

## Ongoing process of privatization in Georgia

The current severe social-economic situation in Georgia has led to an urgent development of macroeconomic stabilization programs and the establishment of a system of changes in charge of anti-crisis measures. According to this program the new economical changes have focused on one of the main priorities, enforcement of the rate of privatization so as to develop the most profitable small-scale businesses.

For countries with a transitional economy, one of the main priorities is a well-conducted privatization process. The privatization of large enterprises and strategic objectives has a positive influence on the development of the state economic system.

The privatization process of public property began in 1992. Prior to this the proper legislative bases had already been adopted. 1,500 enterprises have already been privatized, but the number of properties still owned by the state is still large. 1,800 enterprises have been created, which are partially owned by the state. There are small, medium, and particularly important enterprises among them.

According to Georgian law, privatization is the process of changing a public entity or enterprise to private control and ownership, after which the Government stops the management of the privatized units.

The privatization of state property is performed through tender, auctions, lease or buy, and also by direct sale.

1. The aim of the sale via tender is to delegate the right to the property to the buyer, which proposes the best selling conditions;
2. The aim of sale via auction is to delegate the right to the property to the buyer, which proposes the highest price;
3. The aim of the sale via lease or buy is to delegate the right to the property via a final redemption of its material worth;
4. The aim of sale via direct sale is to delegate the right to the property to the buyer, will which fully and honestly execute the requirements of purchase of the State property.

The terms, conditions and decisions on direct sale are determined by the President of Georgia.

The Georgian Ministry of Economic Development or its territorial body makes the decision on the use of privatized forms; however the President of Georgia makes the decision on questions pertaining to direct sales.

It is important to take into consideration the privatization of large industries, most importantly agricultural and food industries.

Today the Chamber of Control of Georgia handles the oversight for the legal privatization of various enterprises. After transmitting the revision outcomes to the law-enforcement bodies the definite part of the privatized property was returned to the State. Those state officials are criminally prosecuted, which negligently conduct the privatization process.

According to research data conducted by the highest state auditing institution, the Chamber of Control of Georgia, which is, at the same time, pursuant to Georgian legislation, is the only state institution controlling privatization process, many subjective and objective

circumstances have been revealed which interfere with fair privatization processes in the country. The main objective circumstances include the lack of a full and detailed description of the procedures accompanying the privatization. We often meet circumstances that allow unethical statesmen the opportunity for corruption. Georgian legislation does provide for consequences of those disregarding the privatization process. It should also be noted that in many cases the price of state property is determined by independent auditors hired by the government, which very often provide non-realistic and lower-than-market prices. As a result of this, the privatization of expensive state property is done at a low price and imposes a negative fiscal effect on the country. The main responsibility is delegated to the independent auditors.

The privatization of strategic state property is very real. Due to national security reasons in Georgia and its surrounding regions, it is acceptable that the non-implementation of energy sector privatization (e.g. main gas pipeline) be approved not only by the law of “state property privatization”, but also by the supreme legal normative act, the Constitution itself. The subjective circumstances in the privatization process, the attitude of the people which are hired by the state, are a result of a non-effective bureaucratic system, low salaries and imperfect regulation acts, namely, in many cases, they purposefully try to enshroud information about state property privatization, and competition conditions are sometimes complicated. These cases, which lead to the reduction of the number of potential buyers (very often the competition is conducted with the participation of only one buyer), provide opportunities for corrupt negotiations. The bureaucracy offers the buyer a means to avoid oversight and the ability not to comply with contractual obligations.

It is visible by analysis that the progression of the privatization process of public property is considerably handicapped; it is dependent on whether the state has defined not a short and long-term privatization policy that will be an inseparable part of a centralized economic policy. It is significant that the privatization process is not transparent enough.

The Georgian President’ 1997 decree N 671 (Initial price determination order of privatization of state property) become a standard, on the basis of which, during the privatization process, the selling price of the state property may be determined as lower than its initial cost. In other words the determination of the price may be based on a state official’s individual decision. This norm allows the magistracy a degree of discretion, which may allow for an artificially low sale price and a corruption transaction. In most cases there is an irregular determination of the initial price of sale.

One of the methods of money laundering is included in that the heads of enterprises under privatization find potential buyers by themselves and establish relations with them in illegal ways to sell the enterprises. The privatization process of state property may be conducted by buyers by setting artificially reduced prices and establishing various private structures for the purpose of money laundering.

The privatization process of the enterprises may be conducted by leaders or responsible key persons within the organizations, via the changing of ownership, the reorganization or liquidation of its capital, and the seizure of such enterprises at the lowest price.

The starting prices of various privatization projects are not correctly defined by privatization commissions. There are no attached evaluations of the property worth and inventories. In some cases, the formulation of the price of state enterprises was formulated by independent auditors in ways which were neither correct nor transparent.

There are many cases of privatization of underground pedestrian throughways, which were conducted in violation of Paragraph G of the 3-rd Article of the Georgian law on "announcement concerning the delivery into private property of non-rural lands which are in the property of the natural persons or legal entities". Also, state property was privatized, which is prohibited under the law on "state property privatization", Article 4<sup>3</sup>

For example, during an audit on the legality of the privatization of LTD "Batnavtobimpex" it was found that the chairman of the Land Management Department of the Ajara Autonomous Republic presented a letter, which was dated July 1, 1999 # 01-04/148 (attached annex N148), to the chairman of the Cabinet of Ministers of Ajara, Mr.G.Tsintskiladze, about the draft decree of the ministerial cabinet concerning the "classification of the price determination of non-rural lands owned by the state in various parts of Ajara", which was based on the decree N59 "A" of the Cabinet of Ministers of Ajara dated July 6, 1999. According to the above mentioned document, the price for 1 sq. m. of the first sub zone of the first region of the city of Batumi was set at 35 GEL and 30 GEL was set for the second sub zone. According to information in the letter (N 01-09-112 dated June 29, 2004) of the deputy head of the Land Management Department of the Batumi City Administration, Mr.M.Tetemadze, we can see that the land area for LTD "Batnavtobimpex" (39, 89 hectares, three sections), which is located at the plywood factory "Kholodnaia Sloboda", must be evaluated at (39.89x30.00), calculation based on 1 square meter price. 11,967,000. 00 GEL. At the exchange rate of 1 USD is 1.98 GEL we can see that the starting privatization price for three parts of the mentioned land should have been 6,043,939.4 USD instead of 4,191,920.008 USD.

