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**Import of Institutions and Economic Value
Transformation: The Interactions among the
Economic Agents in Georgia**

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Abstract

The present work discusses the decisions of economic agents and the interactions among them in Georgia's transformation economy from new institutional point of view. European integration is an irreversible economic orientation of Georgia, which influences both formal and informal institution formation. The authors argue that the analysis of the economic value formation aspects of the ongoing process of Europeanization is important for the understanding of the stage by stage outcomes of this process.

The Association Agreement between Georgia and the EU represents Georgia's Europeanization action plan. The Agreement stresses that European values represent the cornerstone of economic integration and political association. The implementation of the Association Agreement will bring concrete benefits in terms of increased opportunities for small and medium sized businesses, access to the European education, strengthened rule of law, etc. The authors argue that the success of modernization depend on the one hand, institution imports and on the work of these institutions on the other. The foundation of their effective work will be those value constructs that the society holds.

The success of institution implementation depends on pace of the increase in the number of people, who use them. The faster the realization of the need and benefits of the observation of certain "rules of the game", the faster they will be institutionalized. Institutional adaptation gives the economic agents broader opportunities for their economic activities and they adopt new strategies of behavior related to the changes of the institutional framework. Adaptability to the imported institutions depends on the economic values of the economic agents and the benefits of the implementation of the new institutions.

The present study incorporates economic values in the analysis of the economic agent interactions against the background of Europeanization. The authors offer a theoretical approach to pose the problem and evaluate the behavior of economic agents in the context of importing European institutions and values in Georgia. The nature of the interactions among the economic agents significantly defines the smooth functioning of the economic system. The authors emphasize that study of the economic agent behavior (state and businesses) in institution import and economic value transformation context will enable to identify the challenges of the adaptation process.

Keywords: *import of institutions; transition economy*

Import of Institutions and Economic Value Transformation: The Interactions among the Economic Agents in Georgia

Introduction

The transformation processes ongoing in the world economy make significant influence on developing and transitional countries. Several of them can be referred to emerging economies, where markets make greater progress in their development. This type of countries is characterized by deep changes in their institutional systems. Transformation involves all the fields of social life and short term as well as long term development of their economic systems depends on the direction and depth of these transformations.

The last decade of the past century was related to the radical changes in the institutional systems of countries, which were under transition from command to the market economic system. There have been debates among the economists for several years on the development of new methodologies and new approaches to the economic issues that will be different from the mainstream. Western economic theory comprising two dominant directions – neoclassical and neo-Keynsian – face significant difficulties in finding persuasive theoretical explanations of the contemporary economic events. These debates lead to the emergence and development of the new institutional theory which today is being used not only by the economists and sociologists, but also by the specialists of law and politics.

The topicality of the study of institution formation and development issues in emerging economies is due to the widespread transformation processes ongoing there. Institutions place constraints on economic actors through various regulative, normative and cognitive pressures. Regulative institutions are based on the making and enforcement of rules, such as formal laws that regulate behavior. Normative institutions are rooted in collective moral understandings about legitimate behavior. Cognitive institutions are those based on taken-for-granted definitions of the situation and worldviews. (Jackson. 2010).

Institutions also create opportunities for economic action in several ways. Any economic order requires a basic institutional infrastructure in order to function. Within the institutional infrastructure of emerging economies, the property rights and the rule of law are particularly important. Institutions not only give a basic framework for economic exchange, but may also solve certain collective action problems in ways that facilitate alternative modes of governance over transactions – such as markets, hierarchies, networks, associations, state regulation (Hollingsworth and Boyer 1997).

Georgia represents a transformation economy and the reforms undertaken there touch upon all the fields of social life – political, legal, economic and social. The present paper discusses the decisions of economic agents and the interactions among them in Georgia's transformation economy from the economic psychology and the new institutional point of view. European integration is an irreversible economic orientation of Georgia, which influences both formal and informal institution formation. In our view, the analysis of the economic value formation aspects of the ongoing process of Europeanization is important for the understanding of the stage by stage outcomes of this process.

