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INCLUSIVE AND EXTRACTIVE ECONOMIC INSTITUTIONS: CONFLICTING TRENDS IN "POST-ROSY" GEORGIA

Abstract. In 2004-2013 Georgia implemented a series of radical socio-economic reforms pursuing ambitious goals for the suppression of corruption and creation of the current economic model in one of the poorest transitive post-Soviet states. Despite obvious progress, in recent years the Georgian model has been facing a series of challenges. The author uses the approach of D. Acemoglu and J. Robinson ("inclusive" and "extractive" economic institutions) to cover theoretical and methodological foundations of Georgian reforms which are usually considered as part of the stereotype of the economic "neo-liberalism" policy. System decomposition of economic policy measures of the governments of the "Revolution of Roses" and "Georgian Dream" allows us to see in it a implementation of the course of institutional changes aimed at creating a modern inclusive economy. Institutional economic models of Georgia and countries with comparable levels of socio-economic development (Armenia, Belarus, Serbia, Ukraine) are compared; the results of comparison suggest a deep institutional transformation of the Georgian economy. The current state of the Georgian economy and the problems of its economic dynamics are considered. The author comes to a conclusion about the weakness of the internal drivers of economic growth in Georgia (low level of demand, savings, human capital) that creates a situation similar to the classic "vicious circle of underdevelopment" and the investment deficit according to Nurkse R., P. Rosenstein-Rodan. In this respect, the classical theories of the development economy complement and develop measures based on the methodology of the new institutionalism. The policy of creation of an inclusive institutional framework is a prerequisite for the formation of the modern economy, however, in the absence of formed internal drivers of growth it cannot by itself ensure high economic dynamics and cope fast enough with the problems of poverty and social inequality. To achieve such a goal, a transition towards economic policy of stimulating savings, investment and infrastructure development is required. The theory of D. Acemoglu and J. Robinson itself contains internal paradoxes, indicating that the authors' position aimed at the consistent denial of the cultural, economic and political factors of growth is unlikely to be confirmed by examination of specific examples of national economic policy and unconditionally supported.

Keywords: inclusive and extractive economic institutions, elites, economic reforms, Georgia

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JEL Classification: A10, E10, P41

Introduction. The problem of economic development is a key to modern economic science. Starting with the works of R. Nurkse [Nurkse 1953] and P. Rosenstein-Rodan [Rosenstein-Rodan 1944] a number of theories was put forward intended to create a methodological basis for sustainable economic growth policy. In different periods of time, these theories have shifted their focus from issues of investments in the social and cultural aspects of development [Myrdal 1968], the problem of external economic relations and dependence [Rosenstein-Rodan 1944], social inequality [Kuznets 1966], and so on. New trends in the development cause the need to create updated judgments that reflect the realities of today's economy. One such attempts was the work of MIT economist D. Acemoglu and Harvard political scientist J. Robinson *Why Are Some Countries Rich and Some Countries Poor* [Acemoglu 2015, Acemoglu, Robinson 2012].

The theory of Acemoglu and Robinson, and methodological approaches laid in it reflect the realities of a globalized economy of post-industrial societies, where a key driver of growth is social mobility and innovation. It is interesting to analyze effectiveness of this theory on the example of Georgia which implemented one of the most consistent models of economic reforms, the ideology of which is primarily based on the theory of inclusive and extractive institutions of Acemoglu - Robinson. Or, to be more exact, the theory of Acemoglu - Robinson successfully summarizes the provisions of modern neoinstitutional economic paradigm underlying Georgian reforms and Georgian economic policy of 2004-2016.

