanded into a concept of *cross-domain coercion*, prioritizes the integrated use of informational, economic and diplomatic measures to manipulate public and elite perceptions in order to prepare the battlespace for decisive, limited kinetic military action.⁵¹ Within this interpretation of Russian military policy, Russia's strategic objectives are similar to those commonly ascribed by experts — secure for Moscow a privileged role in Georgia's political system, which would afford Russia an effective veto-power in domestic affairs and the capacity to dictate Georgian foreign policy.⁵² ⁵³ The tactics employed, however, exceed traditional domains of warfare to prioritize informational, economic, and diplomatic measures. Informational operations, for example, stoke fears of Turkish influence by alluding to historical grievances toward Georgia's southern neighbor. Economic measures include implicit threats to re-implement embargos to cripple production and the tourism industry through the sabotage of Russian-owned energy infrastructure.⁵⁴ Diplomatic measures include Russian measures to incentive allied states to recognize Abkhazia and South Ossetia.⁵⁵

⁴⁹ Alexandri, Victor. "The Export of Georgian Agricultural Products." *Georgian Foundation for Strategic and International Studies*, Expert Opinion, no. 67 (2016).

⁵⁰ Utiashvili, Shota. (high-level official in the Georgian Ministry of Internal Affairs from 2004-2012), in-person interview with the author, July 13, 2018

⁵¹ Adamsky, Dmitry. "Cross-Domain Coercion: The Current Russian Art of Strategy." *Proliferation Papers*, no.54 (November 2015). <https://www.ifri.org/sites/default/files/atoms/files/pp54adamsky.pdf>

⁵² Batashvili, David. (civil servant at the Analytical Department of the Office of the National Security Council of Georgia from 2008-2013), in person interview with the author, July 12, 2018.

⁵³ Bilanishvili, Giorgi. (Director of the External Security Department for the State Security and Crisis Management Council of Georgia from 2014-2017), in-person interview with the author, July 19, 2018

⁵⁴ Ibid.

⁵⁵ "Syria Recognises Russian-Backed Georgia Regions." BBC News, May 29, 2018. <https://www.bbc.com/news/world-europe-44291091>.

3.3 Euro-Atlantic Institutions: Integration but Ascension?

Since coming to power, GD has remained publicly committed to joining EU and NATO. This has resulted in an Association Agreement and a Deep and Comprehensive Free Trade Agreement with the EU and continued cooperation with NATO. It remains unclear, however, if this will develop into full EU or NATO membership in the foreseeable future due to geopolitical worries related to Russia and internal political dynamics within the EU.

Motivation: Popular Demand, Security, and Economic Opportunities

Georgian integration with Western institutions remains very popular among the population and a pivot away from stated goals could erode support. Recent polling, for example, suggests that 80% of the population supports plans to join the European Union and 68% of the population supports plans to join NATO.⁵⁶ Furthermore, integration with the EU should open up market access for Georgian firms while NATO accession would provide security guarantees for the state.

Policies: Getting Closer But Perhaps As Close as Close Will Come?

Despite claims from UNM officials to the contrary during the 2012 elections, Georgian Dream has continued on the path begun in earnest by Saakashvili by deepening ties with the EU and increasing cooperation with NATO. In 2014, Georgia signed an Association Agreement (AA) with the EU and in 2016 the Deep and Comprehensive Free Trade Agreement (DCFTA) came into effect.

Georgian Dream's stated goal is to join NATO and it has demonstrated this through continued cooperation in NATO-led training programs, the participation of Georgian troops in combat operations in Afghanistan, and the purchase of weapons from NATO countries.⁵⁷ The government has not, however, sought confrontation with Russia nor have they participated in sanctions regimes targeting Russia after NATO-Russian relations reached a nadir in the aftermath of the Ukraine crisis. Furthermore, an already weak consensus among NATO members to extend a Membership Action Plan to Georgia has been complicated by Russia's signaled willingness and capacity to use kinetic force in response to perceived Western aggression in areas it designates as "zones of privileged interest."⁵⁸ As such, Georgian membership into NATO has remained a question of geopolitics as opposed to bureaucratic procedure.