The success of institution implementation depends on pace of the increase in the number of people, who use them. The faster the realization of the need and benefits of the observation of certain “rules of the game”, the faster they will be institutionalized. Institutional adaptation gives the economic agents broader opportunities for their economic activities and they adopt new strategies of behavior related to the changes of the institutional framework. Adaptability to the imported institutions depends on the economic values of the economic agents and the benefits of the implementation of the new institutions.

The Association Agreement between Georgia and the EU represents Georgia's Europeanization action plan. The Agreement stresses that European values represent the cornerstone of economic integration and political association. The implementation of the Association Agreement will bring concrete benefits in terms of increased opportunities for small and medium sized businesses, access to the European education, strengthened rule of law, etc. The success of modernization depend on the one hand, institution imports and

on the work of these institutions on the other. The foundation of their effective work will be those value constructs that the society holds. At current stage the study of the economic agent behavior (state and businesses) in institution import and economic value transformation context will enable scholars and policy-makers to evaluate the value and institutional distance between the EU and Georgia and draw conclusions on how these interactions will be changed during the adaptation process.

The paper is organized as follows: first the theoretical foundations are discussed, which is followed by the analysis of the institutional problems of transition economies; in the third section the Georgian Case of institution import, economic agent values and behaviors are analyzed.

Theoretical Foundations of the Study

Institutionalism represents a broad stream in economic science. However, not all economists regard it an independent theory, rather a combination of scientific doctrines brought together by a concept of “institution” as a central element of analysis. Institutions represent a stable form of human behavior and the whole diversity of economic and social life stems from it. Application of new institutional approaches in scientific analysis enables to be closer to reality. There are eight Nobel Prize winners among the scientists whose research rely on the tools of new institutionalism: K. Arrow, G. Stigler, J. M. Buchanan, H. S. Becker, D. North and R. Fogel. An important contribution in the development of new institutionalism was made by A. Hayek. New institutionalism was formed during the 1950-1960s. It appears to be not a consistent theory system, but a set of approaches held together by a number of essential ideas.

The following studies create the main directions of new institutionalism:

- *economics of property right* creates the foundations for contract theory;
- *transaction cost economics* created grounds for economic organization (firm) theory;
- *public choice economics* found its further development in bureaucracy theory; economics of crime and punishment; economics of corruption; new institutional theory of shadow and informal economy;
- *institutional evolution theory by D. North is reflected in new economic history*.

The new institutionalism relies on two general preconditions: First, social institutions matter and second, they are subject to study. New institutional theory studies individuals as actual participants of social processes, rather than groups and organizations. In New Institutional theory the basic unit of analysis is an institution, which sets rules, standards of behavior and thinking stereotypes¹. However it does not mean that new institutional theory does not study humans. On the contrary, J. Agassi (1975) argues that the applied methodological approach can be referred to “institutional individualism”, which relies on the following main statements: 1. individuals may have their interests and follow their goals; 2. the framework of human interactions are shaped by the interactions of formal and informal rules; 3. formal and informal institutional changes results from the human interactions under specific situations; ² Thus individual behavior is constrained by the formal and informal rules set by the society, which are observed fearing of punishment or disapproval of the society.

R. Heiner (1983), the follower of G. Simon in his ‘Origin of Predictable Behavior’ showed that uncertainty of external environment promote individuals to use the set of prepared rules of behavior, which correspond with the most frequent economic situations. The larger the gap between the individuals’ ability to identify the problems they face and the choice of the best alternative, the faster they respond with a few settled number of stereotypes to the external environment³.

In North’s (1990) view, the work of Heiner represents a unique effort to link uncertainty and behavior with institution formation. The embedded set of institutions help to avoid problem realization and

¹ Neal W. Institutions // Journal of Economic Issues. - 1987. - V.21. - №3. - p.183.

² Agassi J. Institutional Individualism // British Journal of Sociology. – 1975. – V. XXVI. - №2. –p. 144-155

³ Heiner R. Origin of Predictable Behavior // American Economic Review. – 1983. – V.73 - №4. – P. 560-595.

situations when making choice is necessary. We make our decisions easily, because our interaction with the external environment is institutionalized in such a way that the uncertainty be reduced North (1990).