Literature review and the problem statement. Despite the obvious interest represented by the experience of radical reforms the governments of the President of M. Saakashvili ("the Revolution of Roses") and his political opponents from "the Georgian Dream", we cannot say that this experience has undergone a serious and deep economic analysis. Despite all the evidence, they were ignored in the work of D. Acemoglu and J. Robinson itself. The American science Georgian experience is mostly considered in the context of the geopolitical range of problems and social changes [Verch 2006, Gahrton 2010]. The lively discussion around the Georgian experience in Russian social and political journalism is complicated by excessive politicization of the issue and sketchiness of approaches demonstrated by both supporters and opponents of the Georgian reformers [Burakova 2011, Mendkovich 2012]. Some aspects of economic policy of the country are discussed in the articles of the Georgian researchers [Abesadze 2009, Mekantsishvili 2009, Natelauri 2009], in particular, in papers of V. Papava [Papava 2014, Papava 2015, Papava 2015], and others.

Research results.

Criteria of inclusiveness and extractiveness. According to the definition given by D. Acemoglu and J. Robinson, inclusive economic institutions are considered to be those that 'allow and, moreover, stimulate the participation of large groups of the population in the economic activity', that enables the best use of their skills and talents [Acemoglu 2015, p. 87]. Under this approach, the fundamental ideas of economic liberalism are combined with the concept of "creative destruction", of J. Schumpeter. Economic freedom is a precondition for the implementation of this process. In its atmosphere, innovation, which is the main driver of economic growth, is implemented in the most dynamic and productive way. Therefore, economic freedom requires the necessary guarantees - protection of the rights to private property, fair competition, shared access to social benefits. Without them, the atmosphere of "creative destruction" of

innovation social and economic development is impossible. Having been reached, the institutional environment of freedom and competition makes the growth to be inclusive; all sections of the population become involved in it and the entire society gets the opportunity of inclusive access the economic development benefits.

Conversely, extractive economic institutions provide for a situation of unequal access, monopolies, restrictions and privileges. The possibilities of people in the realization of their creative activity in such situations are limited. The mechanisms of "creative destruction" are artificially blocked, which results in inflexibility, loss of incentives and growth inhibition. D. Acemoglu and J. Robinson recognize that the societies of "extractive institutions" have a very limited development potential, which is dependent in nature and involves the catch-up implementation of achievements of more advanced innovative inclusive economies. In the historical perspective, the societies of "extractive institutions" could be relatively effective and viable, but they are not able to overcome the barrier of development when the innovations become the main driver of growth. As a rule, this barrier is associated with the Industrial Revolution. In the "service economy" (post-industrial economy) extractive institutions demonstrate their complete failure. In today's society, it would be correct to associate "extractive institutions" of Acemoglu-Robinson primarily with obtaining different forms of "administrative rent", including especially that one which is caused by the spread of corruption relations and shadow economy.

Practical application of the Acemoglu-Robinson methodology faces a number of theoretical and methodological difficulties. As M. Boldrin, D. Levine and S. Modica aptly remarked, the definition of inclusive and extractive institutions may have a problem of tautology: "extractive" institutions are those that block the growth and "inclusive" are those who contribute to it [Boldrin, p. 2]. Practical consideration of case studies cited by D. Acemoglu and J. Robinson also points to a number of paradoxes connected, in our opinion, especially with the attempts of formal using criteria of "extractiveness" and "inclusiveness" when comparing the complex political systems. For example, the political system of Germany of the frontier of the 19th-20th centuries is considered as "extractive" that raises the question of the nature of its innovation dynamics. Despite the desire of D. Acemoglu and J. Robinson to deny the influence of non-institutional, for example, cultural, economic development factors [Acemoglu 2015, p. 55-81], without taking them into account one can hardly give a satisfactory explanation to the features of socio-economic dynamics even of close regions located within the boundaries of one state (e.g., the North and South of Italy). The following dilemma arises in a similar way: "the institutional framework or economic policy" – which one is able to influence the pace and quality of economic growth more, at least in the medium term [Boldrin, Levine, and Modica, 2012]?

Institutional economic model of Georgia: comparative analysis.

