

# **EASTERN PARTNERSHIP AND CONVERGENCE WITH EU POLICIES IN GEORGIA**

Study Report on:  
Small and Medium Business  
Innovation Policy  
Social Dialogue



## EASTERN PARTNERSHIP AND CONVERGENCE WITH EU POLICIES IN GEORGIA

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Despite the present challenges to the European Union, the political, social and economic vision of a common European Project for all European countries and societies remains attractive and offers orientation in our rapidly changing environment. The Eastern Partnership proposes concrete formats for closer cooperation between what is today the European Union and their eastern neighbors. It opens opportunities and allows for the active participation in the construction of a wider European House in which the objectives of enduring peace, functioning democracy, and social justice in a social market economy can be achieved and implemented jointly in our societies.

However, for many people these nice-sounding perspectives appear to be distant and not very concrete. They have to be “translated” into the present day realities, and related to the problems and the needs of the people and the society. The project “Promoting and Stimulating the Eastern Partnership Work in Georgia” which is being organized by a group of well-established and successful civil society institutions and organizations, with the support from the German Friedrich-Ebert-Foundation, pretends to fill this gap and to generate more awareness and engagement of the society and its institutions in supporting the Eastern Partnership-Policy in Georgia. Based on a comprehensive research in the three main areas of concern, the project will contribute to debate and to an increased capacity of the Georgian society to make use of the opportunities related to EaP and offered by the European Project, based on the concrete needs and interests of the people and the society. Rather than importing models or imposing ambitious reforms from outside, these objectives will hopefully convert into processes of local and national ownership. If, together with our partners, we can contribute to this endeavor, it is not only challenging but worthwhile and well justified.

*Tbilisi, October 22, 2012*

**MICHAEL WEICHERT**  
*FES Regional Director*  
*South Caucasus*

## PREFACE

Becoming a member of the European Union has been the priority of Georgia's foreign policy since the very day of its independence. Relatively ingenuous expectations of the 1990ies gave way to more pragmatic and close to the reality attitude of the 2000ies. There was a moment when both the Georgian Government and the whole society doubted the possibility of joining the EU. The foregoing was conditioned by absence of real approximation with the EU (meaning the FTA, Visa-free , etc.). The situation has fundamentally changed for the past 2-3 years, first of all, on the part of the EU itself which involved Georgia into Eastern Partnership policy, simplified visa regime with it, signed several bilateral agreements establishing cooperation in specific fields and launched the negotiations on the association agreement aiming at creating the deep and comprehensive free trade area.

The EU-Georgian relationships have always played the role of the catalyst of the country's democratic and social-economic reforms. The EU has been intensively monitoring these reforms for years and, practically, the EU-Georgian relationships have become the major driving factor of the country's transformation. The institutional and political framework of cooperation, like the Partnership and Cooperation agreement,<sup>1</sup> the EU Neighbourhood policy (since 2004) played particularly important roles in proper flow of this process. The Eastern Partnership (since 2009) further enriched the multitude of political instruments, which will promote the Europeanisation and democratic transformation of the country. On the other hand, the main goal of this political framework is the creation of all the necessary preconditions for functional integration of the country with the EU, what does not mean the becoming of a member of the EU, however its essence is fully compatible with such an ambition.

The Eastern partnership, together with the set of related thereto instruments, will be the key factor for the determination of the main trends of country's development during the upcoming years. With the help of the instruments of bilateral and multilateral cooperation the country will be able to identify the main trends of its development in important areas like human rights and rule of law, institution building and good governance, provision for the security and stability, migration management and promotion of the free movement of citizens, Europeanisation of the legislative and regulatory framework, development of the fields of economy, further harmonisation of education with the European standards, etc. The proper development of the country in these directions will ensure Georgia's speedy approximation with the EU, and the implementation of the respective agreements with the EU - provide for moving to a new level of our relationships, free trade treatment, visa-free movement, close political partnership (association), the intensive inflow of investments and, respectively, of new technologies and know-how from Europe; close cooperation in all the other fields and eventual perspective of becoming a EU member.

The realisation of Eastern Partnership requires dedication and coordinated efforts of all the concerned state agencies. For this work to be really efficient, it is necessary to be well aware of the current reality, specifically to answer the questions like: What is the current status with the development of a specific field? What goal should we head to and what roads should we take? What is the respective environment and policy in the EU? Also, it is important to share this knowledge with the society at large, first of all, with all the interested persons, who are directly concerned with the outcomes of the mentioned fields. In our opinion the involvement of the civil society is of crucial importance, as every government needs

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<sup>1</sup> Partially in force since 1997, and fully effective – since 1999.

not only the Parliamentary oversight but also the monitoring of the civil society. For such monitoring it is necessary for the respective studies to reveal the shortcomings and the progress of a country.

Within the framework of the project implemented under the support of Friedrich Ebert Foundation<sup>2</sup> we have conducted a study in connection with three important topics of Eastern Partnership: support of small business, innovation policy and social dialogue. All these studies aimed at the assessment of the policy established within the EU, understanding of the current reality of our country and recommendations for the approximation of our official policy in these fields with that of the EU. All three topics cover the very important aspects of approximation with the EU and economical and social streamlining and development of the country. Introduction of the policy of supporting the small business is one of the important and strict requirements of the EU towards its partner countries. Regrettably almost nothing has been done in Georgia in this respect so far. The development and enhancement of the innovation policy is one of the necessary prerequisites for country's development. This policy should cover many fields and should create the basis and prepare the ground for the international competitiveness of the country. The social dialogue is one of the topical issues on the way to the European integration, it is supposed to regulate the relationships between the employers and the employees, to develop and agree the set of principles and rules necessary for these relationships. The study revealed many shortcomings of our policy pursued in these fields. The European experience is rich in the examples of settlement of similar problems, what is clearly demonstrated in all three studies.

We are willing to support the extensive communication of the outcomes of these studies. They include the recommendations, which can be directly applied by the respective governmental agencies for the attainment of the goals outlined within the framework of Eastern Partnership. To further increase the public activity, we would like to communicate the outcomes of the studies to the interested auditorium through a series of seminars. Thereby we will promote the launching and establishment of the public dialogue about these issues.

These papers will not cover the whole diversity of topics, the research and further coverage of which in the course of policy elaboration is absolutely necessary for the realization of Eastern Partnership and, in general, of Georgia's European aspirations. We hope that many Georgian experts and organizations will make their best efforts to contribute to this process and fill up the current deficit in the knowledge and vision necessary for the efficient implementation of the country's European policy.

I would like to thank all three teams of the researchers, and specifically their leaders – Mr. Oleg Shatberashvili, Ms. Nino Elizbarashvili, Mr. Dimitri Japaridze and Mr. Paata Beltadze. Also I would like to particularly mention the efficient assistance of the personnel of the Georgian Foundation for Strategic and International Studies – Ms. Ketevan Emukhvari and Ms. Ekaterine Meskhrikadze – with the project and specifically, with coordination of the practical issues related to this study.

And finally, I would like to thank the representative office of Friedrich Ebert Foundation in Georgia, whose assistance and efforts enabled us to implement these studies.

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<sup>2</sup> The Project name is: Promoting Eastern Partnership Work in Georgia . The Project is implemented by the Georgian Foundation for Strategic and International Studies in collaboration with the other organizations – European Studies for Innovative Development of Georgia, Association: Women and Business, Association of Georgian Employers, Georgian Trade Union Confederation.

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# Small Business Support Policy Analysis in Georgia

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## INTRODUCTION

Small and medium-sized enterprises (SMEs) traditionally determine the economic system's strength in a country and are the main source of job creation. The main factor of small business formation is the country's legislative environment. Since the second half of the 1990s, significant efforts have been made to establish the institutional foundations for SMEs. As a result of recent radical reforms, the number of newly registered enterprises in the country is rapidly growing. In 2007, this indicator totalled 207.9, making 366.2 thousand in 2011<sup>1</sup>. The share of GDP in the total number of enterprises is also increasing. It should be noted that in spite of the current reforms the number of circumstances interfering with small business development in the country is still significant. The elimination of said interfering factors is a very important task for timely coping with existing disproportions in the sectoral and geographical context of small business. In particular, the absolute dominance of trade and services sectors over the sectors of transportation, communications, construction and processing industry. At present, the SMEs' activity is almost fully concentrated in Tbilisi, in the regions of Imereti, Kvemo Kartli and Adjara, while Racha-Lechkhumi, Kvemo Svaneti, Samtskhe-Javakheti and Guria are almost marginalized in this respect. The circumstance that SMEs play an insignificant role in the country's economic development and that their share in the indicators of employment, GDP and total turnover is rather low is worthy of special concern. The lagging of SMEs is particularly noticeable in the sphere of capital investments and know-how and state-of-the-art technologies transfer.

The objective of this research is to analyze small business environment, legislation and special local or international programs in Georgia. The factors stipulating low indicators of SME business activity are to be studied. Attention will be paid to the European SME promotion model. The emphasis on the EU experience has been conditioned by the following two factors:

- Small business promotion has been recognized as the main conditioning factor of the economic policy in the EU and for the last 10 years special activities have been carried out to realize the issue at political, administrative and institutional levels.
- In Georgia, a special significance of the country's European integration strategy has been clearly declared lately. The proof of preparing the soil for deep and comprehensive Free Trade Agreement is considered the accelerated process of approximation of the Georgian legislation with that of the EU that has become the mainstream of the Georgian economic legislation. Accordingly, it is very important that the legal approximation process took the right direction and the wrong interpretation of the EU priorities in this process be excluded.

The above-mentioned factors have conditioned the conduct of this research, which will study the international community's attitude toward small business as the conditioning factor of economic and social progress of the society on the one hand. On the other hand, on the basis of the model existing in the EU and the criteria introduced in practice, the current situation concerning the small business sector in Georgia have been considered, the economic policy conducted in the direction of SME assistance and small business economic indicators in the last decade has been assessed, as well as the activities in the direction of SME assistance in Georgia taking into account the principles of the Small Business Act, which, though not binding, is widely applied both by the EU and the world community.

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<sup>1</sup> GeoStat



## RESEARCH DESIGN

The objective of the research is to study the environment and the policy followed for the last 15 years in the small business sector, where SMEs are operating. The research design includes a combination of qualitative and quantitative methods. By means of a desk study the main international documents with the administrative and international status which relate to the economic policy, are direct sources of influence of SMEs operation and give us the opportunity of estimating and characterizing the situation have been studied. Also official statistics and existing scientific research, business, reference or any other information connected with the issue have been analyzed.

In addition to the analysis of secondary sources, the attitude of the population towards the topical issues of small business has been investigated. The collection of primary data was carried out in the predetermined geographical area. The quantitative data were obtained with the help of questionnaires made up beforehand, focus groups and in-depth interviews being the source of the qualitative data, by which the attitudes of the small business-integrated population groups with different statuses have been studied.

Quantitative methods were used to investigate a range of SME problems, the entrepreneurs' assessment of the environment, their investment and export activity conjuncture, etc. Overall, sufficient quantitative and qualitative research data have been obtained from the primary source. A comparative analysis method was used in the course of research enabling us to compare the Georgian small business policy to the advanced international experience. A special attention was paid to the demonstration of the EU small business policy, taking into account the processes taking place after 2000. Based on the principles of operation of the Small Business Act, the Georgia's small business operational environment was estimated and recommendations for its improvement were worked out. On the whole, the developed research design suffices to ensure the reliability of the conclusions drawn on the small business policy status in Georgia.

## RESEARCH RESULTS

### Small Business Support Policy in 1999-2010

The formation of the institutional and legislative system for the SMEs development began in Georgia in the late 1990s. The Law on the Support of small-scale enterprises passed in 1999 defined the main principles of SMEs' development. A Center for the Development and Assistance of small-scale enterprises was also set up under the presidential decree. Within its competence was implementation of SME assistance activities and special aid programmes.

Based on the governmental assistance concept and the special programme implementation, the process of the small-scale enterprises' growth became stable and efficient. International experience of small business support in the countries of transition was studied. The necessary SME assistance mechanisms were identified and later introduced in practice. In spite of this, the early 2000s were fraught with many obstacles interfering with SMEs' development: chronic budget deficit, systemic corruption, rigid bureaucracy. The tax and customs systems were extremely inefficient and corrupt. All the enumerated factors could not but affect the business environment quality. Accordingly, irrespective of the carried out legislative and institutional measures and owing to the said interfering factors, no real effect was achieved and small-scale business exhibited a tendency to worsening of the main activity indicators during that period (see Diagrams 5 and 8).

Under Decree #309 of the President of Georgia dated 22 June 2002 "The State Aid Programme of Small and Medium-Sized Enterprises in 2002-2004" was approved. The mentioned programme implied the Government's support of enterprises using the two main methods:

#### **1. The provision of financial assistance:**

- small size direct loans;
- issuing for small-scale enterprises guaranties for getting loans in commercial banks;
- subsidizing the bank credit interest rates.

A special organization established with the aim to assist enterprises would issue guaranties to the selected SMEs in case they fail to meet the commercial banks' claims to mortgages or business risks. The purpose of subsidies was to reduce high interest rates of commercial banks and make the cost of credit acceptable for enterprises. The government used the interest rates' subsidy programme to finance economic and social projects in the preliminarily defined priority spheres.

#### **2. Information, consultation, education and training spheres:**

The programme aimed at satisfying increasing demands of SMEs in the information-consultation sphere. In the programme implementation course, the Centre for the Development and Assistance of Small-scale Enterprises was fulfilling two main goals:

- Information support of the main means and methods of small-scale business promotion;
- Promotion of the enterprises' staff training and the entrepreneurial culture establishment.

So, the following laws and bylaws were adopted in support of small-scale business in Georgia before 2006:

- The 23 July 1999 Law of Georgia on the Support to Small and Medium-sized Enterprises;
- The President of Georgia's Decree of 26 January 2000 "On the Establishment of a Coordinating Board of Small-Scale Enterprises";
- The President of Georgia's Decree #134 of 8 April 2000 "On the Approval of Regulations of the Centre for the Development and Assistance of Small-scale Enterprises";
- The President of Georgia's Decree #309 of 22 June 2002 "On the State Aid Programme for Small and Medium-Sized Enterprises in Georgia in 2002-2004";
- The Government of Georgia's Resolution #21 of 13 April 2004 "On the Establishment of the Office of the State Minister of Georgia for Support of Small and Medium-Sized Enterprises".

The Law "On the Support to Small and Medium-Sized Enterprises" was reversed in 2006. The Government officially declared a liberal economic policy, which, together with other issues, implied the introduction of a policy of non-intervention and concurrently the creation of equal conditions for all enterprises, irrespective of their size. Accordingly, the government was striving to put into effect a favourable business environment, liberal taxation regime, a simplified system of granting licenses and permits. Upon reversal of the Law "On the Support to Small and Medium-Sized Enterprises" the definitions on the small and medium-sized enterprises have been transferred into the Law "On the Georgian National Investment Agency". Currently, only the Law "On the Georgian National Investment Agency" provides us with full-value definitions of small-scale business<sup>2</sup>:

- A small-sized enterprise means an enterprise of any organizational and legal form set up according to the Law of Georgia "On Entrepreneurs", where the annual average number of employees does not exceed 20 and the annual turnover does not exceed GEL 500 000;
- A medium-sized enterprise means an enterprise of any organizational and legal form set up according to the Law of Georgia "On Entrepreneurs", where the annual average number of the employees does not exceed 100 and the turnover is not more than GEL 1 500 000.

We can also find the definitions of small-sized enterprises in the Tax Code:

- The status of a micro business can be assigned to an individual who conducts economic activities independently without hiring employees and receives annual gross income up to GEL 30,000.
- The status of a small business can be assigned to an individual entrepreneur who receives annual gross income from economic activities up to GEL 100,000.

In that way, the small business definitions given in the Tax Code come into conflict with the definition given in the Law on the Georgian National Investment Agency, where the annual turnover limit for a small-scale enterprise constitutes GEL 500,000.

<sup>2</sup> The Law of Georgia on Amendments and Addenda to the Law of Georgia on the Georgian National Investment Agency, Parliament of Georgia, #3087, 24/05.200

The effective Georgian laws do not provide for any special privileges for SMEs. An exception is the tax allowances applicable to micro and small enterprises in the new Tax Code. Based on the given information, one may get an impression that small business support is not considered as the primary source of improvement of the economic situation, which, in its turn, needs promotional activities at the economic policy level. Analysis of the main indicators of economic activity/performance of SMEs for the last 12 years enables us to clearly see tendencies for worsening their performance indicators as compared with large enterprises (see figures 5, 6, 7, 8). Such tendencies can be explained by deterioration of the SMEs' competitiveness factor, where the refusal to implement small business support activities for the last 6 years has played a role. In particular, the reversal of the special Law on SMEs and of relevant normative acts resulted in the gradual deterioration of the SMEs' performance indicators<sup>3</sup>. It is natural that the reason for the deterioration of small business performance is not only the local factors. The embargo imposed by Russia in 2006 and the global financial crisis had an indirect impact on this category of enterprises.

As things now stand, the Government does not seem to have any long-term vision of the necessary activities for SMEs development and support. No strategic development document reflecting an action plan and main concepts of ensuring the growth of SMEs has been worked out. It is noteworthy that in 2009 the civil movement Solidarity drafted a law on small-sized enterprises, which was passed for the consideration to the Parliament of Georgia. Regrettably, this draft law has not been considered up to this day.

It should be noted that in spite of the absence of the strategic development plan, the Government has been carrying out different promotional projects for SMEs lately. Naturally, such projects are financed from the governmental financial resources. For example, according to the governmental Resolution #110 of 30 May 2007, a programme "Employment through the Small and Medium-Sized Enterprises Development" was approved.

In terms of the SME support projects organized by the Government, also noteworthy is the Tbilisi City Hall's programme "Start Business with the Support of Tbilisi City Hall"<sup>4</sup>.

#### **Box 1: Employment through small business development, 2007**

*The aim of the governmental programme was to promote population employment by supporting the regional economic infrastructure and assisting the economic activity of small and medium-sized enterprises engaged in the sphere of tourism through improving their access to credit recourses. The commercial bank chosen by the government under the programme was granted a loan in the amount of GEL 5 million to be allocated among SMEs. The annual interest rate on the loan provided by the bank totalled 12%, which was much cheaper as compared to the operating then market price. The maximum loan term was 5 years. The entrepreneur could enjoy a 1 year grace period from the loan payment, and the maximum loan amount was GEL 50,000. The loan was given to the beneficiary SMEs for the development of tourism infrastructure (hotels, agro-tourism, catering, etc.) and for the carrying out of related activities (rental of travel equipment, folk craft, etc.). The programme also envisaged the arrangement of free training courses and consultations for the beneficiary enterprises' managers to improve their tourism business specificity, business plans, marketing, management and financial skills. During 6 months from the beginning of the programme more than 1,000 applications were filed, out of which nearly 20% were satisfied by the bank in all the regions of Georgia.*

<sup>3</sup> GeoStat, 2011

<sup>4</sup> [www.new.tbilisi.gov.ge](http://www.new.tbilisi.gov.ge)

In addition to the above-mentioned programmes, funds from the state budget have been allocated to finance the following special support programmes:

In 2007, a “Purposeful State Programme for Vocational Training on the Workplaces” was financed in the amount of GEL 20 million, in 2008 – GEL 62.5 million within the frames of “Cheap Credit” programme, from which GEL 49.5 million were spent on the export promotion subprogram. In 2009, the “Cheap Credit” programme used GEL 2.5 million. In 2009-2011, the “Cheap Credit” programme was no longer funded.

Worthy of mention are small business promotion technical aid projects organized by international donor organizations that have been implemented in Georgia since the second half of the 1990s. They have significantly facilitated the development of small business in such areas as the formation of business environment, the improvement of regulations, access to finances, skill improvement of SME staff, etc. Out of the international organizations we should note UNDP, USAID, GIZ, IFC, Millennium Challenge Georgia, Switzerland Agency for Development and Cooperation, the Norwegian Refugee Council, and other governmental or non-governmental organizations. As a result of the accomplished projects, small business was assisted in such areas as the formation of business consultation centers, farmers’ service centers, establishment of enterprises’ value chains, etc.

#### **Box 2: City Hall Programme “Start Business with the Support of Tbilisi City Hall”**

*Within the frames of the programme, training assistance was provided to 700 citizens, who intended to start entrepreneurial activities in the near future. The training programme covered design, financial, managerial and many other important issues. Also noteworthy is the lately initiated project “Get Employed and Employ Others with the City Hall”, which aims at supporting SMEs and correspondingly creating new jobs in the city. The entrepreneurs who meet qualification demands of the project will be enabled to start their own business, develop it and employee others. In order to carry out their own business plan they will be given a loan by commercial banks for a very low interest rate (6-8%) with a 60-month maturity. Tbilisi City Hall will, within the framework of the project, finance together with partner banks all the successful projects creating new jobs in the city.*

Small business support projects carried out by international donor organizations and the Government of Georgia are important and further the handling of specific problems in the definite time periods. Although, in the absence of small business development strategy approaches in Georgia, these activities are generally of a fragmentary nature and their life cycle ends with the completion of projects. Due to the absence of a relevant database containing reliable and comprehensive data archived by the chronological and profile criteria concerning said activities, to evaluate sustainability of the technical or any other support of small business for the last 15 years is practically impossible.

## Small Business Development Tendencies

In spite of the annual growth of the economic performance in Georgia, the small business sector reveals unsatisfactory tendencies of development. In 2010, SMEs accounted for 41% employees and 18.3% of output<sup>5</sup>

In order to evaluate the small business sector efficiency, many structural characteristics need to be analyzed. Within the scope of the present research only some indicator will be assessed. The reason of the above is the fact that the SME performance statistics are insufficient for analyzing in detail the weak and strong sides of the sector. Today, we have formal SME activity-related statistics according to the following parameters:

*Table 1: Statistics according to enterprise size*

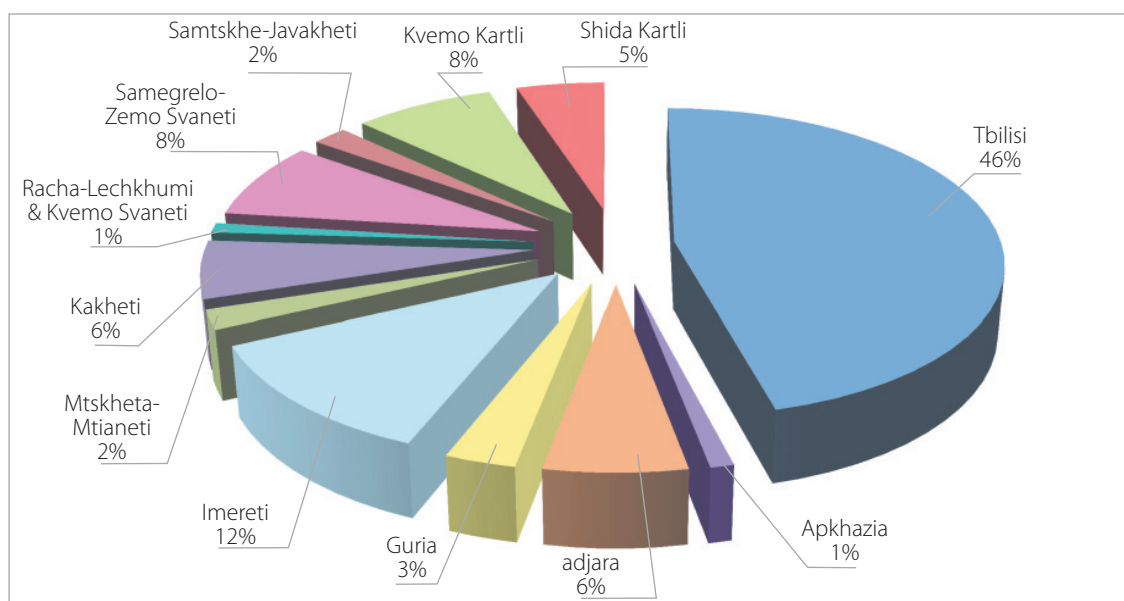
Available statistics	Statistics needed for complete analysis
Turnover	SME foreign trade statistics
Output	
Value added	SME innovation activity
Number of employees	
Salaries and wages	SME share in GDP
Intermediate consumption	
Labour costs	
Purchase of goods and services	
Purchase of goods and services for resale	
Investments in fixed assets	

The table above gives available statistics and the statistics needed for analyzing the small business sector, which currently lacks the proper accounting. Correspondingly, analysed were the SME activity-related indicators that are available and enable to define the state of SME activity and its significance for the national economy.

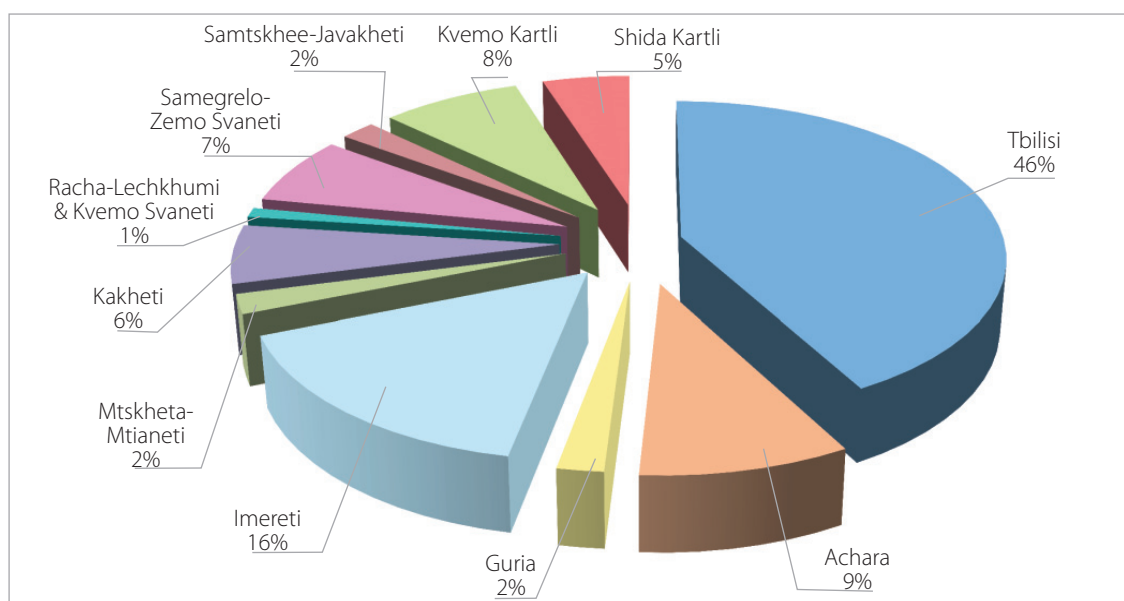
According to the statistics of 1 September 2011, there are 366,229 registered enterprises in Georgia<sup>6</sup>. The biggest share of the enterprises falls on Tbilisi City, the least number being registered in Racha-Lechkhumi, Kvemo-Svaneti and Mtskheta-Mtianeti regions.

<sup>5</sup> Geostat

<sup>6</sup> Geostat, 2011

*Diagram 1: Enterprises registered in Georgia by regions<sup>7</sup>*

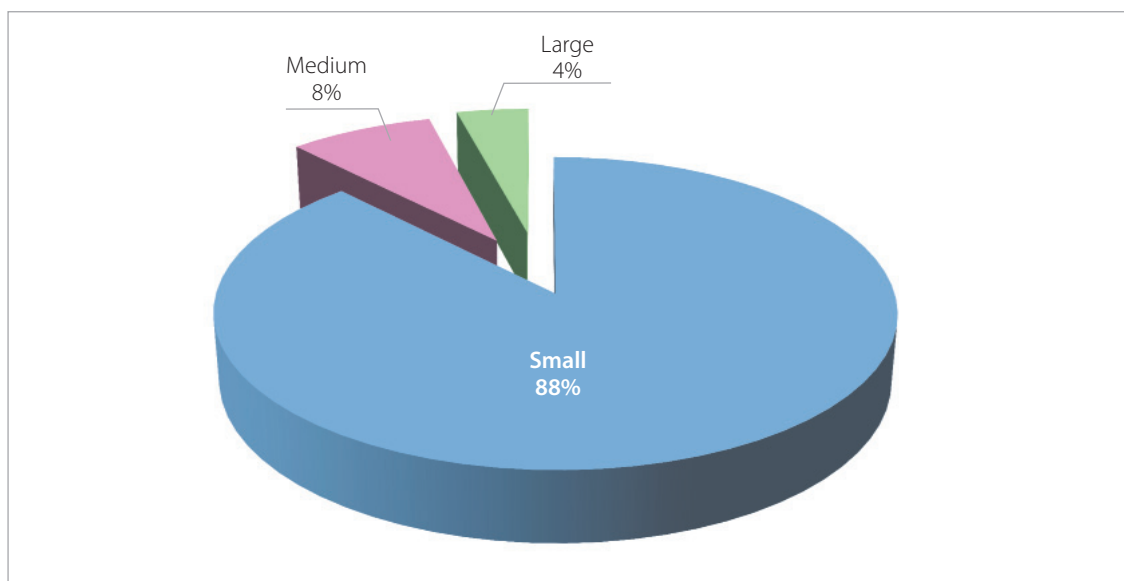
As regards the newly registered enterprises, here too the tendencies similar to those indicated in the case of the total number of registered enterprises are observed.

