

INTRODUCTION

Richard Betts

I am Dick Betts, the director of the Saltzman Institute of War and Peace Studies. And welcome on behalf of Lincoln Mitchell and our institute, and the Harriman Institute, both of which have collaborated to arrange this conference. You'll hear from the Harriman half of the enterprise later. But, I want especially to acknowledge the support of Ambassador Arnold Saltzman who's not just the benefactor of our institute but a long-standing observer of developments in Georgia. And, he'd planned with great interest to attend today but has been called away by an unanticipated responsibility. I think our timing for a meeting on this subject could hardly be more appropriate. And when the conference was first planned we didn't know that Georgia was going to be in the headlines as it has been in recent weeks. So the ideas, reflections, or the simple information that emerged today ought to be particularly useful, not just for those who are always concerned with Georgia, but for policy makers and commentators who deal with the whole broad canvas of international affairs, developments in the area of the former Soviet Union and democratization. There's a lot to be packed into the next seven hours and I expect it will all prove stimulating and provocative, so you don't need to hear anymore prefatory rhetoric from me. Please use every minute from now to five o'clock to maximum advantage and we hope you'll all enjoy your day at Columbia. Kim, take it away.

PANEL ONE: ENERGY AND ECONOMIC DEVELOPMENT

KIM MARTEN

I'm Kim Marten. I'm in the political science department at Barnard College. And I also want to welcome all of you here. I think our first panel is going to be a particularly interesting one. I'm not going to read you the bios of the people who are speaking because you can find them yourself in the materials that you've received. But, it's going to be interesting because we'll hear one perspective from someone who is coming from Georgia,

and two perspectives from people who are currently independent consultants but who have U.S. government experience. And so we're really going to get a wide ranging number of perspectives here. And so I would recommend that we just go in the order that the panelists are listed starting off with Jonathan Elkind.

JONATHAN ELKIND

Thanks very much, Kim. Good morning, everybody. I'm going to talk about the development in the energy sector, developments in the energy sector in the period since the Rose Revolution. And in some respects this will be the kind of easy start to the day, at a time when there are so many profoundly challenging questions about what's going on in terms of the policy-making environment in Georgia, which we will get into, I'm sure, at some length later today. The energy sector is actually an arena where there has been a considerable amount of progress in the course of the last four years. And basically, two key questions arise for me as I tried to go through the exercise of summing up in my own mind what progress has been made and what bits of the agenda left undone in Georgia, in its energy sector. The first being the extent to which Georgia has reduced its energy related vulnerabilities in this period since October of 2003. The second being the extent to which Georgia has used its energy policies and projects and diplomacy for the purpose of enhancing its broader national security position, its economic, environmental health in that time. And the results that one can point to, I think are quite an impressive set of achievements. What happens now going forward, the third big question of my remarks, is a bit more of an open question. But let's remember what 2003 looked like in the energy sector. If you were to look, for example, for starters, at the electricity, the power sector. At that time fuel that was being burned in power plants in Georgia came from a single monopoly seller. Obviously the topic of Russian-Georgian gas relations are one of the, not just energy, but also power,

pardon the pun, political power dynamics that has to be considered. So I'll leave that to come back to in a little bit later. The power-generation capacity all across the country was well beyond its design lifetimes. There was no interest, or very limited interest, in new investments in the electricity sector. Bear in mind that all of the energy systems in Georgia, and it is equally true for Georgia's neighboring countries in the Caucasus, were designed for a different time. They were designed for a unified USSR. And the design capacities, the architecture of these systems- in which direction do the electricity transmission lines flow? In which direction do pipelines flow? All of these systems were designed under an entirely different political premise. And that's said without any value judgment, it's simply a statement of fact that today's reality of three independent Caucasus, South Caucasus countries is distinct from the way in which the systems themselves were designed. In relation to the huge hydroelectric potential of the country, this story was one of, I would say, gross mismanagement. Practically no maintenance. Very unsystematic usage patterns. On an annual basis, the Georgian Ministry of Energy would design intended load patterns for the year that were meant to draw down the hydro-plants, the hydro-reservoirs in an orderly fashion. On an annual basis those plans would be discarded and ignored from the day that they were printed, leaving therefore, Georgia on an annual basis in a state of crisis. Because its water resources were exhausted far too early in the season. The country had no capacity that was in operation for switching fuels. There are many types of infrastructure, power generation infrastructure, where you can either use natural gas or heavy fuel oil, which is an important element of flexibility that allows the operator not to be held hostage, so to speak, to supply issues in relation to a particular fuel. The litany can go on and on. Let me give you just a couple of bits of data to underscore what I'm saying in relation to electricity as of the Rose Revolution. 2002 analysis by the World Bank stated that the cost recovery levels in the electric power sector in Georgia were at 49%. Now bear in mind this is the money that is

collected through the system in exchange for the provision of electricity. It's the money that must be used then to buy new fuel, to pay salaries, to invest in the upkeep of systems, to invest in new capacity as systems age and need replacement. 49% is a prescription for disaster. You simply cannot run energy systems or any other economic systems if you're only collecting 49% of the costs that you incur in operation. Similarly, another little data point. There were critical problems in this time with the reliability of the electric power system. Some analysis that was done by the Strategic Research Center in Tbilisi, in 2005 indicated that on an annual basis, upwards of 365 million Lari, about 180 million dollars at that time, were being lost as a direct consequence, sorry, as a consequence, direct and indirect, of unreliable electric power provision. This was extra costs that were incurred as businesses had to purchase generators and fuel in anticipation of the regular loss of electricity supply. This is money where natural investment plans were out of reach because a given economic producer could not rely on availability of electricity. So, a pretty grim story. In the oil and gas sector the picture was not a great deal better. Everybody is familiar with the effort in that time to build the Baku-Tbilisi-Ceyhan pipeline, and other new infrastructure. But the existing infrastructure was in particularly critical shape. The North-South, the Magistraow [PH] gas pipeline system that carried 100% at that time, of Georgia's and Armenia's gas, was in critical disrepair. The photos that one could see, and the reality one could see with one's own eyes, particularly up in Kazbegi, the northern mountainous region, was shocking. Large diameter high-pressure gas pipelines literally hanging in the open because there had been so much erosion along streambeds. You know, note to self: Do not operate high-pressure gas lines in that way. Not a good idea. In 2002 some analysis that was undertaken by PA Consulting that was then highlighted a great deal by the American Chamber of Commerce in Tbilisi found that 200 million dollars a year of state revenues were not being collected because of irregularities and problems in the liquid fuels' market. So this