Institutional economic model of modern Georgia was being formed in the course of the reforms "the Revolution of Roses" of 2004-2013. The logic of the reforms was based on the conditions of the Georgian society. For it, the problems of poverty, inefficiency and pervasive corruption of the state in which a particularly prominent role was played by criminals, remained acute. Poverty, inadequate income, non-competitive wages made considerably for inefficiency and corruption of the state institutions. Implementation of "the Revolution of Roses" opened up opportunities for the implementation of measures that have been discussed

within the coordination of cooperation programs between national authorities and the IMF at the end of the 1990's [Georgia: This Letter of Intent of the government of Georgia describes the policies that Georgia intends to implement in the context of its request for financial support from the IMF, 1998]. Cooperation programs included blocks of macroeconomic stabilization, legal and framework reforms; their common aim was to create favourable conditions for the revival of business activity in the country (Fig. 1).

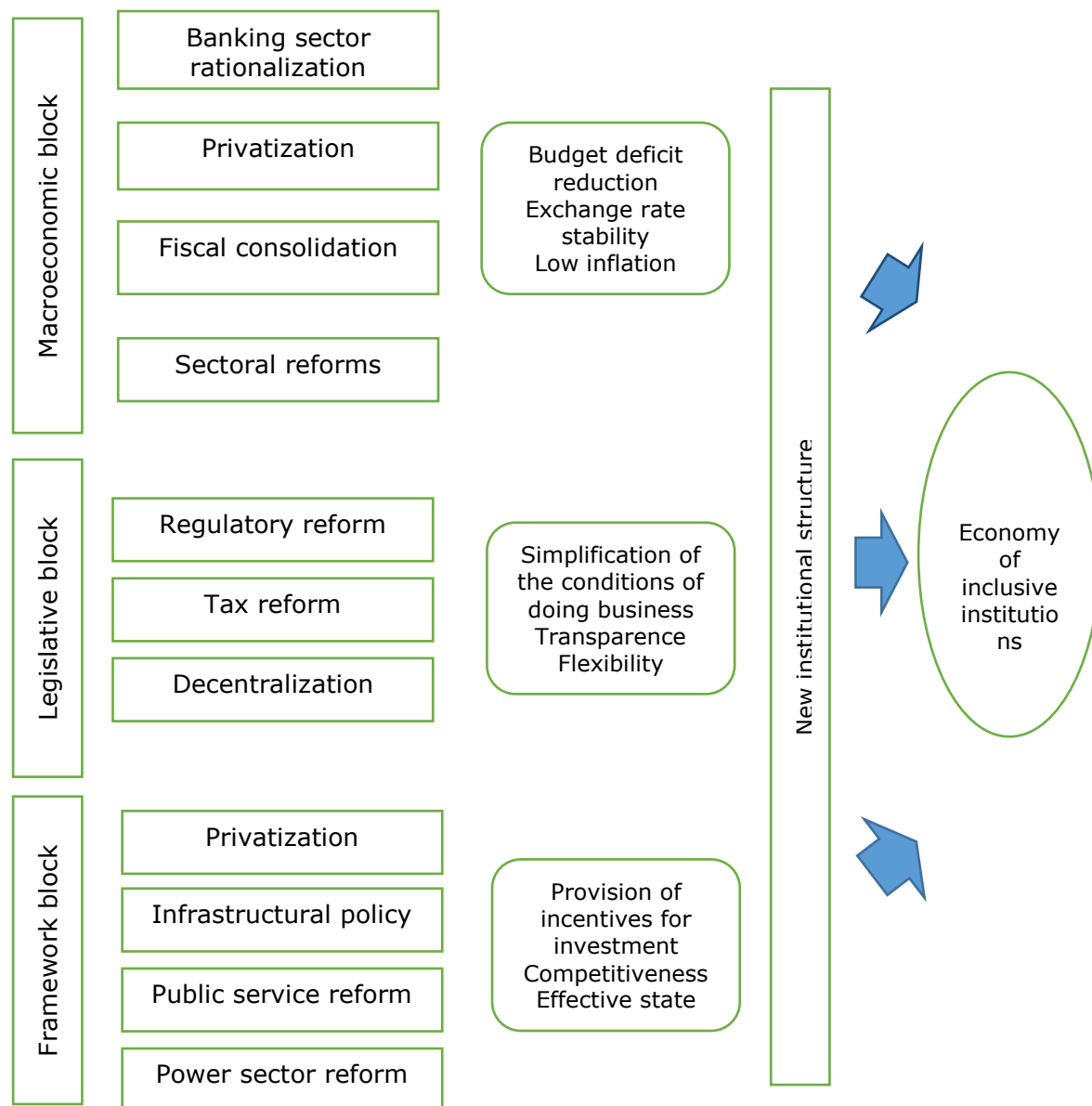


Figure 1 – Tree of objectives of the institutional reformation of Georgian economy, 2004-2016

Source: own development

In the course of reforms was created an institutional framework that provided a new quality of economic growth - its inclusive nature. In 2004-2007, key measures of reform policy were implemented. According to the Doing Business project, in 2008-2013 Georgia continued improve its institutional framework, implementing new projects to improve the regulatory environment and stimulating business activity. In 2008, 6 similar initiatives were implemented, in 2009 - 4, in 2010 - 2, in 2011 - 3, in 2012. - 4, in 2013 - 6.

They include the creation of electronic tax payment system convenient for payers, facilitating procedures of connecting businesses to power grids, extending access to credit resources, and so on. In 2014-2016, the implementation of such initiatives has continued; in 2014-2015 one similar initiative was implemented each year; in 2016 it is planned to implement two initiatives in the area of improving the procedures for obtaining permits for construction work and facilitating the conclusion of contracts by means of informatization of the courts' activity [Business Reforms in Georgia: Doing Business]. The governments of "Georgian Dream" have consistently reaffirmed their commitment to the generated model of institutional reforms [USIP Staff. Georgian Prime Minister: Reforms Will Continue. 2016]. During the last 9 years the Doing Business project has not noted any reform in Georgia which would have made it difficult to conduct business.