*Diagram 2: Newly registered enterprises by regions*

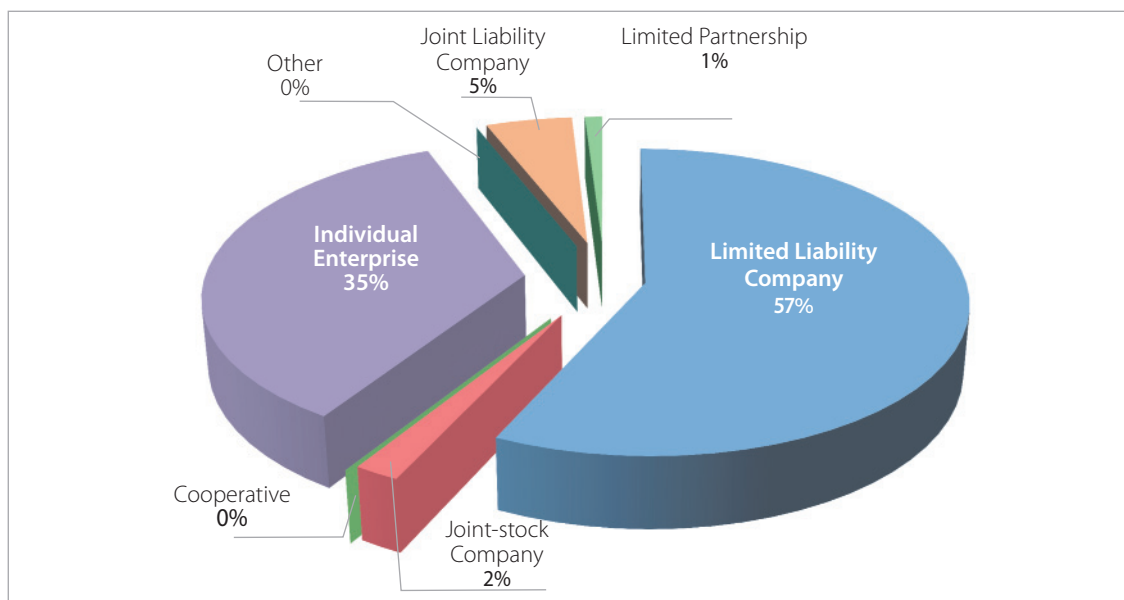
The presented figures clarify the significant inequalities in terms of regional distribution of the registered enterprises in Georgia: about 46% of the enterprises are registered in Tbilisi. By this indicator, Tbilisi is the unconditional leader throughout the country, which is indicative of the capital's dominant role in the country's economic system.

In 2010, the number of active enterprises made 43,530, 96% of which were SMEs.

<sup>7</sup> The sum total of answers exceeds 100%, for several answers could be concurrently given to one question.

*Diagram 3: The share of active enterprises according to their size (2010)<sup>8</sup>*

The major part of medium-sized enterprises (nearly 57%) is registered as limited liability companies. The number of individual enterprises (physical persons) in the total number of SMEs is also great, making about 35%.

*Diagram 4: SME's share according to legal status<sup>9</sup>*

In 2010, the total turnover of SMEs made GEL 3.617.6 million<sup>10</sup>. It is noteworthy that the SMEs' turnover indicators in 2010 comprised 15.6% of the total score of the whole business sector, which was approximately similar to the 2009 indicator, whereas in 2008 it made only 12%. Diagram 5 shows the negative dynamics of the turnover indicators for the last 12 years.

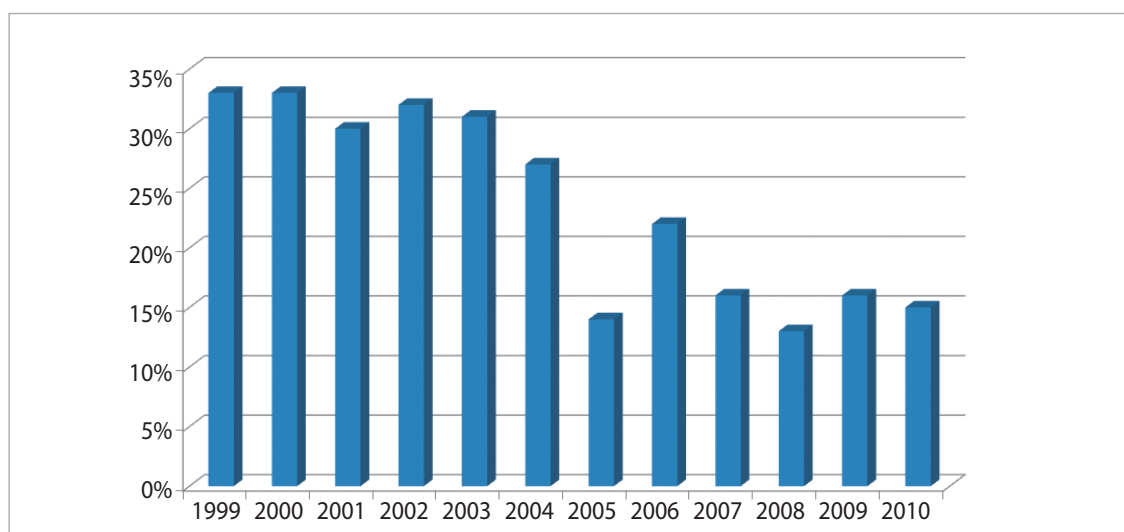
<sup>8</sup> The sum total of answers exceeds 100%, for several answers could be concurrently given to one question.

<sup>9</sup> The sum total of answers exceeds 100%, for several answers could be concurrently given to one question.

<sup>10</sup> The sum total of answers sometimes is less than 100%, for a part of respondents desisted from answering.

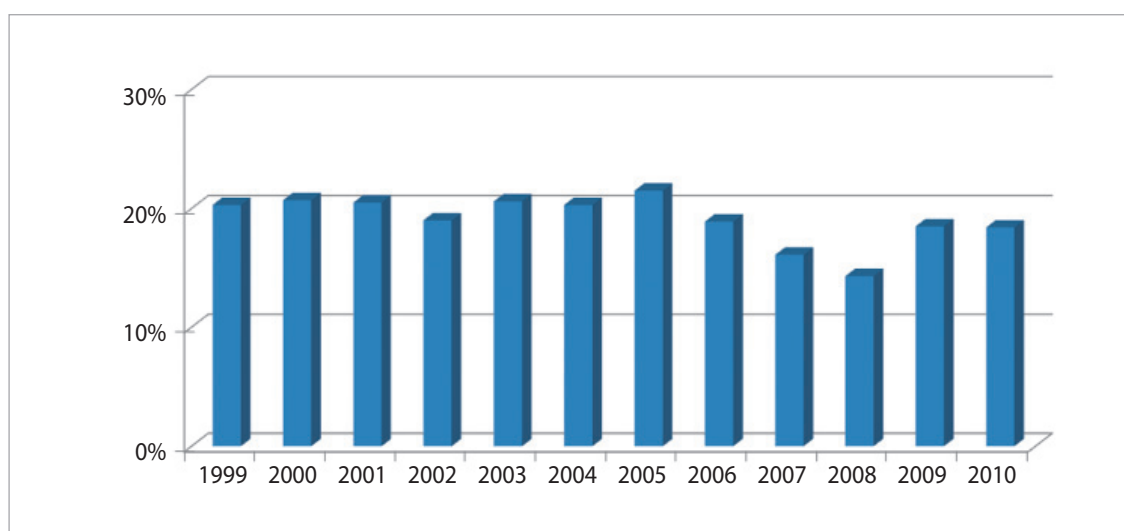


Diagram 5: SME share in the total turnover of enterprises (1999-2010)<sup>11</sup>



The total SME production in 2010 made GEL 2,160.5 million, making 17.7% of the total score of the entire business-sector.

Diagram 6: SMEs' share in output (1999-2010)<sup>12</sup>

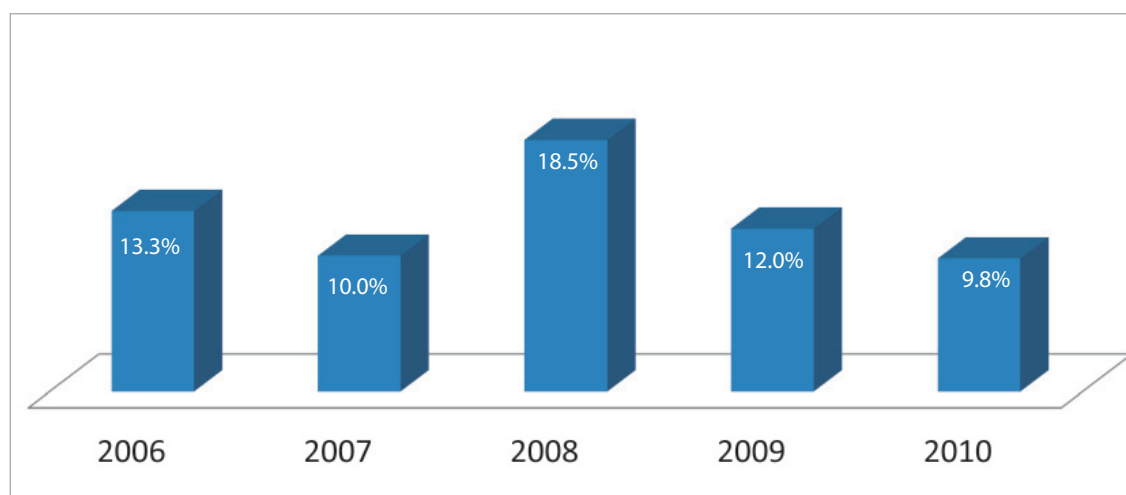


As indicated in Diagram 6 above, SMEs' output declined in 2006-2008, followed by a slight improvement in 2009-2010. In contrast to the enterprises' turnover indicators, the output volumes are characterized of more or less similarity, except the 3-year period of decline (2006-2008).

As regards the investments in fixed assets, their share is rather small and cannot be assessed as the SME development assisting factor.

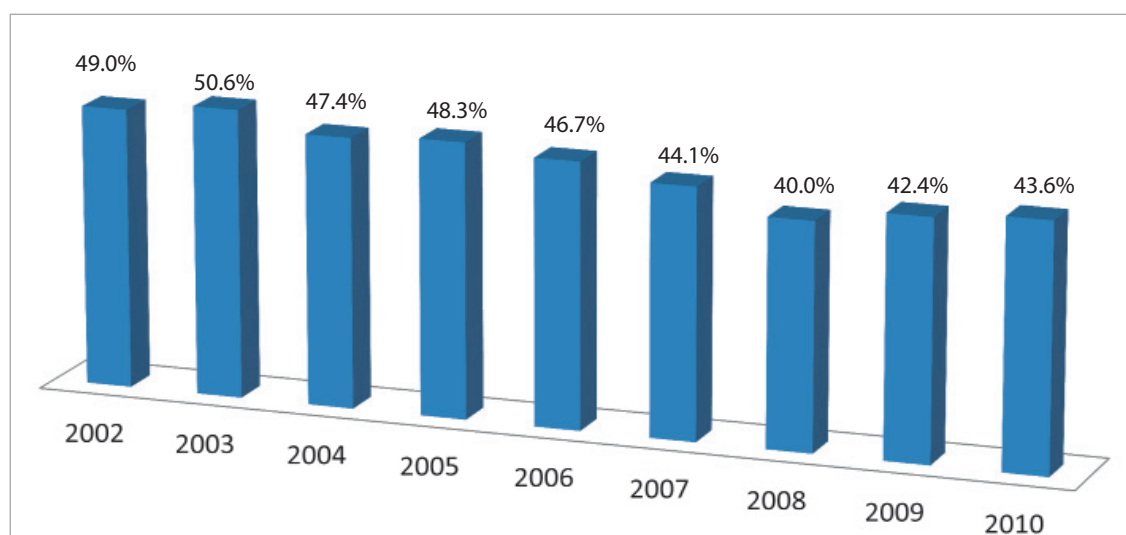
<sup>11</sup> The sum total of answers exceeds 100%, for several answers could be concurrently given to one question

<sup>12</sup> A 'Small Business Act' (SBA) for Europe, Brussels, 25.06.2008

*Diagram 7: SME's share in total investments made in fixed assets (2006-09)<sup>13</sup>*

Investments in the SME fixed assets in 2009 comprised GEL 258.4 million, or 12% of the total investments. It is noteworthy that the same index in 2008 was GEL 412.8 million, or 19% of the total investments.

The total headcount of SME staff in 2010 amounted to 150,672 persons, or 43% of the total employment index. As can be seen from the figure below, the SME headcount of staff reached the maximum level (49%) in 2003.

*Diagram 8: Share of GDP in the total employment indices (2002-2010)<sup>14</sup>*

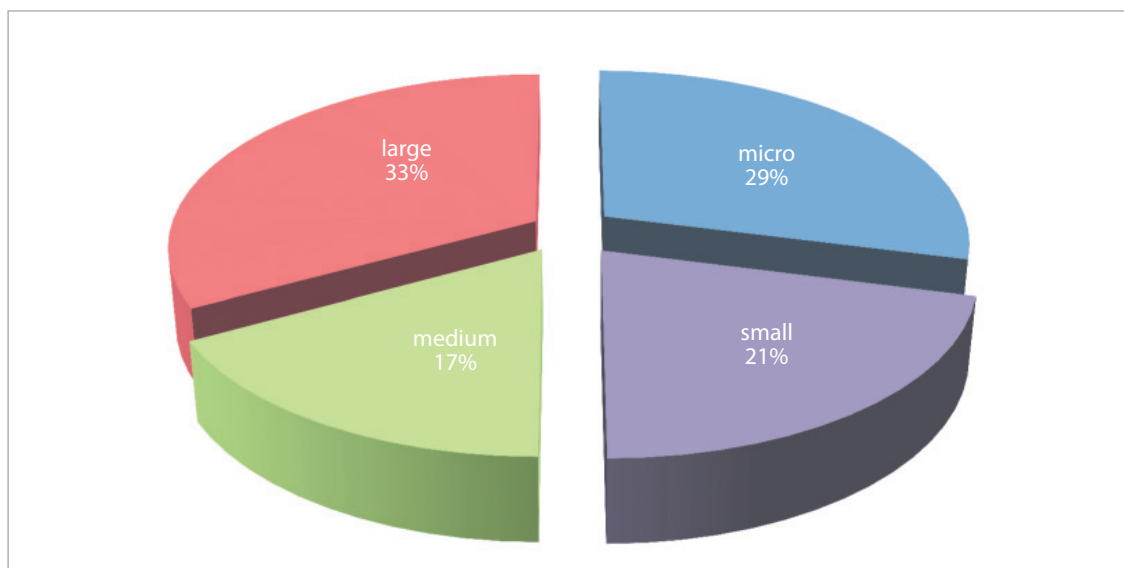
Later, the total employment indices in the mentioned segment began to decrease and, correspondingly, the 43.6% index was fixed in 2010.

<sup>13</sup> The Istanbul Ministerial Declaration on Fostering the Growth of Innovative and Internationally Competitive SMEs, June, 2004

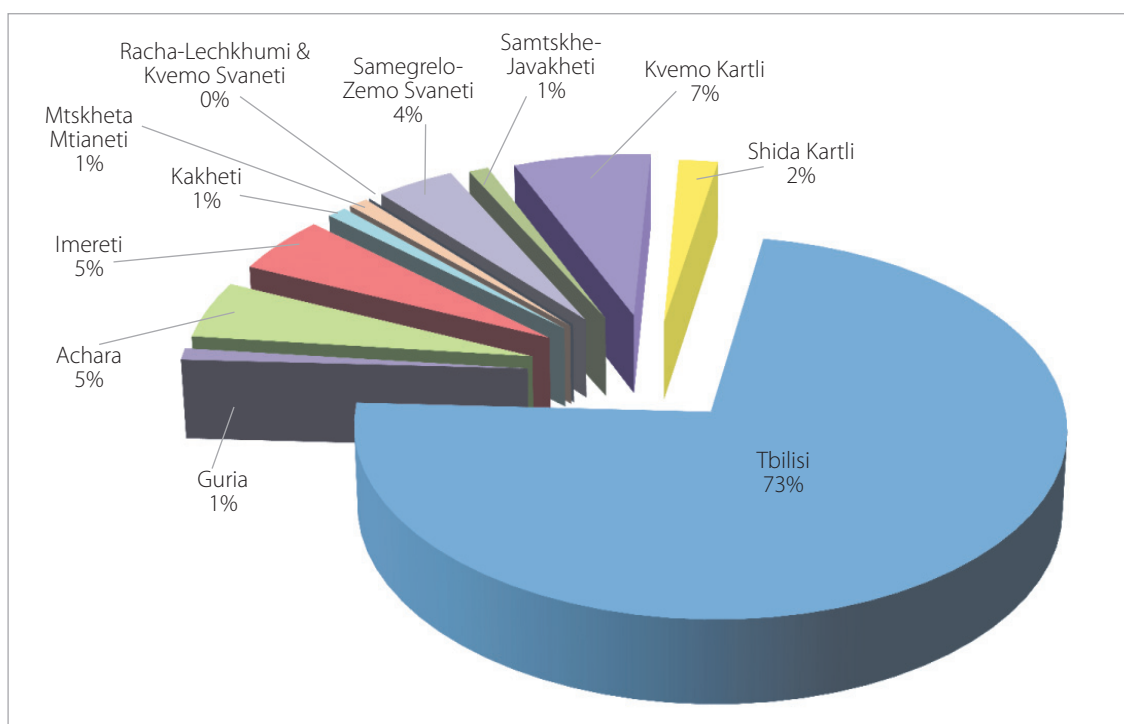
<sup>14</sup> Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions, "Think Small First", A "Small Business Act" for Europe, Brussels, 25.06.2008 (COM(2008) 395 final)

Overall, the 43.6% SME employment index is rather low and can, thus, serve as evidence of low competitiveness of the small business segment in Georgia. We can cite as an example the averaged index by EU Member States, where the SME employment ratio amounted to 67% in 2009.

*Diagram 9: Indices of employment in EU Member States in 2009 according to size of enterprises<sup>15</sup>*

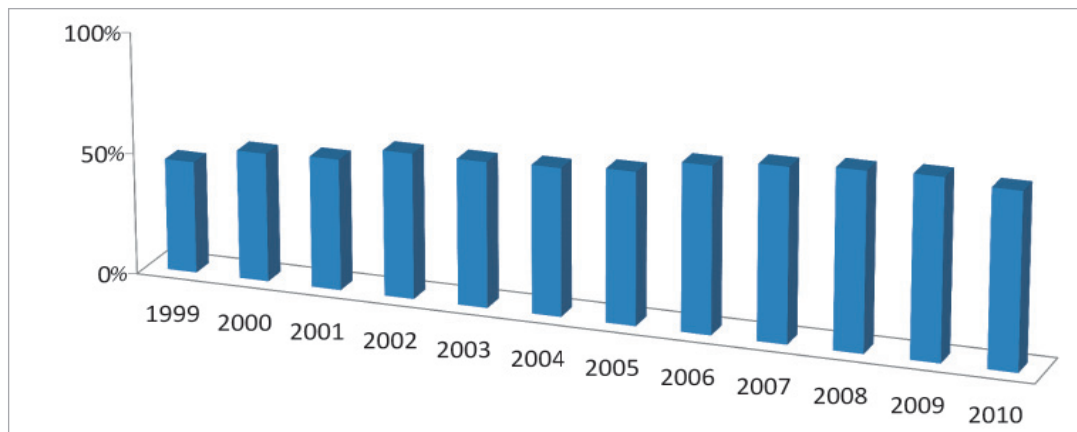


*Diagram 10: The share of regions in the total turnover of enterprises (2010)<sup>16</sup>*

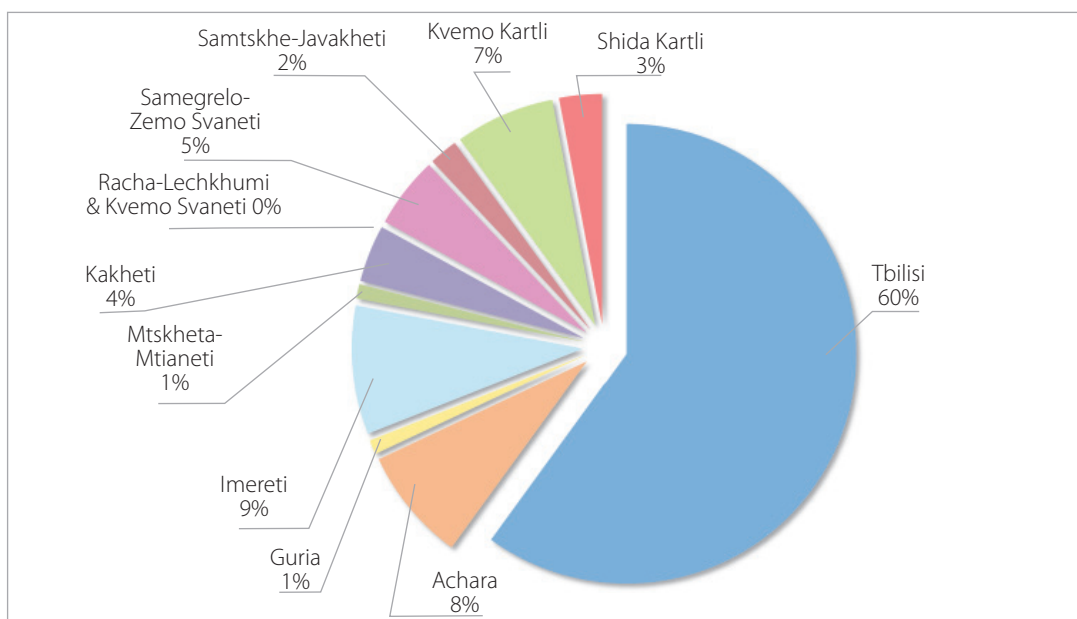


<sup>15</sup> The Georgian Employment Association, [www.employer.ge](http://www.employer.ge)

<sup>16</sup> The Global Competitiveness Report 2011-12.

*Diagram 11: Tbilisi share in the total turnover indices of regions (1999-2010)<sup>17</sup>*

The unequal economic development factor is clearly observed in the light of regional development. For example, Tbilisi is the unconditional leader according to the enterprises' total turnover index, on which nearly 73% of the total turnover fell in 2010. It should be noted that the share of Tbilisi in the total turnover indices for the last 12 years has increased significantly, from 46% to 73%.

*Diagram 12: Share of regions in the total employment (2010)<sup>18</sup>*

The above-mentioned information allows conclude that the unequal regional development is a characteristic problem for the economy of Georgia. Similar tendencies are also found in the small business sector. As can be seen from the presented figures, the unequal regional development increases in scale over time; likewise, the differences between the leading and the lagging regions become more observable. Accordingly, observable is the growing differences between the "growth poles" (Tbilisi, Adjara etc.) and the "stagnant economic regions/spaces" (Guria, Racha-Lechkhumi).

Thus, tendencies for the regional economic polarization in Georgia significantly increase against the background of the interruption of the peripheral economic area development, which founds a similar reflection in the unequal spatial concentration of the small business segment as well.

<sup>17</sup> Geostat, 2011.

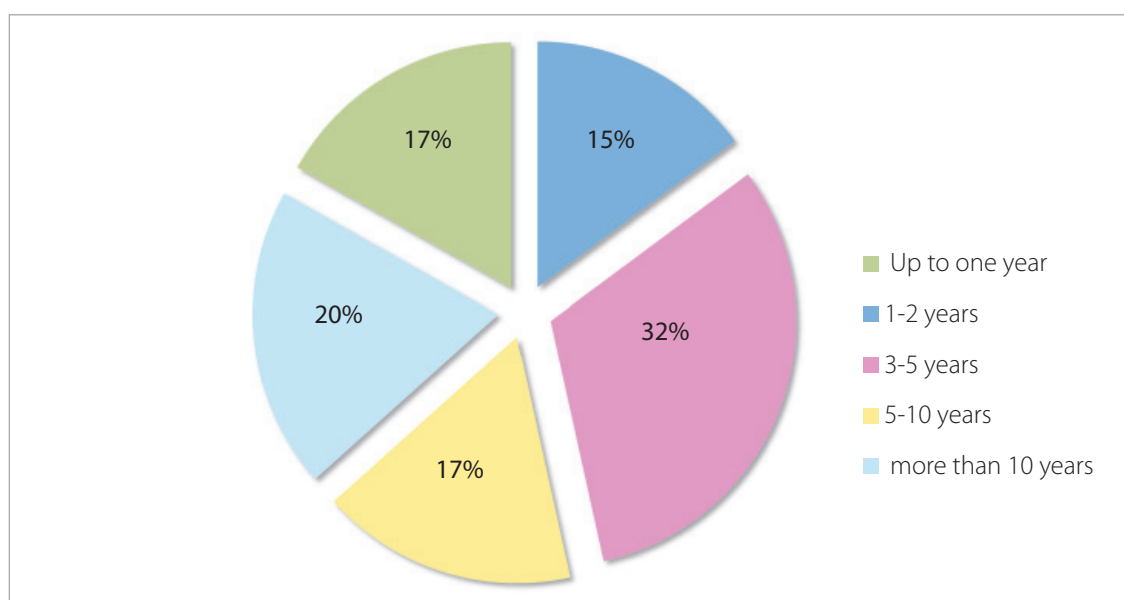
<sup>18</sup> GeoStat, 2011

## Primary Data Interpretation

Based on the research objectives, two types of questionnaires were prepared: one for interviewing micro, small and medium entrepreneurs, the other for interviewing representatives of the governmental structures, local governance bodies, high schools, professional non-governmental organizations (hereinafter - the experts). The research was conducted using an interview-questionnaire-design technique in two regions of Georgia (Tbilisi City and Gori town). 65 respondents were interviewed, out of whom 42 were entrepreneurs and 23 – the Experts (21 entrepreneurs and 12 experts – in Tbilisi, and 21 entrepreneurs and 11 experts – in Gori). The selection criteria for entrepreneurs were: a) size of the enterprise (headcount and the annual turnover), b) scope of activity. In selecting the experts, the main criteria were their activity and estimated competence of the issues of business environment and public policy.

Out of the surveyed enterprises, 25% are engaged in trade, 17% - in social amenities (beauty shops, fashion shops, etc.), 10% - in processing industry (mainly food production, bakeries, confectioneries, etc.), 10% - in hotel and restaurant services (restaurants, cafes, guesthouses), 7% - in healthcare (dental and other hospitals), 7% - in construction, another 7% - in information technology (internet-café, computer services, etc.), and 5% - in education. Also interviewed were micro, small and medium entrepreneurs engaged in electricity distribution, transport, agriculture and financial intermediation. Accordingly, the research results reflected the ideas, problems and recommendations of the entrepreneurs in almost all the main economy sectors. Representativeness of the research results was also conditioned by the factor that the survey concerned enterprises of different size and life. Namely, according to the number of employees, 22% of the enterprises are micro, 71% - small and 6% - medium. As regards the annual turnover, the turnover of 83% out of the investigated enterprises is less than GEL 100 thousand, and of 17% - more than GEL 100 thousand. One of the most important criteria for investigating micro, small and medium business is the life of the enterprises

*Diagram 13: Distribution of the surveyed enterprises according to their life*



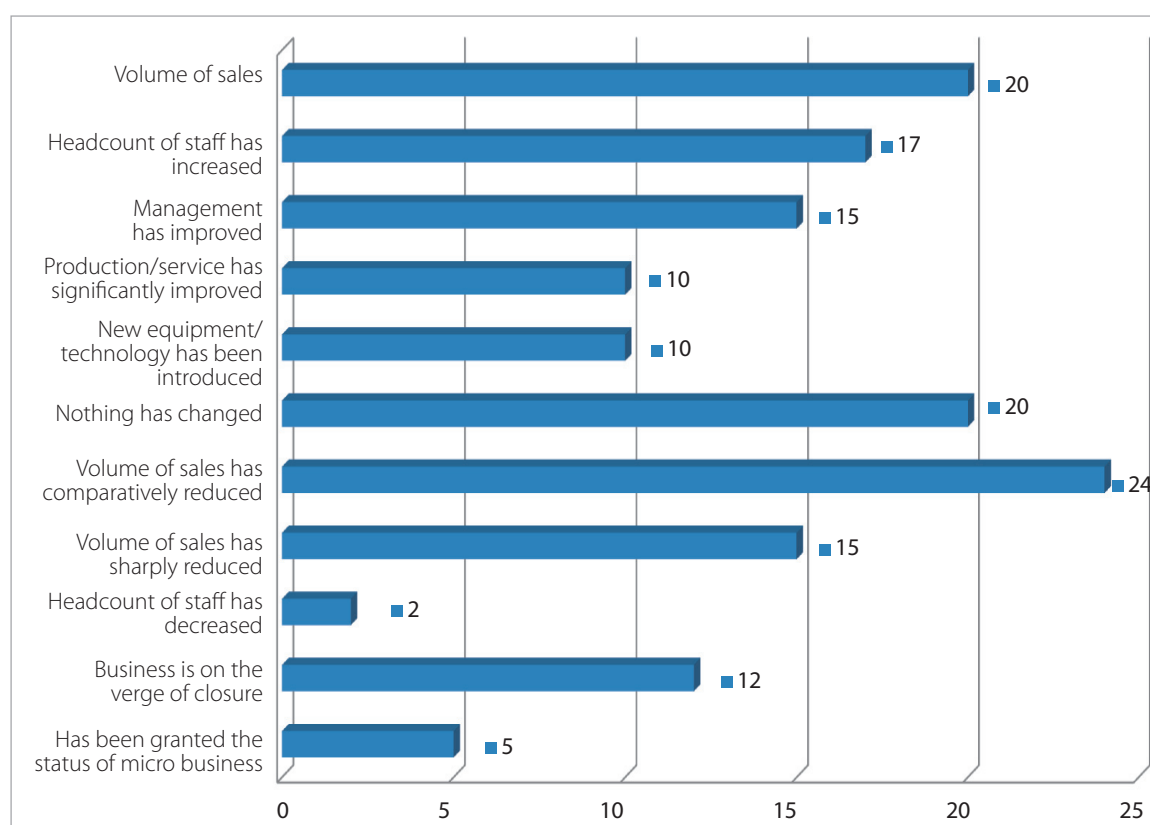
Concerning the representative respondents of the government structures, local government bodies, higher schools and specialized non-governmental organizations, the representatives of the profile services of the Municipality and City Council, well-known experts of economics, and the teaching staff of the faculty of economics and/or business of higher educational institutions, officials of NGOs, who have for years dealt with micro, small and medium business (through implementing different economic projects) were interviewed.

All the above gives grounds to suppose that in spite of a relatively small number of the respondents, the survey results should be generalized and regarded as representative.

### Micro, Small and Medium-sized Business Development Tendencies

According to the research results, positive tendencies in the activities of micro, small and medium enterprises prevail. Namely, during the last 2 years 20% of the investigated enterprises increased the sales volume, 17% increased the number of employees, and 15% improved management, 10% changed the range of products/services, and the same number introduced new equipments/technology (see Diagram 5). For a 1/5 of the enterprises nothing has changed for the last 2 years; 15% have dramatically decreased sales volume; 2% of the interviewed entrepreneurs had to decrease the number of the employees, 12% confess that their business is on the verge of closure.

