

GEORGIA AND MOLDOVA: ECONOMIC ASPECTS OF DEMOCRATIC STATE BUILDING

Democratic state building is the multidimensional process and its economic pillar is the most fundamental one. The objective of the work is comparison of economic transformation of Georgia and Moldova. The paper stresses relationship of economic transformation and democratic state building in both countries on the bases of the Bertelsmann Index (BTI). The comparison revealed that both countries have almost similar positions in market transformation. Also, private property and organization of market and competition (subindexes of the market development) are in more high correlation with democratic transformation in these countries than other pillars. The author offers a theoretical approach to evaluate the success of economic transformation in EaP countries on the basis of correlation of BTI and the European Integration Index . There is an attempt in the paper to find certain correlation between the integration level of Georgia and Moldova into the EU and BTI economic transformation indicators of these countries. On the current stage of the study revealed that the management and approximation pillars of EaP Index have higher significance for successful political and economic transformation processes, than sub index - linkage.

Key words: comparison of economic transformation of Georgia and Moldova, Bertelsmann Index, EaP Index.

Georgia and Moldova have small open economies. The market transformation process began almost simultaneously in these countries. Although some directions of transformation had different levels of success in these countries, the indicators of BTI (which is discussed below) mainly have been approximating. Georgia has succeeded in eliminating corruption, but Moldova still faces challenges in fighting corruption. However, Moldova has more achievements in poverty reduction, which is reflected in reduction GINI coefficient and poverty level (see this and other comparative data in the table 1).

Table 1

Georgia and Moldova: Comparison of Key Indicators (2013)		
Population Georgia 4,5 M. Moldova 3,6 M.	HDI Georgia 0,745 Moldova 0,660	GDP p.c. Georgia 5901 \$ Moldova 4181,7 \$
Pop. growth (% p.a.) ⁽¹⁾ Georgia 0,6 % Moldova 0,0%	HDI rank of 187 Georgia 72 Moldova 113	GINI Index Georgia 42,1 Moldova 33,0
Life expectancy (years) Georgia 73,8 Moldova 68,6	UN Education Index Georgia 0,842 Moldova 0,714	Poverty ⁽³⁾ Georgia 35,6% Moldova 4,4%
Urban population (%) Georgia 53,0 % Moldova 48,4%	Gender Inequality ⁽²⁾ Georgia 0,438 Moldova 0,303	Aid per Capita Georgia 111,3 \$ Moldova 77,1 \$
<i>Compiled by the author according to the World Bank, World Development Indicators 2013 / UNDP, Human Development Report 2013.</i>		
<i>Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$2 a day.</i>		

The author shares the key assumption that economic development contributes to the democratization process, as evidenced by number of theoretical and empirical studies. For example, analysing transition process EBRD points out that "Although the research community remains divided, there is strong support for the proposition that increases in economic development are likely to lead to an increase in democracy (TRANSITION REPORT 2013, EBRD, p. 25) ...Does economic development encourage democratization in transition countries? The literature suggests at least four reasons why average per capita income might influence a country's propensity to democratise. At higher average income levels, high-income voters will be more willing to accept the redistributive consequences of democracy, especially if the costs of repression are considered excessive. Development is generally correlated with lower levels of inequality, at least in the long term. Development is linked to a shift in the nature of wealth – that is to say, from fixed assets, such as land, to mobile capital. Higher per capita income is associated with education and secularization, with educated citizens being more likely to demand political participation and to embrace democratic beliefs (TRANSITION REPORT 2013, EBRD, p. 27).

Taking into account above mentioned we consider that brief overview of the development of the both countries' economic development issues will be helpful for introducing the main question.