is refined gasoline, diesel, et cetera. 200 million dollars to a government that was sticking over at about 500 million dollars at that time, if memory serves, is what they call down on Wall Street “real money.” So again, critical problems. Let me finish the “before picture” with a bit of a cruel joke that I’ve heard numerous times traveling around in Georgia and many of you, I expect, will have heard it as well. The anecdote goes that a young boy is sitting and talking with his dad and he says, “Daddy, I know that back in olden times...” Excuse me, I bungled the joke. “Daddy, back in olden times before the invention of the candle, what did people use to read when it was dark?” And Daddy stops for a moment, sad look comes over his face, and he says, “Electricity.” This, I mean this is an anecdote which I don’t repeat with any intended...I’m not trying to laugh at Georgia’s predicament. This is an anecdote that I heard from Georgians on numerous occasions. So that’s the before picture. In terms of the “after”, where is Georgia today, the picture is substantially improved. Basic electricity service is for the most part pretty close to twenty four-seven in most parts, in most major town, certainly in Tbilisi. 2005, according to survey data from USAID, Tbilisi residents had an average of power for only slightly more than half of every day. And outside of Tbilisi the average was less than seven hours per day on average. So, consider the extent of change there. The financial performance in the electricity sector, which I again, underscore. These are the shoulders on which future performance and the health of the sector rests. Financial performance was substantially improved in the period since 2004. The most recent data that I could find, I’m sure there’s more recent data that are out there, showed that by 2006 already collection rates were up to 90% in the electricity sector, from 12% in 2003. So, a really huge improvement in the health of the power sector. In the oil and gas arena things are improving substantially. Old infrastructure is being refurbished. In particular this is true in relation to the North-South gas pipeline I mentioned earlier. And particular credit, I think, is due to the Millennium Challenge Corporation, the US government-funded

undertaking that has made available funds-, limited funds, relative to the needs, but initial funds for the refurbishment of that system. There have been new investors. The Kazakhstani company KazMuniGas has invested in the Tbilgazi, the distribution system for the capitol city. The Inguri hydroelectric power plant has been rehabilitated refurbished. This is a long-standing, long-overdue project. And you can look across the board in the oil and gas arena as well, seeing actual planning that is being done on a quarter by quarter basis to balance natural gas supply and demand, more than one supplier coming into the country. So, a lot of very, very meaningful elements of progress. In a remaining minute I'll try to put this in perspective and talk a bit, then, about where things may be going ahead. I mean it's clear that as of the time of the Rose Revolution, the energy sector was, for the right people, a source of "get rich quick" money, and for the nation was a huge liability. Where things are now is complicated, but in my opinion, substantially improved. There are risks and opportunities that still remain, to be sure. And as an example, some of the political unrest that has been occurring in recent weeks in Tbilisi relates to people who have not benefited from the change that has taken place in Georgia in the last four years. Well the power sector is one of these arena that is a very complicated setting in that context because in order to get reliable service that enables people to build businesses, to create jobs, to improve living standards, you actually have to do the front end thing, which is to pay on time for the service that you require. And if you are living in a smaller town and have not seen benefits in terms of economic growth or improvements in your day to day living, that's a very, very difficult, bitter pill. There is also a huge risk that is related that I think we need to remember even in talking about the energy sector. To one of the mega-problems, questions that hangs over Georgia at this time, which is the lack of systematization. This reaches from courts that cannot be relied upon to hear issues, to hear cases in an even-handed fashion. To energy-regulatory structures that have been systematically undercut by the current government, and

that therefore, you do not have the ability to have a functioning regulatory process that does everything from determine what rates should be, how much people should be charged for gas and power, what the environmental obligations should be that are met, consumer protection, all of those kinds of functions. That lack of systematization also puts at risk the functioning of companies that are essential for the operation of energy infrastructure. So that's the kind of warning signs that exist. But I'll close on a slightly more optimistic note, which is to emphasize that as service continues either to be restored, because there are many parts, for example, of Georgia that are now much more poorly served by gas, the gas system in particular, than they were in Soviet times. As service is restored, as the energy sector continues, as I hope that it will, to get on a more and more sound economic footing, there's a huge potential that the energy sector, both in relation to electricity and in relation to the oil and gas and refined products, will provide a stronger and stronger economic base, with which Georgia's broad economy will move forward. I'll stop there and be happy to take questions whenever.

KIM MARTEN

Thank you, Jonathan. Now we'll turn to a different aspect of energy questions that relate to Georgia. And to Vasilii Rukhadze.

VASILII RUKHADZE

My presentation also touches the question of energy, but from a different perspective, which is the issue of Georgia being the East-West energy corridor. [UNCLEAR] supporting the huge reserves, huge oil and natural gas reserves from the Caspian Sea Basin, all the way to Europe. This is an issue which became one of the defining components of Georgia's nation-building process up to the collapse of the Soviet Union in 1991. And I will touch on the

historical aspects of this issue and I will move to the 1990's when the issue got accelerated. And, then the period up to Georgia's Rose Revolution, up to 2003, when this issue kind of started to culminate. I'll start from the historical aspect of this topic. From the times of Romans, Georgia represented one of the very important roles in the long chain of the great Silk Road, which stretched from China all the way to the Western Europe. And the process moved into the middle centuries. And the Georgian kings and the statesmen and the different intellectual kind of saw themselves and the kind of saw the Georgian kingdom as having two functions. The first function was protector of this great Silk Road, and the second function was kind of a defender of the Eastern frontiers of the Christian Era from the hostile and the mighty empires of [UNCLEAR], the Persian Empire in the earlier-, and the Mongol incursions toward the West. And like I mentioned, they perceived themselves as such, having the two functions. But, this kind of change in the middle of the 15th century after the fall of Constantinople in 1453, when it was sacked by Ottomans. And up to that time, Georgia lost the only and the main link with the Western World, to which it saw that it belonged, culturally, politically, philosophically, economically. And besides this huge political moment, there were other factors which kind of isolated Georgia from the Western world. This was the discovery of the new route around Africa towards India. And the second was the redirection of a great Silk Road towards the Red Sea, out of this whole line beginning from Constantinople all the way to the Persian Empire, fall under control of Ottomans. So basically, Georgia lost both functions, protector of the Eastern borders, Eastern frontiers of the Europe, Christian world, and the protector of the great Silk Road. And after this, this integration of the great Georgian kingdom followed and there started the long and very painful, bloody process of political turmoils in Georgia which lasted up until the 19th century when the country was entirely incorporated into the Russian Empire. After the incorporation of Georgia and the entire South Caucasus and later the North Caucasus into