*Diagram 14: Changes implemented in the SME for the Last 2 Years, %*



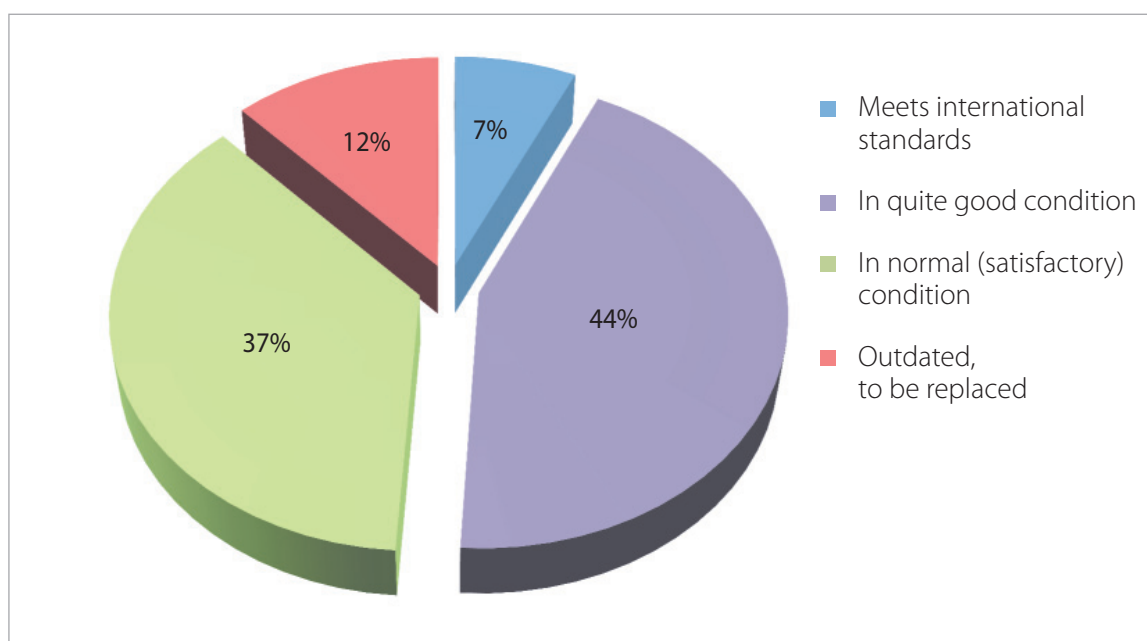
The interviewed entrepreneurs named the constraints to their activity.

Table 2: Constraints to preserving/developing business<sup>19</sup>

	Constraint	%
1	Low purchasing capacity of the population, unemployment/poverty	51
2	Lack of finances/inaccessibility	27
3	Tax system	12
4	Unfair competition; monopolists	12
6	High public utility charges	10
7	Lack of customers	10
8	Keen competition	7
9	Outdated equipment/technology	7
10	High space rental	5
11	Imperfect legal system	5
12	Undeveloped infrastructure	5
13	Unstable prices on products	2
14	Bad location	2
15	Inflation	2
16	No answer	12

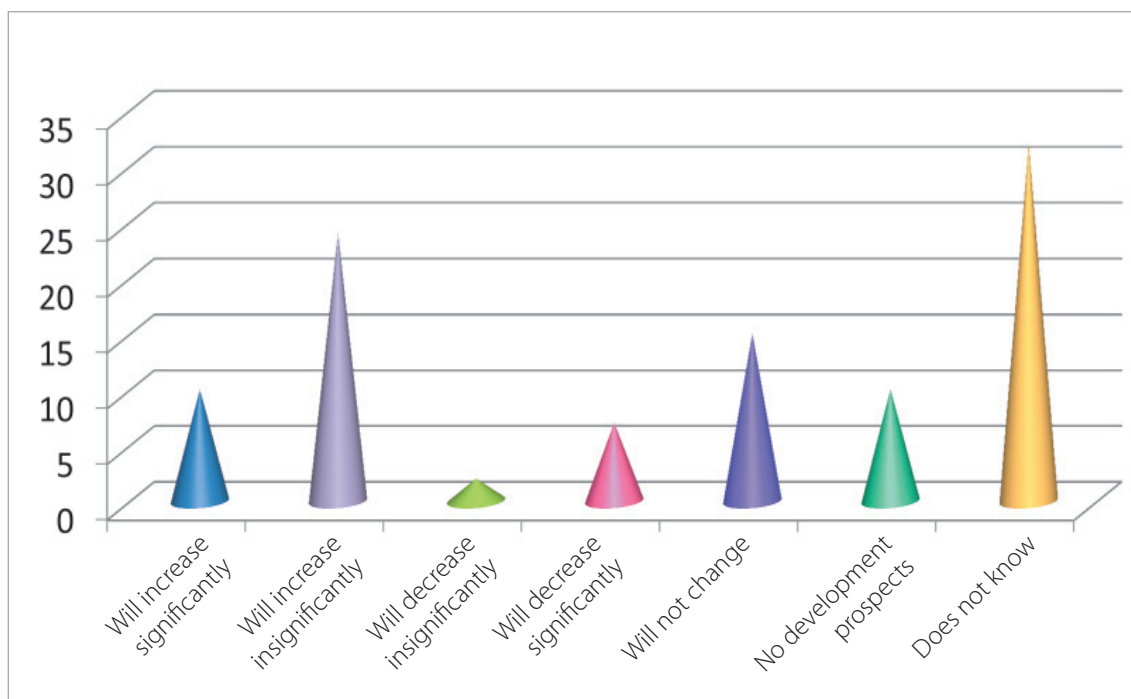
12 % of the interviewed entrepreneurs named outdated equipment/technology as the main constraint to the business development.

Diagram 15: Condition of technical equipment of enterprises



The entrepreneurs fixed a rather pessimistic attitude to the question: "How will your business develop in the near future?"

<sup>19</sup> The sum of answers exceeds 100%, because several answers could be concurrently given.

*Diagram 16: Expectations of business development under the survey results (%)*

The interviewed entrepreneurs named the means, by which they plan to maintain and/or develop business:

*Table 3: Ways of maintaining/developing business<sup>20</sup>*

	Way	%
1	Quality improvement of goods/services	32
2	Improvement personnel's skills	24
3	Production management and labour organization improvement	22
4	Development of new sales markets	20
5	Use of new technologies	20
7	Offer of new goods/services	17
8	Enrolling new partners	17
9	Use of own and/or partners' funds	15
10	Bank credit or other loan	12
11	Increasing the volume of production/services	7
12	Change of the line of activity	2
13	Does not know	10

The above corroborates that the micro, small and medium-sized business development tendencies in Georgia are far from being positive and that the lack of access to finances is one of the most serious constraints thereof.

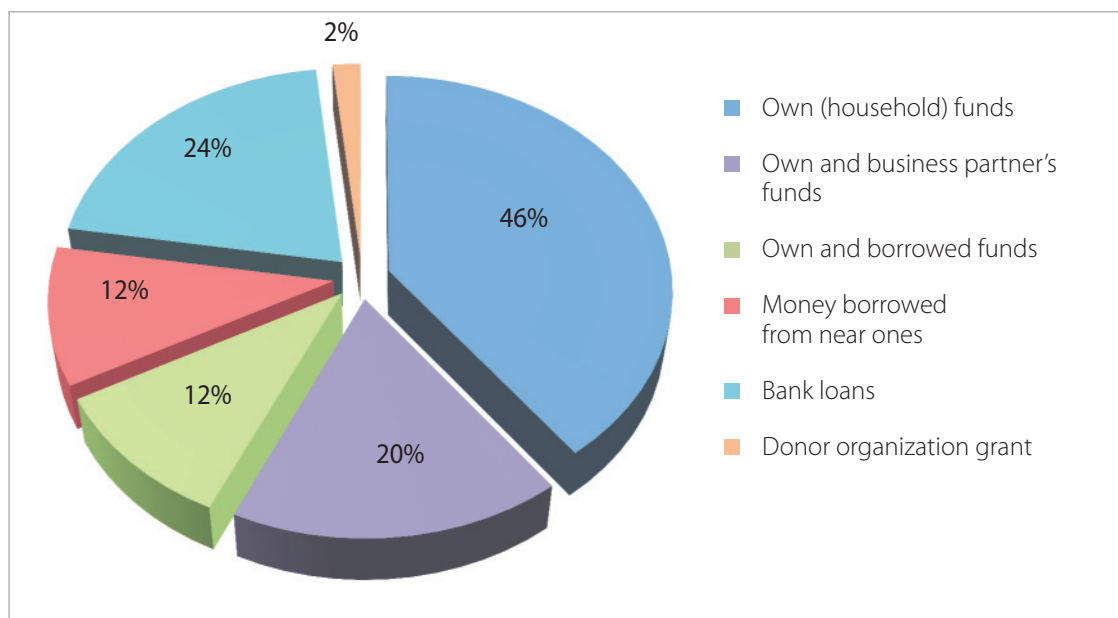
<sup>20</sup> The sum of answers exceeds 100%, because several answers could be concurrently given.



## Business Financing and Access to Financial Resources

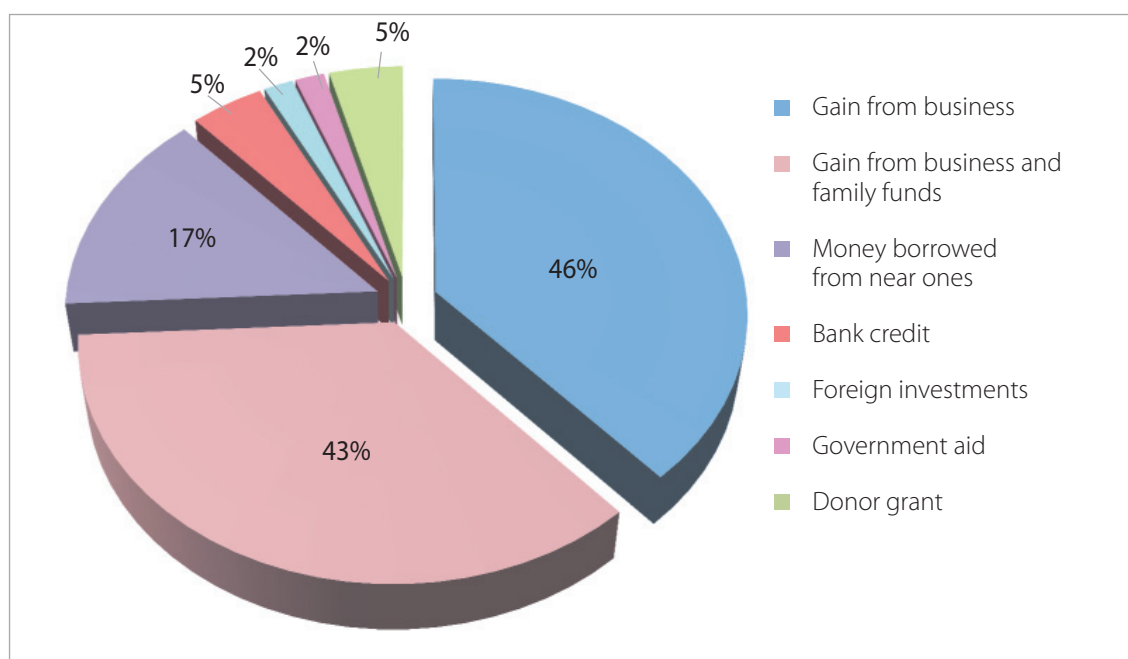
To the question, “By what financial resources did you start your business activity?” the interviewed entrepreneurs answered in the following way:

Diagram 17: Financial sources of starting business



In the interview, the entrepreneurs pointed out the sources of covering operational expenses:

Diagram 18: Business cost coverage sources



The entrepreneurs named quite a long list of problems they have to encounter when dealing with banking institutions:

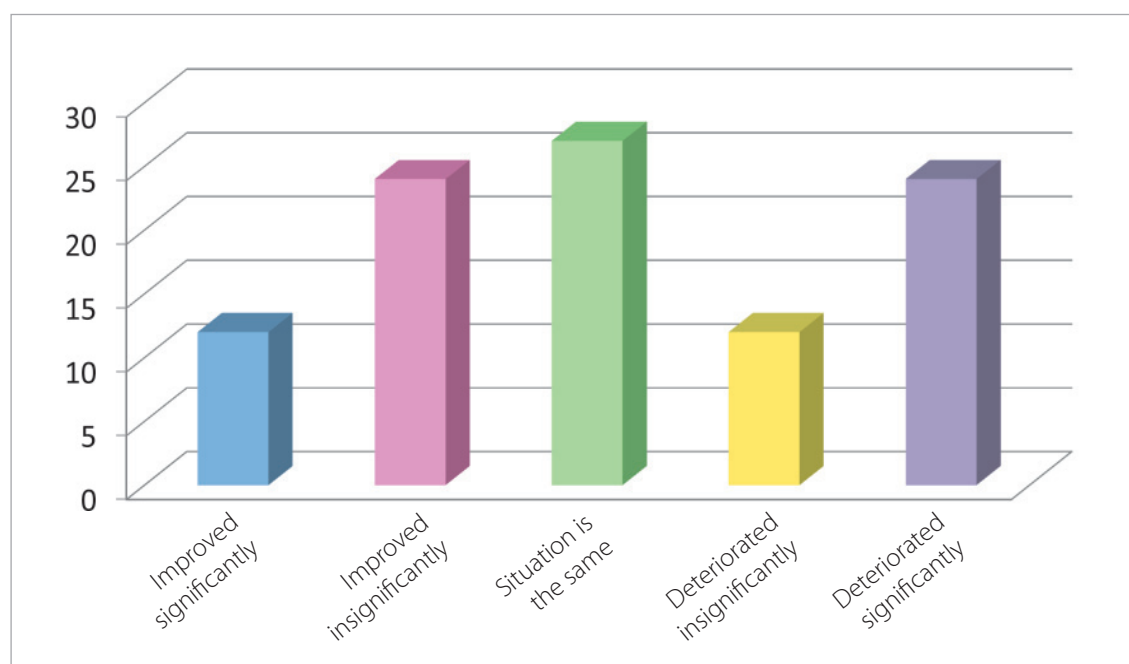
*Table 4: Problems related to obtaining a bank credit<sup>21</sup>*

	<b><i>Problem</i></b>	<b><i>%</i></b>
1	High interest on credits	71
2	Bank issues a credit based only on a collateral and not a business idea	54
3	Bank issues a credit based only on a collateral and not based on the assessment of an enterprise cash flow	39
4	Amount of requested collateral (mortgage) is large	39
5	Bank can refuse without justification	39
6	Bank does not foresee business seasonality	39
7	Procedures for obtaining a credit are complicated	34
8	It takes a lot of time to obtain a credit	27
9	Bureaucratic procedures	22
10	Warranty demands are unrealistic	20
11	Bank refuses to provide a credit	15
12	The terms are violated on the part of bank	7

## Business Environment Assessment

The entrepreneurs answered the question: "According to your evaluation how did the business environment change during the last 2 years?"

*Diagram 19: Change of business environment in the last 2 years*



<sup>21</sup> The sum of answers exceeds 100%, because several answers could be concurrently given.

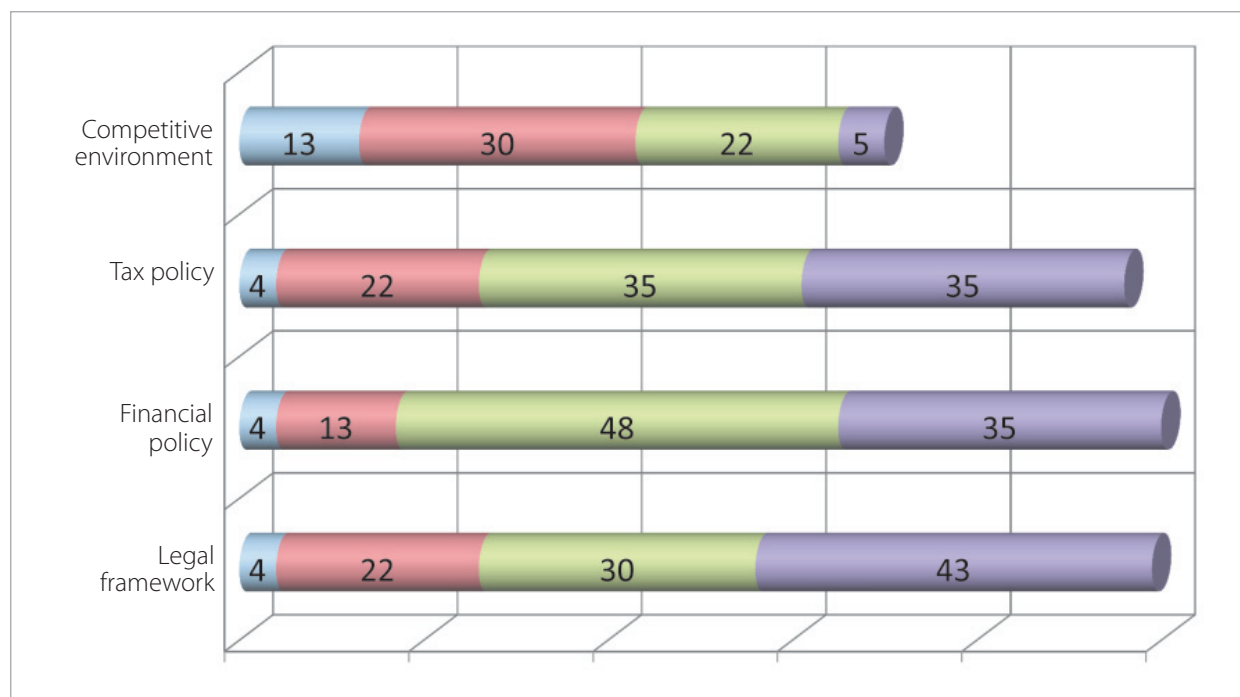
To determine the assessment objectivity, the expert opinions together with the entrepreneurs' ideas on how any component of the business environment has changed in Georgia for the last 3 years were studied. The answers showed that both the entrepreneurs and experts assess the changes in business registration as completely positive.

*Table 5: Assessment of business environment change by entrepreneurs and experts*

	Business Environment Components	Entrepreneurs				Experts			
		Improved fully	Improved partially	Has not changed	Has deteriorated	Improved fully	Improved partially	Has not changed	Has deteriorated
1	Business registration terms	37	39	7	–	43	48	4	4
2	Business starting terms	17	20	24	20	30	48	13	9
3	Licensing terms	20	27	12	10	30	43	17	9
4	Tax legislation	12	41	22	12	9	57	17	17
5	Operation of tax services	15	32	17	20	17	57	17	4
6	Access to credit	–	15	12	46	9	35	26	26
7	State policy towards micro, small and medium business	10	20	44	15	13	48	26	13
8	Support of micro, small and medium business from local governments	7	20	46	7	17	26	39	17
9	Support of micro, small and medium business from donor organizations	2	15	24	20	17	35	26	18
10	Competitive environment	5	10	32	34	13	30	30	26

The respondents expressed extremely critical attitude when answering the question, "How would you evaluate existing environment for the development of small and medium business in Georgia for the given time (legal framework, financial policy, tax policy, and competitive environment)?"

Diagram 20: Assessment of existing business environment components



The entrepreneurs and the experts named different priorities to be carried out in order to support micro, small and medium business in the country:

Table 6: Recommendations of entrepreneurs and experts in support of micro, small and medium business in the country<sup>22</sup>

Entrepreneurs		
№	Activity	%
1	Simplification of a bank credit obtaining procedures	73
2	Reduction of interest on bank credit	73
3	Tax cutting	63
4	Liberalization of tax administration to reduce sanctions and penalties	56
5	Political stability	56
6	Volume of mortgage	41
7	Carrying out anti-monopoly policy	41

Experts		
№	Activity	%
1	Following the anti-monopoly policy	70
2	Political stability	70
3	Reduction of interest on bank credit	65
4	Tax cutting	65
5	Small business exemption from taxes during the first year of operation	65
6	Simplification of tax procedures	61
7	Development of human Resources	61

<sup>22</sup> The sum of answers exceeds 100%, because several answers could be concurrently given.

8	Simplification of tax procedures	37
9	Imposition of fixed taxes on small business	37
10	Development of economic relations with neighbour countries	34
11	Human resources development	29
12	Access to business training and information-advisory services	29
13	Small business exemption from taxes during the first year of operation	29
14	Simplification of the licensing procedure	22

8	Access to of information on new markets	52
9	Access to business training and information-advisory services	52
10	Simplification of a bank credit obtaining procedures	43
11	Imposition of fixed taxes on small business	43
12	Development of economic relations with neighbour countries	43
13	Restrictions on imports of locally made products	43
14	Encouragement of exports by the State	43

The presented interview of the entrepreneurs and employers corroborates the need of changing the state policy towards micro, small and medium enterprises. The existing legal framework as well as the policy in support of accessibility of tax and financial resources both need improvement. Also necessary is to develop the relevant information–advisory system in order to raise awareness and competence of the owners and managers of micro, small and medium enterprises, which is becoming a serious challenge in Georgia's reality.

## OVERVIEW OF SME SUPPORT IN GEORGIA BASED ON THE PRINCIPLES OF THE "SMALL BUSINESS ACT"

Based on the present research objectives, we, while analyzing the Georgian economic policy in the small business sector, consider it necessary to select and recommend interesting experiences being used by different countries all over the world and the political communities at the current stage. The EU policy towards small business may be considered as a useful example of this. Given the declared readiness of the Georgian society in terms of drawing closer to EU and the actions taken in the sphere of economic policy to ensure approaching to the EU model, the arming of small businesses with the EU principles of forming small business and their introduction take on special significance. Correspondingly, the present research has attempted to evaluate on the basis of some principles of the EU "Small Business Act"<sup>23</sup> the economic policy activities in support of small business that have been carried out in Georgia.

### Principle 3: Design rules according to the "Think Small First" principle

#### Institutional Environment

A significant progress in terms of liberalization and improvement of business environment has been made in Georgia lately. This was achieved through simplifying regulatory practice, assisting free trade, and pursuing an active privatization policy. Elaboration and implementation of the National Anti-corruption Strategy and Action Plan have contributed significantly to the modernization process.

What are the benefits that the SME have seen in the process of the business environment transformation? It should be noted that measures to improve general environment for the enterprises of all sizes have been developed and implemented; accordingly, any special emphasis on small business segment has not been made. As an analysis of the carried out legislative and institutional changes showed, the measures initiated in the end of the past decade with the aim to encourage small business were practically abolished in the second half of 2000. At the current stage, save few exceptions, no special benefits are provided for small business development. It should be noted that abolition of a small business-friendly legal environment in Georgia was carried out at the time when the international community was widely declaring a new understanding of SME support:

- On 4 June 2004 – the Istanbul Ministerial Declaration on Fostering the Growth of Innovative and Internationally Competitive SMEs<sup>24</sup>;
- On 25 June 2008 – EU Communication on a "Small Business Act"<sup>25</sup>;

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<sup>23</sup> A "Small Business Act" (SBA) for Europe, Brussels, 25.06.2008

<sup>24</sup> The Istanbul Ministerial Declaration on Fostering the Growth of Innovative and Internationally Competitive SMEs, June, 2004

<sup>25</sup> Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions, "Think Small First", A "Small Business Act" for Europe, Brussels, 25.06.2008 COM (2008) 394 final

In the mentioned period, Georgia's policy towards small business was of a completely different nature and conditioned by the thesis: "Equal Opportunities for All". As mentioned above, based on this thesis, all the decisions of the legal and institutional nature aimed at promoting SMEs were revoked.

At the current stage, no specific institution is operating in the public administration field that would carry out full-value SME promotional activities, namely design of a small business development strategy, drafting and presentation to the Government and implementation of SME promotion programmes, ensuring the submission of experts' conclusions in the process of adopting legal documents having a direct or indirect impact on SMEs, etc. The cooperation between branch ministries for implementing the SME-related projects is of an irregular character and ends with the completion of a specific project.

In terms of improvement of legislation, it is necessary that the SME definitions, which in some cases differ from each other (Law on the National Investment Agency, Tax Code), be standardized. As part of the economic analysis of the present research shows, the small business share in the total turnover and employment is rather small, the probable reason being the lack of small business development policies, of special law and conditions. Consequently, on the agenda is the issue of drafting a strategic SME development document and setting up a special policy-making and implementing body. It should also be noted that these measures cannot be regarded as panacea because the special legal and institutional environment established in the late 1990s and in the early 2000s failed to ensure support to SME development. According to the available statistics, the downward trends of the small business effectiveness as compared with the large businesses appeared exactly in the late 1990s and are still on effect (see Diagrams 5, 6). Thus, taking into account the international experience, to achieve progress of small business, a comprehensive approach rather than activities of individual character should be realized.

### **Dialogue between Public and Private Sectors**

The business community and public administration conduct a constructive dialogue around the issues being of importance for business. The said dialogue has gained a special intensity recently and, correspondingly, the private and public sectors do their best to improve the outcomes of the ongoing consultations. The existence in the country of numerous business associations and chambers of commerce conditions an intensive character of the dialogue, involving the President of Georgia, Prime Minister, branch ministers, etc. The Business Ombudsman's Office is gradually becoming an active defender of the entrepreneurs' interests. At present, many organizations are successfully lobbying for the interests of entrepreneurs and provide them with necessary services. Particularly active are the Georgian Chamber of Commerce and Industry, the Georgian Business Association, the Georgian Employers' Association, the Georgian Banks Association, the American Chamber of Commerce, etc. It should be noted that they are mainly focused on the protection of the interests of large business in the legislative and other spheres. The work on small business problems is mainly within the strategic and operational activities of two associations, the Georgian Employers' Association and the Georgian SME Association.

Also mentionable is that the active dialogue under way creates unequal benefits for businesses of various sizes. The private-public sectors' dialogue is mainly focused on the needs of large companies that currently generate over 80% of the country's GDP. The consideration of topical SME problems and the putting them on the agenda is a very rare event. Thus, we can say that because of the above-mentioned reasons, attention to the needs of small business is minimal and, correspondingly, this segment cannot boast of the interest fixed on the part of public administration.

It can, therefore, be concluded that in spite of an intensive character of the dialogue between the private and public sectors, it is mainly focused on the needs of large businesses. It is desirable that in the course of the dialogue the attention and efforts be redirected at the needs of smaller enterprises, so that this segment

could get more favourable operational environment and yielded higher economic and social results, which are traditionally characteristic of societies with developed economy.

## **Principle 4: Make public administrations responsive to SMEs' needs**

### **Enterprise Registration**

The enterprise registration procedures have significantly changed for the better over the last three years. Correspondingly, the setting up of an enterprise is no longer lengthy. The registration process is swift and not costly, which is positively assessed by the private sector.<sup>26</sup> Georgia scored one of the best results under the Global Competitiveness Report indicators: "Number of procedures to start a business" and "Number of days to start a business" and was ranked the 8th and 3rd respectively<sup>27</sup>. The reforms carried out in the sector are noted for their scope and quality. All the formal procedures are recorded in the entrepreneurial register and end with the issue of identity and state and tax registration certificate. As a result of simplified registration procedures, the number of newly established enterprises increased in 2010 by 17%<sup>28</sup>. The integration of a relevant database, containing registration, movable, immovable and intangible assets, mortgage, hypothecation, cadastral, technical inventory, leasing and other data, has been completed.

As a result of the carried out reform, services of the National Agency of Public Register have significantly improved, the enterprise registration time and costs reduced, and the integration of databases has greatly simplified the registration process, which is a prerequisite for creating a successful business environment for enterprises of all sizes, including small business.

### **Simplification of Regulations**

The process of elimination of administrative barriers and simplification of the regulatory environment has been in operation since 2004. Particular attention was paid to the deregulation process, which implied overcoming all the obstacles and improving the operational business environment. Such activities have laid a foundation for working off the business environment from administrative burden. The licences and permits granting procedures stick to the principle "silence means consent".

In spite of the carried out measures, no special SME promotion activities have been implemented. Public administration practice does not recognize existence of the SME development strategy, as well as the need for special legislative approaches that would bring forth an increase in the number of small businesses. Very little has been done lately in connection with the introduction of legislative changes beneficial for small business. The only exceptions to be referred to are the new Tax Code articles dealing with taxation of micro and small enterprises and simplified customs procedures<sup>29</sup>.

The carried out regulatory changes are undoubtedly a constructive factor to improve the functioning of enterprises of all sizes. It should, however, be noted that sticking to the principle "apply the same yardstick to everybody" when planning legislative changes will not benefit SMEs, because based on the factor affecting the economies of scale, the privilege for using novelties belongs to large enterprises proper.

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<sup>26</sup> The Georgian Employers' Association, [www.employer.ge](http://www.employer.ge)

<sup>27</sup> The Global Competitiveness Report 2011-12

<sup>28</sup> GeoStat, 2011

<sup>29</sup> Tax Code of Georgia, [www.mof.ge](http://www.mof.ge)



## **Regulatory Impact Analysis/Assessment (RIA)**

The Ministry of Economy and Sustainable Development has set up a special division to analyse the impact of business-related regulations – Business Activity Regulatory Assessment Division. A pilot project on regulatory impact assessment in the technical regulation and quality infrastructure sphere has been implemented<sup>30</sup>.

Currently, no regulatory impact assessment in respect of SMEs is being carried out.

## **Use of Government Services**

A significant progress in introducing e-government has been achieved in Georgia lately. Based on the above, SMEs can now practice electronic forms of communication to access many of the available government services. Taxpayers may communicate with the Revenue Service of the Ministry of Finance on tax-related issues and pay taxes by electronic means. Invoice forms can be downloaded directly from the Revenue Service website.

The Law on E-signature and E-documents as well as a relevant bylaw were approved and passed by the Parliament. The necessary infrastructure has been set in the operating mode and some state structures already use the above-mentioned tool. At the current stage, the business sector, particularly small business, is not an active user of this kind of service<sup>31</sup>.

## **Principle 5: Adapt public policy tools to SME needs**

### **Services Providing Assistance and Information Support to SMEs**

The importance of business services has been properly recognized and much has been done recently for organizing special programmes aimed at improving SME technological capacities.