According to the World Bank data (<http://www.worldbank.org/en/country/moldova/overview> 2015), Moldova's economic performance over the last few years has been relatively strong, aided by improved fiscal, monetary and exchange rate policy. Moldova experienced the highest cumulative GDP growth, relative to the pre-crisis year of 2007, in the region. However, growth has been volatile because of climatic and global economic conditions. Real GDP grew by 7.1 percent in 2010 and 6.4 percent in 2011. In 2012, GDP contracted by 0.7 percent, as the economy was hit by a drought-induced contraction in agriculture (-22.3 percent) and the Eurozone crisis. In 2013, growth rebounded, driven by a record harvest, with GDP increasing by 9.4 percent. Due to the weak economic activity of major economic partners and Russian trade restrictions, growth decelerated to a still strong 4.7 percent in January-September 2014, y/y. However, economy decreased 3.7 percent in the third quarter of 2015. Due to a bad harvest, agriculture decreased 17.4% and on the expenditure side the internal demand was weak due to low remittances (also, see Social and Economic situation of the Republic of Moldova, p.24). Nonetheless, good economic performance in the first half of the year, maintained Moldova's GDP growth positive, increasing 0.5 percent, y/y, in January-September 2015. The existing macroeconomic framework is considered broadly adequate, even though macroeconomic risks associated with the financial sector, vulnerabilities to external and climatic shocks, institutional weaknesses and related slippages in the implementation of macroeconomic and structural reforms will continue to be substantial over the medium-term. European integration anchors the Government's policy reform agenda, but political tensions and weak governance pose risks to reforms. Moldova's recent economic performance reduced poverty and promoted shared prosperity. The national poverty and extreme poverty rates, using national poverty definitions, fell from 30.2 percent and 4.5 percent in 2006 to 16.6 percent and 0.6 percent respectively in 2012, making Moldova one of the world's top performers in terms of poverty reduction. Similarly, consumption growth among the bottom 40 percent of the population outpaced average consumption growth. Despite a sharp decline in poverty, however, Moldova remains one of the poorest countries in Europe. The most vulnerable groups at risk of poverty in Moldova remain those with low education levels, households with three or more children, those in rural areas, families relying on self-employment, the elderly, and Roma. Additionally, the reduction in remittances could negatively impact consumption and poverty. Moldova performs well in some areas of gender equality, yet disparities persist in education, health, economic opportunity, agency and violence against women. Human trafficking is a serious problem; Moldova is a source, and to a lesser extent a transit and destination country, for both sex trafficking and forced labor. Considering the fragile economic and political external environment the pace of reforms must be accelerated. Key challenges include fighting corruption, improving the investment climate, removing obstacles for exporters, channeling remittances into productive investments, and developing a sound financial sector. Moldova needs to

improve the efficiency and equity of its public spending, in particular through better management of public capital investments, which are crucial for higher growth. Administrative and judicial reforms remain a challenge for improving public sector governance, which is a precondition for European integration and economic modernization.

According to the World Bank data (<http://www.worldbank.org/en/country/georgia/overview#1>, 2015), the signing of the Association Agreement with the European Union in June 2014 and the coming into effect of the Deep and Comprehensive Free Trade Area (DCFTA) in September are landmark achievements for Georgia. With greater policy certainty, there was an uptick in business and consumer confidence leading to an output expansion of 6.0 percent year-on-year in the first half of 2014, up from 3.2 percent in 2013 as a whole. Georgia's economic growth is projected to be an average of 5.5 percent per year over the medium term based on greater policy certainty, improved market access, and strong structural reform implementation. Medium-term growth prospects depend on a number of factors, including improved economic ties with the EU and the robust reform program outlined in the Government's development strategy, which will support growth in private investment. It seems, due to some external and internal factors some prognosis become unrealistic. According to the geostat.ge Georgia's real GDP growth was 3,4 % in 2013, 4,6% in 2014 and 2,8% in 2015 year (National Statistics Office of Georgia). Although it is important to mention, there are great expectations, that growth prospects depend on Georgia's ability to leverage the Deep and Comprehensive Free Trade Area and Association Agreement with the EU, which will improve market access and encourage FDI.

