# Books

**Vladimer Papava,**
***Necroeconomics,***
iUniverse, 2005.

**Reviewed by Anders Åslund**

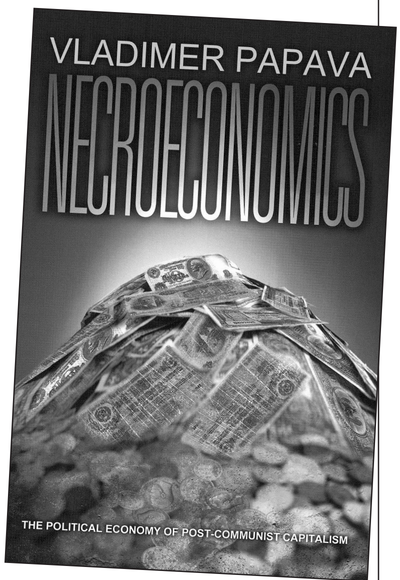
## Georgia on My Mind

The literature about the transformation of the Soviet economy is dominated by writings on Russia, and most books about other post-Soviet economies are of poor quality. Therefore, it is a great pleasure to find a substantial and sensible book on the market transformation of Georgia, the small country in the Caucasus.

Vladimer Papava is a well-read professor of economics and he served as Minister of Economy of his country from 1994 to 2000. At present, he is a Fulbright scholar at the School of Advanced International Studies at Johns Hopkins University in Washington, D.C.

He has written a refreshing and stimulating book, which is a good read. Although he is fond of puns, such as "necroeconomics," his prose is lucid and he has a knack for calling a spade a spade. Unlike so many other economists who have experienced severe crisis, Professor Papava does not display strong ideological preconceptions. His extensive reading is eclectic and his reasoning very open-minded. His interest is simply to find out what works in the real world.

And what a world he has lived in! No former Soviet republic saw as great an economic calamity as Georgia. A brief civil war at the time when it gained independence in 1991–92 brought havoc to the country. Hyperinflation raged and racketeering took over the nearly anarchic country. Officially, output fell by no less than four-fifths. As a realist, however, Papava does not pay any attention to the official statistics. To him, much of the old economy had been misdeveloped into a "necroeconomy," a dead economy of value detraction that could not produce anything of value. Most of the rest of the economy consisted of the shadow economy, in which he distinguishes between productive shadow entrepreneurship and parasitism. You sense how awful the situation was.




So how do you get out of such a mess? Papava paraphrases Churchill's statement about democracy that a market economy is the worst system except all others that have been tried. "Fortunately today, almost no one in post-Communist countries considers seriously whether there is an alternative to a market system…nobody is against private property."

But where do you start? Papava sees only one institution that can salvage society from the morass of corruption: private property. "In order to restrict corruption and establish the institution of private property, it is necessary to legalize the existing results of primary accumulation of capital…."

Georgia's problem was not shock therapy but its absence. Late in the day, in the fall of 1994, when inflation peaked at 15,600 percent, the International Monetary Fund could finally conclude an agreement with Georgia which led to a gradual stabilization. The IMF helped Georgia out of economic naivety and confusion. In its ordinary way, the IMF imposed elementary fiscal and monetary standards, insisted on a limitation of the budget deficit, and provided some financing.

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THE INTERNATIONAL ECONOMY
THE MAGAZINE OF INTERNATIONAL ECONOMIC POLICY
888 16th Street, N.W., Suite 740
Washington, D.C. 20006
Phone: 202-861-0791 • Fax: 202-861-0790
www.international-economy.com

Although Papava's basic view of the IMF is positive, he offers a long and substantial criticism of some of the IMF's actions in Georgia. As have so many others, he complains about the IMF refusing to help his country to introduce its independent national currency after the collapse of the Soviet Union, which greatly contributed to the pervasive hyperinflation in the ruble zone.

Most of his criticism focuses on the IMF advocating too high and too complex taxes. The IMF compelled Georgia to adopt a standard tax code. Whereas the idea was good, the problem was that the tax code was so poorly translated from English that it was not readable in Georgian. Therefore, many tax issues were rendered indeterminate, and the tax system was neither simple nor universal, comprehensive nor even-handed, since it was not even comprehensible.

Papava's criticisms of the IMF's tax policies tally with those of reformers in Russia, Ukraine, or Kyrgyzstan. The IMF forced Georgia to adopt a system of value-added taxation that was far too complex, so it has never worked. After so many years of failure, it is time to reconsider this alien imposition of VAT on the former Soviet republics. As long as so little revenue is collected as in Georgia, the VAT system should be abolished.

Another criticism of the IMF is that it insisted on progressive personal income tax. The new post-Soviet consensus is that only a low flat income tax is collectible. In recent years, the IMF has increasingly accepted these flat income taxes. Russia and Ukraine have already established the standard of 13 percent flat income taxes, but recently Kyrgyzstan has overtaken them with a flat income tax of merely 10 percent, which is probably the maximum that a country like Georgia can take, where a prior flat income tax of 20 percent was a failure because it was just too high for such a poor and corrupt country.

Similarly, Papava favors simple fixed lump sum taxes for small entrepreneurs, notably peasants, rather than the whole panoply of taxes. Also here, the IMF has reluctantly crept to the cross.

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But what happens to revenues? The Laffer effect is never greater than in as profoundly corrupt and shadowy an economy as the Georgian. In 1997, as the social security tax was cut from 37 percent to 27 percent of the payroll, revenues from this tax surged by 41 percent. Conversely, when the IMF forced the Georgian government to almost double cigarette excise taxes to 110 percent, those tax revenues plummeted by 37 percent.

So where does an open-minded and intelligent economist end up after having studied the Georgian economic transformation? Papava is somewhat equivocal but by and large he comes out as a convinced libertarian, quoting John Marshall: "The power to tax involves the power to destroy." It is difficult to harbor any illusions about the goodness or fairness of the state for somebody who has seen all the anomalies of the Georgian Soviet and post-Soviet state.

*Necroeconomics* is an important contribution to our understanding of economic policy in countries with weak institutions. Two of the most elementary institutions are, first, the establishment of private property by any means, and, second, the introduction of a very simple tax system. Unfortunately, mysteries such as the development of a sound judicial system pertain to the future. ◆