Consequently, an important part of institutions – traditions, rules and laws – aim at reducing negative sides of limited rationality and opportunistic outcomes.

Behavioral uncertainty is especially important is realization of *transaction costs* phenomenon. D. North (1990) argues that institutional theory itself originated from the combination of transaction costs and human behavior theories. Combination of both theories enables to understand the reasons of institution creation and their role in social life. Adding production theory to this, allows to analyze the role of institutions in economic system performance.

New institutionalism emphasizes that property rights are never perfectly defined and observed. Any contract can be incomplete and thus transaction costs are always positive. New institutionalism pays greater attention to the organizational (rather than technological) aspects of institutions and to the efficiency objectives (not to the monopoly goals). It relies not on the assumptions on zero transaction costs, but explains creation and operation of institutions based on transaction cost minimization (Williamson, 1985).

Th. Eggersston (1990) distinguishes three areas of new institutional research:

1. How social rules (property rights) and alternative forms economic organizations affect on behavior, resource allocation and equilibrium outcomes?
2. Why different forms of economic organization apply to different types of economic activities even within the same legal framework? What is the economic logic of various contract settings (firms, for example), which are applied in production and exchange?
3. What is the economic logic behind the fundamental social and political rules regulating exchange activities and how these rules are changed?

New Institutionalism represents an evolutionary theory. Contemporary new institutionalists pay special attention to the role of historical processes in the formation of insitutional foundations and their long term viability. According to North (1990) the choice made today or tomorrow stems from the past, while the past can be realized only as an institutional development process. Integration of the concept of institution with the economic theory is an important step taken towards the development of this theory. Such a precondition brings insitutional studies closer to the reality and gives them a serious advantage over other schools of economic thought.

Institutional changes may be slow and invisible and give perceived outcomes later, therefore they are difficult to keep in sight. In transition economies the level of information imperfection and environment uncertainty is much higher, than in developed countries. Therefore, any analysis of the situation there should be based on the tools for the examination of the problem roots and their consequences for the economic system. Considering the above in order to maintain close-to-reality stance and describe the situation in Georgia's the emerging economy, we find it reasonable to analyze the research problem from the new institutional point of view. Georgia represents a small transitional economy. Such countries often link the future of their development to the replication of successful analogies and choose the shortes way of importing insitutions. However, the environment in which they are imported is diverse and does not always guarantee success.

There is evidence that institutions that are effective in some developed countries may give adverse effects in transitional economies. Thus the process of economic development is alienated from the market system path. This is partly related to an unprepared import of several institutions, that is, the lack of adaptation conditions in the existing institutional environment or sometimes the influence of certain lobby groups, who protect their private interests.

Reforms in our country confirm the necessity of more cautious approach to the need of complex reforms. In our view, the main obstacle imported institutions face during the reform is the clash of the existing and the new values, which are being established by new institutions. From the economic standpoint, this above all results in the formation of favorable or, on the contrary, unfavorable environment for the realization of economic interests. The market institutions in transitional countries are not deep-rooted

enough, so the social groups around these institutions cannot be considered the main driving force of reforms. Therefore, we assume that individual values are more important and social groups are more scattered (are not sufficiently united around certain institutions). Under the circumstances, the methodological approach of individual institutionalism is more reasonable to conduct the analysis of the economic reality.

Institutional Problems in Transition Period

Why transitional countries get interested in progressive and advanced institutions? For these countries social technologies that determine the formation of the coordinative institutions of economic agent activities are especially important. The term “social technology” is widely used in neo-institutional theory to describe new institution building related processes. The terms “social technology” is a broad one and we refer only to its institutional side.

Institutional technology is related to “generation” as well as to the imports of new institutions, which enable countries to reduce transaction costs of the operation of various social systems, including the economic system

The following factors promote implementation of institutional technologies:

1. Institutions reduce uncertainty by predicting the outcomes of certain joint actions;
2. Institutions reduce the transaction costs just as physical technologies reduce the production costs.

Transfer of institutional technologies is possible due to the features, which institutions have.