Georgia's relationship with the EU, formalized through the DCFTA, is economic, political, and societal in nature. The economic component focuses on boosting trade between the parties by removing customs duties, harmonizing Georgian regulatory and food quality assurance measures

⁵⁶ Thornton, Laura, and Koba Turmanidze. "Public Attitudes in Georgia: Results of a April 2017 Survey Carried out for NDI by CRRC Georgia." National Democratic Institute (NDI) and The Caucasus Research Resource Center-Georgia (CRRC), May 12, 2017.

<https://www.ndi.org/publications/ndi-poll-georgians-increasingly-support-eu-and-euro-atlantic-aspirations-view-russia>.

⁵⁷ Courtney, William, and Daniel Fried. "Where Is Georgia Headed?" The National Interest, May 22, 2018.

<https://nationalinterest.org/feature/where-georgia-headed-25926>.

⁵⁸ Stronski and Vreeman, "Georgia at Twenty-Five: In a Difficult Spot."

to EU standards, and providing EU funding to support the agricultural industry. As of yet, there has been little concrete impact on the volume of Georgian exports to the EU due to technical barriers and the uncompetitiveness of Georgian firms. The hope remains, however, that through the adoption of EU standards and the implementation of EU support programs, the market competitiveness of Georgian firms will increase in the medium-term.⁵⁹

A significant portion of EU-Georgian cooperation is directed toward the agricultural sector, which employs 50% of the population and is the primary sector of exports to the EU. Much of this focus by the EU and partners in Georgia addresses the following three-part challenge: first, the sector is heavily informal and un-technologized to begin with; second, firms that do exist, which largely cater to former Soviet markets, must incur costs to overcome EU regulatory standards and lack clear information on the benefits of entering the EU market; and thirdly, Georgian firms, in general, that enter the European market often fail to survive due to inadequate knowledge of the market.⁶⁰

EU-Georgian cooperation in the political and societal sphere has resulted in increased cross-cultural exchange and strengthened EU-led civil society initiatives aimed at promoting rule of law, ensuring ecological protection, and fostering inclusive development. Cross-cultural exchange has benefited from a visa-free regime for Georgian citizens visiting Europe, university exchanges, and training programmes connecting European and Georgian professionals. EU involvement in civil society — a consistent condition of European economic cooperation with a partner — has focused on improving the capacity of lawyers and judges to improve the protection of human rights and closing the rural-urban gap through targeted measures.⁶¹

Consequences: Market Competitiveness but Lingering Security Questions

In the medium-term, the formalization of Georgia's relationship with the EU through the AA and DCFTA should help to deepen linkage between Europe and Georgia due to greater economic links, academic and professional co-interaction, and EU-empowered civil society initiatives. Politically, this could translate into higher democratizing pressure; economically, this could result in the increased efficiency and market competitiveness of Georgian firms; and societally, this could result in the proliferation of liberal "European" attitudes toward identity issues and drug use.⁶²

Conversely, however, the deeper penetration of European democratic practices and liberal values into Georgian institutions and society could result in political instability in the medium-term. This arises from the fact that European cooperation in Georgia prioritizes democratic processes, which by definition legitimize opposition. Until now this has been acceptable for GD because the

⁵⁹ Gogolashvili, Kakha. (Director of the EU Studies Center at the Georgian Foundation for Strategic and International Studies), in person interview with the author, July 4, 2018.

⁶⁰ World Bank. *Georgia - Systematic Country Diagnostic: From Reformer to Performer (English)*.

⁶¹ "EU-Georgia Relations - Factsheet." European External Action Service (EEAS), October 11, 2017.

http://eueuropaeas.fpfis.slb.ec.europa.eu:8084/headquarters/headquarters-homepage/23634/eu-georgia-relations-factsheet_en.

⁶² Levitsky, Steven, and Lucan A. Way. "Linkage versus Leverage. Rethinking the International Dimension of Regime Change." *Comparative Politics* 38, no. 4 (2006): 379-400. doi:10.2307/20434008.

opposition has been far too weak to pose a viable challenge and GD has been able to boast to domestic and European audiences that it is a democratizing force. Ultimately it remains unclear if this is due an ideological conviction to democracy or an indulgence allowed by ruling elites who have yet to face strong opposition.⁶³ Thus, should a more capable opposition emerge, it is plausible that GD could respond with repressive, nondemocratic measures to protect the interests of elites integral to continued regime security.⁶⁴ This, in turn, could contrast with expectations of democratic governance, intensifying political competition and repression, ultimately resulting in a worsening of Georgian-EU relations.

