

## Problems with the Competition Policy Formation in Georgia

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### Abstract

In Georgia, since the declaration of independence, there has always existed an attempt to establish legal and regulatory mechanisms that would improve competition. Numerous laws and legal acts were formed with the purpose to analyze the process of holding dominant positions by economic agents at markets, to eliminate the abuse of such positions, to reveal the attempts of limited competition at market, as well as to provide established market with fair competition rules. Georgia has always aspired to integrate with European Union structures. The country is a member of World Trade Organization and a part of multiple bilateral, regional, multilateral agreements and international organizations (that collaborate within international competition field) as a full member or as an observer. Based on the above mentioned issues, the improvement of competition policy becomes inevitable in Georgia.

**Keywords:** competition, antimonopoly regulation, euro-integration, regulation, monitoring.

### Introduction

**The methodology of the study:** The following general scholarly methods were used during the research: analysis and synthesis, observation, comparison, hypothesis and analogy.

### Problems with the Competition Policy Formation in Georgia

Competition is an inevitable component of market relations and implies rivalry between economical agents to provide better conditions for goods [service] production and sale. A market economy is impossible without competition the same as competition without market relations. Although, a victorious competitor is guaranteed to have solid positions and highest profit, gaining a victory in competition is not an easy task. It is experienced by those few who complying the "fair game" manage to give economical preferences to their production, arouse customers' interest and attract them. Competition phenomena has long been expanded from local scale to global scale. Today, competitiveness as a principal indicator of development significantly determines a role and a position of each country in international division of labor. [1]

Since the declaration of independence in Georgia, there has always existed an attempt to establish legal and regulatory mechanisms that would improve development of competition and would not allow monopolies to be formed in the market. Multiple laws and legal acts have been constituted with the purpose to analyze the process of taking dominant positions at markets by various economic agents, to eliminate the abuse of such dominant positions, to reveal the attempts of limited competition at market, as well as to provide established market with fair competition rules. In Georgia, a new antimonopoly law was constituted and antimonopoly service – Competition Agency was established. However, to introduce the legal norms into practice, the programs for competition development and antimonopoly regulation should be started and an action plan should be drawn up based on the abovementioned. Let's discuss the issues that would actually improve contemporary, European type of antimonopoly regulation. To study the problem and to explain the reason why the antimonopoly system has not been functioning properly during the last two decades, we need to briefly review the history of establishment of antimonopoly regulation in Georgia and those hindering legal and institutional factors that affected its operation, we also need to analyze the initial stage, current condition and required steps to be taken for the future. [2]

An independent antimonopoly service has been functioning in Georgia since 1995 but there has always been a problem of free competition at market. Nonexistence of competition, cartel agreements, corruption schemes were explained by the defects of antimonopoly law and the weakness of the service. The way out of the situation was considered to be the reorganization. One of the thoroughgoing reforms was implemented in 2005. Between 2005-2013, the antimonopoly service was acting as a department of nominal importance instead of being a service with administrative duties. Its effectiveness did not turn for the better after transformation. Therefore, effective antimonopoly policy does not depend on the "strict" or "mild" rights entitled to the antimonopoly service, but it rather depends on correct formation of legal and institutional base, the extent of expressing political will by the state power and professionalism of people employed at the service.

The stages of competition policy formation and reorganization in Georgia could be set up by years in the following way:

1992 – 1996. After the declaration of independence, the first document "Regarding the restriction of monopoly business and development of competition" (1992) was issued which regulated the activities by monopoly units in Georgia. They should not have made obstacles to the formation of market economy.

1996 – 2004. The competition and free market legislation, which was based on the European experience, was created during this period. Antimonopoly Service was established at the Ministry of Economy and it was obliged to control the companies that were holding dominant positions. First monopolists were created in this period of time.

2004 – 2013. Implementation of liberal reforms began in Georgia after the Rose Revolution. The Antimonopoly Service was abolished and instead, Free Trade and Competition Agency was established which actually had only analytical functions.