Namely:

1. Institutions are hereditary and can be transferred through generations via their learning mechanism. Learning may involve specialization of a certain organization or be realized as “learning by doing”, when people follow more experienced colleagues and work just as they do.
2. Incentive system: positive and negative. Thus, institutions ensure the freedom of individual action and security within certain limits.

Despite the fact that comprehensive research in institutional technologies was made only during the recent decade, their role in institutional reforms and further economic growth of various countries is undisputable. The problem is that, unlike physical technologies, the development and more importantly the means of implementation of institutional technologies are not still sufficiently studied.

According to Th. Eggerston (1990) these difficulties are related to the following aspects:

- Disagreement over the real efficiency of certain institutional technologies: which system offers better results - decentralized markets or decentralized administration; Should developing countries allow foreign capital to move freely and if the answer is yes, at which stage of their development, etc;
- The prevailing institutional environment which make a decisive influence on the efficiency of imported institutions and may trigger institutional conflict, raising certain problems, which are unimportant during the process of physical technology import;
- Simultaneously adoption of institutional technologies can be related to the positive demands from one group of agents and negative from the other, what generates large transformation costs;
- Despite the sufficiently large amount of knowledge of institutional technologies, the awareness of the dynamic trajectory of transition from one economic system to another is very low. In case of failure economic and social sciences lack ready recipes to correct the imbalances of the economic system.

Consequently, We can say that the „market of institutions“ is principally distorted and to a larger degree, that goods and production technology markets.

It is rather difficult to predict what type of economic environment will be formed as a result of the interaction of social and economic fields of a country and what type of institutions emerge after transformation. This is due to the fact that any institutional system is characterized by such a diversity of

informal norms and relationships, that it is very problematic to constrain them within formal rules and legislation.

Elaboration of institutional technologies is a time consuming process, therefore many countries prefer to import institutions which are already available in other countries.

Recently the terms „import of institutions“ has been frequently used in economic literature. This is related to the deep transformations that take place in developing and transitional countries. By importing effective institutions from developed countries, „followers“, as a rule, try to shorten to decades the length of the processes, on which the exporters spent centuries. The motive for institution imports is the accumulated positive experience in the world economy, as well as the increased cooperation between countries and in many cases the activities of international economic organizations.

The pace of institution implementation depends on the increase in the number of people, which will use these institutions. The faster the necessity of new rule observation will be realized, the faster the institutionalization will be.

Economic institution building can mainly be realized in the following strategies:

- **Strategy of institution creation/development** which is relatively optimal from the institutional change theory point of view, as it considers the specifics of the existing institutional system. Above all it is related to the informal norms, which together with formal ones determine the relationships among the economic agents. The lack of this strategy leads to a rather lengthy process of new institution formation. Although this strategy meets country-specific needs and be compatible with prevailing informal institutions, it does not capitalize on experiences of developed nations with institution building (Ahrens & Mengerlinghaus, 2006).
- **Import of new institutions** (creation of the institutions, analogous to those in other institutional environment). A country adopts the set of economic institutions from a ‘best-practice country (Roland 2004). This strategy implies:
 - a. imports of part of the institution ;
 - b. import of the institution as a whole;
 - c. import of several inter-related institutions;
 - d. import of the system of institutions comprising a number of social spheres (such as reforms in political, economic and social fields of a transitional economy).
- **Import of a new institution combined with preliminary or simultaneous creation of the related institutions.** This strategy enables to loosen the tensions in society and despite the additional costs, related to the creation of one or several additional institutions it ultimately minimizes the total costs. However, the length of institutional transformation increases in this case.

The creation and implementation of new institutions may turn into a managed process. Artificial changes in institutional environment (transformation of the existing institutions or import of principally new institutions) should be based on thorough analysis of the experience of the country, in which similar institutions operated.

New institutions affect differently different economic agent groups – the outcomes are positive for one and negative for the others. Consequently, positive demand for institutions often co-exists with negative demand from the other side, what generates transformation and transaction costs. Aggregate demand for institutions, as a sum of positive and negative demands, results in government expenditures for observation of certain rules and the costs related to their violation. Other things equal, the greater the negative demand for an institution, the higher transformation costs and the costs related to the support for the implemented institutions. Through mass resistance, even minority can impede reforms or distort practical realization of its main points.