A systematic analysis and assessment of the institutional framework of national economies is carried out by the Worldwide Governance Indicators (WGI) project, which data are collected according to the rating assessment of development indicators in six areas: (1) public participation and accountability, (2) political stability and violence, (3) government efficiency, (4) regulatory policy, (5) legality, (6) suppression of corruption [The Worldwide Governance Indicators (WGI) project]. Fig. 2 shows the radar charts depicting the dynamics of indicators for the economies of Georgia and four Eastern European countries that are comparable in quality of the economic potential and conditions of development.

These ratings reflect both the specificity of national models of economic institutions and the dynamics of their development during the period of 1996 - 2014. WGI methodology used is compatible with the Acemoglu - Robinson methodology and can be considered from the point of view of progress of "inclusive" institutions. Thus, the Serbian model shows the distinct influence of balanced and comprehensive reforms aimed at achieving membership parameters in the EU structures. After "the Bulldozer Revolution" in 2000 a fairly rapid progress is noted especially noticeable in the area of the effectiveness of public administration, democratization and the fight against corruption, that by 2014 allowed creating a balanced institutional model. In Armenia, one can observe a stable model with a distinctive corporate or an authoritarian bias, but relatively efficient regulatory system. In Ukraine and Belarus there are expressed "extractive" institutional models characterized by a low level of the development of inclusive institutions and their curved structure. For Ukraine, the development of this system resulted in a sharp regression of the direction of stability and violence in society; for Belarus a characteristic feature is a combination of political authoritarianism and an unfavorable regulatory environment. The peculiarity of the Georgian model is the rapid progress in the areas of regulatory policy, suppression of massive corruption and the establishment of effective government. At the same time, an urgent problem is still a relatively lower level of development of political democracy, and security issue. The combination of effective state with unstable political system which instability has both internal and external dimensions, represents a significant obstacle to further institutional and economic development of the country. As a researcher of ISET Policy Institute E. Livny notes, the political weakness of the judicial and, in a broader sense, legal system of Georgia is one of the key risk factors for foreign investment [Livny 2015].