the Russian Empire, the whole political thought, Georgian political thought, was dominated by the idea and by the search to regain this lost function, the lost function of being the protector and the corridor between the East and the West, kind of the trade corridor, because by then there was no mention of any energy routes or any Caspian oil or natural gas. It basically was only about the trade. But, and I want to mention several names here, there are some works which I want to go through Solomon Leon Leoniza [PH] , for example, who was a chief advisor to the last two Georgian kings. And the later, also, Solomon Dugashvili and Ilia Jangavadze, all these intellectuals worked through this somehow to find a new niche for the liberated Georgia in case of Georgia would be liberated from the Russian Empire. How would Georgia manage to reintegrate itself [UNCLEAR] within the Western world. Of course, they never saw this idea realized, but they created a very rich theoretical basis for this to be realized later on after the second Georgian Republic in 1991 regained its independence. The short-lived Georgian Democratic Republic, which in fact, was the first Georgian Republic in 1918, 1921, had not done much towards this direction. The first, because of the ongoing political turmoil in Georgia, and the second because of the absence and the interest of the great powers, with Western powers, in Caucasus region, and the Caspian Basin region. And throughout the Soviet Union, Georgia just remained as one of the [UNCLEAR] of this last empire. And the all resources and natural gas resources were tightly controlled by Moscow and used as necessary by the Communist Party. After the collapse of the Union in 1991, Georgia found itself in the epicenter of the huge geopolitical earthquakes taking place from Central Asia all the way to the Central Europe to Hungary. And this was not related only to the collapse of the Soviet Union. Basically, this was increasing the Western interest towards the natural gas resources and the oil resources concentrated in the Caspian Sea Basin. And before I move to the next paragraph, I briefly want to summarize (sic) what resources we are talking about in Central Asia. Of course we have different estimates, they

are very different. We cannot really have the precise estimates, what are the number and the quantity of these resources concentrated in Central Asia and Azerbaijan around the Caspian Basin. But we have some. So by the US Energy Information Administration, the Caspian Basin could hold between 17 billion and 33 billion barrels of oil. But there are other estimates which are called as “possible reserves” and the probability of like 50%. The Caspian Basin could hold 233 billion barrels of oil, and I just want to mention that the Saudi Arabia has 261 billion barrels of oil. So, we basically have what proportions we are talking about in Caspian Basin. To break down by the country, Azerbaijan has about four to thirteen billion barrels of oil. And regarding natural gas, it has roughly one trillion cubic meters of gas, and all together combined, Azerbaijan’s oil and natural gas is the one percent of world’s total energy reserves. To move to Turkmenistan, it does not have much, significant oil resources, but has a lot of natural gas, which equals a little more than two trillion cubic meters of gas. Then Kazakhstan has 26 billion barrels of oil and imports around 360-400 million barrels of oil annually. And the natural gas resources equal around two trillion cubic meters of natural gas. So we’re talking about the huge chunk of entire world’s energy reserves. To put in percentages it’s about four to thirteen percent of entire world’s energy resources. When the Soviet Union collapsed all these regions opened up to new competition in the energy sector, because European Union, which was not as formulated as now, by then, got interested by the Caspian Basin because its energy dependence was increasing rapidly- from 20% to 23%, and then from 23% to 25%, and currently it reaches somewhere between 29% to 40% in natural gas exports alone. And I’m talking European Union’s dependency only on Russian energy resources. And the oil exports from Russia reached 29%. So it was quite alarming for the political and economic cycles of Europe and it was natural reactions that they looked to the Caspian Basin from the beginning of 1990’s. And the first of all they looked at the oil sector. The first pipeline which took place and which was realized in the

South Caucasus was the so-called “early Western oil pipeline”, which also is referred to as Baku-Supsa pipeline, but it was of a smaller scale. It was transporting, basically, around 120 thousand barrels of oil. And it went into exploitation after it was renewed on the basis of the old pipeline, which largely was dysfunctional; it was a Soviet-era pipeline. But it was basically harbinger of the new pipeline, which is referred as Baku-Tbilisi-Ceyhan pipeline. And this was a really big pipeline which opened the new perspectives for Georgia in its very painful process of integration with Europe and Western world. There were several routes here, which were discussed in 1990’s as to where the Caspian-Azerbaijani oil should go, which directions it should take. So there were several routes under discussion. The first one was the Baku-Novarasis [PH] direction, which was the fiercely opposed by the European Union because the whole point of getting oil from Azerbaijan was to diversify Europe’s oil supplies, and of course they did not want to have one more pipeline going through the Russia. There was a second route, second option through Iran, but this was strongly objected by the United States because of the ongoing embargo in Iran. And there were third through Armenia. But due to the Nagorno-Karabakh conflict, an ethnic conflict, which just ended in 1994-1995 after the cease fire [UNCLEAR], Azerbaijan objected strongly. So there was only one option left, which was Georgian option. So Georgia, kind of without much fight, got the huge issue sold [UNCLEAR] for its own benefit. But there were some problems in Georgia. Georgia had one civil war which was just over in 1993, and the two ferocious ethnic conflicts, one in South Ossetia, also referred as Svinwali [PH] which ended in 1992, and the second ethnic conflict, even bloodier, in Abkhazia [PH], from 1992-1993. And ongoing instability, political instability, kind of questioned the credibility of the Georgian option. But it won, after all. And Baku-Tbilisi-Ceyhan pipeline started to be built in 2002 and it was completed, basically, in May of 2005 after the Rose Revolution. And the first oil that reached the Ceyhan Reservoir in the May of 2006. Let’s move to the natural gas sector.