After the new government came into power, the law "regarding competition" was amended in march, 2014 and Competition Agency was established. The regulation was approved in accordance with the resolution N288 of Georgian Government, dated as April 14, 2014, "Regarding the Approval of the Regulation of Legal Entity of Public Law – Competition Agency". The Competition Agency is an independent LEPL. It is accountable to the Prime-Minister of Georgia and society. The goal of the agency is to promote market liberalization, free trade and competition in Georgia. [3], [5]

In 2008, the fact-finding board of European Commission emphasized the antimonopoly regulation after evaluating the competitive environment in Georgia. Afterwards, in 2010, the government of Georgia developed "The comprehensive strategy of competition policy", and in December same year, Competition and Procurement Agencies were united as one service. [4]

European Union had two requirements towards Georgia regarding the competition field.

The first – to establish clear competition policy and law regarding the competition;

The second – to form a relevant competition agency which would be responsible for execution of the law.

"Law Regarding Free Trade and Competition" was issued by the Parliament of Georgia in May, 2012. Working on the antimonopoly legislation, as well as the competition policy reform were the priority fields to push negotiations regarding the Deep and Comprehensive Free Trade Agreement between EU and Georgia.

*- What is the situation today in the country regarding the antimonopoly activities?*

According to "The Global Competitiveness Report" of The World Economic Forum 2015-2016, Georgia gained three positions and moved from 69<sup>th</sup> to 66<sup>th</sup> position (with 4,22 points) among 140 countries. The Ministry of Economy reports that in the list of Global Competitiveness Report, Georgia outscored countries such as Slovakia (67<sup>th</sup>), Montenegro (70<sup>th</sup>), Croatia (77<sup>th</sup>), Ukraine (79<sup>th</sup>), Greece (81<sup>st</sup>), Armenia (82<sup>nd</sup>), Moldova (84<sup>th</sup>), Albania (93<sup>rd</sup>), Serbia (94<sup>th</sup>). Georgia improved its positions in 1 factor out of 3 factors, 7 elements out of 12 elements and 58 sub-elements out of 114 sub-elements. The improved factors are: Efficiency Enhancers – gained 2 positions and moved to 77<sup>th</sup> position (4.0 points).

Higher Education, training – gained 5 positions and moved to 87<sup>th</sup>;

Efficiency of product market – gained 12 positions and moved to 48<sup>th</sup>;

Efficiency of labor market – gained 9 positions and moved to 32<sup>nd</sup>;

Development of financial market – gained 8 positions and moved to 68<sup>th</sup>;

Market capacity – gained 4 positions and moved to 99<sup>th</sup> position.

Global Competitiveness Index (GCI), which is determined by the World Economic Forum, measures the quality of macroeconomic environment, state of public institutions of a country and level of technological readiness. The rating is based on the publically open (statistical) data (WB; UNESCO; World Health Organization, IMF, etc.) and the research results conducted by executive authorities of the World Economic Forum and includes the completion of questionnaires by business sectors. It considers the strong and weak points of a country, identifies the priorities to encourage the implementation of political reforms. The research held in 2015-2016 included 140 countries. GCI covers three principal stages in country development (factor-driven, efficiency-driven, innovation-driven) that combine 12 pillars: The 12 pillars that are grouped into three factors include 114 indicators. Georgia has been a member of GCI research since 2004.

The table summarizes the information according to the ranking. <sup>1</sup>

Table 1: The position of Georgia according to the ranking

Ranking by Groups	Position in the World	Point (max. 7)
Basic Requirements	46	4.9
Institutions	43	4.4
Infrastructure	65	4.1
Macroeconomic Environment	40	5.2
Health and Primary Education	64	5.9
Efficiency Enhancers	69	4.1
Higher Education and Trainings	89	4.1
Goods Market Efficiency	46	4.6
Labor Market Efficiency	43	4.5
Financial Market Sophistication	58	4.2
Technological Readiness	65	4.2
Market size	101	3.0
Innovation and Sophistication Factors	113	3.2
Business Sophistication	102	3.6
Innovation	116	2.8

source:<sup>1</sup>

In spite of the fact that some of the indicators are improved, Georgia received low evaluation in several categories from the Global Economic Forum. Georgia maintains a good position in rating regarding the promotion from the state to start a business and reduction of state regulations. However, the situation is very unsuccessful in the field of regulation of domestic goods market. Particularly, Georgia holds 128<sup>th</sup> position by local competition. This is a very considerable fact. It points out the nonexistence of free competition and antimonopoly regulation in the country.