Transaction costs represent a powerful factor of institutional changes. However, transformation costs have greater role. The absence of institutional changes confirms that the majority of agents is not interested in revising the “rules of the game” in action, as any change is related to additional costs for them.

The practice shows that import of institutions from developed into transitional countries is not a soft and linear process. Rather, it is related to a whole complex of negative outcomes determined by the differences in the institutional environments of the importer and exporter countries.

- Reformers often prefer to import advanced institutions in an effort to accelerate their institutional development. This effort leads to mistakes.
- Another negative outcome is related to transfer paradox. It implies that during the transfer of institutions, an exporter may gain at the expense of an importer country. The example of this is liberalization of foreign trade. As practice shows, immediate movement of two competitors to a new equilibrium is always mutually beneficial. The situation changes when one of the markets is uncompetitive.
- Brain drain is often related to the borrowing of new learning programs and improvements in educational institutions.

Sometimes “unplanned” import of ineffective institutions further increases transaction costs. This is due to the “block” type of implementation of the institutions by the reformers, when only parts of institutions are implemented and ultimately we get a number of ineffective institutions. Despite its seeming effect, such an approach towards import of institutions, may increase transformation costs and exacerbate macroeconomic situation.

Economic system may fall into the institutional trap. The problem of institutional trap has recently attracted the attention of economists who study the economic processes in transitional countries. In English literature this is referred to as „lock in effect”. According to North, the idea of this effect is that once adopted decisions are difficult to change. Institutional trap is an ineffective norm with self-supportive characteristics. Once institutional trap is formed, return to the pre-reform situation does not lead to its extinction. The path-dependence effect arises, which is typical to norm formation process and institutional trap, specifically. A system fallen in institutional trap may choose the inefficient way of development and transition to the efficient trajectory may turn out to be irrational.

Georgia’s experience shows that creation of new institutions as it was intended by the reformers do not guarantee effective institutions from equity and fairness point of view. Any reform should be preceded by estimation of transformation costs and expected profit. Because of the inadequate institutional structure and unequal initial conditions, implementation of standard macroeconomic policies of the developed countries may lead to the institutional trap.

There is evidence that the duration of the period of market institution basis formation differs across countries, from a year to several decades. It depends on the nature of interactions among different groups and institutions in a society. It took 2-3 years countries such as Germany and Hungary, where market institutions had been to a certain extent developed, to overcome institutional backwardness. While it may took several decades to establish market institutions in countries, where administrative and command institutions prevailed. Theoretically length of transformation period depends on new institutions. In addition, it refers to both formal and informal norms, as their matching provides institutional efficiency. Otherwise compulsion (police and prison, as formal mechanisms) will always be needed, when there is tension between values and the necessity of observation of formal rules. Therefore, the success of institution implementation depends on a social group’s mental preparedness for reforms and the degree of acceptability of imported rules of the game.

The main institutional problem of transition period is that the length and pace of changes cannot be easily identified. The speed of attainment depends on the ability of individuals to obtain, interpret and transfer new information. Th. Veblen in his Theory of the Leisure Class writes that “When a step in the development has been taken, this step itself constitutes a change of situation which requires a new adaptation; it becomes the point of departure for a new step in the adjustment, and so on interminably. At the same time, men’s present habits of thought tend to persist indefinitely, except as circumstances enforce a change. These institutions which have thus been handed down, these habits of thought, points of view, mental attitudes and aptitudes, or what not, are therefore themselves a conservative factor. This is the factor

of social inertia, psychological inertia, conservatism. Social structure changes, develops, adapts itself to an altered situation, only through a change in the habits of thought of the several classes of the community, or in the last analysis, through a change in the habits of thought of the individuals which make up the community. The evolution of society is substantially a process of mental adaptation on the part of individuals under the stress of circumstances which will no longer tolerate habits of thought formed under and conforming to a different set of circumstances in the past. For the immediate purpose it need not be a question of serious importance whether this adaptive process is a process of selection and survival of persistent ethnic types or a process of individual adaptation and an inheritance of acquired traits”⁴.