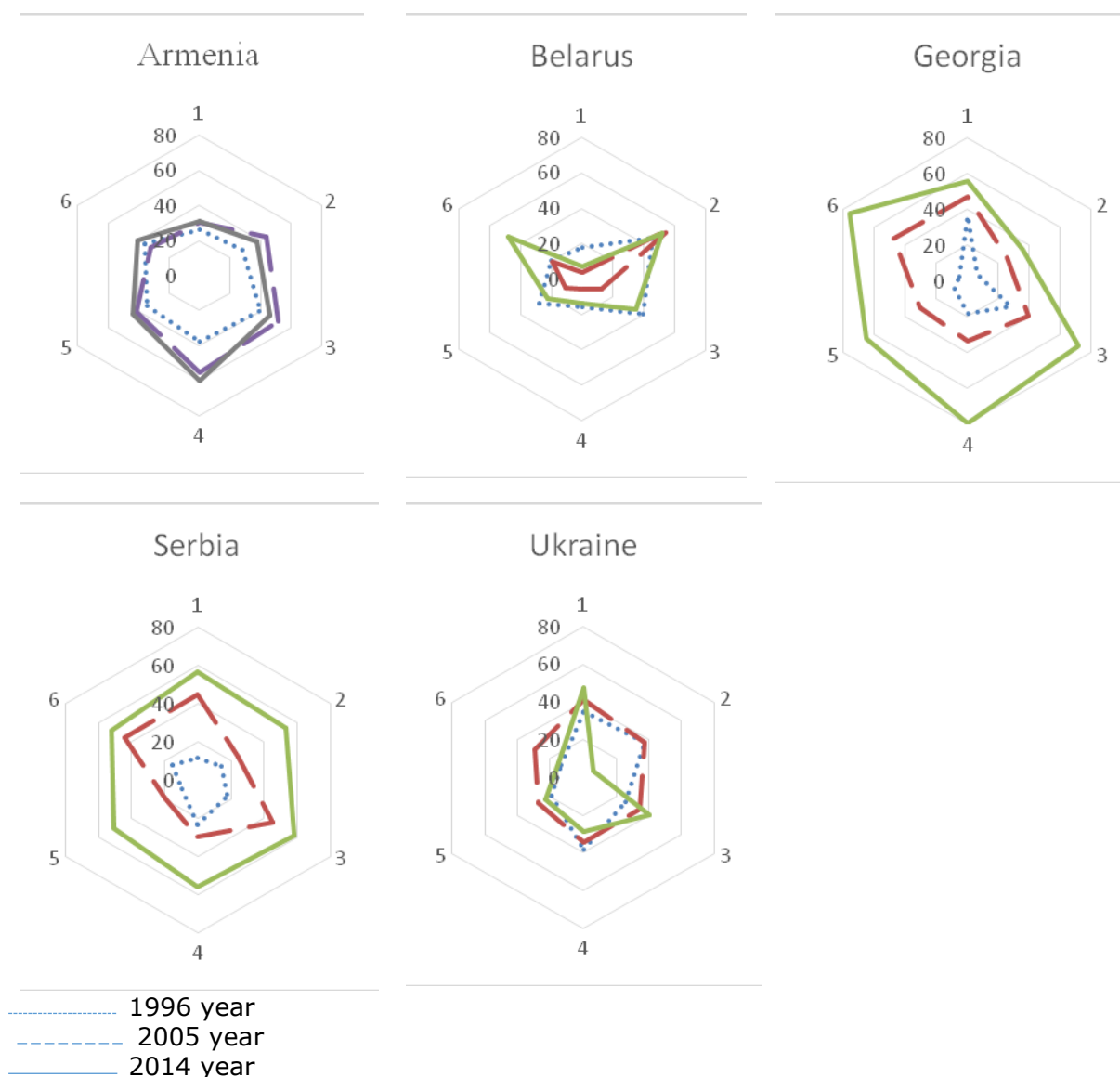


Figure 2 – Charts of the rating position of the states according to the project
The Worldwide Governance Indicators (WGI)
Source: The Worldwide Governance Indicators (WGI)