As we mentioned, Azerbaijan has roughly one trillion cubic meters of gas, and of course this was natural that the Western companies, the British Petroleum, Emirate [PH] Hess and many others got interested by these reserves. And the Shah Deniz gas pipe came into existence with the cost of about 3.6 billion dollars. It is one of the largest projects, along with the Baku-Tbilisi-Ceyhan pipeline, and it is basically building the same channel as Baku-Ceyhan oil pipeline, just to reduce environmental impact. And its capacity is going to reach by 2012 about twenty billion cubic meters of gas, which will be approximately nine percent of European Union's natural gas exports, which is a pretty big chunk. But the real potential of this both pipeline, Shah Deniz gas pipeline and Baku-Tbilisi-Ceyhan pipeline, are really late in the future. And this is related to-, and now the very controversial, and also very painful and sensitive question of two major energy the roads, related to Central Asia. Related to the Turkmen natural gas and Kazakhstan oil. I'm talking about that as Caspian natural gas and Trans-Caspian oil, the pipelines, against which Moscow is very strongly going in defending its monopoly in Central Asia. I just want to mention that right now the Moscow is buying the Turkmen gas on increased price, which was increased in the last week, I believe, by 30 dollars. And Moscow is now paying 130 dollars per thousand cubic meters of gas, which it resells in Europe for 236 dollars per thousand cubic meters. So, we're kind of dealing here with the natural gas speculation. And of course the local governments, Turkmen government and Kazakhstan government, are interested to sell their gas at international prices in Europe, in the West. But there are many issues there. The first and the biggest issue is the absence of viable infrastructure. Absence of viable energy carriers. There are no pipelines. The only pipelines existing there are the ones which existed in the Soviet times like Prikaspilsky [PH] pipeline. And there is a huge political pressure applied also by Russia, which as I mentioned, defending its monopoly in Central Asia. On May 12 of this year, 2007, Moscow, Kazakhstan, and Turkmenistan agreed on a deal which would strengthen the Russian

monopoly in Central Asia. But for some reason, I would say for understandable reasons, the Central Asian governments are trying to redirect their roles and diversify their exports. And most probably, the Trans-Caspian pipelines will come into existence, which will be of huge benefit for Georgia and for the entire region stretching from Central Asia to Eastern Europe, bringing this whole region, economically, politically, back to the European community and back to the Western world. Thank you.

KIM MARTEN

Thank you, Vasili. Now we'll turn to Andrew Sidamon-Eristoff, who I think will give us a broader, economic picture to put this into context.

ANDREW SIDEMAN-ARISTOV

Now for something completely different. Good morning, I want to thank my good friend, Professor Mitchell, for drafting me onto this panel. It's an honor to be included here today. This is a panel loosely centered on economic development in Georgia. So let me confess that I am no expert in economic development. I assure you, however, that I will not let my lack of direct personal experience keep me from sharing my opinion. As you may have noted from the bio included in the materials, I'm a former local politician here in New York City and a public administrator at the city and state level. I've served recently as a short-term consultant to the ongoing USAID Business Climate Reform Project, working to reform the Georgian tax administration, specifically the dispute resolution system. Fascinating in and of itself, this assignment has had special meaning for me, personally, as my grandfather was Georgian. We have cousins living in Georgia today, and my parents and I have known President Saakashvili since he was a law student at Columbia and an intern at my father's law firm in New York City. In other words, I am both professionally and personally

interested in Georgia and will freely admit to being biased in its favor. Let me begin by reviewing the progress of reform. I will then draw upon my specific experience as a consultant to offer perspectives of general application to the ongoing process of economic, civil, and political reform in Georgia. I don't think anyone can dispute that the government of Georgia of President Saakashvili has scored very impressive accomplishments over the last four years since the Rose Revolution. With advice and help from the international community, it has reformed financial and banking regulation, the tax code, the labor code, licensing procedures, customs administration, the bankruptcy laws, and the land record system, to name just a few sectors. By almost every measure, GDP growth, direct foreign investment, the IMF's "Doing Business" rankings, tax revenues, even poverty rates, assuming reliable figures, Georgia is making real progress despite the continuing confrontation with the Russian Federation. Notwithstanding the tragic loss of the late Prime Minister Zurab Zhvania, whom I guided on a tour of New York City Hall with then-student Saakashvili in the mid-1990's, the Georgians are steadily building a modern administrative apparatus with trained professional leadership. For me, as a government groupie, it is utterly fascinating to watch and occasionally advise a generation of young Georgians go about the business of building their country from the ground up. Let me pause to note something that's usually below the radar. Although the Georgians deserve a great deal of credit for their accomplishments, the international community, especially the United States under President Bush, deserves recognition for supporting the Georgian reform process with expertise and massive resources. We're doing effective, sophisticated work in capacity and institution-building, much of it unsung. Moreover, contrary to the cynical assumptions reflected in the popular press, the projects that I'm aware of have not been veiled attempts to impose our American values and vision of reform on Georgia. Rather, we are supporting the Georgian government's reform agenda. In other words, we're helping the Georgians become

fishermen. And we're not alone. There is, in my experience, a remarkable consensus and spirit of cooperation among the many donor nations who are working in Georgia. And I should pause and acknowledge Ambassadors Yallowitz and Miles for their leadership in overseeing the American assistance to Georgia. Although there has been real progress, I think we can all agree that there is more to do, specifically from a governmental perspective, the next big challenge will be to reform the judicial system, which no one in Georgia seems to trust or respect. I've not been involved in the effort to reform the civil justice system, but the general topic does give me a convenient opportunity to segue into a brief discussion of my experience as a consultant. In a nutshell, the Georgian Ministry of Finance asked me to evaluate the tax dispute resolution process, and make recommendations for reform. Over the course of two visits to Georgia, I interviewed key figures in the private sector and in government, consulted with colleagues in the NGO community, researched international best practices, and came up with a package of reform proposals, which were accepted by the Minister of Finance in April. I have since worked with the Ministry on an action plan to implement those reforms. Although the specifics of the reform proposals are not important for our purposes here today, they were based on three underlying findings that may be relevant to today's discussion. Specifically, first, the Georgian tax dispute resolution system suffers from a lack of management discretion. Second, introducing discretion requires a new control strategy appropriate to the Georgian context. And third, any new control strategy should include separate of duties, transparency, and performance monitoring. In essence, mid-level bureaucrats in tax administration lack authority and accountability. On reflection, I believe the same observations could be made about many functions of both government and politics in Georgia. Without exception, NGO's and Georgians alike describe a systemic lack of discretion at lower levels of government, resulting in what I think of as a "big man" approach to decision making. Time and again, Georgians emphasize the "who" of decision