An important role is assigned to the National Anti-Corruption Strategy document incorporating, in turn, several different areas to improve business services: modernization of public and administrative services, improvement and control of public procurement, public finance reform, as well as tax and customs systems. Business services are being gradually upgraded through the business anti-corruption strategy, contributing thus to the improvement of business environment.

As regards information support, in operation are many websites assisting small business in obtaining necessary data of various kinds. However, the problem of information support consists in the circumstance that the internet space contains no address, where small entrepreneurs could obtain comprehensive and updated information concerning the interesting to them issues on business management.

### **Business Services for Start-ups**

Many programmes aimed at supporting start-up businesses have been implemented both by the government or international organizations lately. These programs have been implemented through a network of local providers, who often receive assistance from donor organizations. As practice indicates, start-up businesses show keen interest towards such services. The available, support programmes fail to meet existing requirements and, consequently, only a small part of start-ups is content with such services.

<sup>30</sup> The Ministry of Economy and Sustainable Development of Georgia

<sup>31</sup> The Georgian Employers' Association

Overall, in spite of the recent rapid development of business-support services for start-ups in Georgia, they are still accessible only by a small part of SMEs. Respectively, the component of information and advisory support of SMEs should be strengthened in the years to come so that as many start-ups as possible could get assistance in their start-up stages.

### **Public Procurement**

The Competition and State Procurement Agency of Georgia through a technical assistance project funded by the German International Cooperation Society (GIZ) has made significant progress in introducing e-trading. By means of a new electronic system, natural and legal entities can now fulfil online trade and information retrieval. As a result, the circulation of paper document has decreased and public procurement procedures improved. SMEs have favourable conditions to meet public procurement, because about 40% of the contract amount of e-tenders does not exceed GEL 10 000. SMEs can obtain detailed information on the forthcoming e-tenders on the Agency's website. The tender participation fees have been minimized and procedures simplified.

## **Principle 6: Facilitate SMEs' access to finance and develop a legal and business environment supportive to timely payments in commercial transactions**

### **SME external funding sources**

For the last 10 years a significant progress has been made in terms of providing financial services in Georgia. It should, however, be noted that the progress is observed in regard to large companies, while SME still suffer from a severe lack of finance. SMEs need to increase their working capital in order to ensure own growth. At present, the main source of capital replenishment for SMEs are contributions made by the owners being formed at the expense of own, their household, their friends' or others' savings<sup>32</sup>. A conservative approach to bank lending and high requirements to collateral are the constraints to SME development. At present, a Credit Guarantees Agency that could assist SMEs in attracting investment, export and leasing capital does not exist. The main sources of financial assistance of SMEs are projects funded by international financial and donor organizations. The government has recently elaborated special projects to provide SMEs with soft loans from the state budget. As regards funding from "Business Angels", the practice is of a random nature and therefore cannot be considered as a stable source. At present 64 microfinance organizations are operating in Georgia<sup>33</sup>. They grant loans to small enterprises, mostly to small farms. Despite the developed infrastructure, they suffer from the lack of financial resources and cannot, therefore, meet the requirements of micro- and small enterprises. On the whole, the SMEs' acute lack of financial resources is the main constraint for their further growth and expansion.

## **Principle 8: Promote the upgrading of skills in SMEs and all forms of innovation**

The unsatisfactory level of R&D in Georgia can be explained by a rather weak cooperation between the business community, universities and research institutions. Such a situation leads to vacuum existing in the technology transfer sphere, which interferes with equipping SMEs with up-to-date technologies and developing their potentialities.

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<sup>32</sup> According to the results of the survey conducted in the framework of this research, the amount of funds mobilized on the basis of the abovementioned sources accounts for 74% of total investments

<sup>33</sup> The National Bank of Georgia, 2011

Correspondingly, the country's economic growth and innovative development are characterized of poor indicators. In 2011, Georgia was ranked the 73rd in the world according to the innovation activity indicators<sup>34</sup>. However, the latest efforts of the government in the mentioned direction give grounds for optimism. In the first half of 2012, a Georgian Technology Transfer Centre (GTTC) was set up on the basis of cooperation between the National Intellectual Property Centre "Sakpatenti", the German International Cooperation Society (GIZ), business associations and universities, which will pay special attention to the technological strengthening of SMEs.

## **Principle 10: Encourage and support SMEs to benefit from the growth of markets**

The National Investment Agency of Georgia is charged with the coordination of export promotion activities<sup>35</sup>. Services provided in the export promotion direction imply the provision of enterprises with necessary information, assistance to the exporters, organization of exhibitions and trade missions, SMEs' support at international fairs, and development of professional skills of their managers responsible for export operations. Accordingly, the National Investment Agency is to fulfil important functions, including the assistance of SMEs in the issues of internationalization.

As for export promotion, unfortunately, the state funding of this activity was carried out only once in 2008, when the state allocated GEL 34.5 million-worth loan for the export promotion program<sup>36</sup>. In the following years, the Export Promotion Programme was no longer financed. Also noteworthy is the circumstance that an Export Promotion Division, specially established under the Ministry of Economy, was later wound up, its functions being transferred to the National Investment Agency.

Assistance of SMEs in improving export opportunities is the goal of many projects initiated by international organizations. Of importance in this respect is East-Invest, a regional investment and trade facilitation project for the economic development of the Eastern Neighbourhood region, launched in the framework of the European Eastern Partnership initiative in January 2011<sup>37</sup>. The project runs for 3 years and aims to promote economic cooperation and investment activities between the EU and EaP countries. East-Invest also supports SMEs in their internationalisation process, improves their networking and facilitates their trade development. The project offers technical assistance to SMEs and public sector bodies and implements five specific instruments to achieve its goals. These are: SME Technical Assistance Facility, Trade Fair Technical Assistance Facility, SME Business-to-Business Facility, Business Facilitator (operator) Technical Assistance Facility and Institutional Exchange Facility.

<sup>34</sup> The Global Innovation Index 2011, INSEAD, 2011

<sup>35</sup> <http://www.investinggeorgia.org>

<sup>36</sup> The 2008 State Budget, [www.mof.ge](http://www.mof.ge)

<sup>37</sup> [www.east-invest.eu](http://www.east-invest.eu)

## CONCLUSION AND RECOMMENDATIONS

Gradual abolition of national borders and barriers in international trade has laid the foundation for severe international competition trends. Accordingly, the SMEs, which are unable to meet the demands of international competition, significantly limit their life cycle. The business activity internationalization has become the main item on the agenda of Georgian enterprises. There are different approaches to the evaluation of a successful policy. However, as evidenced by different studies, in the long-term outlook, it is far better to focus main efforts on creating as many as possible SMEs engaged in the international trade, rather than to concentrate attention on the companies with a track record. The present survey of small business policies in Georgia highlights the significant progress trends that have been developed in the country lately through establishing a favourable business environment. It should, however, be noted that:

*Benefits originated on the basis of the business environment improvement are distributed disproportionately within the segment of enterprises of different size.*

The improvement of business environment is found to be generally beneficial for large businesses. The decreasing average share of enterprises in general/total indicators, which is clearly shown in the statistics depicting SME activities, can be cited as evidence of the hypothesis validity. Accordingly, there should be adopted an agenda including the need for policy implementation focused on the growth of small business efficiency in Georgia. The present study has established the basic assumption that:

*The urgent task in the current stage is to transform the abstract business promotion policy into a concrete SME promotion policy.*

Based on the above, there are good prospects for achieving the maximum outcome in the economic activity, employment and social welfare spheres.

*To introduce regular use of RIA, which implies the implementation of the permanent assessment of the expected impact on SMEs as a result of different legislative changes, and their mandatory consideration in the process of planning legislative changes.*

### **SME Promotion Policy Legislative and Regulatory Environment**

In 2004-2010, Georgia has made a considerable progress in updating its old legislation. The regulatory burden has been minimized. Enterprise registration and operations start-up procedures have been significantly simplified. At the current stage, the formation of a special regulatory environment with the consolidation of the legislative and administrative bases to promote SME activities is a must. Accordingly, it is necessary to:

- *Adopt a Law on Small and Medium-Sized Enterprises;*
- *Work out and adopt a SME Development Strategy (fragmentary opinions on the SME development can be found in the 2010-2017 Regional Development Strategy of Georgia, adopted by the Government in 2010);*
- *Establish a Small Business Administration Body to ensure the realization of tasks of the strategic and tactical nature. The body shall also ensure the consolidation of all the stakeholders involved in the development and implementation of SME policies in the country and the coordination of their activities;*
- *Adoption of the SME Law and the Development Strategy will create a fertile ground for small businesses development which, in turn, is a prerequisite for economic progress and prosperity growth. Without establishing the Small Business Administration, the coordination of all the stakeholders, who cooperate today only on occasion, would be impossible.*

### Introduction of "SME Test"

Regulatory Impact Assessment (RIA) implies analysis of the likely economic, environmental and social effects of legislation change by assessing the costs and benefits of policy options. The so called SME Test gives the best opportunity of implementing the above-mentioned activities. The translation of the said test into practice will make it possible to make a preliminary assessment of business likely to be affected; to measure the impact on SMEs (cost-benefit analysis); and to use mitigating measures, if appropriate. Accordingly, it is necessary:

*to introduce regular use of RIA, which implies the implementation of the permanent assessment of the expected impact on SMEs as a result of different legislative changes, and their mandatory consideration in the process of planning legislative changes.*

### SMEs Support through their Business Internalization

To improve the SME business internationalization activities in Georgia, it is, first of all, necessary to analyse what creates constraints to the operation of Georgian SMEs in the international markets. The data obtained in the framework of the current study enables to identify the following constraints:

- Shortage of the working capital needed to finance export operations;
- Limited access to information necessary for analysing and selecting international markets.

Business internationalization cannot be considered as a separate activity of SMEs, rather it should be fully integrated into their long-term development strategies. A special role in the improvement of the SME internationalization index in Georgia consists in the implementation of promotion activities on the part of the government. Accordingly, it is essential that:

- *Government carried out an efficient policy, which implies assistance of fast growing SMEs in becoming aware of the need of internalization;*
- *Government worked out a special policy and action plan for facilitating implementation of business internalization task for enterprises.*

In result of the global financial crisis and hostilities of August 2008 indicators of the Georgian SMEs

### **Encourage and support SMEs to benefit from the growth of markets**

As a result of the August 2008 hostilities and global financial crisis, the commercial risks and liquidity indicators of Georgian SMEs have dramatically deteriorated. Correspondingly, the primary task remains:

*Activation of the available export financing schemes through cooperation with commercial banks. It is essential if the government takes care of the implementation of the mentioned schemes and allocates necessary credit resources, mobilizes in the country resources of international organizations, and encourages cooperation between SMEs and commercial banks by means of using the available resources.*

## **Public and Private Sectors Dialogue**

### **Public-Private Dialogue**

A dialogue between the public and private sectors as well as the role of the business community in it has significantly improved lately.

- *In spite of said improvement, significant effort is required in order to increase SMEs' benefits from such a dialogue;*
- *The main task in the public-private dialogue remains consists in establishing a permanent consultation regime with the SME sector.*

Although many associations, whose primary goal is to protect the business function in the country, the degree of their involvement in regulating small business problems is very low, because they appear to be generally protectors of the large business interests. This is presumably conditioned by the fact that the main object of public policy concentration is the segment of large enterprises, whose share in the volume of domestic production accounts for over 80%.

## **SME Promotion Programs**

### **Individual Assistance Programmes**

The most efficient way of promoting SME activities is to provide individual assistance and to create new opportunities within the enterprise. Accordingly, it is necessary to:

*Implement individual assistance program to identify needs of fast growing SMEs, including allocation of resources and providing other opportunities.*

As a rule, such a program starts with the assessment of the enterprise's readiness to internationalize and with the provision of consulting aid. This stage also implies assistance in other functional spheres: finances, dataware, network development, etc. Individual assistance programmes are characterized of a unified approach and ensure overcoming resistance of individual oppositions within a small enterprise. In other words, they are a "programme of programmes", whose main designation is to act at the micro level through promoting internationalization of an individual enterprise.

## Funding Sources

Against the background of the 2008 August war and the global financial crisis, access to finances has become especially problematic for SMEs. Deterioration of conditions is observable in all the SME funding segments: increase of interest rates on short-term loans, lack of long-term credit facilities, working capital deficit, lack of guarantee schemes, devaluation of collateral and mortgage guarantees, etc. Thus, cardinal changes in the approach to small business financing have been put on the agenda. In such circumstances, it would be ideal if public administration changed the conservative approach to the issue and formed a new strategic guide. The outdated public capital investment guidelines, on the basis of which the budget formation process remains in effect, should be modernized. Thus, the working out of a new priority in the SME sphere implies the inclusion of SME funding in the established public finance model as a priority and long-term subject. Adhering to the cost-benefit principle, all the arguments show that the rate of return on the invested capital is very high in the long-term outlook. Consequently, the confirmation of the state's good will for full-value activation of the SME's economic and social factor would be:

- *The establishment of sustainable SME financing mechanisms by enactment of a special Law on SME Financial Support;*
- *The primary purpose of the Law should be the establishment of legislative and institutional bases to meet the SMEs' financial requirements.*

In 2010 the government set up a so-called "Partnership Fund" to finance projects in different sectors. This is a government fund, whose assets will be used to implement large-scale projects on the co-investment basis and which aims primarily at growing the export potential and employment in Georgia<sup>38</sup>. The value each project in the agricultural sector will exceed GEL 5 million, while the value of projects to be implemented in other sectors should exceed GEL 30 million. Based on the scale of the projects, the fund will be partnering only with large businesses and cannot be regarded as a promoting factor for the SME. Accordingly, it is necessary to:

*Set up a Public SME Promotion Fund, whose main goal will be promotion of fast growing SMEs through improving access to finances and technologies.*

Availability of SME promotion policies and special programmes will make it become possible to consolidate and coordinate all the stakeholders cooperating now on an occasional basis. Implementation of the above-mentioned measures will create a fertile ground for developing small business which will, in turn, serve as a prerequisite for the economic progress and improving well-being.

<sup>38</sup> Strategic "10-Point Plan" of the Government of Georgia for Modernization and Employment, 2011-2015.



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# EU Innovation Policy and Eastern Partnership Programme: Georgia

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## Introduction

Innovation policy is considered as the main driving mechanism towards the European future. Although the European Neighbourhood Policy Action Plan of EU-Georgia<sup>1</sup> and the Eastern Partnership Multilateral Second Thematic Platform Working Program<sup>2</sup> include innovation policy-making commitments<sup>3</sup>, this issue has not been properly reflected in the governmental plans up to this day. It is of importance that the broad public circles in Georgia realized in this sphere the goals and objectives that were items in the EU agenda before 2020. It is also important to assess Georgia's abilities and potential in the innovation sphere. The raising of interest in different social groups (scientists, experts, regional and central government officials, politicians, entrepreneurs) towards these issues and the awakening of a desire to make own contribution to the transition of the country's economy from a factor-driven to an innovation-driven regime are the tasks of national importance. In parallel, specific recommendations for the governmental policy are to be worked out.

The present study is dedicated to the assessment of the state of Georgia's innovation system and the clarification of the attitude of different organizations' leaders towards the innovation process. On the basis of such study and taking into account the EU experience, specific recommendations on the national innovation policy for Georgia have been prepared.

### 1. Study Objective and Targets

The objective of the study was to assess the opportunities of innovation policy elaboration in Georgia by European analogy and to work out in this context useful for the country recommendations.

The study envisaged the following targets:

- Identifying the latest trends of the EU innovative development and its indicators;
- Identifying the current state of the Georgian innovation system and its trends;
- Identifying differences between the state and trends of innovation systems in Georgia and EU Member States (with the emphasis on the Central and Eastern European countries);
- A comparative analysis of some indicators of innovation systems in the Eastern Partnership countries;
- Evaluating the stakeholders' awareness of the issues of innovation policy and degree of involvement in the innovation processes;
- Identifying the circumstances interfering with the working out of a policy in this sphere;
- Assessing the efficiency of existing mechanisms and instruments of the Eastern Partnership in terms of strengthening the innovation policy;
- Developing recommendations for the Government of Georgia based on the study results.

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<sup>1</sup> Action Plan of Georgia-EU, p.7. See: [http://ec.europa.eu/environment/enlarg/pdf/enp\\_action\\_plan\\_georgia.pdf](http://ec.europa.eu/environment/enlarg/pdf/enp_action_plan_georgia.pdf)

<sup>2</sup> [http://eeas.europa.eu/eastern/platforms/docs/platform2\\_151109\\_en.pdf](http://eeas.europa.eu/eastern/platforms/docs/platform2_151109_en.pdf)

<sup>3</sup> Though the thematic programme of the second platform does not tell us directly about the innovation policy, but it establishes SME flagship initiative, which is based on the EU legislation in this field and European Small Business Act. In its turn, the VIII principle of the Small Business Act implies especially promotion of the innovation activity. It is well-known that in the process of Eastern Partnership the EU has already requested the partner countries for convergence of the legislation in this field. See additionally <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2008:0394:FIN:en:PDF>

## 2. Methodology

The main instruments used for the study were as follows:

- Analysis of the official statistics and the materials published by researchers (articles, reports, official websites); In-depth interviews with the heads of organizations of various types and levels (large and small enterprises, professional associations, local and central governments, the Parliament) to reveal the knowledge of innovation processes and the attitude towards them.

The first instrument was used to study EU Member States, with the emphasis on the Central and Eastern European countries (former Socialist countries). A comparative analysis of some indicators of the innovation systems of the Eastern Partnership countries (Armenia, Azerbaijan, Belarus, Georgia, Moldova, and Ukraine) and the other former Soviet states (Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan) was also carried out.

## 3. The EU Development Agenda

The EU growth program up to 2020 "Europe 2020"<sup>4</sup>, consists of seven flagship initiatives, one of which is called "Innovation Union", the remaining ones being six interrelated initiatives with specific directions. In particular:

"A Digital Agenda for Europe"

"Youth on the Move"

"Resource Efficient Europe"

"An Industrial Policy for the Globalisation Era"

"An Agenda for New Skills and Jobs"

"European Platform against Poverty"

All these initiatives imply innovative solutions, new technologies or processes, without which fulfilment of the designed ambitious plans will not be possible.

**A digital agenda for Europe**<sup>5</sup>. This flagship initiative implies for the Europeans for the creation of sustainable economic and social advantages through developing a Digital Single Market based on the very fast Internet and interoperable ITC systems. It is based on the following pillars: interoperability and standards; trust towards electronic systems and security; access to the very fast Internet; research and innovation in this field; enhancing e-skills, ICT for social challenges; international aspects of the agenda, the initiative implementation and management.

**Innovation Union**<sup>6</sup>. This flagship is the central and the largest part of Europe 2020. It aims to improve education, to strengthen the research system, to improve the single research and innovation area, improve the research results' utilization mechanisms (first of all improvement of the innovative SME participation), to concentrate on the innovation of the financial instruments, territorial aspects of innovation, enlargement of the international cooperation, registration and management of the process. Its central part is the European Research Program Horizon-2020 (EUR 85 billion for 7 years), which will substitute the FP7 Program (EUR 54 billion for seven years). Growth of the funds dedicated to the research is impressive.

<sup>4</sup> [http://ec.europa.eu/europe2020/index\\_en.htm](http://ec.europa.eu/europe2020/index_en.htm)

<sup>5</sup> A Digital Agenda for Europe. COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS. COM(2010) 245 final/2, EUROPEAN COMMISSION, Brussels, 26.8.2010

<sup>6</sup> Europe 2020 Flagship Initiative Innovation Union. COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS. Brussels, 6.10.2010 COM(2010) 546 final

**Youth on the Move**<sup>7</sup>. This flagship initiative sets out a series of actions to help young people gain the qualifications and skills they need to succeed in the jobs market, get them prepared for the challenges created by the knowledge economy. It establishes new educational programmes, enhances existing ones, and provides allocation and funding of the youth-care component in all the relevant European programmes. The initiative will be carried out in close cooperation with another Europe 2020 initiative “An Agenda for New Skills and Jobs” (see below).

The above-mentioned three initiatives constitute a part of the Europe 2020 strategy called “Smart Growth”. Its next part is “Sustainable Growth”, which consists of the following flagship initiatives:

**Resource Efficient Europe**<sup>8</sup>. This initiative responds to the expected shortage of resources (fuel, minerals and metals, as well as food, soil, water, air, biomass and ecosystems) and increase of pressure on them. It gives the action directions, which will alleviate the pressure on the one hand and ensure economic growth and additional employment opportunities on the other. At the same time, it is implied that while tackling the problems, an incentive to the development of new innovative will be given. The initiative supports the shift towards a resource-efficient, low-carbon economy to achieve sustainable growth. It also provides a long-term framework for actions in many policy areas, supporting policy agendas for climate change, energy, transport, industry, raw materials, agriculture, fisheries, biodiversity and regional development.

**An Industrial Policy for the Globalization Era**<sup>9</sup>. Europe 2020 pays due attention to industry and maximises its significance. The reason of it is that Europe has failed to retain leading positions in some novel areas of industry (for example, solar power system), where Europe was a pioneer and even now is the largest holder of knowledge on the one hand. On the other hand, a reason contributing to the 2008 economic crisis has become the ‘infatuation’ for the service sector, in particular the financial sector. The industrial policy flagship initiative implies smart regulation of competition, access of business to finances (especially for SMEs), the strengthening of the Single Market, standardization, enhancement of the innovation, professional growth, better use of globalization (access to raw materials, use of international trade regulation), resource and energy-efficiency, corporate social responsibility, space industry development (a strong source of innovation and new service areas), sustainable mobility of labour force. Also considered are new schemes of industrial policy management. It should be noted Europe has lacked an integrated industrial policy to this day.

The third and the last part of Europe 2020 is “Inclusive Growth”, which includes two flagship initiatives:

**An Agenda for New Skills and Jobs**<sup>10</sup>. This flagship initiative is how the Commission will help the EU to reach its employment target for 2020: 75% of the working-age population (20-64 years) in work. The measures include a policy in respect of employment and skills, which will assist transition to the green, smart and innovative economy. The European approach is as follows - high unemployment is the unacceptable waste of human capital. Its goal is: more skilled labour force, which can make changes in technology and also keep pace with the technology change through the new organization of jobs. The activities include a continuous improvement of education. A better use of resources, such as mobility (currently only 2.4% of the population of Europe are foreigners from 27 EU countries, and only 4% are from the non-member countries)

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<sup>7</sup> Youth on the Move. COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS EUROPEAN COMMISSION. Brussels, 15.9.2010, COM(2010) 477 final

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is provided. A labour market research and forecast is expected in order to plan training activities according to future market demands (for example, if the research expenditure in EU will reach the desired level of 3% of the GDP, additional 3.7 million scientists will be needed in Europe). Legislation, social protection and social dialogue are the instruments discussed in this initiative. In addition, its important parts are a) the development of appropriate financial instruments and b) the development of entrepreneurial and managerial skills to reach higher self-employment.

**European Platform against Poverty**<sup>11</sup>. 16.5% of the population lives below the poverty line in the EU<sup>12</sup>, which is not acceptable for the 21st century Europe. The Platform goal along with the other flagship initiatives is to solve this problem. The main directions are as follows: to carry out measures in respect to the whole range of the policy, better usage of the European funds to support social inclusion, development of a meaningful social innovation, social economy potential usage, and coordination of the Member States' policies. The key measures include a variety of sources for tackling the problem: access to new jobs, social protection and access to essential services, education and youth-related policy, migration and integration of the migrants. It is foreseen to use existing European funds for performing the tasks, and at the same time, to aim the member states' governments to concrete objectives.

The Europe 2020 flagship initiatives lay down specific indicators to be reached by the EU.

Study of the European Commission Communication texts of the each flagship initiative evidences that they are interconnected. The linkage of each of them to the innovation policy is also observed. To demonstrate how strong the linkage is, we have carried out a simple content analysis of the Communications' texts. The aim of the quantitative analysis was also to convincingly demonstrate to interested Georgian groups the interconnection between the European Economic and Social Development Strategy and the Innovation Policy, which is insufficiently understood in Georgia. The methods and result of the content analysis are described in the box below and Table 1. The result shows that all the Communications are terminologically (thematically) overlapped with the Innovation Union's Communication. The overlap makes 62% (Youth on the Move) to 17% (Resource Efficient Europe).

Despite thematic differences in the flagship initiatives (poverty, youth, resources, industry, communications, innovation), solution of the problems faced by all of them is connected with the innovation policy implementation. The Europe 2020 flagship initiatives do not include the development of agriculture. This issue is discussed separately in EU due to its special place and importance. The development of agriculture and, more broadly, rural development in EU is also strongly connected to innovation. Two papers in Georgian were dedicated to this issue<sup>13</sup>. To demonstrate the thematic linkage of the rural development with innovation policy in the abovementioned way we have applied a content analysis to the document Community strategic guidelines for rural development<sup>14</sup> and have obtained 25% terminology overlap with the Innovation Union Communication. We have also applied a content analysis to one more EU policy document which is not part of Europe 2020, namely to Sustainable Development Strategy<sup>15</sup>. A 20% overlap with the Innovation Union Communication was obtained.

<sup>11</sup> The European Platform against Poverty and Social Exclusion: A European framework for social and territorial cohesion. COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS EUROPEAN COMMISSION. Brussels, 16.12.2010, COM(2010) 758 final.

<sup>12</sup> See reference 9

<sup>13</sup> O. Shatberashvili. EaP and Innovation Processes in Agriculture. In book: European Union's Eastern Partnership Programme and Prospects of Innovation Development in Georgia. Editor I. Gogodze. Association ESIDG, Tbilisi, 2011, pp. 125–145 (www.inovdev.ge). O. Shatberashvili. European Innovation Policies in Agriculture. Edited by I. Gogodze, O. Shatberashvili. Association ESIDG, Tbilisi, 2010, pp. 245–280 (www.inovdev.ge)

<sup>14</sup> 2006/144/EC: Council Decision of 20 February 2006 on Community strategic guidelines for rural development (programming period 2007 to 2013). Official Journal L 055 , 25/02/2006 P. 0020 - 0029

<sup>15</sup> COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS. Mainstreaming sustainable development into EU policies: 2009 Review of the European Union Strategy for Sustainable Development. Brussels, 24.7.2009, COM (2009) 400 final.

Thus we can conclude that EU's economic growth and social development is largely ensured by the innovation policy. It is the driving force of the EU development. Development plans, which are not closely connected with it, simply do not exist in EU. Therefore, the European integration process for any country is impossible without the implementation of an innovation policy. It is proved by the experience of former socialist countries that are currently EU Member States. Their success in terms of economic integration is measured, inter alia, by innovation indicators.

### ***Box: Content analysis of the Europe 2020 Flagship Initiatives***

We have used a simple content analysis method to analyze the Economic Growth and Development Programme "Europe - 2020". We have defined a glossary of terms descriptive for the innovation process and all the wordforms of these terms. In the European Commission Communications' texts for each flagship initiative we have counted the number of the wordforms corresponding to each term and total number of wordforms. The ratio of the number of innovation-related words to the total number of the words in the text indicates the strength of text's linkage to the innovation problems. The terms are:

- Innovation + all the wordforms (innovations, innovative, innovate. . .)
- Research
- Research and Development - R&D
- Standards
- Education
- Training
- Technology
- Knowledge
- Learning
- Patent
- License

The results of the calculation are given in Table 1. We can consider that the vocabulary of the EC's Communication Innovation Union, which is entirely dedicated to the development of the innovation process in Europe, reflects this subject by 100%. The terms chosen by us (including all the wordforms) in the Innovation Union Communication amount to 4% of the total number of words. A comparison of the percentage of the same terms in other flagship initiatives to this result gives us a comprehension of the links of flagship initiatives with the innovation problems.

We have obtained the following results: Digital Agenda for Europe - 25% overlapping with the Innovation Union, Youth on the Move - 62% overlapping, Resource Efficient Europe - 17% overlapping, An Industrial Policy for the Globalization Era - 37% overlapping, An Agenda for New Skills And Jobs - 40% overlapping, European Platform Against Poverty - 25% overlapping.

## 4. New EU Member States and Georgia

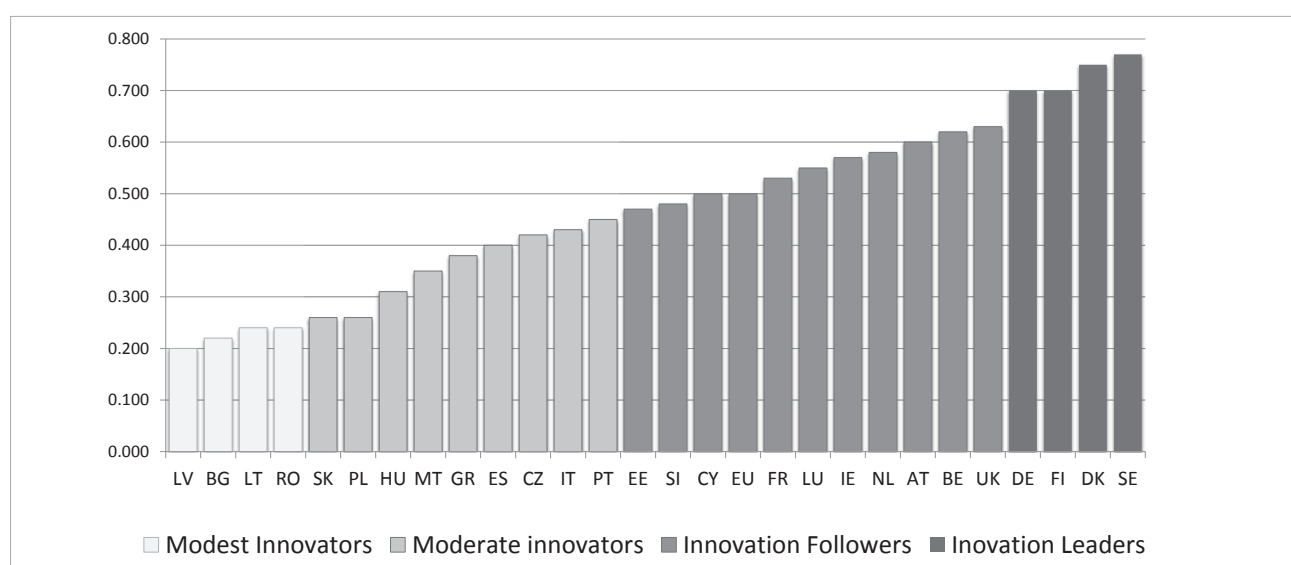
The countries being of particular concern for the present study are those from the Central and Eastern Europe. They have just traversed the path, which Georgia has to follow. These countries are still being ranked as innovation followers, moderate innovators and modest innovators rather than innovation leaders.