Beyond the facade of “top-rate illusion”: utilitarian approach of elites towards the institutions. In spite of the success in various rankings, inclusion of institutional structure of Georgia’s economy still remains as a problematic issue. This can be discussed in the context of the elites’ behavior. During almost all Post-Soviet period the process of institutional transformation in Georgia was characterized by excess “elitisation”. Fate of institutions as public goods had been determined by the approach of political and economic elite towards them. Narrow coalition controlling institutional choice and society represented as an object (not subject) of reforms contributed to the utilitarian approach of elites towards the institutions, including abusing them.

While 1990s were characterized by total corruption and “institutional inertness” (because of the absence of political will and necessary knowledge in ruling elite), “rose government” transferred most of the institutes created by it into the “club good”. Decrease of total corruption was followed by increase in

"elite" corruption. The result of "institutional utilitarianism" of "rose" elite was seizure and submission of political institutions (in order to increase political life) in the one hand and manipulating with these institutions [Balarjishvili 2016] for transferring political power into economic one, on the other hand. Examples of this include constitutional changes in 2004 and concentration of the power in president's hands; submission of institute of justice and reducing its independence; transforming law of plea bargaining into "ransom" (according to official dates in 2009-20012 Georgia's budget received more than 140 million Lari from plea bargaining agreements); creating completely non-transparent special "non-budget accounts" (2003), that actually was taxation (it is worth to mention that foreign business also appeared to be under such taxation); entry of National Statistics Office into the Ministry of Economic Development that gave political function (showing improvement in country's economic development) to it; abolition of Antimonopoly Office in 2004 that gave an impetus to the strengthening of monopoly trends (Gogiashvili 2013) and etc. Such scenario of institutional developments caused lower trust in economic agents towards legitimate system of rules.

Institutional policy of "post rose" elite despite its less violent and obviously progressive character (new law regarding competition, improving regulatory law of plea bargaining, abolition of accumulation principle for aggregate of crime, healthcare reforms and etc.), couldn't stipulate inclusive economic growth. Existing situation in Georgian economy still leaves questions regarding inclusivity of Georgian institutions. On the one hand lobbyzation of decision making and maintained informal tradition rejects considerations of D. Acemoglu and J. Robinson stating that "culture doesn't matter". On the other hand, delay of changes in electoral code and corrections in the constitution (including changing the rule of president's election) announced by "Georgian Dream" confirms opinion of D. North stating that "Institutions are not necessarily efficient; rather they or at least the formal rules, are created to serve the interests of those with the bargaining power to create new rules [North 1994].

How much the institutional structure is inclusive in Georgia: Paradoxes of economic dynamics. Based on the concept of an inclusive economy with the prevailing institutional framework, it would be logical for it to expect stable and high economic growth rates, improvement of the quality of growth (predominance of its intensive factors), achievement of inclusive growth (revenue growth combined with low or declining level of social inequality). In practice, in 2010-2015 the economic situation in Georgia is determined by the following indicators of the dynamics (Table 1).