making over the “how”. It is taken for granted that a decision is not valid unless the “big man” makes it. Why is this important? In my opinion, the “big man” approach to decision making is symptomatic of a critical challenge facing Georgia’s economic, civic, and political development. There is little, if any, culture of process. What do I mean? Defining a “culture of process” is tricky because it’s so subjective and contextual. To some it means the rule of law. And that’s a very good start. But I’m searching and reaching for something a little extra. Let’s call it a cultural or social consensus that process, the laws and procedures that determine how decisions are made, has a value that is real in and of itself. And that a shared reliance on, and an almost instinctual faith in process is a keystone of both economic and political progress. In Georgia today, there seems to be little faith in process. Moreover, there is little patience for developing experience, and hence greater comfort with the control strategies that support process, such as transparency, separation of duties, or power, and performance monitoring or accountability. One way to think of this “culture of process” concept is to associate it with the concept of a social contract, the general sense, in some societies, that citizens are bound to each other and their government in mutually beneficial obligation. For example, many of us, not all, in America, believe that paying what we owe in taxes is our civic obligation, and a roughly fair exchange for the services and protection we receive from our government, and that cheating on our taxes ultimately means cheating ourselves. It should come as no surprise that roughly 95% of tax revenue in America is collected through voluntary compliance. In Georgia, by contrast, the portion of tax revenue that came in voluntarily before the recent reforms was just about 40%, meaning that a majority of revenue came through audits and criminal investigation. Not a great way to do business. I don’t have recent figures, but I believe the proportion of revenue attributable to voluntary compliance is improving in Georgia. Nevertheless, it illustrates the continuing impact of what I will call, the “black market mentality” in Georgia. During the Soviet era,

Georgia was the center of black market activity. Flouting the laws of the foreign occupier and its local viceroys was economically desirable and culturally acceptable. Indeed, it was celebrated. But now that Georgians have to come to terms with the fact that the laws they are evading are their own. In other words, they have a marvelous opportunity to develop their own version of a social contract, one that I hope will be based, at least in part, on a culture of process. I believe that developing a culture of process will prove critical to Georgia's economic development over the long run. Let's face it, many people who did well in Georgia during the 1990's did so by leveraging their relationships with people in government, much as they might have done during the Soviet era. I'm not referring to "corruption" in the classic sense, but to the widespread assumption that dealing with government meant dealing with specific individuals in authority rather than institutions and established procedures. This attitude, which still seems pervasive, works to a degree. But I believe it both increases the risk of real corruption and, in its reliance on individuals, who of course change on a regular basis, rather than relying on established processes, this approach perpetuates a level of uncertainty that is anathema to economic investment. In other words, sophisticated businesses look for assurances that even if the substance of policy decisions changes over time, the process of decision making is fair and relatively stable. As important as a culture of process is to economic development, it's also critical to the development of democracy in Georgia. Georgia has a lively politics. Many of the prominent players are well-schooled in Western-style political methods and vocabulary. For me, however, the real question is whether the political process in Georgia will remain self-absorbed and ultimately self-destructive, or whether it will mature into a stable process that actually supports governing. At the risk of condescension, my name frustration, this is personal, with Georgian politics, is that the tenor and substance of the dialogue, at least in translation, is generally immoderate and often borders on the hysterical. It is not normal or healthy, when a

major political figure goes on TV and accuses a sitting president of conspiracy to murder. Or when a candidate for president adopts a campaign slogan that proclaims that quote, “Georgia without Saakashvili is Georgia without terror” end-quote. The consequences are plain. First, this kind of dialogue poisons the normal give and take inherent in both democratic process and the art of governing. Protest and demonstrations should be welcomed as part of the political process, but shouldn’t be confused with or equated to the process itself. Second, this rhetoric frightens the heck out of foreign investors, who value stability. Third, it undermines the credibility of the opposition, which is already challenged. And finally, it perpetuates a political culture that equates losing a single election or vote to figurative death. There’s no sense that in a democracy you win and you lose some and that you live to fight another day or retire with dignity. Or that, as a winner, your treatment of today’s losers will determine your future treatment as an eventual loser. The ultimate issue is, again, a limited culture of process. In this case, political process. Is Georgia building democracy? Professor Mitchell and others may say no this afternoon, especially in light of the events of November 7th. If you don’t mind my adding my two cents, I am more willing to grade Georgia on a curve, taking into account the performance of Putin’s Russia and the general neighborhood’s depressing examples. Although I do not subscribe to the Realpolitik view that democracy and nation-building are incompatible, it’s hard for me not to be somewhat sympathetic to the government’s impatience with Western critics. Western expectations, self-imposed, were probably too high. Real reform, which we Westerners have pushed so relentlessly, always generates politic controversy. And the current opposition in Georgia has lacked coherence and credibility. That said, I deeply regret the events of November 7th, and believe the government’s overreaction did lasting harm to Georgia’s international reputation. As part of the Georgian Diaspora, and as someone who has seen firsthand the enormous commitment that has been made to reform on the part of Georgians as well as the international

community, it is deeply frustrating for me to watch as the events of November 7th and the subsequent controversy threatened to overshadow and undermine all the good things that have been happening in Georgia. Let me conclude by emphasizing just that: good things are happening in Georgia. Resist the temptation to wallow in disillusion. Instead, look forward to the day a few years hence, when we will reconvene this conference and talk of this difficult period as the crucible that ultimately helped forge a stronger and better Georgia.

Thank you.

KIM MARTEN

Thank you for that fascinating analysis. We're now going to open this up to questions from the audience. We will try to avoid a "big man" approach to things. We hope that you don't get hysterical, but we would like to institute a democratic process, which is that we'd ask you to line up behind the central microphone, and when you ask your question please let us know what your name and affiliation are.

