Georgia's Wise Decisions

By Richard W. Rahn
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Despite having been invaded two months ago by a country 30 times its size, the Republic of Georgia appears to be dealing with that crisis far better than the United States and other major governments are dealing with the international financial crisis, and thus the question is, "why"?

The answer quite simply is that the Georgia leaders are not so arrogant to think they know better than markets, and hence they are relying on the market to solve most of their problems.

Georgia is a poor country, but for the last four years it has experienced some of the highest economic growth rates on the planet - from more than 9 percent to 12 percent per year. It has been eight years since my last visit to Georgia, and observable changes are quite remarkable. The New Economic School in Georgia just hosted the European Resource Bank (a coalition of primarily European economic policy organizations) meeting this year, which is what brought me back.

After having experienced sputtering reform and progress from the time of the fall of the Soviet Union, Georgians elected perhaps the freest market government in the world four years ago. The president, prime minister and state chancellor are all dedicated free marketeers who studied F.A. Hayek and Milton Friedman and have learned from the successes of Margaret Thatcher and Ronald Reagan.

Many, including former high-ranking Russian officials, have argued that part of Moscow's motive in invading Georgia was to punish this newly successful upstart that was formerly part of the old empire. While Russia was becoming less democratic, Georgia was becoming more democratic. While Russia has engaged in renationalization and re-regulation, Georgia has engaged in mass privatization and deregulation.

Much of the inspiration and drive for the radical free market reform of the Georgian economy comes from a mountain of a man named Kakha Bendukidze, whom I first had the pleasure of meeting some years ago in Russia. Kakha, as he is commonly referred to, is the head of the State Chancellery and one very smart and wise fellow.

Commenting on the international financial crisis, he correctly observed that as long as governments continue to rely on central banks and extensive regulation of the financial industry rather than free banking, "periodic financial crises will continue to plague mankind." He argues that it is unrealistic, as Hayek and

Friedman also did, to assume central bankers know more and can outguess the market, and that financial regulators can somehow prevent the next crisis, since they are unlikely to see where it is coming from.

Georgia has been engaged in fundamental tax reform, rate lowering and flattening, including removing almost all taxes on capital that are the seed corn of the economy. The Georgians are actively reducing the size of government by doing away with ineffectual programs and those that can be better done by the private sector.

As part of their successful effort to get rid of much of the corruption that had been rampant, they reduced the number of government workers by 50 percent, raised the salaries of those who remained and put in place a zero tolerance policy regarding corruption.

As part of their effort to deregulate, they have reduced the number of required licenses from 950 to 144. It is now possible to do all the paperwork and obtain the permits to start a new business in one day. Registration of a change in property ownership now takes two hours instead of the previous 30 days.

Georgia once had a major problem with smugglers, but the new leadership removed almost all tariffs and other trade barriers, and with it the profits for smuggling and related corruption.

At the time of the invasion, the government resisted putting in price controls and other forms of resource allocation. As a result, there was no sustained jump in prices, and the free market quickly filled whatever shortages were caused by the war. In fact, if the leaders of the central bank exceed the inflation targets, they will be fired.

The Prime Minister, Lado Gurgenidze, was both educated and spent considerable time in the United Kingdom and clearly was influenced by Mrs. Thatcher. I asked him if he was concerned that the pressures to grow the size of government because of the invasion would undermine Georgia's reforms (note: history shows governments almost always grow in relative size versus the private economy in the time of crisis, such as wars or financial instability, even if governments create the crisis).

The prime minister replied that the Georgians have not retreated from their reforms, including shrinking the size of government, and they fully understand any retrenchment would be very damaging.

Georgia does have problems, including the large number of refugees resulting from the war. But unlike Washington and the European governments, the Georgian leaders did not deal with their crisis by creating the new "program of the day." Instead, they told the people the government would continue to stay out of their way and the people would have to find ways to solve the new problems. Most of them have done that quite well and the government remains highly popular.

There is a message here for the political leaders of America and Europe, but I expect most of them still will not get it.

Richard W. Rahn is a senior fellow at the Cato Institute and chairman of the Institute for Global Economic Growth.