Table 1 - Economic dynamics indicators of Georgia, 2010-2015

Indicator	Year					
	2010	2011	2012	2013	2014	2015
Real GDP growth rate, change rate %	6.2	7.2	6.4	3.4	4.6	2.8
Average monthly per capita income, change rate %	4.0	7.2	13.5	10.3	8.6	-0.7
Gini Index	0.43	0.42	0.41	0.40	0.40	0.40

Source: GeoStat, World Bank

According to estimates of the National Statistical Service and the Ministry of Finance of Georgia, in 2010-2012 in the structure of manufacture increase of

the national economy the share of total factor productivity grew most rapidly, despite the fact that the contribution of labor was negative as a rule, and capital contribution increased at a slower pace. Throughout the period of economic reforms of 2004-2015 average annual growth of total factor productivity in GDP growth was 2.8%, with an average real GDP growth of 5.67%. The growth of savings in the national credit and financial system and increase in the share of domestic investment in gross accumulation of fixed capital of Georgia should be considered a positive trend. In 2007, gross capital accumulation was 25.7% of GDP, including foreign investment which accounted for 18.5% and internal investment – for 7.2%. In 2012 this ratio changed: external sources of accumulation accounted for 5.0% of GDP, and internal – for 19.9% [Social-Economic Development Strategy of Georgia "GEORGIA 2020", p. 7-8].

At the same time, as the IMF experts note, in 2014-2016 the economic dynamics of Georgia was considerably influenced by the factors that cannot be attributed to institutional. Despite the renewal of trade with the Russian Federation in 2013, in 2014 Georgia's economy faced a lengthy external shock associated with downward fluctuations in commodity prices and US dollar strengthening. Despite the weakening of the Georgian lari committed by the National Bank, the foreign balance deficit balance of the country reached 12% of GDP; in 2015 this was followed by the growth of foreign debt which exceeded 100% of GDP, and the growth of the state budget deficit up to 3.8% of GDP [Georgia: Program Note, 2016]. The problem of poverty and social inequality remains unresolved. The proportion of people with an income of \$2 a day has virtually unchanged during a period of reforms [Social-Economic Development Strategy of Georgia "GEORGIA 2020", p. 10]. The value of financial resources (credit) remains high. In the country there is a situation of a poor country's consumer economy [Papava 2014, p. 87-88]; the listed features of the economic model in aggregate are very similar to the classic "vicious circle of underdevelopment" of R. Nurkse. Eventually, despite a much more effective institutional framework of the economy, comparison of basic economic indicators the Georgian model demonstrates minimum advantages over neighboring Armenia - corrupt country with strong patron-cliental relations in the society [Nasuti 2012, p. 2].

As we judge by the content of the strategy for socio-economic development "Georgia 2020" developed by specialists of the Ministry of Regional Development and Infrastructure of Georgia, the need to make corrections in the course of reforms is realized. The analysis of the country's development problems leads to building updated tree of objectives of promising economic policy. Low return of the economic activity in the country and the high cost of financial resources are identified as its main problems. It is noteworthy that the experts point to "market failures" as one of the causes of poor economic dynamics. The main objectives of the renewed economic policy may be the development of human capital, improvement in infrastructure (including the creation of innovative infrastructure of the economy sectors) and an increase in domestic savings [Social-Economic Development Strategy of Georgia "GEORGIA 2020", p. 68]. An alternative scenario is the expansion of the Georgian market due to the country's entry into a free trade area and customs unions, in particular with the EU, Russia and Turkey. Such steps should accelerate growth by attracting foreign investors who expect a more capacious market [Papava 2014, p. 91].

Conclusions and prospects for further research. Thus, Georgia can be

seen as an example of the implementation of consistent and effective set of reforms aimed at creating a modern structure of inclusive economic institutions. However, this example demonstrates the insufficiency of only the institutional component of reforms in terms of economy where domestic growth drivers are weak or are not formed. The weakness of domestic sources of accumulation, low levels of human capital even in terms of effective inclusive institutions do not allow achieving rapid breakthrough rates of economic development. Although inclusive institutional reforms can and should be seen as a necessary prerequisite for growth in today's innovation economy, they need to be complemented by measures of economic policy aimed at the creation and stimulation of internal drivers of growth.

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