PAUL ROBERTI

Good morning. My name's Paul Roberti [PH], I was the senior treasury advisor in Tbilisi from 2001 to 2005. I worked with Zurab Noghaideli and for a brief period Mr. Gugushvili [PH] or Gogushvili, I always get those two mixed up, and then back with Zurab again. If we can address, I think it'd help everybody, the role that the AES Telasi did, and the whole power structure and how it retarded or helped the growth and what it meant to direct foreign investment, when you see American companies get basically railroaded out of the country at a great financial loss.

JONATHAN ELKIND

I'll give you just a couple of comments on that question. The performance of AES Telasi was not without its shortcomings. And so my comment is not meant to gloss over that. I've heard numerous times from Georgians about behaviors by AS that were disappointing in some of the implementation. But AS was a risk taker that was fundamentally poorly served by Georgian government and especially by the Georgian courts. And in that regard, their inability with whatever achievements and shortcomings, their inability to do business on a sustained basis in Georgia, I think definitely had a retarding impact on other potential investors. The thing that is-, I say this as a former government official myself, I think that it is altogether easy for government officials anywhere to forget the basic point, which is when business people are exploring the possibility about going to a new market, the first thing they do is start talking to other business people that are already there. And so one story like the unceremonious departure of a company like AS from Georgia undoes a lot of positive stories that are out there and that take a much longer time to build.

VASILII RUKHADZE

Well I still lived in Georgia by that, when AS came into Georgia's [UNCLEAR] in energy sector. And it was real difficult time by then. And I think that one of the main the problems of their-, I would not-, it probably it would be very radical word to say, but kind of "failure" was the psychology of the society. That you have to pay for your bill. And that was the main hit for the only investment they made in the capitol and elsewhere. And the second, it was, as was mentioned, the government's attitude of many officials towards this the company. There were divested interests in order sell the oil instead of pure electricity in Georgia. There were many clients around and they just wanted to keep everything the way it

was, and our American company, of course, failed. There were many, the whole cascade of problems there relating to the psychology and towards related to the different groups, again who exported oil on large scale and sold to the population. The source of heat and everything else.

JONATHAN ELKIND

If I can just jump back in for one second, I want to, I love this point that Andrew made about the lack of a “culture of process”, and in a way this is, again, another indication of the same overall phenomenon. You know, paying bills on time is not something that anybody does with any particular sense of relish. But if you fail to do it, then you’re cutting the legs out from underneath your electricity provider’s ability to give you service when you want to have it. It’s just a very fundamental point.

ANDREW SIDAMON-ERISTOFF

I’m no energy person, but at 80,000 feet there’s another level of inquiry here, which my understanding is that the American company was really one of the first to invest in Georgia in a big way, and that’s a little bit like being on the bleeding edge. And I would be interested, if there are other people here who can speak to sort of what is experience of that first wave of investors, as opposed to those who hang back and perhaps watch the others fail or have a difficult time and then come in, pick up the pieces, and build out their investment. I mean, there’s got to be a cycle to the way foreign investment works. And I know that I instinctively would never want to be part of the bleeding edge in any country anywhere. But I would rather see other people go first and then see how it goes.

LAUREN NINOSHVILI

Hi, thank you very much. My name is Lauren Ninoshvili, I'm a graduate student in the School of Arts and Sciences here, also a Harriman Institute affiliate. My question is conveniently, I think, quite related, also about the investment climate in Georgia. I did a little bit of research on the healthcare and energy sector privatization processes over the last year and I'm wondering, I mean, my question is specifically, I suppose, targeted for Mr. Sidamon-Eristoff but anyone can feel free to comment. I'm wondering if you could comment on what the government has done, I suppose, perhaps specifically on Bendukidze's style of, sort of, all-out privatization and de-regulation of the sector and the extent of transparency of privatization procedures as perhaps a site where culture of process is lacking.

ANDREW SIDAMON-ERISTOFF

I'd love to comment, but I have no direct experience in the privatization process. Perhaps my colleagues on the panel could speak to it. But I don't have any direct experience with that process and I've never interacted with the minister Bendukidze. So I wish I could opine on it, but I just can't.

JONATHAN ELKIND

I can't speak to the healthcare piece, but I'll just say a little bit about the electricity, the power sector stuff. First of all, there are questions in Georgian policy making circles that simply wouldn't be asked-, important questions that wouldn't be asked, wouldn't have been asked, if Minister Bendukidze had not been there for this period. But any good idea can be taken to an extreme. And, I mean this is where you start getting into tricky territories. If you do as has been done and fire all of the energy commissioners without replacing them, you

basically create a, in my opinion, exceptionally undesirable situation because there is no voice in the system on behalf of a technical analysis of the economics of a very complicated sector like electricity. Look in any setting around the world, how much electricity costs people on a retail basis is a hugely political matter. And one of the functions that independent regulators play in lots of different settings is to de-politicize some of those decisions so that actual costs are the basis for determining what it is that the person has no choice to pay, in theory, for their electricity. So my point is I'm in favor of many of the questions that have been posed by Minster Bendukidze about what the important, the defensible, the needed rules of government are, but a blanket impulse to deregulation is not, in my opinion, a good place to be. Obviously, it's not my country, it's a country that I am interested in and look at, but there's that. Second comment, there are a lot of questions about the nature of the investors, again, process matters. When Energoprom was brought in as the investor in a significant chunk of the assets in the electricity sector, there were a lot of questions that were raised that said, "Where did this capital come from?" I don't still believe that I understand the answer to that question. It doesn't mean that the answer or the true answer is a bad answer. But, again, the lack of an orderly process, not only depresses the amount of money that an investor is willing to bid, but then leaves these questions hanging in the air for years to follow. And that doesn't do anybody any good.

VASILII RUKHADZE

Well, I don't have any structural experience dealing with the healthcare in Georgia, just the pure life experience when I lived there in mid-1990's. And regarding privatization, the first, my answer would be that that whole system is so expansive for the budget which is so small. Probably the size of one American county somewhere in New York state or New Jersey. So the country simply cannot afford it. I don't know how many hospitals have been privatized

in Georgia lately, I have not been there for awhile. But my experience in 1990's was that everywhere you would go for a medical treatment, the state of the medical stuff was just dismal. Everywhere you would go the hospitals were filled with new graduates from, I don't know, tens, dozens of the medical schools, is very little medical knowledge, and I hope the situation has improved much after that. And that was a huge burden on the government. But the methods of the privatization, I don't know how to reply, I don't know how they carry out the privatization. But overall, I do support it because like I said, I have personal experience, life experience with it. It was overstuffed, poorly funded, and largely, very unprofessional system, which needs to be treated, definitely.