Georgia's membership into NATO remains a cornerstone of Georgian Dream's publicly stated foreign policy and has been backed up by continued cooperation and adoption of NATO standards and requirements. For Georgian Dream, the benefits of membership would include heightened national security through Article V commitments, a clear signal of Georgia's escape from Moscow's orbit, and a likely bump in popular domestic support. It remains highly unclear, however, whether there is a consensus among the NATO members that Georgia should be extended an offer of membership.

3.4 The South Caucasus as Transit Corridor: Azerbaijan, Turkey, and China

Politicians and business elites see Georgia as a key cog in a Chinese-led economic corridor connecting East and West through the South Caucasus. While optimism abounds and investment toward infrastructure continues, there are no definite estimations of the extent to which this project will energize the Georgian economy and if it will survive the competing geopolitical interests and local conflicts that criss-cross the region.

Motivation: Foreign Direct Investment & Productivity Growth

From the "Deal of the Century" under Shevardnadze to GD hosting a high-profile "Belt & Road Forum" in 2017, the last three governments have sought involvement in regional and continental transport projects for economic and security reasons. Under GD this has predominantly been focused on China's ambitious One Belt One Road (OBOR) project, whose stated goal is to increase commercial connectivity across Eurasia by bridging China and Europe. It is seen by Georgian government officials and policymakers as a project rich in FDI and development opportunities, and, at least theoretically, providing a layer of security.

Policies: Attracting Investment and Valuing Stability

Sizeable Chinese investment in Georgia began in 2007 and has continued under Georgian Dream, who have worked to maintain an open climate for business and to attract investment for large infrastructure projects. Principal targets of Chinese investment have been the free industrial zones

⁶³ Freedom House, "Georgia: Country Report"

⁶⁴ Rumer, Eugene, Richard Sokolsky, and Paul Stronski. "U.S. Policy Toward The South Caucasus: Take Three." *Carnegie Endowment for International Peace*, May 2017.

in Kutaisi and Poti, roadway connectivity projects, and the deep-sea port in Anaklia, which is being built by a US-firm but with Chinese investment.^{65 66}

Consequences: Optimism and Pessimism at the Crossroads

With the Baku-Tbilisi-Kars high-speed railway completed and construction underway on east-west road and railways in Georgia, the hope is that goods traveling between China and Europe will cross the Caspian from Atkai in Kazakhstan to Alat in Azerbaijan and then on through Georgia to Europe via either domestic ports in Poti, Batumi and Anaklia or via Turkey. Those even more optimistic see Georgia's free trade agreements with China and Europe as a reason for Chinese firms to ship raw materials to Georgia, produce the goods in largely Chinese-owned free industrial zones, and then export them to Europe from Georgia.⁶⁷ Furthermore, the optimistic logic runs that the transit of goods will incentivize Europe and China to value stability in the region while deepening already existing cooperation between Georgia, Azerbaijan, and Turkey, thereby placing a check on Russia adventurism in the region.

Optimistic forecasts for greater regional integration into global trade flows are balanced, however, by high risks of political instability in the South Caucasus and the development of more financially competitive routes that bypass Georgia.

Political instability in the region would have negative effects on the Georgian economy by decreasing production, reducing the volume of goods transported through the country, and deflating investor confidence. There exist three major, plausible political events that could occur in the short- and medium-term that would evoke the problems raised above: conflict between Georgia and Russia, including Georgian operations in Abkhazia and South Ossetia and/or non-kinetic Russian operations; a return to hostilities between Armenia and Azerbaijan; or high levels of domestic instability in Turkey.

The likelihood of the first variant — conflict between Georgia and Russia — is diminished by the foreign policies employed by Georgian Dream, outlined in section 3.2. The second variant — renewed hostilities between Armenia and Azerbaijan — is plausible as evidenced by the breakout of violence in 2016. Such an event would be disastrous for Georgia and the region as it would incur all three consequences outlined above; cause instability in Georgia through the actions of Armenian and Azeri minority populations; possibly drag Russia and Turkey into open confrontation; and provide a justification for greater Russian military engagement in the region.⁶⁸ The third variant — domestic instability in Turkey — would arise from political opposition

⁶⁵ Jardine, Bradley. "With Port Project, Georgia Seeks Place on China's Belt and Road." EurasiaNet, February 21, 2018.