Social structure is changed, developed and adapted with the changed conditions. However, the state of various social groups also changes. The situation may be heterogeneous even within the single group. In their struggle for self-maintenance, and namely for financial needs, people try to adapt with the new circumstances. Economic incentives and specifically, financial difficulties play a significant role in institutional changes. This century-old description of institution formation by Veblen is still true today.

Individual persists as the agent of institutional changes and responds to the incentives underlying the institutional system. If these incentives are rather controversial, presumably, the introduction of new institutions will be slow and difficult. Economic tension transforms into social tension and it will have boomerang effect on political life. Georgia had similar experience.

Georgian Case

Georgia follows the strategy of import of new institutions. Georgia’s economic orientation is irreversibly related to the EU and it represents such a “best practice model“. The Eastern Partnership was a significant program for Georgia along with Partnership and Cooperation Agreement (PCA) and European Neighborhood Policy (ENP), aimed at facilitating Georgia’s progress in EU integration. European integration obliges Georgia to continue its reform course, realizing that EU represents an integrity based on certain norms and values, such as peace, freedom, rule of law, human rights and respect for basic human freedoms. They create not only its identity in the world economy, but also underlie its market system. Institutional harmonization represents an important challenge for the current period. The economic and social integration is the main issues in the general context of the EU integration. Therefore, Georgia faces two interlinked challenges: to strengthen its state and democratic institutions and to fix the country’s economy (Kobzova, 2013).

The social and economic development strategy of Georgia, Strategy 2020 is an open declaration on Georgia’s aspiration to become a country based on European values and deepen its economic and political integration with the Europe⁵. The prerequisite of this is the successive and consistent implementation of the actions foreseen by the Association Agreement between Georgia and EU. Therefore sustainable development and harmonization of competition policy, higher education, food safety, protection of intellectual and industrial property, poverty reduction and social equality, consumer rights protection, social partnership etc. are among the most important areas of reform.

Euro Barometer is an important survey which reveals fundamental human values, as well as social and economic values of Europeans⁶. The most important human values are peace, human rights and human life. They are followed by democracy, rule of law, individual freedom, equality and tolerance. The Survey distinguishes EU countries’ priorities among the following social and economic values: justice, freedom, immigration, leisure, environment, free competition.

Society’s positive attitude and support for EU integration is very strong in Georgia. At the same time, the European Union has put significant efforts and resources in Georgia in support for democracy,

⁴ Veblen Th.. Theory of the Leisure Class. <http://moglen.law.columbia.edu/LCS/theoryleisureclass.pdf>; pp. 88-89

⁵ Strategy 2020 Georgia. p. 3. <http://static.mrdi.gov.ge/530226580cf298a857ab7dcf.pdf>

⁶ http://ec.europa.eu/public_opinion/archives/eb/eb69/eb69_values_en.pdf

pluralism, transparency, and economic prosperity (EPF, 2013) Association Agreement marks a new stage of development in the EU-Georgia relations and is likely to further deepen political, economic, and trade relations between the European Union and Georgia. Simultaneously this deepening will require that the country undertake further reforms for improved approximation to European standards and practices.

The Association Agreement between Georgia and the EU represents Georgia's Europeanization action plan. Here Europeanization is understood as exporting forms of political organization and governance that are typical and distinct for Europe beyond the European territory (Olsen, 2001). Europeanization represents a serious challenge for Georgia. An important thing is that institutional transformation the main difficulty is the tension between the new formal rules and the existing informal norms, what leads to institutional conflict. Neither law will be effective if informal norms do not support it. The example of institutional conflict is high transaction costs, characterizing the transition systems and hindering economic development. We can look at the level of Georgia's institutional development and the country's value system to evaluate the probability of institutional conflict.