According to the general plan of LTD "Batnavtobimpex" belongs the Black Sea Coast area. The various fixed assets of "Batnavtobimpex" are allocated in the central zone of the first sub zone of Batumi, where price for 1 sq. m. is 35.00 GEL and the mentioned land area is 4.7 hectares. Based on the information obtained from Batumi Maritime Port it can be assumed that the mentioned enterprises do not fall under the category of water engineering structures, therefore, while privatization, the cost of the land must have been reflected in the selling price as well. Thus, there were not any restrictions for the privatization of the mentioned land area.

The price of the land area was (47,600x35) 1,666,000.00GEL or 841,414.10 USD using the exchange rate 1.98. Privatization of the mentioned land area must have been done according to the law on "announcement concerning the delivery into private property of the non-rural lands which are in the property of natural persons or legal entities" and the privatization price of LTD "Batnavtobimpex" must have been increased as well to the amount of 835,087.72 USD. Finally, the price of the mentioned land areas must have been much more than starting price.

In the process of privatization conditions and obligations of legal tender must be clearly defined, which must not be complicated with various barriers.

During the audit of JSC "Poti shipyard" we can see that according to the minutes of the session of the Georgian government dated February 26, 1998 and letters from the Ministry of Industry, the Ministry of State Property issued an order (N1-3/188 19.03.98) concerning the privatization of the share holdings (99,39%, 5,636,060 shares) of the JSC "Poti shipyard", which was state property and was sold at a symbolic starting price (1 GEL/share) through commercial competition with conditions of investment.

In the letter N 164 from the executive director of "Darling Worth Limited", dated 20 May 1998, the Privatization Commission of the Ministry of State Property has been informed that the mentioned company received information from the newspaper "Mesakutre" regarding the tender and was ready to participate in the competition. It is remarkable that in a list of such important objects for the state, it was not mentioned at the Ministry of Economic Development.

According to the minutes from the session we can find that only one application was received for the tender. "Darling Worth Limited" is a subsidiary of the "Hyundai" Financial Group and is registered in the British Virgin Islands town, Tortola.

The mentioned company, as it was underlined in the tender protocol, was presented as the subsidiary of the worldwide "Hyundai" brand, but they had no documents to prove this. According to the application of the tendered, "Darling Worth Limited" has taken the responsibility to execute all the tender rules; however the company was ready to pay the equivalent of 101,000 USD in the national currency. Also they were able to transfer 60,000 GEL to the state budget and 80,000 GEL to the Poti local budget. In the minutes of the tendering commission it is also mentioned that the members of the commission became acquainted with the letters of warranty presented by the "Intellect bank", which describe warranty and penalty payment conditions.

During the audit it was found that the warranty letter was presented de facto, but according the Article 6 of the competition rules, instead of 567,066 USD the same sum was indicated in GEL. In fact, the conditions of the competition were violated, which should be a reason for termination of the competition. The competition commission had not paid attention to this fact. According to the minutes of the competition commission, "Poti Shipyard" was sold to only one buyer, "Darling Worth Limited". The fact that only one buyer participated in the legal tender is a vivid example of how low the level of information transparency was.

During the privatization process the state does not maintain an equally fair policy, which indicates the fact that the focus is made only on the fiscal effect. For example, during the audit of JSC "Ferro", it was found that none of investment policies were implemented. Therefore, the privatization of 48% of the stocks of JSC "FERRO" conducted in 1998 should be considered as non-effective and non-profitable for the enterprise.

Thus, it is necessary to establish a clear and transparent privatization policy in long and short-term programs with an assessment of detailed conditions, directions, etc. In this way, the situation will be fully controlled. It is also important to assign a status of "normative act" to the program. Furthermore, it should strengthen the level of legality and its execution should be obligatory so as to prevent further illegal digressions in the field of privatization. This fact will reduce the possibility of the corruption, which will be the keystone for the correct and fair decisions.

The establishment of such programs will provide an opportunity for the state to sell property at the highest price and attract serious investors. This will also influence the level of unemployment and economic development. For national security and the stable cooperation with strategic partners it is necessary to list the objects not to be privatized (for example gas pipe lines) which will be determined by the highest state law, the Constitution of Georgia.

In order to ensure the transparency of the privatization process, it is also necessary to state the obligatory norms in the legislation and to establish direct monitoring and control of the execution of agreement requirements. The violation of the abovementioned conditions

should be the subject of legal arraignments. It is urgent to develop normative and legislative acts so that the executive power may function better.

The highest priority is the law, the simplification of judiciary procedures and transparency, and the reduction of variations of the laws as well.

Article 7 of the Georgian law on privatization of the state property has some discrepancies (different types of price reducing) and could be used improperly by unethical government officials. The main reason that market competition is not completely free is due to the fact that the market economy system is not yet fully established, which in turn affects economic development.