<https://eurasianet.org/s/with-port-project-georgia-seeks-place-on-chinas-belt-and-road>.

⁶⁶ Inan, Feride, and Diana Yayloyan. "New Economic Corridors in the South Caucasus and the Chinese One Belt One Road." The Economic Policy Research Foundation of Turkey (TEPAV), April 10, 2018. http://www.tepav.org.tr/upload/files/1523615843-0.New_Economic_Corridors_in_the_South_Caucasus_and_the_Chinese_One_Belt_One_Road.pdf.

⁶⁷ Jardine, "With Port Project, Georgia Seeks Place on China's Belt and Road."

⁶⁸ Utiashvili, Shota. (high-level official in the Georgian Ministry of Internal Affairs from 2004-2012), in-person interview with the author, July 13, 2018

galvanised by worsened economic conditions. As of now, even with the collapse of the lira, the likelihood of this occurring appears low, as evidenced by Erdogan's prior consolidation of power and proven willingness to use coercive measures against opposition.⁶⁹ A depreciation of the Turkish lira and worsened economic conditions in Turkey, in general, should have mixed effects on the Georgia economy; the high volume of Turkish imports should decrease in price but this will likely be offset by decreased Turkish FDI and remittances from Georgian workers.⁷⁰

Ultimately, to meet the optimistic expectations of OBOR's effect on the Georgian economy, the route through the South Caucasus must be competitive with the northern route through Russia and the southern route through Pakistan and Iran.⁷¹ Furthermore, some experts see the current Chinese investment in 46 countries as a testing method aimed at finding the most cost-efficient routes for future development. In either case, beyond the political risks mentioned above, the continued competitiveness of the South Caucasus route depends on overcoming four main challenges: first, reducing the costs and time of crossing the Caspian Sea; second, increasing rail connectivity between eastern and western Turkey; third, addressing differences in rail gauges between the Soviet model used in Central Asia and the Caucasus and the standard gauge used in Turkey and the EU; and fourth, harmonizing border and tariff procedures among the states along the route.⁷²

4. Concluding Perspective: Political and Economic Stability Going Forward

GD's six years of governance have resulted in peace, moderate economic growth, and macroeconomic stability but the central issues facing the country since independence in 1991 — the status of Abkhazia and South Ossetia, the prospect of future Russian aggression, high levels of rural poverty, and a lack of policies aimed at medium- and long-term inclusive growth — remain unaddressed.

To a large extent, re-assuming control over the breakaway republics or definitively deterring the prospect Russian aggression are beyond the capabilities of the Georgian state alone and it would be unfair to measure GD by such a parameter. Formulating economic policy geared toward inclusive growth and societal benefit is, however, squarely within the ruling government's capacity but it has failed to adequately do so. While growth in the tourism industry and hopes for a regional economic corridor augur well, it is unclear that they will have the effect necessary to deliver

⁶⁹ Gall, Carlotta. "Erdogan's Next Target as He Restricts Turkey's Democracy: The Internet." *The New York Times*, March 4, 2018, sec. World. <https://www.nytimes.com/2018/03/04/world/europe/turkey-erdogan-internet-law-restrictions.html>.

⁷⁰ Hess, Maximilian. "Turkish Lira Casts Pall over Caucasus and Central Asia." EurasiaNet, August 21, 2018. <https://eurasianet.org/s/turkish-lira-casts-pall-over-caucasus-and-central-asia>.

⁷¹ Avdaliani, Emil. "Growing Chinese Interests in Georgia." *The Central Asia-Caucasus Analyst*, March 15, 2018.

<https://www.cacianalyst.org/publications/analytical-articles/item/13503-growing-chinese-interests-in-georgia.html>.

⁷² Inan and Yayloyan, "New Economic Corridors in the South Caucasus and the Chinese One Belt One Road."

substantial society-wide growth or provide the resilience to avoid external shocks caused by economic crises or geopolitical conflicts.

As such, in the medium- and long-term, Georgia will plausibly remain vulnerable to economic crises caused by a high external debt, low domestic production, and an undertrained and under-educated workforce. Furthermore, based on the past six years, it seems unlikely that Georgian Dream will undertake any shifts in policy that will result in a different development trajectory.