In Georgia, hidden monopolies exist in many fields. According to the official statistics, the small and average business held 15% portion in total business turnover of Georgia in 2014, while in 2000, only the small business portion was 33%. This value indirectly indicates that competition level at Georgian market has significantly decreased by almost 2,5 times in recent years, which is reflected in high prices on products and low quality. [6] The opinion is being propagandized in the society that antimonopoly agency will restrict private business which is wrong approach. In the countries with developed economy, the general function of antimonopoly bodies is to prevent the state from interfering in business because the state is the power which enables an entrepreneur with more preferred position compared with other competitors.

The leniency program, which is one of the main tools to fight against the noncompetitive behavior from an economic agent in the USA and Europe, is being introduced and established in Georgia. The program offers the economic agent the partial or total release from statutory responsibility if it collaborates to the agency during elimination of noncompetitive action. The leniency program enables the agency to obtain required information for the investigation regarding the noncompetitive

behavior of the economic agent. The functions of the agency and regulating authority were significantly marked of. Any kind of interference from the state which makes potential obstacles or directly impedes the competition is prohibited. Efficiency of competition policy and effectiveness of the agency is also improved during controlling the state assistance which is related to the facts of unlawful restrictions of competition, in order to provide open and transparent market, to protect principle of equality in business, to prevent government institution from establishing administrative, jurisdictional and discriminative barriers for entering the market and to avoid unlawful restriction of competition. [7],[14]

*- Why are the local Georgian entrepreneurs in haste to put antimonopoly legislation into force?*

In past, up to 70 flour-mill plants used to be operating in Georgia, while today, only one fifth of the mentioned number continues working. Majority of the companies which stopped working in the past years explained that the reason of their break was Azerbaijani company "Karat Holding". According to them, they could not withstand the competition and had to be closed. Those who stayed on market are on the edge of bankruptcy. Their share on market is reducing day by day and is taken by the Azeri company. The flour-mill plants are watching for the antimonopoly law because existence of such agency is their last chance to survive.

'Progresi' Ltd, which is located at Rustavi Highway, is one of the old flour-mill plants in Georgia. The plant is able to process 120 tons of wheat daily which is considered as a middle scale of production. The flour-mill plant sells part of the flour production at market and uses the other part of it to bake bread. The company continued to grow till 2007 when Azerbaijani company "Karat Holding" appeared on the market. The appearance of powerful competitor disturbed the peace on the flour market. The Azeri company entered the market with huge financial resources and purchased the largest flour-mill plants after two years. It grabbed the country's four biggest flour-mill plants out of five and became the leader of the market. The company holds "Karmenka" Ltd in Kakheti, flour-mill plant in Kachreti which owns the biggest 120 tons of grain storage elevator (large building is used to store grain and is equipped with elevating, conveying, ventilating, drying and other facilities). Besides, the Azeri company owns "Mzekabani" Ltd in Tbilisi and "Agrosistemebi" Ltd in Kvemo Kartli with Marneuli elevator which is the largest in Georgia and is able to process 600 tons of wheat a day. "Karmeni" Ltd, which is also included in the holding, allocates the flour-mill plant in Gori with 350 tons of daily production.

According to the data of Flour-Mill Plants Association, Karat Holding holds about 70% of flour market and 90% of elevators existing in Georgia (except port elevator in Poti). All four plants can process up to 1200 tons of wheat a day which absolutely satisfies daily demand of the country,

The flour-mill plants which still stay at market. Only 12-13 flour-mill plants out of 70 are going on working. Among them five plants are relatively big. All of the small and middle size flour-milling plants were closed. The monopolist Karat Holding does not leave even 20% of market free. They artificially raise or cut the prices at their convenience. All of the flour-mill plants will be closed very soon. There will be only one company on the market which will dictate prices and local farmers will be dependent on it. The farmers will have no way but to reduce the price if the company requests. The government of Georgia must manage the issues related to the monopolists by coercing them to work at 35% and leave space for other entrepreneurs to exist at market.