According to the 2011 European Innovation Scoreboard<sup>16</sup> (see the diagram below), grouping of the countries by their innovation index is as follows:

- **Innovation Leaders:** Denmark, Finland, Germany, Sweden
- **Innovation Followers:** Austria, Belgium, Cyprus, Estonia, France, Ireland, Luxembourg, the Netherlands, Slovenia, United Kingdom;
- **Moderate Innovators:** Czech Republic, Greece, Italy, Hungary, Malta, Poland, Norway, Portugal, Slovakia, Spain;
- **Modest Innovators:** Bulgaria, Latvia, Lithuania, Romania.

It should be noted that Estonia and Slovenia, according to the European Innovation Scoreboard 2008, were one step downward - in the group of moderate innovators. Currently they are in a group of such countries as Austria, Belgium, France, and others. Poland, Hungary and Slovakia also went one step upward.

Chart 1. Innovation Performance of the EU Members<sup>17</sup>



Overall, given the hardest and lengthy economic recession of the former socialist and Soviet countries in the 90s of the last century due to the collapse of the Soviet Union and rapid transition to a market economy, their innovation performance is impressive. For example, Estonia overtook such EU old Member States as Spain, Italy and Greece. However, it should be also noted that a small group of the relatively backward modest innovators also consists of former socialist countries: Bulgaria, Latvia, Lithuania, and Romania. One of the conclusions that can be made is as follows. The starting conditions of the former Soviet and socialist countries and currently EU Member States were approximately the same in the beginning the European integration

<sup>16</sup> European Innovation Scoreboard (EIS) [http://ec.europa.eu/enterprise/policies/innovation/facts-figures-analysis/innovation-scoreboard/index\\_en.htm](http://ec.europa.eu/enterprise/policies/innovation/facts-figures-analysis/innovation-scoreboard/index_en.htm).

<sup>17</sup> Innovation Union Scoreboard [http://ec.europa.eu/enterprise/policies/innovation/facts-figures-analysis/innovation-scoreboard/index\\_en.htm](http://ec.europa.eu/enterprise/policies/innovation/facts-figures-analysis/innovation-scoreboard/index_en.htm).

process (we mean the time, when the country declared its European integration aspirations rather than the time of becoming a member). The other former Soviet countries had also just the same starting conditions (some of them even better), but their performance is dramatically different. As can be seen from tables 3 and 5, it particularly concerns Georgia and some other former Soviet countries, which, in the first place, is manifested in the condition of the national research systems.

Table 1. Outcome of Europe Economic Growth Programme Europe 2020 Content Analysis

Programmes	European Commission Communications	Total number of words	Number of innovation-related terms											All terms	Share of terms	Overlap with Innovation Union
			Innovation	Research	R&D	Standards	Education	Training	Technology	Knowledge	Learning	Patents	Licenses			
Europe 2020	Digital agenda for Europe	14,243	44	26	10	41	10	6	12	3	4	0	0	156	1%	25%
	Innovation Union	17,920	377	189	36	29	39	11	18	42	3	9	40	793	4%	100%
	Youth on the move_	8,400	10	10	0	0	103	25	3	9	50	0	0	210	2,5%	62%
	Resource efficient Europe	6,200	20	9	2	3	0	0	6	2	1	2	0	45	0,7%	17%
	An industrial policy for the globalization era	13,857	85	25	10	47	7	3	25	8	3	6	0	209	1,5%	37%
	An agenda for new skills and jobs	9,477	21	8	5	3	43	41	4	5	30	0	0	160	1,6%	40%
Other	European platform against poverty	9,200	29	6	0	1	18	6	27	1	6	0	0	94	1%	25%
	Sustainable Development Strategy	6,900	8	7	4	0	19	7	16	0	0	0	0	61	0.8%	20%
	Strategic guidelines for rural development	5,330	17	2	0	5	5	12	0	6	5	0	0	52	1%	25%



The last two documents are not included in the Europe 2020 system of documents. Agriculture and sustainable development, due to their special significance and peculiarity, are considered in EU as individual strategic blocks. By their content, these documents bear the same load as the Europe 2020 documents, i.e. they represent the European Development Strategy. We have also subjected these two documents to a content analysis by the aforementioned method and made sure that their terminology is being significantly overlapped by the Innovation Union vocabulary.

Table 2. Some innovation indices for Georgia and EU East European Member States

Indicator	Georgia	Finland	Slovenia	Latvia	Lithuania	Estonia	Bulgaria	Slovakia	Czech Republic	Hungary	Poland	Romania	Turkey
Research costs, GDP %	< 0.2	3.94	1.84	0.59	0.84	1.42	0.53	0.48	1.53	1.15	0.68	0.47	0.84
Business costs	–	2.83	1.20	0.17	0.20	0.64	0.16	0.20	0.92	0.66	0.19	0.19	0.34
Number of people engaged in science per 1,000 population	< 3	20	8	5	–	–	–	–	–	–	–	–	–
Scientists per 1000 population <sup>18</sup>	–	7.7	3.5	1.93	2.5	2.96	1.5	2.33	2.88	1.73	1.62	0.90	0.68 (2007) 2.1 <sup>19</sup>
International publications per 1 mln inhabitants	150	1113	750	132	199	491	191	333	426	329	186	118	200 estim
Risk (venture) capital, GDP %	–	0.145 0.24 <sup>20</sup>	N-A	–	–	–	–	–	0.13	0.04	0.03	–	–
International patent applications per EUR 1 billion of GDP	0	9.96	2.56	0.69	0.35	2.00	0.38	0.49	0.99	1.54	0.31	0.15	0.46
% of small innovative enterprises in total number of enterprises <sup>21</sup>	–	41,83	31,02	17,22	21,93	43,92	20,72	19,04	34,86	16,82	17,55	16,66	29.52
Employment, knowledge in science-intensive sectors (% of total employment)	–	36.5	31.9	30.1	31.2	31.8	26.0	29.1	29.2	33.5	28.0	19.8	18.4

<sup>18</sup> www.tradingeconomics.com, 2008.

<sup>19</sup> 2010, per thousands of labor forth.

<sup>20</sup> www.oecd.org/dataoecd. SCIENCE AND INNOVATION: COUNTRY NOTES. Finland.

<sup>21</sup> http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/pdf/2010\_2011. SMEs introducing product or process innovations, 2008.

As can be seen from Table 3, Georgia seriously lags behind all the countries in terms of the value of innovation indices (including Latvia, which occupies the last place according to the Summary Innovation Index. The data for Georgia and Latvia are singled out). The state of its innovation system is characterized by the decreasing dynamics of its indicators, in contrast to those of EU member States. This is evident from tables 4 and 5.

The data for Georgia are obtained by evaluation, as the innovation process recording block has been inoperable for years. This is another significant difference from the EU practice.

*Table 3. Some indicators showing changes of the Georgian Innovation System*

Indicator	1985	2011
Spending on Research, GDP %	3%	< 0.2
Number of research organisations	250	~ 60 <sup>21</sup>
Of them legal entity	230	< 10
Number of design offices	Several dozens	–
Number of experimental and selection farms	70	< 10
Number of research libraries	300	< 50

The Georgian research and research service systems have suffered heavy losses, especially in recent years. They have lost their staff, the age of research staff has sharply increased; they have been deprived of property worth hundreds of million dollars in land and buildings (including such important things, as agricultural experimental farm plots). This process sharply contradicts the EU practice.

Georgia has announced European integration as principal direction, but, as has been underlined above, European integration without the appropriate innovation policy is impossible. As regards the above-mentioned data, they indicate degradation of the innovation system. This is a fundamental contradiction between the declared and actual policies.

Table 4: Science expenditures, % of GDP (GERD as % of GDP) in FSU countries

Country		2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Central Asia and South Caucasus	Armenia	0.18	0.28	0.25	0.24	0.21	0.21	0.24	0.21	—	?	?
	Azerbaijan	0.34	0.34	0.30	0.32	0.30	0.22	0.17	0.17	0,27 <sup>22</sup>	0,2 (нд11)	0,2 (нд11)
	Georgia <sup>23</sup>	0.22	0.24	0.19	0.22	0.24	0.18	—	—	0.169 <sup>24</sup> (Dolidze)	< 0.2	< 0.210 <sup>25</sup>
	Kazakhstan	0.22	0.18	0.22	0.26	0.25	0.25	0.28	0.24	0.21	—	0,26
	Kyrgyzstan	0.16	0.17	0.20	0.22	0.20	0.20	0.23	0.23	—	—	0.1
	Tajikistan	—	0.09	0.07	0.07	0.07	0.10	0.10	0.06	—	—	0.1
	Turkmenistan	—	—	—	0.4	—	—	—	—	0.05	0,07	0.1 (evaluation)
	Uzbekistan	—	—	—	0.2	—	—	—	—	—	—	—
Eastsrn Europe	Belarus <sup>26</sup>	1.1	—	—	—	—	—	0.66	0.96	—	0.75	0.67
	Moldova	—	—	—	0.3	—	—	0.41	0.55	—	0.7	0.58
	Ukraine	1.0	—	—	—	—	—	0.95	0.85	—	—	0.86

<sup>22</sup> National Report. The State and Development Strategy of the Agrarian Sector in Azerbaijan 2011 (CACAARI, [www.cacaari.org](http://www.cacaari.org)) Azerbaijani statistics for 2008 – 2010. The 2011 statistics for Kazakhstan, Kyrgyzstan and Tajikistan are taken from the same source

<sup>23</sup> Sources for Ukraine, Belarus and Moldova are: <http://data.worldbank.org/indicator/GB.XPD.RSDV.GD.ZS>, also, ERA Watch. National Reports (<http://cordis.europa.eu/erawatch/>). The other statistics are taken from the report: Regional report on the status of ICM/ICT in Agriculture research for development – Central Asia and South Caucasus, Oleg Shatberashvili, Coordinator of the Group of National Experts. 2011 (CACAARI, [www.cacaari.org](http://www.cacaari.org))

<sup>24</sup> It should be mentioned that the GERD/GDP correlation between Ukraine and Georgia was particularly high. In 1985, it made 3%.

<sup>25</sup> <http://www.increast.eu/en/157.php>

<sup>26</sup> The assessment is taken from the article by O. Shatberashvili: Innovation Processes and Effective Governance of a Country: Opportunities in the Eastern Partnership Framework. In book: EaP and Prospects of Innovation Development in Georgia. Edited by I. Gogodze. Association ESIDG, Tbilisi, 2011, pp. 13 – 48.

## 5. Innovation Process Assessment in Georgia by its Main Stakeholders

The obstacles mentioned above can be overcome if the main stakeholders of the innovation process have realized its importance and existing difficulties. Also of importance is to know their attitude towards European integration as the mechanism contributing to the development of innovation in Georgia. Therefore, it was of interest to understand whether scientists, entrepreneurs, government management bodies had recognized the importance of innovation problems, development of the innovation system in general and, in particular, in the context of European integration. To get the answer, a special study has been designed.

### 5.1 Methodology

A small-scale sociological interview (Gallup poll) was conducted in order to evaluate the current state of Georgian innovation potential.

The interview was conducted on the basis of an in-depth interview method (see Appendix) covering the representatives of main 'stakeholders' - civil servants, scientific and business communities and non-governmental organizations (heads of organizations - at least 3-5 representatives having a doctoral degree for all the above-mentioned categories). The total number of respondents made 20. Interviews were made in a period from 15 November to 15 December 2011, in Tbilisi and some other regions of Georgia.

### 5.2 Results of the Interview

#### 5.2.1 Awareness of EaP

According to the respondents, only general information about the EaP and its relation to innovation is known to them. After the interviewer had provided them with information on the EaP, the respondents expressed general trust towards the EaP-conditioned processes and mentioned their benefits for Georgia on the whole (they expressed their positive attitudes towards the European integration processes in general). They regard Europe as a source of knowledge, the place of certification of products, and the generator of novel technologies).

The respondents also expressed hope that EaP may, in principle, mark out new opportunities in such areas as the introduction of new technologies, staff training, and participation in international research programs. According to the respondents, the progress of Georgia is dependent on the all the following components of EaP:

1. Good governance
2. Development of small and medium-sized enterprises (SMEs)
3. Protection of industrial property
4. Energy security and environmental protection
5. Development of international relations for specialists and students.

At the same time, the respondents have outlined the following directions of the EaP, which in the framework of the above-mentioned EaP components are desirable to be developed in the near-term outlook: working out of an efficient "innovation" legislation<sup>27</sup>, improvement of the legal base of standardization and quality control, mastering modern eco-protection technologies and training of relevant specialists, setting up consulting centres for farmers and for SMEs of the processing industry.

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<sup>27</sup> According to one of the respondents, "innovators' protective" legislation in the broad sense means copyrights, comfortable environment for activity (namely fiscal), different mechanisms of stimulation, and even social welfare.

### 5.2.2 New technologies

The most important issue connected with the development of new technologies is the availability of information. Thus, the respondents were asked to name and evaluate the available to them information channels on new technologies in terms of efficiency.

The respondents declared Internet as the main (and frequently the only) channel to obtain information on new technologies. About half of the respondents named foreign partners in joint projects, conferences and exhibitions, or analysis of their competitors' activities to be additional channels for them to obtain information on new technologies.

Other channels of information on new technologies (namely, patent-licensing researches and universities) are considered by the respondents as inefficient under the current conditions.

The respondents were also asked to evaluate various forms of introducing new technologies (directly materialized, patents, licenses, etc.) in terms of their efficiency under the current conditions.

According to the respondents, the most efficient form of introducing new technologies today is the bringing of technologies in the directly materialized form with the accompanying training of the personnel. The reason of it for the respondents is the lack of necessary knowledge and human and financial resources, which has become dramatically evidenced of late and interferes with transfer of any new technology only by means of documentation<sup>28</sup>.

At the same time, any form of introducing new technologies is generally acceptable for the respondents and, in their opinion, the selection of this or that form depends on the specific situation. The setting up of joint ventures the respondents consider as one of the most accessible form of importing new technologies.

Practically unanimously, the respondents point out the lack of knowledge (in society, in general, and among the decision-makers, in particular) as the main obstacle to the import of new technologies which, as a result, brings forth the lack of general competence and conditions the absence of the necessary political and/or administration will needed for importing new technologies, a deficit of the institutional and legislative support, and the lack of financial resources.

The way out from the created situation the respondents see in prioritizing the country's innovation development at national level, in establishing the appropriate legal base, in sharing the EU experience in the field of innovation policy and its adapting to the conditions of Georgia.

### 5.2.3 Research and Development (R&D)

The respondents almost unanimously point out that currently the research and development (R&D) system has been substantially deranged in Georgia, and if any R&D works are still being carried out, they are far from being effective. Such a state of R&D is said to be conditioned by the following: the abnormally low level of funding, the inefficient management of grants system, the destruction of the material- technical infrastructure, the human resources shortage, and the difficulties of practical application of research findings.

According to the respondents, the State should be considered today as the only main source of R&D funding, since business cannot bear the burden of R&D financing in Georgia. The respondents also believe that the Georgian R&D system participation in international research programmes should be considered as an effective channel of financing.

Out of the prospective directions of R&D in Georgia the respondents named: chemistry and metallurgy, materials science, composite materials and constructions, agriculture, microelectronics and electrical engineering, information technologies, geology, cartography and geodesy, seismic stability. This list, because of a small scope of research, cannot certainly fully reflect the R&D potential remaining in Georgia. When

<sup>28</sup> The respondents give examples of the technologies known to them that have been recently introduced in the materialized forms – design software, Geographical Information Systems (GIS), new technologies of using the monolithic construction, and non-conventional power sources.

interpreting the list, the main point, in our opinion, is the fact that the respondents still see the possibility of the R&D system revival in Georgia.

#### **5.2.4. Involvement in the innovation process**

Based on the respondents' answers, we can conclude that the cooperation in the field of innovation between organizations is carried out mainly on the basis of short-term contracts for implementing specific projects and, as a rule, lacks a methodical approach.

At the same time, in the respondents' answers the following tendency is clearly outlined - organizations prioritize the cooperation with specialists (namely with university specialists) rather than the cooperation with universities themselves, which turns out to be much cheaper for them.

Also noteworthy is the fact that municipalities/city halls can afford only the innovations provided by foreign donor organizations (because of the lack of funds). The essence of such innovations depends, as a rule, on the donors' will and they are carried out in a small number of municipalities with hope for subsequent diffusion. Diffusion is regarded by all the municipalities (and not only municipalities) as a very important mechanism for distributing not only the imported knowledge but also the useful achievements inside the country. The respondents point out that the novelties implemented by donors are frequently lost without the post-project support. The NGOs engaged in the environmental protection also are directly dependent on the innovations obtained through foreign donor organizations.

The respondents mentioned a number of specific general problems having resulted from incompetently implemented reform. For example: standardization problems, adaptation of the international system of environmental indicators, absence of the united geodetic network, etc.

Only a small number of the respondents noted that some Georgian technologies (mainly developed in the last century) are still exploited (manganese and cement-related technologies, power stations control, etc.). About half of the respondents pointed out that their organizations utilize/distribute new imported technologies/materials in Georgia and also export special equipments/items (although this happens rather rarely - only one out of 20 respondents informed so).

The respondents unanimously stated that they have the experience of cooperating with foreign specialists (who come to Georgia) and they positively consider such cooperation. The respondents noted that their cooperation with foreign specialists is carried out on the basis of short-term contracts in the framework of specific projects being implemented in Georgia (only one respondent indicated the cooperation in the framework of the EU's FP7 programme).

The respondents also unanimously declare that, notwithstanding its importance, a viable system of training/retraining of specialists does not exist in Georgia. Only individual training/retraining activities are carried out in the framework of various projects; however, to render a systemic character to such activities within the framework of international networks would be more reasonable.

The respondents almost unanimously (with the minor exception of the organizations getting the basic and/or grant funding or performing the governmental contractual work) point out that they lack the State support in the field of innovations (R&D funding, tax remissions, etc.).

#### **5.3. Conclusion of the Interview**

The respondents have demonstrated quite a good knowledge of the components of innovation policies related to their activities and good vision of the bottlenecks emerging in case such components are absent. However, they do not have, as a rule, a clear idea of the general innovation policies and their components. The interviewed representatives of all the groups have unanimously agreed that the innovation policy is important and the European integration should be used for its development. Many respondents stressed the importance of a horizontal transfer of knowledge (technology) inside the country (appropriate innovation), particularly with regard to agriculture. The importance of innovations for agriculture has been stressed by many respondents not engaged in the sector.

## 6. Innovation Policy Recommendations for the Government of Georgia and Political Parties

The most important issue is the development and adoption of the national innovation policy document. The Government shall draft and submit to the Parliament a document reflecting fundamental principles of the policy. The document is to serve as a basis for making amendments to the relevant legislation and implementing necessary organizational activities. The innovation policy shall be recognized as the priority target of the Government. A National Innovation Development Council chaired by Prime Minister shall be formed.

Given below is a list of issues with short commentaries to be included in the strategic document (the list is not exhaustive).

### 6.1. Innovation Infrastructure Development

**Research system development:** This issue has been discussed publicly lately, although without yielding positive results. One of the serious reasons of the above is the fact that the research system has not been considered in the context of the country's innovation development, while other context is simply absent.

A modern definition of research and equalled to it activity should be developed. Its organizational and legal forms, as well as the rights of stakeholders both in the public and private sectors should be determined. The research system, as the impartial non-partisan institution, should be protected from the government change risks.

Research activities should be considered as a special sphere of human activity, which, due to its socio-economic importance and its internal structure, requires from the state different from the other branches methods of planning and management. The process of the research system de-institutionalization should be stopped. A gradual increase in the research volume and of other indicators (costs, as % of GDP, the number of researchers per 1000 population, age distribution, etc.) shall be planned both in the private and public sectors. From this standpoint, the innovation policy should clearly define the government's responsibility.

**Research promotion in the private sector:** In case the appropriate measures are taken and correct growth factors are established, the growth of research in the public sector will lead to the same beneficial effect in the private sector as well. Enterprises (primarily SMEs) shall, on the basis of adoption of a relevant law, become eligible to research grants, the right of which they currently lack. Tax and tariff benefits, shortened amortization terms and other internationally tested financial instruments shall be applied to the enterprises engaged in research and innovation activities. Enterprises shall also be offered non-tax assistance, such as personnel training gratis or for reasonable (subsidized) prices, research assistance on the part of universities and research organizations, consulting in the field of intellectual property and technology transfer, etc. A system of incentives for experimental testing (for example, testing of medicine preparations and methods, testing of species in agriculture, etc.) and work, design (engineering) and other science-equalled activities should be introduced.

**Development of higher education, occupational training and lifelong learning systems:** Innovation is a dynamic process demanding constant changes in the personnel profile. This process is facilitated when: a) the country spends public funds on education, and b) the education system provides a good fundamental knowledge. The latter is ensured if the university research in natural and exact sciences is publicly funded. In regard to spending public (social) funds on education, Georgia occupies the last place among the former Soviet countries (given that these countries are poor spenders on science). Both fields - education and science - are the branches where the government is obliged to act as an investor and gradually raise expenses to the level of successful countries. Research must become a necessary condition for the accreditation of the universities.

In a system of higher education, tested but new for Georgia mechanisms should be activated, such as technological parks, spin-off schemes, and technology transfer centers.



Research (scientific) service system development: Here we have to do with such services as species testing and consulting in agriculture, hydro-meteorological, geological, geodetic, meteorological, quality management, intellectual property protection, sci-tech information, etc. Most of them require rehabilitation. Some of them (for example, advisory services in agriculture) have never existed before and are to be established. At the same time, in respect of this, it is necessary to conduct legislative, organizational and financial measures. These activities will require the taking of necessary legislative, organizational and financial measures. The development of the above-mentioned services should become a priority task of the corresponding ministries.

Intermediary service development: Georgia practically lacks services, which would facilitate the transfer of research results to industry – business incubators, technological parks, consulting and technology transfer centres. An exception is the services established in the framework of international donor projects that close down with the completion of such projects. It is intolerable to make this sphere dependable on the good will of donors. Georgia lacks mechanisms for promoting technology diffusion, such, for example, as high-tech economic zones. The government should develop legislation and find resources to establish model services with the aim to develop on their basis a network of intermediary services in the future.

## 6.2. Formation of the Innovation Environment

The Government is the catalyst and regulator of the innovation process. It creates conditions/ environment (e.g., legislative) to encourage the innovation process. Through the innovation policy it can exert influence on all the channels of innovation. In addition to the measures referred to in section 7.1, the following listed below measures/activities need to be carried out.

Amendment of a small business definition methods; determining an innovative business definition: The methods of defining SMEs in Georgia are radically different from the internationally recognized ones, which greatly affects the innovation process. The Tax Code provides small tax privileges for the enterprises whose annual turnover is less than GEL 100,000. This is a very low ceiling for innovation activities. There is no definition of an innovative enterprise in Georgian laws. The legislation excludes direct financial assistance to private enterprises (for innovation and research activities). Therefore, it is essential that the effective legislation be adjusted and harmonized in line with the international, in particular EU, best practices.

**Support to agricultural innovation:** Innovation activities are particularly hardly implementable in small farms. At the same time, their implementation acquires a global significance for success in combating poverty. The carrying out of an innovation policy shall, in addition to well-organized consulting services, require joint actions of farmers. Much significance in this respect is given to farmer co-operatives. An obstacle to agricultural innovation development in Georgia is the lack of a legal definition of a farm and farmer and a law on co-operatives. The conduct of a technical and organizational innovation in agriculture will be impossible without recognizing a farm as a legal and organizational entity and determining the farmer's rights and obligations. Definite legislative initiatives are available today. They should be matched and adjusted in line with the innovation policy targets.

**Support to non-research innovation:** In the wide sense, innovation is the practical application of new ideas. According to such a definition, all types of activities and operation of all the channels leading to innovation shall be regarded as innovation processes. In Georgia, like in the other developing countries, innovation is mainly carried out through non-research channels (for example, import by Georgian companies of machinery with a stitched-in technology and patent licence directly accompanying a foreign investment). Franchise (franchising) stands close by its content to this channel. Efficient management of a non-research innovation through a system of incentives is an issue of great importance for Georgia. This issue shall find a proper reflection in the effective legislation.

**Reasonable innovation support:** Among the general knowledge-based 'conventional' technologies there are many which could be successfully used today and their utilization at local level could be considered as an innovation. Such 'routine' innovations are important for developing countries. Governments, especially local governments, should respond to such innovations with respective incentives measures.



The encouragement of the directions/activities listed in sub-section 7.2 implies the creation and operation of respective financial, tax and non-financial mechanisms.

### 6.3. Public Administration and the Innovation Process

On the one hand, the Government acts as an investor, investing in general education and research systems and also in innovation tools and specific innovation projects, and on the other hand, as a catalyst and regulator, who creates conditions/environment (e.g., legislative) to support innovation processes. Implementation of the innovation policy requires the realization of these functions, which must, in turn, make significant changes in the state governance.

**Government involvement in the management of innovation processes and the research system's involvement in the governmental decision-making:** Innovation-oriented countries create high-level innovation councils (under the leadership of the prime ministers). Their members include several ministers, representatives of the research system (academic circles) and business circles. This practice should also take root in Georgia. The Council shall have a respective working body. To ensure the knowledge-based work of ministries, research organizations should be established or restored within their systems, also subdivisions responsible for the innovation policy shall be set up within the structure of the ministry. Research organizations can be under double subordination of the Ministry of Education and Science and other government agency responsible for development of science. Ministries shall also have funds for ordering research work.

**Involvement of local governments in innovation processes:** Regional and local governments play a significant role (formation of local innovative enterprise clusters, rural and agricultural production development, etc.) in the implementation of innovation policies. This role is closely related to the regional competitiveness and, in the good sense of the word, to the issues of competition among the regions. The regions must have substantial financial resources to fulfil their role. At present, regional/local governments are dependent on transfers from the central government. This circumstance will interfere with the innovation policy implementation. Georgia should revise the legislation determining the creation of the powers and funds of the regional and local governments. Regional development funds and the centres shall be formed for accumulating funds from various sources for the purpose of implementing innovation programmes.

**Large-scale retraining of civil servants in the field of innovation development:** The innovation policy concerns many areas of the country life and, what is most important, is based on priorities. Its implementation requires high qualification of public servants. Therefore, a very important issue of retraining officials is put forward, which requires financial resources. However the outcome of retraining – the availability of highly-skilled civil servants - justifies the costs.

Innovation sphere management on the basis of state programmes; the legal status of programmes: Setting priorities, especially in the field of research (science) in Georgia, gives rise to heated debates. On the one hand, this is a really difficult task. On the other, if we reduce it to the question How to start? it is considerably simplified. Obvious, natural priorities are brought to the forefront, on which basis several programmes can be formed to give a start. All the programmes shall have a national law status to be valid until the end of the programme.

**The First Group of Priorities** – human life support in a changing environment. It includes: provision of population with food, agricultural research, development of an advisory system for agriculture; development of a robust system of environmental research, observation and consulting; perfection of the medical research and health care system.

**Second Group of Priorities** – research in the processing of local mineral and non-food agricultural raw materials.

**Third Group of Priorities** – research in the sphere of energy-efficient and energy security-related technologies and environmental protection.

**Fourth Group of Priorities** - information and communication technologies; creation of new electronic information resources, including the transformation of archives into the digital form.

**Fifth Group of Priorities** – development of research in the field of the humanities and society study, which will ensure information support and consulting of the government aimed at efficient governance and state organization in general.

These programmes can direct activities of many thousands of researchers and practitioners at solving the problems of vital importance in the beginning of the process, the rest being made clear by life. It should be underlined that the study implies the generation of both new technologies as well as the adaptation of existing ones. In addition, the research system shall fulfil one more important function – informing the Georgian community about the ongoing global innovation processes.

#### **6.4. Information Support of the Innovation Policy**

Implementation of the innovation policy requires monitoring of its course. It must be based on a system of indicators developed by the European Commission and the OECD. For that the innovation activities accounting unit in the system of national statistics should be restored. It is not improbable that some additional indicators need to be introduced at the initial stage, towards which the system will be more sensitive than towards the standard indicators. It is important to assess performance of the research system and ensure accessibility of the results of research carried out on the basis of public funds. To implement successfully the innovation policy, an analysis of the scientific and technological information analysis in the world is to be made. With that end in view, a special dataware can be developed.

### **7. How well does EaP respond to the Development Agenda of Europe and the Development Objectives of Georgia?**

European integration is a long-term process and not a single act. Its agenda should include the content and dynamics of European development, as well as the development of long-term objectives of Georgia. However, EaP, in its current form, does not consider the issues of innovation policy and the realization of its action plan (flagship initiatives) requires a well coordinated work of a number of the innovative infrastructure components. For example, the signing of the Association Agreement Deep and Comprehensive Free Trade Areas (DCFTAs) envisaged under EaP in addition to the existence of relevant legislation, will require quality control of the goods produced in Georgia (enough capacity and standardization of the testing system), traceability of products' origin (operation of the quality control systems and provision of support from the consulting services in agriculture), a detailed description of production conditions (analysis of soils, data tying with the land cadastre, standards of consumption of fertilizers, insecticides and pesticides) and so on. These issues will become urgent either at the initial or the next stages. The intellectual property protection issues envisaged by EaP (being currently limited to the discussion on the existence of piracy products on the market, which at this stage is in the EU's interests) will be discussed in a broader context (inventions, licensing, etc.), which will encounter the poor implementation of the relevant Georgian legislation and the poor personnel preparedness. Energy security envisaged by EaP would be impossible without the development of energy saving technologies and environmental protection technologies, without the diversification of the energy sources, etc.

In other words, not evidently, the efficient use of EaP as the European integration mechanism implies the innovation policy implementation. Such interpretation of it is in the interest of Georgia.