Net FDI is likely to amount to 6.3 percent of GDP on average, while the national savings rate is expected to increase to 20.5 percent of GDP by 2017. Georgia's public debt remains sustainable. Total public sector debt fell from 38.7 percent of GDP in 2010 to 32.2 percent in 2013 due to continued fiscal consolidation efforts. About 80 percent of public debt in 2013 was external and was dominated by bilateral and multilateral debt. Located on the shortest route between Europe and Asia, Georgia's transport system is a key link in the historic "Silk Road". The Government's commitment to rehabilitating main, secondary and local road networks has intensified in response to the global economic down-turn, as road rehabilitation will improve access to markets and services, and create short-term employment through civil works. Georgia has a developed, stable and reliable energy sector but efforts are required to improve the efficiency in domestic energy use. The most promising source of additional energy generation is hydropower and the Government is focused on securing private investments for construction of new hydropower stations. Currently, only 12 % of Georgia's hydropower potential is being utilized. Georgia has also adopted a State Strategy for Regional Development to create a favorable environment for regional socioeconomic development and to improve living

standards. Addressing regional disparities, poverty, and unemployment has been flagged as a key priority for intervention by the Government in its new Socioeconomic Development Strategy of Georgia: 2020. One of the potential drivers of economic growth in cities and regions is tourism, which recently saw rapid growth in Georgia and has become an important source of job creation. The number of visitors increased from 560,000 in 2005 to 5 million in 2013, with 6.3 million expected in 2015. An integrated and demand-driven approach to regional development has been designed with the support of the Bank and is currently seen as critical in spurring growth and job creation in historic cities and cultural villages (<http://www.worldbank.org/en/country/georgia/overview#1>, 2015).

There are different approaches to determine economic transformation processes. The paper stresses relationship of economic transformation and democratic state building in both countries on the bases of the Bertelsmann Index (BTI). It gives us opportunity to compare economic transformation in the field of socioeconomic development, organization of market and competition, currency and price stability, private property, welfare regime, economic performance, sustainability; to analyze similarities and differences and reveal correlations with democratic transformation (see below table 2). (The BTI is published every two years and allows us to assess observed trends and identify the outcomes of transformation strategies. The state of economic transformation (market economy status) is measured in terms of seven criteria, which are based on a total of 14 indicators. The BTI's concept of a market economy includes not only aspects such as economic performance, regulatory or competition policy and property rights; it also includes elements of social justice, such as social safety nets, equality of opportunity and sustainability. In BTI terms, comprehensive development not only aims at economic growth, but also requires successful poverty alleviation and the freedom of action and choice for as many citizens as possible) (<http://www.bti-project.org>).

Table 2

**The State of Economic Transformation of Georgia and Moldova
According to the BTI, 2006-2014 (evaluation scale: 0-10)**

Year	2006		2008		2010		2012		2014	
Country	Georgia	Moldova	Georgia	Moldova	Georgia	Moldova	Georgia	Moldova	Georgia	Moldova
Level of socioeconomic development	4,0	3,0	4,0	3,0	4,0	3,0	4,0	3,0	4,0	3,0

ent										
Organization of market and competition	4,5	5,0	7,0	5,5	7,5	5,5	7,3	6,0	6,8	6,5
Currency and price stability	9,0	6,5	8,5	7,5	7,5	7,0	6,5	8,0	7,0	8,0
Private property	5,0	5,5	7,5	5,5	7,0	5,5	7,0	6,5	6,5	6,5
Welfare regime	4,0	4,0	4,5	4,0	4,0	4,0	4,0	4,5	4,5	4,5
Economic performance	6,0	5,0	7,0	5,0	6,0	5,0	5,0	5,0	6,0	5,0
Sustainability	5,0	4,0	6,0	4,5	6,0	4,5	5,5	5,0	6,0	5,0
Market Economy Status	5,4 (#64)	4,7 (#82)	6,4 (48)	5,0 (78)	6,0 (#56)	4,9 (84)	5,6 (64)	5,4 (67)	5,8 (#57)	5,5 (#67)
Plase in category: functional	functioning (11), functional flaws (48), poorly functioning (38)	functional flaws (48), poorly functioning (38), rudimentary (8)	functioning (14), functional flaws (51), poorly functioning (38)	functioning (14), functional flaws (51), poorly functioning (38)	functioning (14), functional flaws (53), poorly functioning (39)	functional flaws (53), poorly functioning (39), rudimentary (7)	functioning (15), functional flaws (51), poorly functioning (40)	functioning (15), functional flaws (51), poorly functioning (40)	functioning (15), functional flaws (50), poorly functioning (39)	functioning (15), functional flaws (50), poorly functioning (39)