Generally, low level of institutional development in a country increases the uncertainty and, therefore, the costs for the economic agents. Degree of governance is an important institutional variable as far as a country's governance structure displays the interconnection between different formal as well as informal economic institutions. Since institutions shape the incentive structure within a society, the quality of governance determines whether or not the formulation, implementation and enforcement of reforms will be effective. Worldwide Governance Indicators (WGI) provides the outcomes of population, experts', business sector opinion survey in developed and developing countries. The indicators range from -2,5 (weak governance) to 2,5 (strong governance).

Table 1

Georgia in Worldwide Governance Indicators

Country	Worldwide Governance Indicators			
	2009	2010	2011	2012
Georgia	-0,22	-0,18	-0,21	-0,02

Source: Worldwide Governance Indicators, 2013

Georgia as a country with the communist background tend to have much lower levels of governance quality, than developed market economies. Among the EU countries North European countries have The highest level indicators (Finland, Sweden, Denmark), while the level of governance is lower in former command market countries (Poland, Bulgaria, Romania)⁷.

Georgia is a very interesting country in the region because of its institutional progress. This progress is primarily related to the reduction of corruption. According to the estimation of the organization International Transparency "low-layer corruption has actually disappeared from the daily lives of Georgia citizens". The anti-corruption laws have been improved and the transparency of government activities increased in a number of fields. However there are still problems with the private sector transparency and accountability, especially with regard to ownership of major companies as off-shore shell companies control these firms⁸. In 2013 Georgia took 55th position among 174 countries by the Corruption Perception index. The study of Caucasus Resource Research Centre is also noteworthy, which reveals that corruption was named as the most acute problems of the country by 0% of population⁹

Global Competitiveness Index provides important indicators to evaluate the degree of economic and legal institution development of countries. Georgia ranks in 2013-2014 GCI in 72th position out of 148 countries. The most problematic factors for doing business in Georgia are access to financing, poor work ethic in national labor force, inadequately educated workforce and policy instability. The components in which Georgia manifests low level of development are effectiveness of anti-monopoly policy (138th rank),

⁷ http://ec.europa.eu/europe2020/pdf/themes/34_public_administration.pdf

⁸ <http://www.transparency.org/country#GEO>

⁹ <http://caucasusbarometer.org/en/cb2013/IMPISS1/>

intensity of local competition (123th rank), property rights (120th rank), intellectual property protection (124th rank), etc¹⁰.

Georgia's positions are evaluated as weak by the property Right Alliance Index, where Georgia takes 112th position out of 130 countries.¹¹ There is much empirical evidence confirming the country's weak positions in property right protection. During 2010-2011 many businesses complained that government interfered in their activities. Nowadays among the complaints filed with the Prosecutors Office against the previous authorities, those concerning property rights figure prominently. According to domestic NGOs reports, property and land in which touristic infrastructure was developed appears to have been particularly affected, as well as areas of economic interest in and around the capital city. In certain mountainous regions of Georgia, where land was traditionally being passed on from generation to generation without formal registration, owners attempting to register their land started facing insurmountable obstacles in doing so when their interests happen to collide with those of the State. The statistics is that to date the Prosecutor's Office has received 1 289 complaints related to alleged violations of property rights¹².

Many experts argue that the structural problems of Georgian economy can mainly be explained by the elements of „crony capitalism“. Transparency International Georgia reveals some evidence that Georgia's big Business is engaged in close collaboration with the authorities and even covers some of the costs that would normally be borne by the state. Big Businesses are very cautious about their relations with the government and do their best to please the political leadership. There were several reports of journalists trying to investigate several obscure fields of Georgian economy and they revealed cases of close relationships between business and government in waters, lottery, cattle slaughter houses, retail trade and parking management sectors.

The expectation and desire that the government play more active role is high in Georgia society. One of the confirmations of this is World Values Survey 2008 results. 31.6% of Georgian population think that government should take more responsibility and only 2.1% think that people should take more responsibility. One of the main problems, which state faces in transitional countries, is the spontaneous character of economic reforms, while the society demands for the efficient state. Such an approach towards the increase in state participation in the economy can partly be explained by the institutional conditions. The path-dependence effect works, implying the influence of the previous periods. 70 year period of administrative and command system established its physical as well as cognitive institutional foundations. This is typical not only for Georgia, but also for almost every post-Socialist country. However, it is also noteworthy that demand for the government role also increased in developed countries after the recent global financial crisis.