On the other hand, we should recognize that the EU does not demand such an interpretation from EaP. EaP countries are not required to register innovation processes, to improve the indicators, etc., which is strictly required from the EU candidate countries. However, objectively, it should be in the interests of the EU to have sustained, healthy economies in the neighbourhood rather than having just stable markets and suppliers of raw materials. From this strategic point of view, EU should demand from its neighbours the convergence of the context of economic development with that of European, which would push the innovation policy, as condition, ahead.

It should be admitted that neither ENP (the European Neighbourhood Policy), nor EaP can, under their current design, exclude such processes in the neighbourhood that strongly oppose the essence of the European integration. We have discussed above the examples of such processes in regard to science, education and innovation systems. Thus, EaP is undoubtedly a useful tool but it has failed up to now represent a guarantee or even a sign of the EU integration progress in Georgia. It should be mentioned that the European Union has already raised before the governments of the Member States an issue on the widening of the discussion panels operating within EaP concerning innovation (primarily in agriculture and other directions).

Below we present the recommendations for the European Commission, whose realization would give much to Georgia, while the European Commission would have a good example of success achieved in the neighbourhood through its assistance.

## 8. Recommendations on EaP for the European Commission

Proceeding from the EU's natural concern for having steadily developing countries in the neighbourhood and also for acquiring by EaP a true European integration nature, the Commission commits itself:

1. To raise the issue of developing and implementing the innovation policy in the EaP countries as a flagship initiative.
2. To develop for these countries an innovation scoreboard based on the EU-adopted indicators, using at the initial stage their limited number, in order to facilitate for the countries the beginning of their work.
3. To assist the countries in establishing/strengthening the innovation block under the structure of the state statistical services, together with other activities, by training the corresponding personnel.
4. To develop annual national innovation reports and publish them on the EU website, both separately and in an aggregate form, as it is done for the candidate countries.
5. To assist countries in training main stakeholders of the innovation process in the sphere of innovation policies.

## 9. Conclusion

The carrying out of the measures proposed in this study report implies a substantial change of the economic model of Georgia. It requires amendment of the laws in many fields and adoption of new, currently inexistent laws. It requires from the state governing mechanism to carry out more difficult tasks. It requires serious changes in the governance: management based on the approved priorities, more independence of local governments, and more extensive and in-depth understanding of the European integration process. The innovation policy implementation means a change in the economic development of the country. On the other hand, the implementation of these changes is worthwhile as far as it is the only way to get gradually closer to the club of developed countries. For a country like Georgia it is a strong challenge, a peculiar long-term super goal. For its setting, consent of the political forces, moreover the national agreement that the country can and will start to implement it, is required.

## Appendix A

## INTERVIEWER'S GUIDE

<b>I. Introduction</b>	
Welcome and thanks	Thank you for finding time for this interview.
Introducing oneself	My name is _____. I represent a non-governmental organization Association "European Studies for Innovation Development of Georgia" ( <a href="http://www.inovdev.ge">www.inovdev.ge</a> )
Purpose of interview	We investigate the prospects of innovation development of Georgia in general and, in particular, in relation to the EU Eastern Partnership Programme. The interview with you will concern exactly these issues.
Length of interview	The interview will not last more than an hour.
Asking permission for recording	In order to use time more effectively, would you let me tape your answers and take notes.
Confidentiality	The interview is confidential in the sense that your answers will be generalized with the answers of other respondents and reflected in our report without the respondent's instructions.
Respondent's rights	You may refuse to answer any question which you don't like and, of course, you can stop the interview at any time you want.
<b>2. Time &amp; Place of Interview</b>	
Date (day/months/year)	
Place	
Start (hr/min)	
Length	
<b>3. General Questions</b>	
EaP awareness	1. Lately there has been much talk of the EU eastern Partnership Programme (EaP), and particularly of its innovation component. What do you think, how does it concern and how useful can it be for your organization/sector/region/country?

	<p>2. The EAP innovation component influences many spheres: country administration efficiency, establishment of SMEs, intellectual property protection, energy security, environmental protection, growth of international unions for specialists and students, etc. What is of priority for you from this list? What are your expectations in connection with this, and how can it benefit your organization/sector/region/country?</p>
New technologies	<p>3. How accessible do you think is the information about new technologies for your organization/sector/region/country? What channels do you have to obtain such information (patent and license research, universities, customers, competitors, etc.)? How efficient are these channels?</p> <p>4. What forms of introduction of new technologies do you consider most convenient for your organization/sector/region/country (directly materialized, patents, licenses, etc.) and why? Which of the technologies introduced during the last five/ten years do you consider particularly useful for your organization/sector/region/country and in which form was it introduced?</p>
	<p>5. What are, in your opinion, main obstacles to the introduction of new technologies for your organization/sector/region/country? Are these their cost, shortage of personnel, etc.? What channels do you think most effective for their bringing/introduction (spin-offs, joint ventures, licensing, direct purchase, etc.)?</p>
R&D	<p>6. How efficiently is, in your opinion, carried out R&amp;D in your organization/sector/region/country? What are the interfering or conducive reasons of it (financing, personnel, production/experimental basis, problems of introduction of results, etc.)?</p> <p>7. Which sources of financing of R&amp;D do you consider most effective for your organization/sector/region/country (government, private sector, foreign (and why?</p> <p>8. What R&amp;D directions do you think most urgent today for your organization/sector/region/country and why?</p>
Involvement in innovation process	<p>9. With what type of the organization listed below does your organization/sector/region cooperate in the sphere of innovation: universities, research organizations, organizations representing other sectors, technology centres, joint foundations, etc.? What type is this cooperation of (regular/long- or short-term /contractual? What does this cooperation express in?</p> <p>10. What kind of research assistance does your organization/sector/region need? What are, in your opinion, the difficulties in getting such assistance?</p> <p>11. Could you name enterprises (organizations)/regions that make use of the local technologies developed by your enterprise (organizations)/ region or vice versa the local technologies developed by other enterprises (organizations)/ regions? Please specify.</p>

	<p>12. How reasonable do you think for your organization/sector/region cooperation with local/foreign highly-skilled specialists on an occasional or continuing basis? Do you have such experience? Do your highly-skilled specialists cooperate with other organizations on an occasional or continuing basis? Please explain your attitude to this issue.</p> <p>13. To what extent are employees of your organization/sector/region involved in training programmes? Please state your attitude to this issue.</p> <p>14. In what form does your organization/sector cooperate with state-funded institutions in the sphere of innovation (R&amp;D funding, tax support, etc.)?</p>
<b>4. End of the Interview</b>	
Additional questions	Perhaps there are other issues of special concern to you or do you think we have missed such an issue?
Informing the results	We shall finish the summing up of the interview results in the next month.
Farewell and thanks	In case you are interested, we shall be pleased to provide you with the initial version of our report and for a month period wait for your remarks and comments. Thank you once again for your attention and patience.

# Status of the Social Dialogue in Georgia

Paata Beltadze

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## Research Objectives and Methodology

The objective of the research of the condition of social dialogue in Georgia is the following: to determine to what extent there is culture of social partnership in the country; to demonstrate the main defects which interfere with pragmatic leading of social dialogue; to survey historical preconditions of social dialogue, to present the best European experience of this phenomenon and the main features of European social dialogue; to analyze Labor Code of the country and international conventions ratified by Georgia and to draw appropriate conclusions; to analyze collective contracts operating in different spheres of economics and industry in Georgia and to determine what sort of positive effect the successful progress of social dialogue could have on the development of the country's economics and on the improvement of social condition in general; to assess what the situation is like in terms of fulfilling international obligations undertaken by Georgia in the sphere of labor relations; to give several examples when, as a result of low culture of social dialogue relations between social partners grow into confrontation and those that are distinguished by negative effects; finally, to elaborate appropriate recommendations with the help of creating an unbiased real situation, which will assist Georgia in the process of European integration, will create a more comfortable working atmosphere, will refine labor relations and will encourage, on the one hand, the growth of the country's economic potential and, on the other hand, will guarantee social peace, more social security and defend the rights of the employed.

Methods of both academic and field investigation have been used during the research. Materials on forming a commission of Tripartite Social Partnership have been gathered from different internet sources, there have been analyzed Georgian Labor and other normative acts operating in its concomitant spheres, conventions of International Labor Organization ratified by Georgia as well as conclusions drawn by the expert committee of the same organization and those made by (Committee on Freedom of Association), European Social Charter, mid-term reports of European Commission about the implementation of the obligations undertaken by Georgia within the frames of the European Neighborhood Policy, the report of the European Parliament on the commence of negotiations about free trade with Georgia; information about the models of social dialogue of European countries has been sought from various internet sites, about 30 collective agreements requested from Georgian Trade Unions' affiliate organizations have been analyzed on the basis of specialized and regional principle, materials concerning unsuccessful social dialogue have been requested from specialized trade unions. With the aim of studying the state of social dialogue at the industrial level, keeping maximal anonymity, 150 people employed in industries throughout Imereti region were questioned (Zestafoni Ferroalloys Plant, Chiatura Manganese Factory, 'Saknakhshiri' Ltd - Tkibuli enterprise). The received results have been analyzed and a general conclusion has been presented.

## General Review

In order to evaluate the development of social dialogue in Georgia it is essential to emphasize that, despite many problems existing in the course of the dialogue during its active phase, still the process of social partnership in this period is on the stage of institutional formation. However, the sides, especially the government, are obliged to make more efforts for the further development of this phenomenon and to take practical steps in order to develop the culture of efficient social dialogue.

While discussing this period, out of justness it must be mentioned (it is fair to mention) that the results in the development of social dialogue were achieved with the assistance of International Society and high degree of their involvement in the current processes as well as efforts made by Georgia Trade Union, which



actually gave rise to the demand of practicing efficient social dialogue in the country. In this aspect the contribution of systematic work of the International Labor Organization and the structures of European Union is really significant.

Historical review of the development of social dialogue.

Stimulation of social dialogue was initiated by the conclusion elaborated by the committee of labor standards at the 97th Conference of International Labor Organization<sup>1</sup> and a joint statement signed for its practical implementation by the partners operating in Georgia on 31 December 2008. According to the statement the sides expressed their readiness for cooperation and their will for creating widely available decent working conditions.<sup>2</sup> In addition, by this document the partners undertook the obligation to elaborate a working plan of joint activities within one month. In this case it is remarkable that representatives of the International Labor Organization took active part in elaborating the working plan on the basis of this act.

As a result of the written agreement the three sides participating in Tripartism elaborated the working plan within the established time limit. The plan was officially accepted on 16 December 2008 through the 'trilateral agreement' signed by the highest ranking persons.<sup>3</sup>

The received document acquires special importance not only for its historical character, but also for the valuable provisions defined in it. The document represents not only the format of the working plan, but also it embraces the unity of regulating norms of relations between partners. It must be noted that the document pointed out particular issues which have to be worked on jointly with the aim of easing social and economic problems of the country and their further solution. In spite of the declaratory character of the content of the agreement, at present it represents an essential basis for transferring social dialogue into its active phase. By officially signing this document the 'stagnation period' in the country came to an end and, at least the foundation for starting intense cooperation process between social partners was laid.

Mutual opposition mainly between Trade Unions and employers, the government's positions occurred throughout the year of 2009 both within the ideological format and in the context of discussing practical examples. The positions of the government and the employers were compatible. While positions of the Trade Unions were based on proving the shortcomings of the Labor Code on several examples in practice and relied on critical comments of international organizations towards Labor Code, the absolutely different positions of the government and the employers was based on arguments for flexibility of the legislation and encouraging the development and investment of free entrepreneurship.

As a result of the partners' work lasting for several months, a project of changes to be entered Labor Code was prepared. Initially it was approved by the government; moreover, it was presented to the norms department of the International Labor Organization for expertise. However, later, after the interference of lobbyists of big business, it was rejected by the government. The material proving this fact does not exist, but Trade Unions believe that it was the reason for the further obstruction of the draft law. There was a strong confrontation and presentation of personal views at the conference held in Tbilisi in October 2009 in which a high rank delegation of the International Labor organization took part. At the conference social partners met at the highest representative level.

In the context of opinions put forward at the round table leaders of the International labor Organization presented the correct position towards the fact that for the efficient work of social partnership in Georgia it would be much more important to give priority to the problems of security of institutional arrangement.<sup>4</sup> Accordingly, the recommendation document of the round table outlined the problem of necessity of implementing the mentioned approach in the nearest future. In addition, it is necessary to point out two main

<sup>1</sup> [http://www.ilo.org/ilolex/cgi-lex/pdconv.pl?host=status01&textbase=iloeng&document=4986&chapter=3&query=Georgia%](http://www.ilo.org/ilolex/cgi-lex/pdconv.pl?host=status01&textbase=iloeng&document=4986&chapter=3&query=Georgia%20)

<sup>2</sup> The statement was signed with participation of the representatives of the International Labor Organization and the sides expressed their desire of creating trilateral social partnership.

<sup>3</sup> Between Sandro Kvitashvili, Minister of Labor, Health and Social Affairs of Georgia, Elguja Meladze, President of the Georgian Trade Unions Confederation, and Irakli Petriashvili, Head of the Georgian Trade Unions Confederation.

<sup>4</sup> This opinion was formed by Karry Tapiola, the Executive Secretary of the International Labor Organization at the time, who was intensively involved in the problems of development of social dialogue.

characteristic features of the attitude the International Labor Organization has towards Georgian problem. Both of them are absolutely logical and justified. The first aimed to form institutionalism in the country, and the second was a certain support of the changes of norms in Labor Code, which, on the whole, caused further separation of the discordant positions of the sides.

According to the approach stated as a result of the agreed plan of the round table, on the initiative of an expert (R. Lecourt) of the International Labor Organization a team of experts was created on the parity principles by all three participant sides. It must be mentioned here, that, by the very first meeting of the team, Statement N325 had been launched by the Georgian Prime Minister on November 12, 2009<sup>5</sup>, which solved the problem of creating a trilateral commission of social partnership and determined obligations of taking appropriate measures for the functioning of the commission and those of people in charge. In November of the same year an action plan was elaborated by the team as well as the priority issues for further discussions. Resulting from the above mentioned Statement launched by the Prime Minister, the team considered its priority to elaborate principles of the statute of the tripartite commission of social partnership and its functioning with the purpose of regulating the institutional mechanism of social partnership.

In January 2010, for the first time in the history of Georgia, despite different opinions of the sides, the team of experts elaborated the charter of the tripartite council on the basis of consensus, which was ratified by the decree of Georgian Prime Minister issued on March 2, 2010.<sup>6</sup>

Ratification of the statute of the commission and its members conditioned the formation of institutionalism of tri-partite work in Georgia, which undisputedly is an essential factor in the active phase of the development of social dialogue.

**In the commission the government is represented by:**

- Alexander Kvitashvili, Minister of Labor, Health and Social Affairs of Georgia;
- Vakhtang Lezhava, Chief Advisor of the Prime Minister of Georgia;
- Dimitri Dzagnidze, Deputy Minister of Justice of Georgia;
- Zurab Alavidze, Deputy Minister of Economic Development of Georgia;
- Jambul Bakuradze, First Deputy Minister of Regional Development and Infrastructure of Georgia.
- Employers' Representative Union is represented by:
- Elguja Meladze, President of Employers' Association of Georgia;
- Mikheil Kordzakhia, Executive Director of Employers' Association of Georgia;
- Mikheil Alkhanishvili, President of 'Iberia Business Group';
- Lasha Akhaladze, Head of the committee of employment and labor relations of the 'Georgian Business Association';
- David Koghuashvili, member of the committee of employment and labor relations of the 'Georgian Business Association';

**Trade Unions are represented by:**

- Irakli Petriashvili, Head of the Georgia's Trade Unions Confederation;
- Joni Janashia, President of Free Trade Union of Health, Social Security, Medical and Chemical Industry Workers of Georgia;

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<sup>5</sup> See: Electronic Legislation Code, chapter of statutory normative acts.

<sup>6</sup> Georgian Prime Minister's Statement N57, issued on March 2, 2010, see: Electronic Legislation Code, chapter of statutory normative acts.

- Lavrenti Alania, Head of the Trade Union of Transport and Roads Workers;
- Suliko Mashia, Head of the Trade Union of Communications Workers;
- Tamaz Dolaberidze, Head of the Trade Union of Metallurgy and Mining Industry Workers.

The agenda for meetings became the subject of disagreement from the very beginning. Despite the fact, that one of the reasons for forming the commission was reaching consensus on changes in Labor Code and conducting work in this direction in a more representative and legitimate format, the complaints lodged for discussion as main subjects in the agenda of the first meetings by the government were those sent off to the International Labor Organization and European Union by the Georgian Trade Unions. It was the government's desire that such complaints would not be sent off to international organizations and instead they would be discussed within the frames of such a commission.

The formation of the commission was followed by holding its first session in May. It was also attended by top representatives of the International Labor Organization and certain accountancy took place in front of them about the reforms implemented in the country in recent years. The conducted work was highly appreciated by the representatives of the International Labor Organization and creating of a constantly operating body in the form of a commission in the country received positive evaluation. However, it was also mentioned, that the main job was still ahead to be done by the partners, which would require readiness of all sides for seeking consensus.

Despite the evaluation of the high-rank delegation of the International Labor Organization, unfortunately, Georgia's problem was represented with negative attitude at the annual conference of the International Labor Organization in June 2010, which could have had a negative effect on the processes which had started in the country with certain difficulties. The way out of this situation was found by adopting an extremely diplomatic and balanced resolution of all three sides and the International Labor Organization during the conference.<sup>7</sup>

As a result of changes of the personnel implemented in the Georgian government in August and September 2010, working process of the commission was slightly held up, but it was intensified from November, after the new management of the Ministry of Labor, Health and Social Affairs started regular work. Three meetings of the commission were held during November and December and a team working on problematic issues was formed.

Work of the commission became somewhat systematic during the year 2011. However, the format of its operation grew into endless discussions, in which they considered facts of particular work-related claims introduced by Trade Unions as well as the facts of putting pressure on Trade Unions and the circumstances reflected in those facts. With regard to these circumstances, there emerged a necessity of forming a team under this commission for discussing 'cases', which would enable the commission itself to work towards solving global problems, including refining of social legislation and elaborating an efficient mechanism for solving work-related problems. The recommendation of a similar content was presented to the sides by the Executive Director of the International Labor Organization at the conference held in Tbilisi in October 2011. The sides immediately approved of it.

At present the fact that the dialogue exists and that it has further potential can be considered the main achievement of this trilateral dialogue. The obligation taken by the sides, which implies meeting each other, exchanging and discussing ideas limits the possibility of deterioration of circumstances and growing it into bitter confrontation to some extent. However, absence of concrete positive results and the slowdown of the process point to the threat of falling it through. It is a real threat considering the fact that the sides' expectations and strategic purposes towards the dialogue are different. Trade Unions of Georgia hoped that the tripartite commission would be equipped with the mechanism of adopting resolution. However, the commission has not resolved any work-related dispute so far.

<sup>7</sup> <http://www.communicatinglabourrights.wordpress.com/2010/06/18/ilo-2010-conference-committee-the-transcripts-of-25-case.de>

Trade Unions are the most interested in the success of the dialogue. It is the matter of life and death for them. Although Trade Unions started the process of internal reforms and transformations, still they are rather far from the steady condition in which their institutional existence is not under threat. They have to try hard to balance between dissatisfied employed and rough employers in the conditions of extremely inconvenient legislation and ill-disposed attitude.

It is important to note cooperative aspects of social partnership in the sphere of professional education which started by creating a national professional council with the Prime Minister of the country in 2009. Apart from the top persons of all the state departments those of trade unions and employers took part in the council.

Working efficiently with the help of the above mentioned additional directions will probably give start to forming a strong system of social dialogue in the country in this sphere too, which will definitely require making occasional corrections.

Full-scale involvement of social partners has not been achieved so far, which would provide conformity with demands of labor market and existing conditions; it would bring proper common benefit. At present it is the government which is responsible for orientating on the priorities of creating a system of professional education and standards and content of the sphere of professional education determined by the authorities. Although the level of participation of the employers and of several leading organizations of the employed rises, still all this is implemented without intensive participation of wide circles of the employers and the employed. There are still many entrepreneurs who are suspicious about participating in the system of professional education, especially when it comes to inexperienced and superficially prepared youngsters who are often improperly prepared to encounter the reality at jobs. Although, according to presentations, leaders of professional colleges are getting more and more interested in the employers' participation, it is still noticeable that the employers' unions are passive and a wide spectrum of the employers' interests is not considered. As for the cooperation on the national level, we must underline the recent fact of Tripartite agreement. On July 29, 2011 at the extended session of the professional council Georgian government and social partners signed the 'Memorandum of Mutual Understanding'. It is mentioned in the Memorandum that it is based on: strategy of professional education,<sup>8</sup> a new law 'On Professional Education'<sup>9</sup> and the memorandum concluded by European Union 'On Lifelong Learning'.<sup>10</sup> The Memorandum says that joint efforts of social partnership will be used for:

- Elaborating a new educational program;
- Elaboration professional standards;
- Elaborating partnership mechanisms between school and business;
- Developing professional abilities;
- Creating and disseminating of social advertisement.

All these can be reached by means of elaborating mechanisms of cooperation on management, implementation and financing at all levels of professional education and preparation. The 'Memorandum of Mutual Understanding' formulates rights and obligations of each partner. Particularly should be pointed out the weakness of partnership at low levels of partnership - at regional and industrial levels it is not yet developed as general social partnership in the country. Finally, it can be concluded with regard to social partnership in the sphere of professional education that, despite some extent of revival, the mentioned direction needs to be intensified and whatever is achieved should not be satisfactory.

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<sup>8</sup> <http://mes.gov.ge>

<sup>9</sup> <http://www.eqe.ge>

<sup>10</sup> [http://etf.europa.eu/web.nsf/pages/lifelong\\_learning](http://etf.europa.eu/web.nsf/pages/lifelong_learning),

## Results in the format of social dialogue:

### In the three-party format:

- A trilateral commission was formed in Georgia at the national level;
- Teams of trilateral commissions started functioning;
- There started activeness in the sphere of professional education, which is reflected in regular work of sessions of professional national council and in the trilateral agreement concluded by three sides;
- Thematic groups of social partnership both in the sphere of professional education and, in general, a social one have been formed and are functioning , though with some delay.

### In the format of bilateral cooperation:

- A standing committee of professional security and healthcare has been formed;
- On the basis of the fundamental document of the International Labor Organization (ILO-OSH 2001)<sup>11</sup> methodical instructions of professional security and healthcare were elaborated and adopted for implementation in production;
- Work is in progress towards considering labor relations at the industrial level and forming opinions;
- At the industrial level work is in progress towards popularization of collective negotiations.

## European Models of Social Dialogue

Social dialogue in Europe is a practiced method of reaching balance of the interests of employers and the employed as social partners. Creating an effective model of social dialogue is the central element of labor relations. At present it has been formed in Europe as an example of stabile institutionalized relations between employers and the employees. It is a trade mark of market economics and is a significant ingredient of European social model. In Europe social dialogue is not an end in itself. In the conditions of fast changing technologies and globalization social dialogue makes a significant contribution in providing competitiveness and supporting enterprises. It also implies: modernization of the labor market, prediction of changes and coping with them, encouragement of employment, regulation of labor relations, providing labor security at jobs, harmonization of professional and personal lives, and fight against discrimination, dignified old age and active cohabitation.

Three groups of countries were singled out as a result of investigation of social dialogue in Western Europe:

- There are trilateral institutions in a number of countries, which function constantly and meet regularly to elaborate joint, coordinated decisions;
- Countries in which a constantly operating trilateral body is not formed and special procedures are established for providing collective negotiations;
- Third group of countries where relations between three sides are based on pragmatic opinions run irregularly, are often informal in nature, depend on an opportunity and certain circumstances.

### 1. Institutionalized Tripartism

The best examples of long-term institutionalized tripartism are Belgium, The Netherlands and Ireland.

**Belgium.** From 1944 a bilateral organ (a national labor council) and a central council in the field of

<sup>11</sup> <http://www.scribd.com/doc/50370743/ILO-OSH-2001> Guidelines on Occupational health and safety management

economics operated on the basis of an appropriate pact<sup>12</sup> between employers and the trade union, which were responsible for organizing consultations in social and economic spheres. This system operated until 1974 and a new trilateral mechanism was founded in 2000<sup>13</sup>. The format of bilateral negotiations initially covered only the problem of payment insurance, but later the list of problems gradually expanded.

**The Netherlands.** Like Belgium, in 1945, after the World War II, a coordinating organ - Labor Fund - was formed in Holland, which ensured joint consultations and formulation of contracts between trade unions and employers. In 1950 an economic and social council was formed which, apart from representatives of trade unions and employers, comprises experts put forward by the government. Among recently discussed problems it is appropriate to mention two of them: From 2008 a problem of raising the value added tax was considered within the format of trilateral commission; the result was an agreement about maintaining the level of salaries and reducing unemployment benefit payments.<sup>14</sup> In 2009 the trilateral 'Crisis group' was formed with efforts made by the government and social partners. The group was to work on the problems of modernization of labor market. A joint agreement was prepared which considered employment policy in the directions of youth education and mobility. In spite of this fact, 2009 marked two serious conflicts: one connected to extending the retirement age and another- to suspending reduction of state expenses by 20%. These proposals were supported by the employers, which was disapproved of by trade unions.<sup>15</sup> These cases represent an example that, although it is not always possible to reach consensus through trilateral cooperation, but with the help of this format it is at least possible to reach rational compromises in the majority of cases.

**Ireland.** Ireland's experience is younger than that of Belgium and Holland, but it is more ambitious. A British model of bilateral relations operated in Ireland, which meant that an employer and a trade union carry on negotiations independently, without the state's involvement and is limited to elaborating the minimum of only essential social legislation. In 1986 National Economic and Social Council (NESC) - a multilateral consultation organ formed the development strategy,<sup>16</sup> which laid foundation to the first trilateral agreement. Since then analogous agreements were reached regularly. The trilateral organization was formed in order to carry out supervision on implementation of such agreements. In the crisis of 2006, the sides concluded a ten-year agreement.<sup>17</sup> The salary policy appeared in the center of attention of trilateral debates. The second phase of salary negotiations started in April 2008: trade unions demanded rise of salaries to exceed the inflation rate, which employers did not agree with. In September 2008 trade unions started national strikes caused by the government's inactivity in regard with employment, wage freeze and redundancies in the state sector. The government offered trade unions to make changes in the following matters: the rights of the working-class people, direct taxes, expenses in social projects, collective measures, etc.<sup>18</sup>

**In Norway** all three sides operate in coordination. In February 2009 the government presented a package of additional measures with regard to the crisis. The package considered demands of the employers and the trade unions. Eventually, as a result of mediation process, a political agreement was reached in the sector of metallurgy,<sup>19</sup> which created a sample model for other sectors of economics too.

**In Finland** problems to be discussed by the tripartite commission are: standard of living, job opportunities, protection of reserves, employment, rise of unemployment benefit payments, etc. The employer organizations and trade unions approved of the measures package directed towards the stimulation of economics. In Finland the government used the format of trilateral dialogue for solving various important problems. In spite of this, in December 2009 the employers decided to drop out of these negotiations for the reason that the employees went on strikes frequently and they appealed to the government to toughen the strikes legislation.

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<sup>12</sup> [http://eng-lbc-nvk.acv-online.be/social\\_dialogue/social\\_dialogue.asp](http://eng-lbc-nvk.acv-online.be/social_dialogue/social_dialogue.asp)

<sup>13</sup> [http://eng\\_lbc-nvk.acv-online.be/social\\_dialogue/social](http://eng_lbc-nvk.acv-online.be/social_dialogue/social)

<sup>14</sup> <http://www.ilo.org/public/english/region/eurpro/geneva/what/events/malta/dialogue.htm>

<sup>15</sup> <http://www.ilo.org/public/english/region/eurpro/geneva/what/events/malta/dialogue.htm>

<sup>16</sup> <http://www.eufound.europa.eu/comparative/tn070019s/is0710019q.htm>

<sup>17</sup> <http://www.eufound.europa.eu/comparative/tn070019s/is0710019q.htm>

<sup>18</sup> <http://www.worker-participation.eu/National-industrial-relations/contrises/Ireland/Collective-Barging>

<sup>19</sup> [http://www.hse-bg.org/HSE\\_DOCS\\_WEB/ConferenceEN/KBT-Bulgaria%20presentasjonEN.pdf](http://www.hse-bg.org/HSE_DOCS_WEB/ConferenceEN/KBT-Bulgaria%20presentasjonEN.pdf)



**In Austria**, where after World War II the formats of relations between social partners was traditionally strong, these unions became even stronger after constitutional changes carried out in 2007,<sup>20</sup> in which the role and importance of social dialogue are put forward. Institutionalized tripartite contacts were established among the employers, the trade unions and two political parties. With a few exceptions, the government always shares the responsibility in regard to the reached agreements in this format.

## **2. Flexible combination of bilateral and trilateral relations:**

A two-level system is formed in several European countries: on the one hand, a practice of collective negotiations is implemented in the form of internal sector (or professional) negotiations, and, on the other, a dialogue is conducted with state bodies which, in most cases, is finished by signing joint documents.

**In France** trilateral relations were represented as consultations only for a long time. Since 1950 acts of collective agreements covered only the spheres salary relations. In 2007 a special law was formed with the view to modernizing social dialogue. In accordance with this law, employers and trade unions must provide the government with the information about the plan and the schedule as well as the contents of initiatives planned in the spheres of labor relationships, employment and professional training. In the case when the problem is topical, social partners can express their desire for negotiations, and in the case of reaching an agreement, the government prepares legislative and regulating acts. At the same time, the parliament maintains its sovereignty and is not obliged to accept all the agreed issues for discussion. The uniqueness of the case of France is that there is strong relationship between negotiations in the internal sectors and the state policy.<sup>21</sup>

**In Spain** trilateral relations have a unique and interesting history. In the country social dialogue began after overthrowing Franco's dictator regime, in 1977, in the period of transition into democracy, which was accompanied by economic fall and a huge wave of unemployment. In 2000 new dynamic processes were commenced: a bilateral all-national agreement was drawn annually about establishing levels of salaries on the basis of considering inflation levels and incomes. In 2004 the new government resumed trilateral consultations. In favor of social dialogue, a joint declaration on supporting economics, employment, competitiveness and social progress was adopted. Frames of state policy and collective negotiations were established, the limit of minimal salary was determined, a trilateral agreement related to reforming the labor market was reached.<sup>22</sup>

**In Italy**, after the fundamental pact of January 22, 1993,<sup>23</sup> the employers, the trade unions and the government managed to solve several issues jointly. They were: organization of collective negotiations, management of the labor market, social security, taxes, state investments and so on. As a result of mutual agreement, on May 6, 2009 the Council of Ministers adopted the frame document named 'Future of Social Model'.<sup>24</sup>

**In Portugal** a tripartite consultation body was established in 1984. The trade union organization expressed negative position in regard with the establishment of the trilateral commission and refused to sign social pacts. The agreement between the government and social partners on the reforms of Labor Code was signed on June 25, 2008, still without the trade unions. Trilateral activities still continue to function in the country, but the main organization of the trade unions, which participates in negotiations, does not sign any agreement.