Democracy status	6,1	5,4	6,9	6,9	6,1	6,7	6,2	7,1	6,5	7,2
Status Index (Democracy + Market Economy Status)	5,7	5,1	6,6	5,9	6,0	5,8	5,9	6,2	6,2	6,2

Source: Compiled by the author according to the BTI data - <http://www.bti-project.org>

It seems, that both countries have almost similar positions in market transformation. If there were some noticeable differences in previous years, now there is a trend of convergence.

Level of socioeconomic development is unchanged 2006-2014 years and Georgia has 4,0 and Moldova has 3,0 out of 10 points. Organization of market and competition position was more successful in Georgia in previous years, but in 2014 both countries have similar indicators: Georgia - 6,8 and Moldova - 6,5. The same may be said about private property. According to the 2014 year data, Georgia has 6,5, as well as Moldova. As for Currency and price stability, if Georgia had high indicator in 2006, in the following years Moldova showed even better results, but difference is not large (Georgia - 7,0 and Moldova - 8,0, 2014). Welfare regime is convergence in recent years in both countries. Economic performance and sustainability were equal in 2012 (5-5) and according 2014 data for Georgia is 6,0 and for Moldova - 5,0. The Difference is not high, it is only a one point.

Primary observations show, that from the determinants of market economy status, both private property and organization of market and competition are in more high correlation with democratic transformation in these countries than other pillars. Suggested idea is based on that fact that the market status is slightly better for Georgia than for Moldova, but the status of democracy is vice versa. Exactly these pillars improved in Moldova. Also, as mentioned above, Moldova has gained more success in poverty reduction, which seems affected on the improvement the status of democracy.

Georgia and Moldova have many similar peculiarities of economic development. The composition of GDP by sectors is similar. The most part comes on the service sector - 69.9% (2013 estimate) in Georgia and 66.2% (2013 estimate) in Moldova - in both countries; On industry sector - 21.6% in Georgia (2015) and 19,9% in Moldova; As for

agriculture sector, only 8,5% (2015) of GDP in Georgia and 13,8% (2015) of GDP in Moldova are created in these sectors while the most part population live in rural are in both countries - in Georgia rural population is 46,53 (2014) and in Moldova - 55,08 (2014) (Global Data; Trading Economics). High share of services in these countries does not reflect the post-industrial stage of development. High share of the rural population indicates that human potential is not properly implemented, while the both countries have high Education Index and HDI is not low, particularly in Georgia (see table 1). We agree that, the relationship between economic development and democracy is considerably weaker in countries that rely heavily on the extraction of natural resources as a means of generating national wealth (TRANSITION REPORT 2013, EBRD, p. 25). It is recognized in both countries and radical changing the development paradigm is highlighted in National Development Strategies:

"Economic policy of the Government of Georgia is based on three main principles. The first principle implies ensuring fast and efficient economic growth driven by development of real (production) sector of the economy, which will resolve economic problems that exist in the country, create jobs and reduce poverty. The second principle implies implementation of economic policies that facilitate inclusive economic growth – it envisages universal involvement of the population in the economic development process (including Diaspora, migrants, ethnic minorities and other groups), prosperity for each member of society through economic growth, their social equality and improvement of the living standards of population. The third main principle is based on rational use of natural resources, ensuring environmental safety and sustainability and avoiding natural disasters during the process of economic development. Government of Georgia recognizes principles of democratic development, rule of law, efficient administration, respect for human rights and basic freedoms; the Government's policy is based on those principles"(Georgia 2020, p. 3).