Free competition represents the backbone of the efficient market system. observation of free competition is one of the declared objectives by the Strategy 2020. The perception of the need of its observation is acknowledged by the majority of the society. According to World Values Survey 2008 results, 31.9% think that competition is good against 1.7% who regard competition harmful¹³. As a matter of fact, effective free competition institutions still does not exist. The reports of NGOs and several international organizations has confirmed for years that there is only one dominant player in many markets (fuel, pharmaceuticals, etc) who dictates prices. The study of the cases on monopoly power abuses is especially difficult because the majority of businesses with unknown owners are registered in offshore.

In 2014 Competition Agency was formed in order to secure free and fair competition as well as transparency and nondiscrimination in the markets¹⁴. Its objectives are in conformity with the general

¹⁰ The Global Competitiveness Report 2013–2014, p. 193
http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2013-14.pdf

¹¹ <http://www.internationalpropertyrightsindex.org/profile?location=Georgia>

¹² http://eeas.europa.eu/delegations/georgia/documents/virtual_library/cooperation_sectors/georgia_in_transition-hammarberg.pdf

¹³ <http://www.worldvaluessurvey.org/WVSONline.jsp>

¹⁴ http://www.bpi.ge/index.php?option=com_content&view=article&id=26933%3A2014-06-25-06-30-45&catid=939%3A2011-11-06-17-42-27&lang=ka

principles of free competition: elimination of administrative and discriminatory barriers; creation of free market access conditions for the economic agents; elimination of unfair practices of competition restriction; observation of the principles of fairness and equality among the economic agents; elimination of the abuses of market dominance, etc.

When import of institutions is successful, they are positively adapted in a relatively short period of time with new environment, i.e. they begin to perform the same functions as in the exporting economy. Institutional adaptation gives the economic agents broader opportunities for their economic activities and they adopt new strategies of behavior related to the changes of the institutional framework. Some of the economic agents observe the set of rules, while others violate them. The differences in their behavior is due to the operation of new institutions (observation of the new rule of the game), which cause cost and benefit changes among the agents. According to the research of Centre of Social Sciences (2012)¹⁵ unemployment was named as the most important national issue by the majority of respondents. The majority thinks that the economic policy of government improved the well-being of only small part of population; 45% of the population thinks that the biggest failure of government is unemployment; 22% think that poor people are round us, because government doesn't care for them.

These results show that the economic institutions which have been implemented for already two decades could not respond to the expectations of people. Under the circumstances resistance towards new institutions is inevitable. Georgia's liberal course of reforms after Rose Revolution gave hope to Georgia's citizens that the country would develop on the basis of democratic values, respect for human rights, and economic reform. The fact that many of those expectations have not been fulfilled has caused much disappointment (Papava. 2006). Reforms based on violence are rarely successful and are related to huge transformation costs. Therefore, states should reach a compromise.

Conclusion

As a conclusion, we can say that institutional reforms directed to the creation of the new system, are completed when the foundation of the new economic system is formed and at the same time the institutional system is characterized by development inertia. In most cases this requires that formal rules be matched with informal ones, which embed in the rules of behavior.

Based on the new institutional approach the present study enables us to conclude that people's great expectations to the role of government is due to path-dependence effect in Georgia. Government (state) plays a special role in institutional reforms even when these reforms aim at reducing the influence of state on the economy. In our view, under conditions of institutional imbalance, no agent other than state can incur large costs of overcoming the institutional trap and make effective long term decisions. Other agents are unable to incur long term social development costs.

At current stage the course of institutional reforms towards Europeanization should go on gradually. The recommended directions for institutional stabilization involve: to overcome the interconnected institutional traps (free competition distortions, violation of financial obligations, tax avoidance, corruption) and to observe property, employee, foreign investor rights; to implement social policy measures to compensate against the losses of certain groups during the reforms.

¹⁵ http://css.ge/?lang_id=GEO&sec_id=49

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