Despite the internal conflict between the employers and the trade unions, the country's government makes efforts to maintain forms of tripartism and reach certain agreements.<sup>25</sup>

<sup>20</sup> <http://www.eurofoundeuropa.eu/euro/2008/02/articles/at080219i.htm>

<sup>21</sup> [www.ilo.org/wcmsp5/groups/public/---asia/---ro-bangkok/..](http://www.ilo.org/wcmsp5/groups/public/---asia/---ro-bangkok/..)

<sup>22</sup> <http://www.eurofoundeuropa.eu/euro/2001/07104f.htm>

<sup>23</sup> [www.espanet-italia.net/conference2009/paper2/3-Jurado](http://www.espanet-italia.net/conference2009/paper2/3-Jurado)

<sup>24</sup> <http://www.eurofoundeuropa.eu/comparative/tn0710019s/pt0710019q.htm>

<sup>25</sup> Social partners are involved in creating norms themselves, which conditions efficient and timely solution of later originated disputes.

### 3. Pragmatic and Coincidental Tripartism:

A number of western European countries do not have any desire and tradition to form an official body of trilateral dialogue. Resulting from the content of the problem, considering economic, social and political circumstances, all three sides are capable of sorting out problems by conducting negotiations in informal situations.

**United Kingdom.** Employers in the Great Britain set up organizations which independently resolved negotiations on topics of their interest. On the basis of regulating labor legislation and with the assistance of Labor Relations Organization, interference with labor relations by the government was reduced to the minimum. Since 1979 the Conservative governments gradually disintegrated all forms of tripartism and the mentioned problem has not become a priority yet.

Despite substantial experience and tradition of conducting social dialogue, Denmark and Sweden objected to this form of relations in the period of the crisis.

Dynamics of the development of social dialogue is especially interesting in the countries of transitional economics in Central and East Europe, or in the countries of post-Soviet countries. In this regard there are differences in authorization of social dialogue and in how much the results achieved in trilateral dialogue are perceived as obligatory in the process of forming political will.

**Social Dialogue in East Europe.** State factor stands out in industrial relations: tripartism plays an important role - firstly, through minimal wages, instead of tariff contracts. If the experience of finding compromises is little, the employers object to sectoral agreement and strikes arranged by trade unions has less influence. In the beginning tariff agreements are concluded at the production level. Trade unions representation in an enterprise is very weak, especially in small and medium businesses. Councils are an exception.

**Social Dialogue in Western Europe.** A state makes maximum effort to avoid interference with social dialogue. It mainly regulates misbalance (e.g. in the strike law). At first tariff contracts are made at the sector level autonomously. Strike, as an extreme measure, is used during a conflict in order to find compromises at various levels. The weak representation of trade unions in enterprises is partly compensated at the expense of enterprise councils. Legal basis entitles the participants of a social dialogue to freedom necessary for action. In the case of a conflict labor courts provide control of norms by complicity of social partners.<sup>26</sup>

As a result of analysis of the above mentioned data we can generalize the main features of social dialogue in Europe and show the main criteria of European social model.

#### Principal basis of social dialogue:

Instead of depending on hierarchal structure, subordination and directions, each side is identified as a partner of equal rights.

- Consent of common economic purposes having different social interests.
- Readiness for dialogues and negotiations in order to find realizable purposes.
- Loyalty to made decisions and reliability of negotiated consensus('social peace' during negotiations).

Considering social dimension and its integration within the politics of European Union is an important element of expanded Europe. Its characteristic feature is combining outlined economic dynamics with the structure of social equalizing. The term 'European social model' has not been defined unambiguously yet. Some speak about European social model as an expression of the identity of European Union, while others are suspicious of its existence at all, pointing to only one very general similarity of labor and social norms, which hardly differs from experiences of other countries in the world. At first the term 'European social model' was coined by Jacques Delors, former president of the European Union, in the middle of the 80s and by this he emphasized the general value which, despite various differences, could have become the basis for European identity.

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<sup>26</sup> The social partners are involved in the standard-creation activities, which later affect on effective and timely resolution of disputes.



The aim of a social dialogue is, on the one hand, to support economic advance and, on the other, to provide social security of the employed. Negotiations are the means of conducting a social dialogue intended to reach compromises and to balance interests. Consequently, we have to deal not with the victory or defeat of this side or that, but with compromise, which can be accepted by both or, moreover, is in their interests. Social partners have to be ready for this.

In this regard, there was no experience of this kind in the countries of transition economics with the so called “planned treatment”, as different principles operate in practice. Before establishing independence and a new state system, decisions were not the result of any kind of a dialogue, but they were authoritative state action plans and statements. A conflict was considered to be an obstructing factor and was not considered as an essential component of social changes. Therefore, neither a social dialogue was considered a momentum for conflict regulations and for equalizing interests of partners with equal rights.

**The following aspects are emphasized in the process of a collective labor law:**

- form and the rights of the representations of the employed in an enterprise;
- authority of competitor trade unions;
- determination of laws of tariff contract system, tariff autonomy and strikes;
- joint solution of problems of providing active employment and social security systems;
- Influencing the mentioned spheres with an appropriate form of tripartism.

## **Analysis of Collective Agreements Reached through Social Dialogue in Georgia According to the Status of 2011**

According to the status of 2011, 165 collective contracts and agreements operate in member organizations of the trade unions. It is 73% more than the data of the corresponding period last year. It is also very important, that the index of quantitative growth of agreements is obviously high over the last two years, though in terms of content and social results, their qualitative aspect still contains problems of a substantial degree. Their improvement depends on a number of factors, including that of the presence of real, effective trade union organizations.

The process of further development of a social dialogue and raising its efficiency is implemented consistently in enterprises and organizations united in trade unions of service, communal and bank workers. Over years the collective contract of 'Telasi'<sup>27</sup> covers almost all the elements of labor relations, including employment security - gradual increase of the duration of labor contract and after 3 years of work experience going over to an unlimited contract; improvement of payment and working conditions, additional social guarantees; specific articles on discussing disputed problems, mechanisms of constructional cooperation and distribution of responsibilities, in particular, the workers' labor norms, payment systems, forms of material encouragement are established in agreement with trade unions. The administration provides a worker with a Christmas bonus according to the results of a financial year. Amount of payment for working on night shifts and overtime, additional and leaves with pay are regulated as well as free medical insurance and problems of other social allowances. The minimum salary in the company was determined to 300 GEL, which proves favorable to defending labor rights and social interests of the employed.

The positive experience and practice of the enterprise, a number of standards were reflected in collective agreements of other enterprises of the sector, and in some cases, they were even improved. In the agreement of the enterprise “Georgian Water and Power” Ltd<sup>28</sup> the minimal term of the contract grew to 3 years. Collective agreements of enterprise 'Batumi Tskalkanali' Ltd established the unlimited time of labor contract.

<sup>27</sup> The collective agreement was concluded between the administration of 'Telasi' and trade unions.

<sup>28</sup> The collective agreement was concluded in 2008.

Considering capabilities of enterprises, conditions of labor relations were substantially improved in collective agreements signed with the administrations of 'Batumi Sandasuftaveba' Ltd, 'Kakheti Energodistribution' Ltd. On the whole, 12 collective agreements have been signed in the organizations of the branch and they embrace 5,300 people, 81.5% of the employed in the branch, which undoubtedly is a high index. The above mentioned index was worked out on the basis of the analysis of collective agreements requested from the member organizations of the Georgian trade unions.

Despite long-term and tough negotiations, over the last year trade unions of the Communications managed to overcome obstacles and to sign a new contract with the administrations of 'Silknet', 'Georgian Post' Ltd and "Georgian Tele-Radio Center" Ltd. What is the most important is that the degree of all three agreements has substantially improved compared to the previous ones, more guarantees and allowances have been considered, in particular, all three employers took responsibility of annually conducting consultations with trade unions about rising payment to the workers.

There has been substantial improvement of employment guarantees. The employees working for 'Silknet' for more than a year, the ones working for "Georgian Post" Ltd and for "Georgian Tele-Radio Center" Ltd for over three years and if it is constant occupation, are entitled to signing contracts for unlimited period of time. In case of violation of employment contracts on the initiative of the employer, the employed will be paid two months' salary. A number of social allowances are considered as well as financial aids. The whole staff of 'Silknet' and "Georgian Tele-Radio Center" is provided with free medical insurance. At "Silknet" a social protection commission is formed for parity problems, which is financed at the administration expenses.

A collective agreement of 'Georgian Post' considers ratification of regulations on the basis of agreement with the trade union. In addition, the administration took responsibility to inform the trade union about expected redundancies, liquidation of the organization or full suspension of the enterprise and to conduct negotiations with them with the purpose of defending social interests of the employed. Furthermore, measures of gradually clearing wage arrears of previous years are considered. As a result of the analysis of the information about the collective agreement requested from the trade union of Georgian Communications and Post it becomes clear that these agreements refer to 67% of the employed in the organizations of this branch.

Problems of raising efficiency of social dialogue are particularly topical in the activity of the trade union of the workers employed in metallurgic, mining and chemical industry. According to their information, collective negotiations with the administration of "Karat-Plus" Ltd (former "Energy-Invest") came to an end. The project went through all the stages and soon it will be registered officially. The new project of the agreement considers further improvement of labor standards in the enterprise and a high quality of protection of social interests of the employed. Since 1 June 2011 there has occurred rise in salaries by 15% and that of bonuses by 5%. Further rise in salaries in the same amount is planned at the end of the year, which, on the whole, points to substantial rise of payment. The agreement is also reached with the administrations of 'Madneuli' and the Kutaisi Auto Mechanical Plant about signing collective agreements. The trade union carries on intensive work with the administration of "Georgian Manganese" Ltd on elaborating the project of collective agreements and conducts negotiations. As it is known, at the beginning of 2010 the situation in the enterprise became very tense. The staff demanded cardinal improvement of payment and working conditions. A new trade union organization was formed, protest demonstrations were held, including strikes. On 13 June 2010 a memorandum was signed between the administration of "Georgian Manganese" and the Georgian trade unions. According to this memorandum, the administration took responsibility of solving a number of labor and social problems in the shortest period of time. The most important fact is that the sides agreed to start constructive dialogue on elaborating a project of collective agreement. The administration partly satisfied some of the demands of social and labor character, though it changed its position in regard with concluding a collective agreement and actually refuses to do so with the reason that the agreement, they believe, should be signed with participation of one, i. e. yellow trade union - 'Mine Metal', which the newly formed trade union organization and the sector trade union do not agree. According to the existing information, an extended meeting of the workers of the Ferroalloys Plant is being planned in the nearest future, which will principally consider the fulfillment of all the obligations undertaken by the administration of "Georgian Manganese"

Ltd through the memorandum. After discussing the problem, the sector trade union will make the decision adequate to the created situation.

Measures taken for regulating the created situation in Tkibuli enterprise of 'Saknakshiri' Ltd is also topical. Ten miners were killed and 14 received bad burns over the last year as a result of three explosions in the Mindeli mine, which caused extreme tension in the collective. The strike going on in the enterprise, an agreement was signed between the administration of "Saknakshiri" Ltd and the Trade Union of Metallurgy and Mining Industry Workers on February 3, 2011, according to which the management of the enterprise took responsibility of protecting and improving labor security and hygiene norms, salary indexation (considering the level of inflation), extending the length of labor contracts, introducing a different tariff system for overtime and holiday payment, insurance, compensations for the families of the unemployable and the deceased at work and many other problems. Particularly important is the item of the agreement in which 'Saknakshiri' Ltd (GIG Group) expresses its readiness to guarantee the beginning of the process of preparing and discussing a collective agreement in cooperation with the sector trade union, which already is a topic of a productive dialogue between the sides.

The negotiation with the administration of 'Kvartsit' Ltd on signing a collective agreement is also under way. Social dialogue is successfully carried out in the structures of trade unions of public servants. Over the last 18 months nine new territorial agreements have been signed with bodies of local self-governments. Among them are Gori, Tianeti, Tskaltubo, Samtredia, Aspindza, Marneuli, Sachkhere, Ninotsminda, Borjomi municipalities.

The agreements consider stable guarantees of employment of public servants; length of fixed-term contracts has increased, labor security conditions of the employed have improved. Problems of providing medical service through policies, organizing cultural popular events, teaching and training, etc. are also considered in the agreements.

As a result of collective negotiations, territorial agreement projects have been worked out between Signaghi, Bolnisi, Gardabani, Vani, Martvili, Senaki, Chiatura municipalities and regional trade unions and these projects were transferred to the authorities of the corresponding municipalities for discussion.

There is a progress in social dialogue in the trade union of workers of healthcare, pharmacy and social security. Fifty collective agreements operate in the field, 37 of which were signed in 2010 and the first five months of the current year, 15 agreements were signed at the healthcare organizations in Adjara. The agreements consider labor and social guarantees of the employed - problems of increasing contract lengths and maintaining jobs, amount of minimal payment, additional social guarantees. Among them are:

- the employment contract is made for unlimited period of time, while that signed with the hired to accomplish particular work, is made in accordance with the time of completion;
- labor relation, which uninterruptedly continues twice in succession within the time period considered in the employment contract, will be regarded as an unlimited-term labor contract.

There is another important article, according to which: in case of violation of the employment contract on the initiative of an employer the employee will be paid at least one month salary if labor relations in the same institution do not exceed 3 years, at least two months' salary if labor relations are between 3 and 5 years, at least 3 months' salary if these relations lasted more than 5 years and so on.

Some other problems are also considered, e.g. extra payment for working on holidays, night shifts, overtime and in harmful conditions, bonuses, and additional social allowances and so on.

Collective negotiations are under way with the administrations of 'New Hospital' Ltd (National Center of Ophthalmology and Neurology), the Tbilisi Koridze N4 Maternity Home Ltd, Jsc Acad. Ghudushauri National Medical Center, with medical institutions in Rustavi, etc.

According to the information of the sector, collective agreements were rejected by the administrations of 'Prof. Ghvamichava National Oncology Center' and 'Burns and Thermal Injuries Center'. Despite repeated addressing, making specialized collective agreement with the Ministry of Labor, Health and Social Affairs was not managed. According to their official respond, measures considered in the agreement project presented

by the sector trade union goes beyond the authorization conferred to the Ministry by the Resolution N249 issued by Georgian government on 31 December 2005. It must be noted, that as a result of the campaign conducted against public and medical trade unions in August 2011, the positive dynamics of social dialogue was delayed.

In trade union organizations of fuel and energy nine collective agreements are operating. The articles on implementing labor rights and social interests of the employed are at a relatively high level in collective contracts of "Vardnilhesebis Kaskadi" Ltd and "Enguri Arched Dam" Ltd. 90% of the workers of 'Vardnilhesebis Kaskadi' Ltd are employed on the basis of the unlimited-term labor contract and the article of the collective contract. It is inadmissible to switch them onto a limited-term contract. In case of violation of the contract on the initiative of an employer, the employed is paid a 3 months' salary. At the end of each year, in cooperation with the trade union, the administration considers the issue of rising salaries (taking the inflation rate into account). Every employee is provided with health insurance 70% of which is paid by the administration. In the period after childbirth, up to the child's age of 18 months, mothers are entitled to receive a partly paid leave - 50% of their salary. The rate of the employees working on the basis of unlimited-term contracts in "Engurhesi" Ltd is 85%, while that in the collective of "Engurhesi Arched Dam" is 80%. In all three enterprises extra payment for working on holidays, night shifts, overtime and in tough and harmful conditions is regulated. The administration pays for medical expenses of all the employees. According to the information of the field, new collective contracts have been worked out and are in the process of discussion in "Georgian International Corporation" Ltd and in Jsc "Electroavtomati". Their official registration is foreseen in the nearest future. It is also mentioned that, despite long negotiations, the contract was not managed to be signed with the administration of Ss "Energo-Pro-Georgia". The project was considered three times by the representatives of the sides, but the agreement was not reached.

In the organizations of trade unions of agriculture, light, food and processing industries eight out of ten collective contracts were signed in 2010 and one - this year. In terms of social values, special attention must be paid to collective contracts of 'Coca Cola Bottlers Georgia' Ltd, 'N2 Borjomi Water Plant' Ss, and 'Imeri' Ss sewing company. The document foresees a rather wide range of labor and social rights. Based on the sector information, facts of non-fulfillment of the mentioned obligations have not been recorded. At present negotiations are under way with 'Batumitex' Ltd, 'Carmen Ltd (former 'Forte' Ltd).

Despite every effort, sector trade unions did not manage to begin collective negotiations with the employers of 'Bagrationi-1882' Ltd, 'Progress' Ltd, 'Kakheti' Ss and the administration of the Georgian Agricultural University because of their negative attitude towards social dialogue.

With regard to the above mentioned, trade union emphasizes the fact that the requirement - promotion of social dialogue in the country at all levels - imposed by the resolution of the national trilateral commission of social partnership is not implemented, which is a substantial hindering factor.

At present in the organizations of the trade union of oil and gas industry collective agreements operate in eight out of 17. Particular rising tendency of the level of labor and social standards is recorded in "Batumi Oil Terminal" Ltd. 90% of the employed in the company are guaranteed by unlimited-term employment contract, by particularly high labor security conditions. Every employee is provided free medical insurance, one meal. A number of social programs whose overall cost is 2.5 million Gel are being implemented. The process of implementation of obligations considered by collective agreements is successfully progressing in "Socar Energy Georgia" Ltd, "Kutaisi Gas", "Jindal Petroleum Operating Companies". At the same time, despite many efforts made by trade unions over years, conducting a social dialogue and signing a collective agreement remains unreachable with the administration of "Kaztransgas-Tbilisi", as a result of which violation of labor rights of the employed bears a systematic character.

As a result of negotiations conducted with the trade union of Tbilisi Metropolitan and the administration, changes were made to the collective agreement on 26 March 2010, according to which the length of the labor contract of the employed in the company grew to 5 years (chiefs of structural units, their deputies and chief engineers are not entitled to these changes). Labor guarantees of the absolute majority of the staff have improved substantially.

It is remarkable, that on 31 March 2009 the trade union demanded the fulfillment of the paragraph 3.1.3 of the collective agreement of 25 February 2008 by the suit brought to Tbilisi City Court. According to this paragraph, in the fourth quarter of the same year the administration was to determine the amount of the bonus for the personnel working in special working conditions, which did not happen. The suit was not satisfied by the City Court and neither by higher levels. As a result of this, on 20 April 2011 the dispute between the administration and the trade union ended in agreement. According to the decision, for the individuals working in specific working conditions, the company would institute additional paid days to the 24 day leave period considered by the Georgian Labor Code - one, two or three days in a differentiated way considering charged salaries of the mentioned persons, in particular:

- 3 days in the case of those with accrued salaries of up to 500 Lari;
- 2 days in the case of those with accrued salaries of between 501 and 750 Lari including;
- 1 day in the case of those with accrued salaries of over 750 Lari.

The administration will make the allowance for those who have used their leave with pay in the period between 1 January 2011 and 21 April 2011.

Over the last two years work of the trade union of transport and roads has become more active in the sphere of social dialogue, which is largely conditioned by reforms being carried out in the sphere. At the end of the last year and in the current year memorandums of mutual cooperation were signed between sector trade unions and regional and city bus stations of the transport companies 'Tbil Line' Ltd, 'Public Car' Ltd, 'Tbilcar' Ltd, 'Sachkhere' Ltd and so on. The above mentioned measures are accompanied by the process of founding new primary trade union organizations.

The aim of the trade unions is, in cooperation with the participant sides of social dialogue, to provide defense of the rights and interests of the employed in transport, to improve their service conditions while running on relevant routes and to increase the degree of safety efficiency of passengers' transportation at bus stations, to encourage the rise of qualification of those occupied in the sphere of transport. The above mentioned measures embrace up to 7,000 people employed in the sphere.

In the organizations of the trade unions of sportsmen and sport workers 33 collective contracts and agreements have been signed. New agreements were formed with Olympic committees, Sports and Youths Ministry, National Federation and regional sports schools.

In contracts and agreements main attention is directed towards sports development, improvement of labor and social guarantees of the employed in this sphere. However, a large part of the contracts is general, lacking of preciseness. The control over performance is still very weak. According to the information of the sector, authorities of certain sports organizations in Gardabani and Rustavi avoid cooperation with trade unions; they are unwilling to start collective negotiations. At the end of the last year and in the current year organizations of the trade unions of arts people signed 15 collective agreements in Baghdat, Sachkhere, Tbilisi and Abasha. It must be noted, that the content of the text of each of these agreement is identical to the sample sent out by the sector. Therefore, it lacks real social value. As the authorities of sector explain, that the employers do not agree to consider essential paragraphs of labor and social spheres, the situation is particular tough in Tbilisi theatres, which encourages signing of formal agreements.

The world's financial-economic crisis caused particular harm to the member sailors of the trade union of Sea Transport and Fish. As a result of reduction of the volume of International Sea Freighter Carriers the American company "Eastwind" went bankrupt and hundreds of Georgian sailors working on the ships of the company were left unemployed. Despite efforts made by the trade union of the sector, the sailors remained unemployed. However, over the last two years, with the help of the trade union, some of the ship owners were made to pay the sailors' debts of about 800,000 USD. According to the same source of information, in recent years the General Director of the Batumi Port has been changed several times and the collective agreement has not been signed. The contract of the employed at the Batumi Port was determined by one year period of time. The payment was increased by 15-20%. Those occupied in tough and harmful jobs are given bonus over their salaries. The workers are entitled to free medical insurance; problems of social assistance, bonuses



and food are more or less regulated. Work on the project of collective agreement has already started. The crisis had serious effects on the building sector, which had adequate influence on the work of trade union and primary organizations of the sector. Social dialogue is actually at a zero level. According to the data of the sector, a collective agreement is signed in a building organization - 'Iberia-21' Ss; the obligations foreseen by it are mainly fulfilled.

According to the information of the trade union of the self-employed, entrepreneurs and those working in trade, three collective agreements are concluded at: 'Khelvachauri Breads Factory' Ltd, 'Sursatmrecveloba' Ss and 'Rome-2011' Ltd; however, they do not have any social effect.

Overall analysis shows, that by present situation these agreements embrace 38.2% of the whole number of people employed in these member organizations. We should also consider the fact that 30 collective agreements have been worked out and are in the process of agreeing. As a result of signing, general number of those embraced by collective agreements has grown to some extent. According to the supplied information, 13 employers refused to conduct collective agreements. However, we should assume that the real number is much higher and more employers refuse to conduct social dialogue.

The following conclusion can be made as a result of the analysis of the above mentioned collective agreements:

- 1) Even in the conditions of the existing Labor Code and low culture of social dialogue there is a possibility of advancing the development of social dialogue to a new stage.
- 2) Collective agreements achieved through collective negotiations, on the one hand, provide protection of social and economic rights of the employed and, on the other, is a precondition for rising of labor productivity and smoothly creating material welfare.
- 3) Collective agreements concluded at the sector, industrial level are one of the good bases for economic development and the best means for refining industrial relationships in the country, especially when European integration is Georgia's number one priority. It is exactly labor relations consolidated through collective agreements that constitute the main element of a European social model.
- 4) Guarantees of social security provided by collective agreements do not fully meet the demands of the employed and in the future it will be necessary to implement more sophisticated collective agreements with more aspects.
- 5) The tendency of a growing number of collective agreements is a good example of the fact that the employed can conduct negotiations with their employers considering common interests.
- 6) Collective agreements are the best means of preventing social conflicts and industrial disputes, when the sides learn the art of compromise and it becomes possible to bring different positions on common economic interest closer.
- 7) Concluding collective agreements does not yet mean inevitability of their implementation and it is important to form a joint internal structure in order to conduct monitoring over implementing the agreement, which will occasionally study the state of fulfilling obligations taken by sides and gives proper recommendations.

On the basis of the above mentioned conclusion it becomes clear that although there exist grounds for developing social dialogue, the government, employers and trade unions should make more efforts towards popularization of this phenomenon not only at the national level, but at sector and industrial levels too. In these processes special importance should also be attached to the bodies of government and self-government, whose potential in this direction has not been used properly.

## Social Dialogue and the Analysis of Georgian Legislation

Main documents forming the legislative basis for labor relations are Georgian Constitution, ratified conventions, Labor Code, law on trade unions, Law on Assembly and Manifestations, other normative documents.

Georgia has ratified the convention about freedom of forming associations and protection of the rights to organize 1948 (87, ratified in 1999)<sup>29</sup> and the one about the right of setting up an organization and the right to collective negotiations 1949 (98, ratified in 1993)<sup>30</sup> and other conventions connected to labor relations. The independent committee of the International Labor Organization gives annual evaluation of implementation of international conventions and recommendations connected to them in the countries of the world, including Georgia. The conclusions of this committee are used by other international organizations while evaluating the legislation of regulating labor relations. The International Labor Organization has given recommendations to Georgian government several times<sup>31</sup> on making changes in Labor Code and other legislations in order to put it in conformity with Conventions 87 and 98.

After the Rose Revolution European Social Charter was added to these obligations taken earlier<sup>32</sup>, which was ratified (partly) in 2005. Freedom of labor is declared in the Georgian Constitution, which at the same time obliges the state to consider labor through human rights: 'Protection of labor rights, fair payment and safe, healthy conditions, labor conditions of the under-aged and women are determined by organic law'.<sup>33</sup>

The Law<sup>34</sup> on Trade Unions, which had been adopted as early as 1997, has hardly changed, and the laws about collective contract and agreement and the one about regulating collective labor disputes was later abolished (in 2006), which leaves a certain blank space in the legislation. The law declares freedom of setting up trade unions and getting their membership. Trade unions are admitted in public institutions too, except for some categories (law enforcement bodies). An employer is obliged to conduct negotiations with trade unions with the aim of concluding agreements (Article 12 [2]). An employer is also obliged to give information to trade unions about expected redundancies and/or expected deterioration of labor conditions in advance (at least two months earlier) [Article 11(2)].

According to the law, it is possible to set up a trade union as an independent legal entity on the initiative of at least 100 persons (Article 2 [9]). A trade union is able to create primary organizations in enterprises. These primary organizations have to be guided by the trade union statute and by their own provision. The primary organization with at least 15 members is able to elect the organizer who will take the function of a representative of this organization.

By establishing the minimum of 100 members the law, to some extent, limits an autonomous right of small size collectives to associate with trade unions. Where the number of members is less than 100, a trade union can exist only as a subdivision of a bigger association. It is unable to be a legal entity and to conclude a collective contract independently either.

Prohibition of small size organizations limits the possibility of autonomous operation of labor collectives and encourages the establishment of hierarchical relationships in trade unions, which is the development of internal democracy. According to the independent experts of the International Labor Organization,

<sup>29</sup> [http://www.ilo.org/wcmsp5/groups/public/---ed\\_norm/---](http://www.ilo.org/wcmsp5/groups/public/---ed_norm/---)

<sup>30</sup> [http://www.ilo.org/wcmsp5/groups/public/---ed\\_norm/---relconf/documents/meetingdocument/wcms\\_gb\\_297\\_lils\\_6\\_en.pdf](http://www.ilo.org/wcmsp5/groups/public/---ed_norm/---relconf/documents/meetingdocument/wcms_gb_297_lils_6_en.pdf)

<sup>31</sup> Committees of experts of the International Labor organization of 2008 and 2010 gave recommendations to the government about the necessity of changes, as Georgian legislation does not correspond with the main principles of these conventions <http://www.ilo.org/ilolex/cgi-lex/pdconv.pl?host=status01&textbase=iloeng&document=25&chapter=4&query=general+repo>

<sup>32</sup> [http://www.coe.int/t/dghl/monitoring/socialcharter/default\\_en.asp](http://www.coe.int/t/dghl/monitoring/socialcharter/default_en.asp)

<sup>33</sup> See: Georgian Constitution, article 30, paragraph 4

<sup>34</sup> See: Statements of Georgian Parliament, N15-16, 1997.

requirement of 100 members is discriminatory and the government should reduce this number.<sup>35</sup>

The main document which regulates labor relations was adopted in May 2006. Since then this code has been repeatedly criticized on the grounds that it substantially limits the rights of the employed and trade unions and was adopted without reaching an agreement with trade unions. Besides, the Code opposes ratified conventions. Despite the demands made by Georgian Trade Unions Confederation, International Labor Organization, European Union and other organizations about revising certain articles of the code, its provisions have not changed so far. Moreover, in accordance with the additions brought in the Constitution in December 2010, the Labor Code became higher in status without any changes and from an ordinary law turned into an organic law. It means that it became even harder to improve it: in order to bring in changes into it, over half of the members of Parliament on the list will be necessary.

Articles 37 (d) and 38 (3) are considered to be main faults of the Georgian Labor Code in effect. In Article 37 (d) it is formulated that cancelling the employment agreement is the basis for seizing the relationship between an employer and an employee. In Article 38 (3) it is formulated that in the case of cancelling the labor agreement on the initiative of the employer, the employed should receive at least one month compensation for dismissal. Articles 37 (d) and 38 (3) of the Labor Code allows an employer to stop the labor agreement without warning despite the reason for dismissal. These articles grant an employer with an unlimited right to stop a labor contract without any explanations.

Furthermore, according to Article 5 (8), an employer is not obliged to name the reason for not taking on a worker or their dismissal. Accordingly, in the case of legal dispute the whole burden of proof is on the employed and not the employer. All this creates an opportunity for an employer to dismiss workers for their trade union, public or political activities, which has been practiced quite often in recent years. According to the experts of the International Labor Organization, that these articles together leave an opportunity of discrimination and restrict the rights of the employed to defend their labor rights.