ANDREW SIDAMON-ERISTOFF

Again, it all comes down to process and control. Privatization is a policy tool. It's a way to get something done. But it needs a control strategy at the same time. And I can't speak to what strategies are in place, but it sounds, from the tenor of your questions, and, and some of the other stuff that we've heard that they haven't implemented a comprehensive control strategy to make the process as transparent and as efficient as it might be.

KIM MARTEN

I would ask the next speakers to please keep your questions short and to the point.

ANATOLIZA

[UNCLEAR] I'll try my best [UNCLEAR] I also wanted to comment on the previous question. My name is Anatoliza [PH], I'm at the New York University, but formally from the Georgia Young Lawyer's Association. And first of all, my question to Mr. Elkind, I think I agree completely with your analysis on the energy regulatory commission and its role,

and my question is whether you have any specific policy recommendations I would love to hear them. The second question is concerning the transparency of revenues, budgetary revenues from extraction industries and from energy resources. I represent the organization that monitors continuously revenues from the Baku-Ceyhan, mentioned, Baku-Ceyhan pipeline. And I can assert to you that, for example, the last year, 40 million grant that was given to the state by the British Petroleum so-called “grant” was expended without any criteria on things from paying pensions to pensioners Samtskhe-Javakheti to building an amusement park in Borjomi. And when the Ministry of Finance is supposed to provide a quarterly report to the BP on how it spends the finances from the 40 million grant, and it doesn't, there are only two reports so far, after two years of operating out of these expenses. And unfortunately, it's neither the Ministry or the British Petroleum that cares about the reports and about the accountability. This is just to illustrate, I think, and tackle the previous question. So I was wondering, well I guess you already responded to that, if you would like to add anything on the general energy, transparency of energy revenues. And my last point on-, lack of process, concerning which I agree completely with you, but I think one of the main contributors to that is to your very right assessment on the ground, is the fact that unfortunately the government didn't do much to institute a viable and objective and independent civil service in the country. And this concerns the processes for recruitment, promotion, and dismissal of public officials, which is extremely politicized. So, I was wondering if you have any views on-, or your impressions on that. Thank you.

JONATHAN ELKIND

Yeah I just- a nickel's worth on the revenue issue and I'll-, as full disclosure, mention that I was a consultant for BP for a series of years in relation to the BTC project. The position of a major investor in a small country is very tricky, because it is inevitably the case that there are

accusations of trying to manipulate the host government, etc. But the reality is that the investor must find a way peacefully and respectfully to work with the host governments. BP went through a very difficult period in that summer of 2004 when it was being accused of all sorts of outrageous things, unfounded things, in terms of the despoliation of Georgia. And it, with some difficulty and some serious risk to a total of twenty billion dollars of investments made by BP and its consortium partners, it found a way to calm the waters with the then new Georgian government. And as a part of its global practices for how it does business, it called for transparency in the disbursement of those monies. So it is, I believe, not only inaccurate, but unfair to say that BP has no interest in the transparency. It does. But let's acknowledge, at the end of the day, it's not the sovereign in Georgia, the Georgian government is. And so, if as has been the case, the Georgian has not been interested to provide that transparency, that is to be laid at the feet of the government and not the investor. So, I think that BP deserves credit, throughout its Caspian activities, for being willing to stretch the envelope and increase transparency in forms that were utterly without precedent in the industry. That doesn't mean that they're perfect, and it doesn't mean that everything has been seamless. But nonetheless, I just wanted to inject that note of comment. It's a very, very complicated business to deal respectfully as an outside investor with a government that's, let's face it, very dynamic, lots of change going on, what's true one day is not true the next day. This is the reality of Georgia in a time of change.

VASILII RUKHADZE

I want to comment briefly regarding the failure of the government to create the professional civil service. I think the creation of a professional civil service is a life-long problem for any nation. For a developed nations. It's not like a one-time operation or surgery. You cannot create, overnight, in four years or five years or even ten years the professional civil service.

It is related to the larger picture and the problem of the economic development, of the political stability, and it's a sensitive question. But through development of a work ethic at large in a society. We just emerged from the Soviet mentality, and are still emerging from the Soviet mentality when-it's kind of harsh to say but-many people did no work but still survived. And this is the psychology which needs to be changed entirely. It's unimaginable that the fifteen ministers, four heads of the departments, and one president, can walk from door to door and control every civil servant. It's, again, the attitude of the society toward the work, and towards the shape up of the bigger structure, this is how I think.

ALEXANDER MELIGISHULI

Alexander Meligishuli [PH] , Monterey Institute of International Studies. I want to thank you, the panelists. Very informative comments and particularly your comments about the lack of the process. Very much appreciated, in fact I would like to ask you later on to-, if it's possible, to get a copy of your speech, it will be very interesting. I have two somewhat related questions. And really quickly, how would you characterize the level of Russian investments in Georgia as of now? This is a bit tricky question, because it's sort of paradoxical, because we have very antagonistic relations with our giant northern neighbor. And yet it seems that the level of investment is quite significant. In particular to Mr. Elkind, this question, more specifically, how would you characterize the level of Russian investments in the energy sector in Georgia? And then, the sort of comment that I would like to hear your comments about. In general, with regard to investments in the post-Soviet space, Russian investments have a tremendous advantage as compared to the Western investors who are far more risk-averse and far more reluctant to invest in the post-Soviet space. How would you address this program? Because now, you know, you have a situation in which Russian investments are actually making strides across the post-Soviet space. So, I would appreciate

your comments. Thank you very much.

JONATHAN ELKIND

[UNCLEAR] On the extensive Russian investments in the Georgian energy sector, Russian companies and Russian capital have some very important roles, including the role of AES Telasi. This is not inherently a bad thing. It does go back to the idea of proper checks and balance. I mean, one of the reasons why you need an energy regulator is to prescribe fair terms of operation that all operators are required to live up to. So if you take away the regulatory structure, you leave the consumer much less protected from the wilds of any investor of whatever nationality. Let's face the facts. The geography of Georgia is not going to change. That does not mean that any action that is taken by Moscow as a matter of state policy toward Georgia is acceptable. But there is this very fundamental fact, which is that Georgia needs to find a mutually acceptable way to live next to its neighbor. This is a challenge that falls disproportionately on Georgia. And if economics are-, I mean, Russia represents a huge potential market, which unfortunately, and I think to its own detriment the Russians have cut off now, Russia represents a huge potential market for Georgia and Georgia also represents an interesting market for Russian companies that are interested in doing business. That natural state of affairs, ideally, should be facilitated, not limited.