"Economic growth in Republic of Moldova and the poverty reduction trend is closely correlated with the flow of remittances and consumption generated by the latter. Revenues from Moldovans' work abroad have fuelled the disposable income of households, thus leading to an increased aggregate demand for consumption. Constrained by the limited capacity of domestic production, this demand was largely met by imports of goods and services. The national public budget has benefited from this, but the trade balance has turned into an alarming trade deficit. Economic growth based on consumption and remittances exposes the economy to a number of vulnerabilities, but there is a greater danger associated with this model of economic growth, i.e. that remittances, at one point in time, will start to decline. Currently, migration breaks families of Moldovan citizens. .. Two conclusions emerge from the aforementioned: first conclusion relates to the fact that it will be difficult to maintain the pace of economic growth, which, in the absence of a structural change of national economy, proves to be unacceptable from the perspective of Republic of Moldova's development agenda; second

conclusion refers to the actual change of the growth model, namely: the need to replace the inertial growth model based on consumption fueled by remittances in favor of a dynamic model based on investment and development of goods- and services-exporting industries... Economic development, wherever it occurs, is based on three factors, namely accumulation of capital, labor force and its productivity level, which includes and other parameters, such as: technologies, efficient governance, skills, etc."(Moldova 2020,p 5-6).

The fact that both countries were socialist economies, they experience post soviet path-dependence up to now. Institutional Economics researchers pay particular attention to this issue. For example, Professor Gerard Ronald on the base of analysis of opinions of scientists Oliver J. Blanchard, Michael Kremer, Thierry Verdier formulate the opinion of particular methodological approach in the study of former socialist countries: "The output fall in Central and Eastern Europe forced economists to take a fresh look at how markets emerge. It is not just a story of supply and demand, forces that work well when markets pre exist, that is, when search frictions are not too significant and when there are strong formal institutions to enforce contracts and help resolve business conflicts. Supply and demand are thus only part of the story. But analyzing markets only the lens of supply and demand can result in misleading conclusions" (Ronald Gerard, p. 374).

It should be noted, that to overcome the difficulties of independent economic development and democratic state building, that began in both countries simultaneously, Georgia and Moldova choose the way of integration into the EU, which means supporting in institutional development. These countries are members of Eastern partnerships. The EU signed the Association Agreements with Georgia and Moldova on 27 June 2014 and a number of provisions, including the DCFTA. The cooperation with EU will significantly deepen political and economic ties between the EU and signatories with a long-term perspective and gradually integrate these countries in the EU's Internal Market. It is important to mention, that closer political association and economic integration with EU create certain preconditions for successful reforms in the field of strengthening the rule of law, advancing judicial reforms, fighting corruption, ensuring respect for fundamental rights and freedoms and strengthening democratic institutions, which in turn has tight casual relationship with market reforms (<http://europa.eu>).

There is an attempt in this work to find certain correlation between the integration level of Georgia and Moldova into the EU and BTI economic transformation indicators of these countries (*The European Integration Index for Eastern Partnership Countries* (EaP Index) charts the progress made by the six countries towards integration with the EU. The Index is designed to generate recommendations to guide countries along the reform process and to raise the alarm when countries depart from the expected trajectory, when progress is being held back or even reversed. The Index also serves as an important monitoring tool for both civil society and policymakers in the partner countries and the EU <http://www.eap-index.eu>).