As far as trade unions and collective agreements are concerned, the Code admits making collective agreements, but does not mention trade unions and is not precise enough concerning the problems of regulating collective agreements.

According to the Code, a collective agreement is the one concluded between an employer and any group of the employed consisting of more than two members. An employer has no obligation of conducting collective negotiations even in the case when it is demanded by trade unions.

A collective agreement and an individual agreement have the equal footing, which can be used against trade unions. The role of trade unions is not well-defined in collective negotiations and they can be conducted by any representative.

Due to such an interpretation of a collective agreement, Labor Code contradicts with Article 4 of the convention of the International Labor Organization. On these grounds the ILO believes that a part of collective negotiations should either be changed in Labor Code, or be regulated by a separate legislation.<sup>36</sup>

Due to such a shortcoming in Labor Code, or in legislation about a separate legislation for collective agreements, there are a number of cases when an employer refuses to conduct collective negotiations, when the renewal of the previously concluded collective agreements do not occur, misunderstandings, which make this problem complicated.

According to Paragraph 3, Article 25 of the Georgian Legislation 'About Trade Unions', an employer, an administration of an enterprise, institution, organization, every month transfers trade union membership fees to accounts of trade unions from the salary of trade union member workers in accordance with conditions defined by a collective agreement. Single-sided violation of a collective agreement causes non-fulfillment of this obligation by an employer. Prevention of such a practice, which has become particularly frequent

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<sup>35</sup> The recommendation was worked out in the conclusion by the expert committee of the International Labor Organization and the governmental committee of the European Social Chart in 2010.

<sup>36</sup> The conclusion of the expert committee of the international Labor Organization of 2010 about implementation of Convention 98 by Georgia.[http://www.ilo.org/global/standards/WCMS\\_123515/lang--en/index.htm](http://www.ilo.org/global/standards/WCMS_123515/lang--en/index.htm)



in recent years, is complicated due to the faulty legislation. Blocking the collection of membership fees is often used for financial weakening of trade unions by employers. These facts have been provided by free trade union of teachers and scientists of Georgia and by the one of Georgian Railways' workers. In the part of the research which deals with unsuccessful collective agreements, we also give a review of the matters of teachers' and railway workers' trade unions.

The Code substantially limits the right of workers' strikes. Article 49 recognizes the right of strikes, while Article 51 resolves a number of limits. For instance, an employee is forbidden to strike in the case of making redundancies of the staff by an employer if the employee was warned in advance about a possible dismissal. A strike becomes illegal if the labor contract was stopped during a legal strike. An arrangement for the strike must be preceded by a warning strike after which, within the period of 14 days the sides must make attempts to come to an agreement through negotiations. However, the law does not clearly define procedures of these negotiations. If as a result of exchanging written notices an agreement is not reached, one side is entitled to turn to the court or arbitration. The International Labor Organization believes, that there should be mechanisms of negotiations with the help of the third side, which will encourage reaching an agreement.

In the case the agreement is not reached, the right of addressing to the court or the arbitration limits the right of a strike. Although this right does not completely exclude the right of starting a strike, but after the court concludes a decision, this decision is obligatory and must be obeyed by everyone, which gives the following strike an illegal status.

The length of a strike is limited to 90 days. Furthermore, strikes are banned at the places where they may cause public damage. According to the International Labor Organization, limiting the length is inadmissible, and instead of banning a strike the term 'minimal service' should be established.

Apart from purely legal aspects, lack of protection of labor rights is caused by practical deregulation of management. Abolition of labor inspection created vacuum in terms of possibility of control of working conditions. There is no registration of unemployment, and there is no granting of unemployment benefit. Not a single ministry is occupied by elaborating and implementing labor policy, by gathering relevant statistical information and its analysis. There are no specialized courts or mediatory institutions responsible for discussing labor disputes.

These shortcomings of the legislation undermines the declared course of European integration. According to the European Commission, the Code contradicts not only with the conventions of the International Labor Organization, but also the standards of the European Union and the European Social Charter. In this it relies on the conclusion of the European Council about implementation of Articles 2, 4, 5, 6, 26 and 29 of the Charter<sup>37</sup> ratified by Georgia. According to the conclusion, Article 2 (10) is violated because, according to the Labor Code, an employee can agree on such a contract in which the upper limit of their working hours is not limited. Article 4 (2) is violated because an employer and an employee may agree on unlimited overtime work; moreover, the Labor Code does not guarantee the increased payment for this overtime work or the compensation for additional break. Article 4 (4) does not correspond with the Charter as it does not foresee an advance warning of an employee about their dismissal, while for those employed for a probation period does not foresee an advance warning about their dismissal at all. Article 5 of the Charter is not fulfilled because in order to set up a trade union too many members are required; a demand of not joining a trade union may be inserted in a labor contract; prevention from discrimination caused by a membership of a trade union is insufficient while taking on at work or dismissal; Article 6 (2) is not kept as it is possible for an employer to ignore a collective agreement unilaterally and concluding collective agreements is not encouraged.

Apart from the legislation immediately related to labor relations, the success of social dialogue depends on the degree of defense of common civil rights and freedom. According to the above mentioned evaluations several important factors can be pointed out:

<sup>37</sup> Ratified by the Georgian Parliament's Resolution N1876 of 1 July 2005.

1. Georgian Labor Code contradicts with the internationally recognized norms and conventions ratified by Georgia; its flaws have encouraged discriminative practice in recent years.
2. Labor Code is discriminative towards the employed. It gives employers the possibility to dismiss an employee from work any moment without giving any explanation. This norm may be used, and is sometimes used discriminatively, also against trade union activists.
3. Labor Code is discriminative towards trade unions. It does not consider trade unions as the only possible representative of the employed while concluding collective agreements and does not contain any provisions which would explain the role of trade unions in labor relations.
4. Labor Code admits collective agreements but does not contain enough regulation in this respect, which prevents conclusion of agreements.
5. Labor Code creates important obstacles in terms of arranging strikes, which prevents workers from defending their rights.
6. The rise of legal and practical restrictions of political and civil rights in the country gives an additional reason for the reduction of the ability of workers to defend their own rights.

## **International Obligations Taken by Georgia in the Context of Labor Relations and Social Dialogue**

The International Labor Organization has been cooperating with the authorities, trade unions and employers for many years with the aim of bringing labor legislation in conformity with international standards. It has an expert and recommendation function which it implements both in Georgia and in other countries in the world. It was the outcome of the dialogue between this organization and the World Bank that from 2009 there started a discussion about transformation of the index of easiness of doing business (EDBI). The aim of this discussion is to prevent governments from improving their rating through violating internationally accepted standards. Thus, social dialogue at a local level is partly related to the success of this dialogue at a global scale. From 2010 an agreement was reached and the workers' employment index was taken out of the indicators of 'Doing Business', an international financial corporation.

Apart from ratified conventions, Georgia has taken a number of obligations referring to regulation of labor relationships. European Neighborhood Policy Action Plan, which contains main aspects of Georgia's approximation to Europe, directly considers "constant efforts for guaranteeing the implementation of standards formulated in the European Social Charter, protection of the rights of trade unions and international labor standards in accordance with conventions of the International Labor Organization ratified by Georgia."<sup>38</sup>

Even more distinct obligations are connected with Georgia's involvement within the system of commercial preferences with Europe. Generalized System of Preferences (GSP+) with European Union, which Georgia makes use of, contains conventionality and means that the country should fully satisfy main principles of labor standards of the International Labor Organization:

Georgia's Generalized System of Preferences (GSP) with the USA also considers bringing labor relationships in Georgia in conformity with international standards. It is expected that the problem of this conformity will arise in further US-Georgian negotiations about this agreement. The American Federation of Labor AFL-CIO addressed the White House Trade Representation with an appropriate petition in order to start investigation of facts of violation of trade unions' rights in Georgia. The Trade Department accepted the petition and the investigation began. On 24 January 2012 argumentations of the representatives of the Georgian government about violations indicated in the petition was heard. The process is under way.

These international obligations, together with ratified conventions, create the frame due to which the European Union, International Labor Organization, the US State Department and other organizations outside

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<sup>38</sup> [http://gurkanates.com/index.php?option=com\\_content&view=article&id=8&Itemid=18](http://gurkanates.com/index.php?option=com_content&view=article&id=8&Itemid=18)

the country should be considered as the participating sides of the dialogue which can have an immediate effect on this process. Their involvement and interest has several times been recorded in public statements and practical actions.

Main recommendations which Georgian government has received in recent period referred to improving the legislation and bringing it in conformity with given obligations. As early as in 2007, in the 'Report of Implementation of European Neighborhood Policy' it is said that "the Labor Code adopted in 2006 without preliminary consultations with trade unions does not conform with the standards of the International Labor Organization". The report of 2010<sup>39</sup> again mentions shortcomings of the Labor Code: despite the agreement reached on minor amendments in the Code through social dialogue, these amendments have not been implemented yet and the pressure on trade unions has increased, which creates threat to continuation of advantages granted by GSP+.

Dignified labor relationships and trade unions enjoying full rights are considered by the US government as an integral part of strong democracy and civil society. Therefore, the US State Department scrutinizes their situation in the countries going through the process of democracy. The annual report of the US Department about the situation of human rights is unequivocally critical towards the protection of labor rights and labor legislation in Georgia.<sup>40</sup>

In the resolution about concluding a Free Trade Agreement with European Union, adopted by the European Parliament, two remarkable points were put forward. In particular, Georgian government should provide bringing of Conventions 87 and 98 of the International Labor Organization - conventions about freedom of association and about collective negotiations respectively - in conformity with Georgian Labor Legislation and, the second, make all the efforts to encourage the development of non-discriminative, real social dialogue and to implement the culture of social dialogue.<sup>41</sup> These nearest assessments emphasize once again the situation, that labor relationships in Georgia have not been regulated yet neither at the legislative level, nor in practice. There has been made a number of official statements by people on high positions in the structures of European Union that, although negotiations about Free Trade have started, still one of the most important preconditions for its successful completion is improving the labor legislation, regulating labor relationships on the level of legislation and essential encouragement of real social dialogue. As the irreversible process of European integration implies in itself maximal approximation to the European social model, and the latter is largely based on high political culture of social dialogue and pragmatic cooperation in common interests in labor relationships. Taking the above mentioned into consideration, in Georgia all three sides, i.e. the government, the employers and the trade unions should be enthusiastic about making more effective steps forward in this direction, of course in the conditions of existing a strong political will.

## Examples of Unsuccessful Social Dialogues

### Georgian Teachers' and Scientists' Free Trade Union

From 2005, within the frames of education reforms, secondary schools became autonomous employer organizations, which concluded agreements with school teachers actually independently from the Ministry. Appealing with this reform, in 2006 Alexander Lomaia, the Minister of Education, did not respond to the appeal of the trade union about renewing the branch agreement which operated since 1998 between the Ministry and the teachers' trade union.

The trade union was compelled to appeal to the court. Although the contract signed in 1998 still functioned, but due to a number of changes that had been brought about, this contract became dated and

<sup>39</sup> [http://ec.europa.eu/world/enp/documents\\_en.htm](http://ec.europa.eu/world/enp/documents_en.htm)

<sup>40</sup> <http://www.humanrightshouse.org/Articles/16050.html>

<sup>41</sup> <http://www.europarl.europa.eu/sides/getDoc.do?type=REPORT&reference=A7-2011-0374&language=EN>

required renewal. Adducing the reason that employment conditions are established by the Ministry, and teachers' salaries and forms of encouragement are determined by it too, thus the Ministry retained the right of continuing the collective agreement, in February 2007 the Tbilisi City Court, and later in 2008 the appeal court established that the Ministry is a social partner of the trade union and is obliged to resume negotiations with the trade union in order to conclude a collective agreement.

The government is ignoring the trade union became particularly obvious when the trade union addressed to the Parliament with a petition about making amendments to the law about general education. This petition was signed by 60,000 teachers. The petition dealt with regulating the problem of teachers' certification. In legal terms this petition was to be debated by the Parliament. However, it never occurred. Instead, the Parliament adopted amendments to this problem brought in by the Ministry without holding consultations about this problem with trade unions.

By the time that the trade unions lodged a complaint in the International Labor Organization, the situation had become quite tense. Together with other facts the complaint protested against the government's interference with the activities of education and scientific workers' free trade union. Facts of discrimination, persecution, and insult were given. At the same time, by that moment it became clear that the Ministry supported institutionalization of a new body as the syndicate of an alternative organization of trade unions, of professional education.

Unlike trade unions, education syndicate was set up as a non-governmental organization encouraging the rise of teachers' qualification and training. The aim of the professional education is to protect professional interests of workers of education and to promote the development of the system of education in Georgia. It was founded in 2007 and unites up to 18,000 members. The Syndicate permanently conducts free trainings for teachers and school authorities, publishes professional/methodical periodicals. Apart from the Syndicate, in 2008 one more organization was set up the association of school principals, which signed a memorandum of cooperation with the professional syndicate of education on 26 March 2009.

When did the transfer of membership fees start to delay? On the initiative of the Ministry, schools started to create obstacles to collecting trade union membership fees. Agitation was led among teachers to join the Syndicate instead of the existing trade union. Facts were attested when the collected membership fees were transferred to the Syndicate's account instead of the trade union's one.

As a result of the interference of International Labor Organization, there started trilateral consultations between trade unions, employers and the ministry of Labor, Health and Social Affairs, which brought about a certain advance in the relations between trade unions and the Ministry of Education. With the aim of reviving collective agreements and collection of membership fees a bilateral commission was formed. This commission worked out a form of bilateral agreement; the process of its presenting started in Adjara and then other regions followed. Besides, the teachers' trade union had an ambition to become a partner organization of the Ministry in the process of elaborating the Teachers' Ethic Code. However, in April 2010 a commission was set up to work out this code, in which trade unions was not found.

Actually, a compromise version was found through a dialogue. On November 30 the Minister appealed to schools to regulate the practice of working with trade unions. On the grounds of the members' statements, schools had to start negotiations with primary organizations about concluding collective agreements. At first up to 500 agreements were concluded which were signed by principals and regional organizations of teachers' trade union.

According to the information of Georgian Teachers' and Scientists' Free Trade Union, after the local elections in May 2010 the situation became tense again. On 8 June Dimitri Shashkini, the Minister of Education, met representatives of regional organizations and school principals, where he made an oral command that every school principal had to stop transferring membership fees to the teachers' trade union. As a result, local heads of Georgian Teachers' and Scientists' Free Trade Union started to collect fees directly from the members. On hearing this information the Minister declared that the principal, who allowed such an activity at school, would bear legal liability.

In the meantime, the time of the meeting on which the new leader of teachers' trade union was to be

elected approached (30 October 2010). Before the meeting the transfer of membership fees was still delayed and pressure on teachers was intensified. The aim of this pressure was to pass off a new leader who would be acceptable for the Ministry.

Elections of the leader at the meeting went in the situation without an alternative. A part of the delegates tried to walk over the meeting with the pretext of absence of quorum. However, these elections were still held. Maia Kobakhidze was elected on the basis of their results and their legitimate basis was confirmed by independent international observers from Education International and American Teachers Federation.

The conflict did not wear off even after the meeting. The results of the elections were appealed in court and the process is still going on. The Ministry did not express the desire to contact the newly elected leader. Transfer of membership fees is still suspended which puts the organization in difficult situation.

#### The Matter of Georgian Rail Workers Trade Union

From 2006 there occurred centralization of enterprises in Railways and turning it into a whole structure. Railways remained a limited liability company, but its management was changed and, at the same time, it changed its attitude towards employment relations. In this new philosophy the balance of management power changed between employers and employees in favor of the employers, which made the necessity of agreement with trade unions, as a legitimate partner, suspicious.

Since then only one collective agreement has been concluded, without concluding ones at the level of primary organizations. This agreement was far more modest than the previous one. It did not cover such specific problems that used to be regulated at the level of primary organizations. For instance, workers of locomotive depot or those of mountain passes lost the allowances which they had on the basis of specific agreements.

Since then trade unions tried hard to reach convenient conditions, but the relations were getting complicated. The collective agreement concluded in 2006 was renewed only once, in 2008, when the discordance with its content became evident. Considering this disagreement, the management adopted the renewed version of the agreement unilaterally, without holding negotiations with trade unions, which was against the rules of renewing collective agreements.

In 2000 the changes were made to the agreement by the management unilaterally which caused narrowing of a number of articles. The allowances considered by these articles were not annulled, but were moved to the so called 'loyalty program', which has nothing to do with trade unions.

By the unilateral agreement proposed in 2010, centralized collection of membership fees and transferring them to the account of trade unions was stopped, which put the existence of the organization under the question.

By the time, due to long-term passivity, the trade union appeared very weak and its leaders did not enjoy proper confidence in order to rely on solidarity efforts of the employed. Besides, there was lack of average authoritative leaders in the trade union and a necessity of electing such leaders. This is why at the early phases of the conflict the trade union was still oriented at non-confrontational activities, avoided lodging complaints in international organizations and used the central trade union, the trilateral commission and court for arbitration.

Despite the complaint lodged in the Tbilisi City Court in 2010 and discussing the problem, it is still unsolved in 2011. Having lost the first instance, the trade union continued legal action in higher instances of the court. As for the Tripartite commission, the government gave recommendation to the railways' management to carry on negotiations with the trade union. However, it was not followed by a practical result.

Since the management stopped transferring membership fees to the trade union's account, there occurred a dramatic decrease of the members as well as the budget. Negotiations with banks were held and signatures on individual applications were collected from the remained members so that their membership fees were to be collected by banks. Presently it unites only 3,000 members and the proceeds gathered through banks, make only 10% of what it used to be. It actually resulted in the necessity of setting up a totally new organization. On 10 April 2011 an extraordinary meeting of the trade union took place. New management



was elected. By holding this meeting the railway trade union at least avoided the biggest danger: turning into a yellow trade union. But it is only the beginning of the route which needs further development.

The mentioned matter was considered three times at the meetings of Tripartite social partnership commission. Recommendations about starting social partnership and collective negotiations by the sides were accepted. However, the administration of railways still avoids relationships with the trade union. This example is one more evidence to the fact that the Tripartite commission of social partnership does not have a real decision-making mechanism and it requires certain development in order to raise effectiveness of this institution and encourage further development of social dialogue.

### **Poti Port**

In January 2007 the authorities of the port broke the collective agreement with the trade union with the reason of its expiry and suspended centralized collection of membership fees.

The trade union still tried to fight and decided to switch to measures of striking. In October 2007 a half-hour warning march was held with the demand of collective agreement and transparency of tender. A few days after the march the management sealed the trade union office and the leaders were dismissed from work.

Despite the fact that, the management did not admit dismissing the leaders with the reason of trade union activities, the trade unions turned to the court. The city court and then Kutaisi appeal court did not satisfy the suit and in 2008 Supreme Court refused to accept the case of Poti port for discussion and thus it left the decision made by the Kutaisi Appeal Court in effect. In 2009 the port filed a suit in the European Human Rights Court.

Despite the fact that the process of privatization of the enterprise came to an end and therefore Poti port has a new management which does not contact with the trade union, the process has not finished yet. The case of Poti port became subject of repeated consideration and discussion within the frames of social dialogue. It features in the complaints made trade unions, the freedom committee of the union of the International Labor Organization appealed to the government in its conclusion to investigate the mentioned facts and guarantee restitution of the workers dismissed for their trade union activity. However, the government has not taken any action.

### **BTM Textile**

This sewing plant situated at Khelvachauri was purchased by Turkish investors. About 500 workers employed in it had to work in hard conditions. According to the workers, the working hours were not regulated and a working day could last up to 12 hours and even more, without extra wage. They had to make up for any time missed, even if they had to see a doctor at the time. It was cold in the enterprise, using showers was limited; they had to get a permission even to drink water. Labor contracts were mainly short-term: 3-month, 6-month and one-year, although there were shorter ones too. This allowed the employer to keep the employees under constant threat of being dismissed. All these dramatically differ from the labor relations which would be fair and acceptable for the employees.

Before its privatization there was a good trade union organization in the enterprise which was headed by a strong and independent team. At first they managed to continue their activity. On their initiative, on 16 March 2008, 250 workers of the enterprise set up a new trade union which joined the Adjara regional subdivision of the Georgian trade Unions Confederation. A 9-member trade-union committee was elected. The general director of the plant was informed about this establishment of the trade union on 10 April. He was officially handed in documents in which names of the members of the committee elected by the meeting were given. On the next day all 9 members of the committee were dismissed from work without any explanations.

These occurrences were accompanied by a warning action, while the dismissal of the members was followed by a protest action at the entrance of the plant.

These occurrences were followed by the warning of the workers by the management according to which they were under threat of losing jobs for trade-union activities. Furthermore, the enterprise management distributed orders on other enterprises in which the workers did not demand to limit a working week or extra wage for overtime work. There occurred redundancies in enterprises as a result of which a large part of trade-union members lost their jobs.

The trade union turned to the local authorities for help, but they did not take any measures to defend the rights of the employed. The Batumi City Court heard this case for a year and eventually refused to satisfy the suit. The issue was also considered within the frames of the Tripartite commission, but the trade unions have not received the response yet.

## **The Case of “Eurasia Steal”**

The nearest example of unsuccessful collective negotiations and absence of the will of social dialogue is events that took place in August and September of the last year at the metallurgical enterprise “Eurasia steal” in Kutaisi. Later it became the subject of acute criticism of the government by the whole international society as well as the Georgian civil society.

At the beginning of August the workers of the mentioned enterprise set up a trade union and sent a letter to the administration with the request of starting collective negotiations. The Minister of Labor, Health and Social Affairs, who at the same time is the head of the commission of the trilateral commission of social partnership, was informed about establishing the trade union through an official letter and was asked to take this case under personal control in order to avoid pressure of the employer on the members of the trade union. Despite legitimate demands of the trade union, the administration of the enterprise, instead of starting negotiations, started intensive persecution of the trade-union members and dismissed 29 activists within the period of one month. The culmination of this confrontation was dispersing of the workers who had been on strike considering all the legal requirements, by law-enforcing units. Some were detained and later three activists were given administrative detention.

It is remarkable that as a result of the employer's participation in negotiations this kind of confrontation would have been avoided and neither the employees' nor the employers' interests would have been damaged. The government was naturally able to show interest in this confrontation and give recommendation to the employer about beginning negotiations, which did not happen. On the contrary, the government structure interfered with the conflict ignoring legal norms, which was expressed in dispersing the legal strike with the help of the police.

The analysis of examples of unsuccessful collective negotiations allows us to outline what negative effects might follow disputes between employers and employees:

- 1) The above mentioned examples clearly show that liberal labor legislation operating in Georgia leaves the harmonization of employment relations to the good will of an employer and there always is threat of radical industrial actions, such as, for example, strike. The latter has an equally negative effect on both an employer and an employee.
- 2) The will of employees to conduct real and negotiations with good face with employers is limited or, in a number of cases, completely ignored.
- 3) The demand of starting collective negotiations in a number of cases associated with loss of a job for employees and with limiting their right Association.
- 4) Unsuccessful cases of collective negotiations have a negative effect on the international image of the country too and it naturally undermines to Georgia's distinctly declared aspiration towards integration with European Union.
- 5) Sense of insecurity and industrial disputes give a negative example on the way of development of

social dialogue in the country and it complicates the process of essential mental changes, which separates Georgia even more from the best European practice of regulating employment relations.

- 6) On legislative basis, it is only declared that an employer is obliged not to ignore the will of an employee to conduct collective negotiations and it is not clearly defined what might be caused by such an activity of an employer. A common homogeneous court practice also shows that labor legislation does not contain precise norms and give a wide opportunity for interpretation.

## **A Short Analysis of a Survey Conducted in Enterprises**

The following questionnaire was compiled with the aim of studying the present situation of social dialogue in enterprises.

1. Do you know the employees who left the company? What was the reason for leaving? (wages? overtimes? any other reason?)
2. When you have a desire to protest against something, who do you address? Do you think the company has the best ways of proper listening to the employees on the issues that are important for them, connected to work?
3. Is every employee treated the same way? Is there any difference between males and females? Does the company take care of pregnant employees and does it provide them with proper conditions? If so, in what ways?
4. What do you think are the three issues or approaches which the company should change in order to make going to work enjoyable for an employee?
5. Are there any best ways which will make a job better and more desirable? (Are regular meetings arranged in order to discuss these issues? Does an advice box exist? Or is there any different idea?)
6. What do you know about the term social dialogue in general? What does it imply in itself?
7. How much aware are you of the main essential articles of the collective agreement? Which of them could you name?
8. Do you believe that the presence of a collective agreement will defend your employment rights more efficiently and improve social conditions?
9. After concluding a collective agreement in what ways did conditions improve in particular (safety standards, indexation of salaries, etc.)?
10. Are there any employees who are formally in charge of defending conditions of labor standards?
11. To what degree are conditions of labor standards foreseen in the job description?
12. How was the role of a social dialogue reflected on the work of your company?
13. How necessary, do you think, are social dialogue and efficient relations with trade unions?
14. Can you name specific factors which obstruct more efficient development of social partnership? (Fear for being dismissed from the job, low level of awareness, improper culture of dialogue, etc.)

With the aim of studying present situation, with maximal anonymity, 150 employees from different enterprises were questioned (including Zestafoni Ferroalloys Plant, Chiatura Manganese Factory and 'Saknakhshiri' Ltd - Tkibuli enterprise).

The survey showed that 70% of the interviewees have no idea about social dialogue, 25% possess general information, only 5% turned out to be aware of the essence and importance of social dialogue. As for the information about collective agreements, the majority is not aware of the important articles which regulate labor issues. There is a remarkable fact connected to labor safety service: as a result of monitoring it turned out that none of the enterprises had a person delegated with proper entitlement who is responsible for labor



safety conditions. More than half of those questioned say that improving working conditions and pay rise are means of improving their conditions in the enterprise. There were attested restrictions related to trade-union activities (fear for being dismissed from work).

The results of the monitoring point to the fact that there is low level of awareness of social dialogue, which speaks about acuteness of the problem itself. It is also noteworthy, that a large part of those questioned have vague impression about main principles of collective agreements.

Despite the fact, that one part of those questioned is aware of the concept of partnership in general, still they find main functions and role of social dialogue in terms of efficiency quite obscure. This fact proves once again that there is obvious deficiency in understanding of social dialogue in the country. Therefore, we consider that it is absolutely necessary to start conversations about social and labor topics because, as the research showed, it remains at the stage of infancy. The government is making a slow progress towards forming a systemic model of social dialogue in the country and its clearer consolidation at the legislation level.

The situation is far more complicated in regard with implementation of social dialogue at the industrial level. In this case we are dealing with ignoring of collective agreements and employees' interests by an employer. The majority of the respondents admit that they are unaware of fundamental principles of a collective agreement and, accordingly, the low level of awareness creates perfect conditions for an employer.

The research enabled us to analyze the real situation characteristic of workers.

In order to raise the level of awareness among the employed it is necessary to continue intensive work through propaganda of social dialogue. In addition, the mechanism of labor inspection should be restored in the country. Special attention should be paid to consolidation of real fundamentals of defending workers' employment and social rights. It is obvious that this can be achieved through raising awareness of social dialogue among workers.

## **Conclusion, Recommendations and Further Prospects of Social Dialogue**

Resulting from the situation reflected in this research it is clear that it is necessary to form close cooperation between social partners, at least in order to somehow distribute the responsibilities which the state has to take in this hardest period of the country's development.

In general, relationships between partners can be evaluated as infancy of the development of social dialogue, with the hope for better future. As a result of the analysis of the present situation of social dialogue in Georgia and social-economic policy of the country, we can outline prospects of the development of social dialogue for the period of several years.

1. Due to the country's aspiration for European integration, it is presumable that in the nearest future the involvement of the International Labor Organization, European Union, European countries and international foundations in this process and their assistance will significantly determine general directions of the development of the process;
2. Proper mechanisms will definitely be worked out within the frames of tripartite partnership commission with the purpose of resolving disputes and a proper team will start work much more systemically and seriously;
3. Due to the position of trade unions it remains absolutely topical to lobby changes in the Labor Code which will help in attempt to reinforce positions in the International Labor Organization and other foreign organizations;
4. Presumably, the government will initiate putting forward issues which have been non-topical among partners up to present, for example, issues like reducing the level of poverty in the country, employment policy and so on;

5. There will be attempts of activating works in the sphere of professional education in order to sort out problems in this direction;
6. In the format of bilateral partnership, close cooperation in labor protection in enterprises and implementation of safety systems will presumably continue.

This short list, naturally, cannot claim itself to be inevitable and it might come in useful as one of the versions of theoretical hypothesis of the development for the next couple of years, based on the analysis of the events that have occurred in the immediate past and attitudes of the sides towards the problems. We would be happy to extend the list if the sides will manage to put other topical subjects forward and update them, will definitely prove favorable to the development of the country on the whole.

In this case it will be desirable if there occurs updating of a number of problems the country faces and if the sides begin efficient cooperation in the following directions:

- regulation of labor migration problems;
- outlining the state policy of employment and its strategic planning;
- providing state pension reforms in the country;

Development of private insurance systems, such as:

- a) Insurance of labor protection and safety in enterprises;
- b) Working out efficient measures for operating private pension schemes, etc.
  - intensification of cooperation in reforming education and healthcare systems;
  - intensification of partners' involvement in working out the policy of the country's economic development;
  - Participation in the strategy of regional development of the country and its implementation.

The success of social dialogue will be encouraged by its implementation step by step at first at the industrial and company levels, where it has much more pragmatic, immediate contact with the fate of concrete individuals. In this regard the government is able to do much more than it actually does. In recent years business, especially the big one has experienced intensive assistance from the authorities. If the authorities do not pay adequate attention to the rights and problems of the employees, it will bring about degradation and demotion of the workforce which will eventually obstruct economic advance of business and the country.

Involvement of rational interests within the frames of tripartite dialogue and searching for mutually beneficial compromises inevitably requires openness and transparency. The mode of dialogue between partners must be clearly demarcated from attempts of reaching deals. Position and strategy of each side must be clear and understandable to all the social forces the sides represent. In order to provide this, while entering a dialogue, in its progress or critical moments, the participants should look for the mandate of compromise or confrontation among those who they represent. In order to achieve this it is necessary that every side of the dialogue should be equally represented in media. It refers to not only labor, business and the authority but international actors too.