ANDREW SIDAMON-ERISTOFF

I can only respond to that from my perspective as a tentative minor investor in Georgia. I think it's important to make a distinction between being risk-averse, which you can deal with by simply increasing your projected or required rate of return, and being reluctant to invest because you are concerned about other standards of compliance. What am I talking about? I, from time to time, have talked to people about investing in Georgia. And very often, in

different ways, the main challenge arises in terms of the opacity of business affairs in Georgia. In other words, as an American investor, we operate here with certain standards of transparency and accountability. Regular financial reporting and so forth. At least in my limited experience, I have not seen the same expectation in every circumstance in Georgia. And indeed I suspect that may be the case in much of the world. So I would say that maybe the Russians are a little bit more comfortable with that state of affairs than the typical Western observer, or potential Western investor. I, for instance, am a former tax administrator, I won't invest in a situation where I would feel any confusion in reporting the entire transaction to the IRS. I need everything to be so squeaky clean and transparent. That standard may not be ubiquitous or pervasive in other parts of the world, including, in some cases, Georgia.

VASILII RUKHADZE

Just briefly, to comment on the general comment on Russian investments in Georgia. Overall, we have to understand the sensitivity of current Georgian administrations and Georgian societies at large in regards to Russian investments, whatever kind it is in the country. Everybody's concerned every time we hear something from the newspaper or the TV channel, "Oh, is this new investment or is this takeover? What they are planning to do?" So it's a very, very sensitive issue. As the current administration many times declared that the Georgian market and the infrastructure and everything else is absolutely open for the Russian investment. They are very welcomed. Unfortunately, well, there was some kind of some Russian investments lately in Georgia. But unfortunately, the bigger portion falls into illegal investment, let's say in Abkhazia, which is on the Georgian embargo right now. And this issue, somehow, is related-, is a question of politics rather than just pure economic benefit on part of Moscow, I think so.

KIM MARTEN

One last question. And when the panelists are responding, could I ask you to think of this as your final remarks as well.

TOBY DAVIS

Thank you very much. Toby Davis, US Department of State. What would you panelists recommend that the Georgian government and the Georgian citizenry do to encourage the development of a “culture of process”? Is there anything they can learn from their successful reforms? Is this generation of Georgian leaders capable of encouraging the development of process, and for that matter the payment of electricity? The Georgians went from people who did not expect to pay for their electricity, if I understand correctly, they know they must pay for electricity now if they want it. Is that an example of process or just “big people” telling them to pay their bills? Thank you.

KIM MARTEN

Should we just go in the order that?

ANDREW SIDAMON-ERISTOFF

[UNCLEAR] I think in many respects the government has been heading in the right direction, and is slowly developing this culture of process. I say this knowing I’m going to take a little bit of an intellectual risk here, but people in power have to lose elections every now and then. And until they’ve been through several cycles of opposition and power and back and forth, I’m not sure that the leadership of Georgia, both in terms of this opposition and in the current government, I’m not sure that process or an appreciation for the value of

process will arise until there's been some experience going through that loop. That's my sense of it. I have no horse in the coming elections in January. And, you know, I hope that they are fully transparent and fair, and that they are perceived as such in the international community. I think it's critically important for Georgia. But I guess I would add in the final analysis, what I would like to see happen is I would like to see Georgian politics be very boring. Right? You know, just as boring as most American politics really is. And then you'll know that there is a culture of process and normal process of politics that supports governance. Thank you for having me today.

KIM MARTEN

[UNCLEAR] You want to go next?

VASILII RUKHADZE

Sure. Regarding the current Georgian administration, in general, the progress in Georgia, well I was born in Georgia and I grew up in one of the most painful periods of recent Georgian history in early 1990's when everything around me was in turmoil. I remember darkened Tbilisi and other cities. I remember the armed mobs, the roaming the streets of my city. I remember myself sitting in a dark room without electricity for a week. I remember people fighting each other for a bucket of water, and I remember absolute devastation when you had to stand in a line for bread for about four, five hours in the freezing temperature below zero. I don't see any of that in Georgia right now. Is there progress? I guess so. What the Georgian administration has to do? A lot and there is a [UNCLEAR] now to be down there and all these reforms should be moved down to the medium and the lowest level of infrastructure and the social services. I think the Georgian government should push very hard to development the professional cadres from the young people, to recruit the people the

Georgian immigrants, there are about one million about the world. Bring them back to Georgia. And there is a lot depending on the society, also. It's only about-, any nation-building process is about the developing the hard-working ethic. When you finally realize that there are no lights, there is no water, there is no bread, if you do not really, really work. And again, it's related to the question of developing the social culture, the civic culture. When you really feel that this neighborhood, this city is yours. And it's you, not only the policeman on the corner, who has to take care of it. I think there are absences of these two elements in Georgian society right now. The hard-working-, the work ethic. And the absence of civil culture. If we deal with this, there's a site of progress. And of course, the government, any government, not only the current administration, has a share in it. After the Rose Revolution, government was heavily concentrating on the development of the state structures like security, army, the building of the new roads, and the foreign policy has been heavily, how to say, taken care of. And I think the government kind of missed out that society. Kind of. But after all, it's not a big crime. We came up from real darkness of 1990's when there was a question about whether Georgian state existed at all. So we have to compare, take a bigger picture and judge from this. So it's a double-shoot work. From the part of the government and from the society. You cannot expect the government to do everything. This is a Communist mentality, which did not work, and the country collapsed. And it collapsed on our heads and it's enough. It was enough. So I think society has to wake up and take its part of responsibility. And hold the government accountable also, I don't release them from the responsibility. This government has done many things and they have to do many more things regarding the question whether they are capable of doing it. In the political forces which existed in 1990's, so far, this group of people proved that they can do something. So I think we have a right to expect something from them in the future also. Thank you for having me.