At this stage, we can not generalize the desk research results, because the index is created only three years ago, but in the future on the bases of correlations between EaP Index and BTI Index we will draw conclusions about the impact of integration processes on the transformation processes. Now might be said that the management and approximation with EU and convergence progress in transformation processes will be more helpful for successful political and economic transformation processes (see below table 3) than sub index - linkage.

Table 3

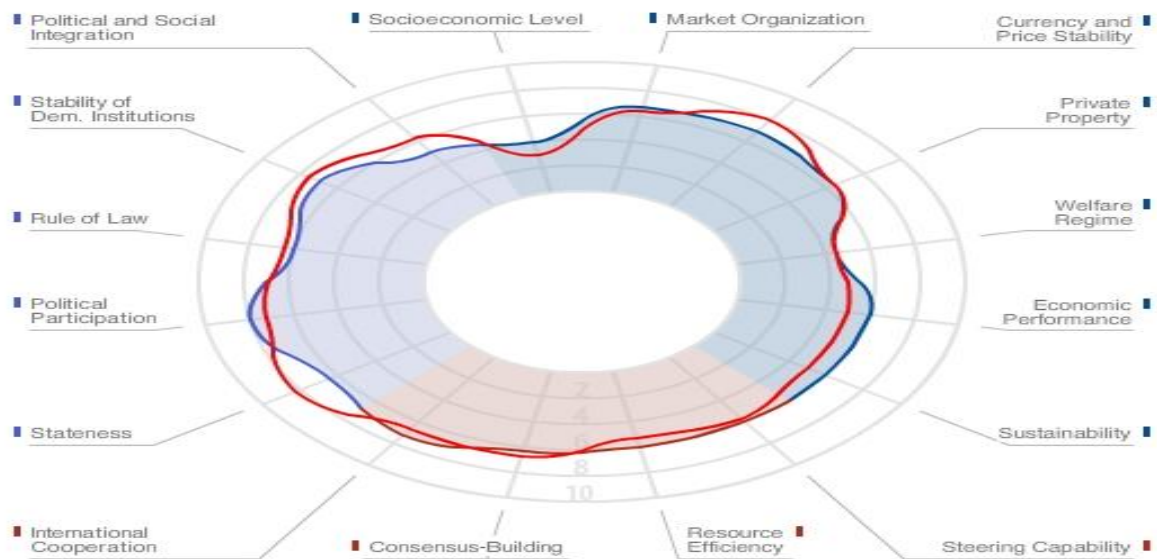
Year	2012		2013		2014	
	Georgia	Moldova	Georgia	Moldova	Georgia	Moldova
EaP Index:						
Linkage	0,54	0,69	0,58	0,70	0,59	0,70
Approximation	0,57	0,67	0,63	0,69	0,69	0,70
Management	0,58	0,58	0,58	0,59	0,74	0,71
BTI Status Index	5,9	6,2	-	-	6,2	6,2

Source: Compiled by the author on the base of [European Integration Index for Eastern Partnership Countries](#) <http://www.eap-index.eu> and BTI data - <http://www.bti-project.org>

Finally, the summarising figure 1 obviously show the similarities of democratic and economics transformation processes in Georgia and Moldova. The graph reflects all subindexes of BTI (Democracy status - state of political transformation; Market Economy status - state of economic transformation; Management Index - ranks the countries according to their leadership political management performance).

Figure 1

Comparison of transformation in Georgia and Moldova according to the BTI Index



Source: Graph by the author on the base of BTI data - <http://www.bti-project.org>

Conclusions

The comparison of transformation processes of Georgia and Moldova revealed that both countries have almost similar positions in market transformation;

Private property and organization of market and competition are in more high correlation with democratic transformation in these countries than other pillars of the Bertelsmann Index;

Theoretically it is possible to evaluate the success of economic transformation in EaP countries on the basis of correlation of BTI and the European Integration Index;

The management and approximation pillars of EaP Index have higher significance for successful political and economic transformation processes, than subindex - linkage;

The factor of path-dependence matters for correct evaluation of transformation processes in post socialist countries.

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