1100-1200 tons of wheat is necessary to satisfy the daily demand on bread for Georgian population. Karat Holding flour-milling plants manage to process 1200 tons of wheat a day. This means that this company has enough resources to meet the country's demands completely. At the same time, as we mentioned the company holds 90% of existing elevators. The company is able to store and keep large amount of purchased wheat in its own elevators. Other flour-milling plants does not have such resources. These issues endanger food market safety of the country. Moreover, the Azeri company owns the flour-mill plants in the areas where wheat is grown. As a result, it dictates prices to the local farmers. The competition almost disappeared from the market. The flour-milling plants are no more able to withstand the oppression. It is possible that they will stop flour-milling and start to import ready flour. [8]

The Competition Agency of Georgia studied the flour market in 2012-2015. According to the research, the Agency considers that the defendant economic agent, consisting of "Agrosistemebi" Ltd, "Karmeni" Ltd and "Karmen K" Ltd, as interdependent parties, is holding the dominant position at wheat flour goods market of Georgia. However, facts of abusing the dominant positions by them are not verified.

Georgia has always aspired to integrate with European Union structures. The country is a member of World Trade Organization and a part of multiple bilateral, regional, multilateral agreements and international organizations (that

collaborate within international competition field) as a full member or as an observer. Based on the abovementioned, the improvement of competition policy becomes inevitable in Georgia and therefore, we need to work to provide the elements, such as:

- Existence of clear and predictable rules of competition;
- Effective control from the state power to protect the rules;
- Reliable and transparent practice of execution.

In every country, the enhancement of competitive policy is considered as a crucial course. The opinion can be supported by the work of international organizations in this aspect, as well as by competitive policy of over 100 countries and steps made to maintain stability of the policy.

### **Recommendations**

Although, the agency has long been established, its role still remains ineffective and unfortunately, the events might continue the same like past years' scenario, unless necessary measures are taken that would encourage proper functioning of this service;

The antimonopoly service should timely start to monitor the behavior of monopolist companies at market in order to prevent them from abusing the dominant position. The idea should not be understood as "tighten the screw" policy because old and new laws do not prohibit the monopolist condition, but abusing this condition. For instance, a particular business might be quite successful, while having a good strategy and lots of customers and consequently, it can hold 70-80% of the market. In this case, the controlling body should not be interested in the size of the company's share on the market, but the body should avoid abusing such dominant position. In other words, to prevent the company from fixing such high prices or special conditions that would make troubles for customers;

Competition policy is very important for prevention of corruption in the country. Sometimes, so-called elite corruption, which is quite frequently talked about in Georgia, is expressed in granting the privileged conditions for particular companies (those with having political ties). The precondition for eliminating corruption is the presence of an independent and powerful competition agency which would be entitled with due proper capability and authority.

Newly-established competition agency could not be effective without active collaboration with regulation bodies (commission for communications regulations, gas, water and electricity regulation commissions)

It is essential to develop methodologies of qualitative and quantitative evaluations of market, as well as to create and improve methods of revealing the monopolies. Each of such documents should find out whether it restricts suppliers' number and customer's choice or not.

The antimonopoly service must be a regulatory agency which regulates the behavior of companies at the market so that to provide maximum social welfare and it should not be regarded as a crime-fighting institution. Crime-fighting is a prerogative of governmental powers and not of regulatory body.

The regulatory agency should establish sanctions, fines, pricing limits. The amount of fines should be equal to the social disbenefit; In all respects, the recourse distribution instrument will be ineffective and will create even more loss than it does during monopolies.

The regulatory commission should reveal monopolistic price and not a monopolist company. It is not the presence of monopoly that reduces social benefit, but only the monopolistic price provokes losses. To find the monopolistic price, the agency should investigate the market demand, i.e. the amount of products sold at different prices. Afterwards, the agency should collect information regarding expenses and incomes of the company and subsequently, it should calculate values of the company's marginal expenses and marginal incomes based on the information. The agency should also calculate the level of sales amount where the company's marginal expenses and marginal incomes equal to each other and bases on that, it should find out conformity of restricted demand amount to demand price. The result should be compared to the market price and only if they are identical, it could be considered that the market price is definitely monopolistic.

### Literature review

During the work, we discussed information material published in the following Georgian magazines:

The magazine – Economy and Business;

The magazine – Economist;

The magazine – SEU and Science;

The magazine – Science and Life;

The monthly magazine for entrepreneurs and finance experts – Audit, Calculation and Finances;

The magazine – Forbes Georgia;

The magazine – New Economist;

The magazine – Social Economy;

The magazine – Economy of Georgia;

The magazine – Tabula;

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