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***Environmental Sustainability of Georgian Economic Policies in  
2004-2013***

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(Working Paper)

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## **Acronyms**

**EU – European Union**

**FDI – Foreign Direct Investment**

**GDP – Gross Domestic Product**

**GNP – Gross National Product**

**HPP – Hydro Power Plant**

**HDI – Human Development Index**

**IMF – International Monetary Fund**

**SSE – Steady State Economy**

**UN – United Nations**

**WB – World Bank**

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## **Chapter 1. Introduction**

Georgia has gone through drastic socio-economic and political changes in the last few decades. However, most of the research conducted on Georgia is based on foreign policy issues and reviews the problems and perspectives of the country's relations with Russia, USA or European Union (Freire, M.R./Kanet, R. E., 2012; Darchiashvili, D., 2000). Another well-studied area is security studies (Felberbauer, E. M./Labane, F. eds. 2013; German, T. C., 2008, 2013; De Waal, T., 2010; Boden, D., 2011) and covers the conflicts with Abkhazia and South-Ossetia, as well as the topics of energy security. Security and foreign affair issues have dominated and outweighed the importance of internal problems in academic circles, public discussions, media and political party programs. Especially the questions of economic development in the environmental framework have been more or less left in shade. The academic literature on Georgia in the framework of sustainable development is quite scarce. There are certain organizations and researchers who work on environmental (NGO-Green Alternative, Matcharashvili 2012, Inasaridze 2013) or social aspects (Rekhviashvili 2012) of economic development but still, not in the framework of sustainability. It might sound paradoxical, but even though since 2010 the Georgian ministry of Economic development is called the ministry of Economy and Sustainable Development (there is also a special department for sustainable development), still no official sustainable development strategy exists (Gegeshdize/Gujaraidze 2005:2).

Therefore, this study aims to shed some light to economic policies and examine their compliance with sustainable development principles. The paper takes the Rose Revolution as a benchmark for policy reforms as a number of significant shifts have taken place since then. What kind of changes have actually occurred and how? How did the Rose Revolution government perceive development? What were the main principles and priorities guiding the reforms and policies from 2004 to 2013? What were the means and aims of development? These and other questions will be answered through this research from a rather narrow angle explained below. The hereby study aims to analyze: *How have the principles of sustainable development been followed in the process of Georgian economic development during Saakashvili's government (2004-2013) in the framework of environmental sustainability and why?* The main goal of the paper is to identify the understanding of

development by Saakashvili's government, analyze its compliance with sustainable development principles and study the reasons for their absence or existence.

As the concept of sustainable development is very broad, it shall be clarified that the understanding of this concept will be based on Amartya Sen's capability approach. Even though sustainable development combines political economic, social, environmental and cultural aspects, in the framework of this study the focus will be made on environmental sustainability of economic policies only. The environmental aspect is further narrowed down to two case studies: Forestry reforms and construction of Khudoni Hydro Power Plant. The economic policies, as well as environmental reforms based on the mentioned case studies will be analyzed with the focus on economic growth orientation, privatization, attraction foreign direct investments and public participation in the decision-making process.

The paper is structured as following: Chapter 2 provides a short review of the theoretical debate about development. It presents some of the major development theories and identifies their shortcomings, as well as justifies the choice of sustainable development. The chapter also defines the main theoretical concepts applied in the paper.

The following chapter (3) reviews economic policies. It provides a brief literature review on the empirical case and identifies the gap in analyzing Georgian economic development trends from the point of sustainable development principles. This part of the paper presents a brief historical background about the Georgian economy since the collapse of the Soviet Union in order to make the post-revolution policies more understandable. The main accent is made on Rose Revolution economic policies with the emphasis on privatization, property rights and investments.

The fourth chapter represents one of the key parts of the paper as it introduces the environmental dimension of sustainability. The chapter is divided into two parts along two case studies. The first sub-chapter (4.1) presents forestry reforms and describes the government's policy of privatizing the forest ownership rights in long-term perspective, while the second chapter analyses the construction of Khudoni HPP. These cases are discussed with the focus on privatization, investment conditions and conditionalities, as well as public involvement in decision-making process. The chapter explains the reasons for government's policies and identifies the violation of some fundamental instrumental freedoms.

## **Chapter 2. What is development - how to develop?**

*“How can we possibly give priority to the means of living, which is what treasures and wealths are, over the ends of good and free human lives” (Anand/Sen 2000:2032)*

Development studies emerged as an academic discipline in the second half of the twentieth century as a response to the heated discussions about possible development scenarios for new independent countries. However, post-communist countries have mostly been approached in the framework of transition theories. This study examines the development of the Georgian economy within the framework of development approaches. The main aim of this chapter is to review some of the dominant post WWII development theories, identify their shortcomings and justify the choice of sustainable development approach based on Amartya Sen’s ideas.

The proponents of transition studies<sup>1</sup> (Lavigne M. 1999; Pickles J./Smith A. 1998; Peck M/Richardson T 1992; Aslund A. 1992; Moses, J.C 2003; Peimani H. 2002) share several common postulates: pushing post-communist countries into West European direction, that is to say - establishment of market-economy, neglect of local cultures and traditions and negative assessment of communist past. These assumptions are very close to the main claims of Modernization theory from the 1940 and 50s. As Rekhviashvili argues, it is more relevant to study the ongoing processes in post-communist countries in the development framework, while transition approaches limit the scope of research to “looking at how close is the country to textbook democracy and capitalism ideals” (2012:4-5).

Development studies incorporate a variety of theories, many of which can be grouped under development economics. This field studies economics in developing countries and combines different areas of knowledge, such as: economy, anthropology, sociology, political science, biology, and demography (Ray 2007:1). One of the dominant development theories during the last 60 years

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<sup>1</sup>Most of the transition authors (Lavigne M. 1999; Pickles J./Smith A. 1998; Peck M/Richardson T 1992; Aslund A. 1992; Moses, J.C 2003; Peimani H. 2002) argue in favor of market economy based on modernization theory principles, but there are also some scholars (Chang H.J./Nolan P. 1995) who assess such rapid transition processes critically and call for more carefulness.

has been the theory of Modernization<sup>2</sup>. The theory considers capitalism as the key factor for economic growth and urges for political modernization in terms of changing the governance forms in developing countries, as well as the growth and ‘naturalisation’ of political and economic institutions. “[...] in reality this ‘naturalisation’ was Westernization in disguise” (Joshi 2005 np) as the development principles are meant to follow western standards (ibid.).

The idealization of the west in modernization theory has been widely criticized by the proponents of dependency theory<sup>3</sup> in the late 1940s. The name *dependency* is meant to underline the dependence of the west on developing countries in terms of resources and cheap labor. Underdevelopment is viewed not as a condition, but as a process in relation with development, as two sides of the same process. According to the main assumptions of the theory the western world is responsible for the poverty in developing countries as a result of colonialism and imperialism (Joshi 2005 np). Thus, if the modernization approach takes the West as a role model for developing countries, the dependency theory blames the same West for most of the miseries in these states.

In similar with the pioneers of development economics (Rosenstein, Chenery, Hirshman, Lewis, Rostow) neoclassical development theory (Bhagwati and Krueger) also perceives development mainly in terms of growth. They believe in international trade as a way of development and promote the idea of “open-economy growth, tariff and subsidy reductions, more uniform tariffs and less generalized bias towards imports” (Adelman/Morris 1997: np). The classical and neo-classical development theories focus on the role of human and physical capital productivity which is the key for economic results (Rekhviashvili 2012:8).

Hence, the above reviewed development theories mostly examine two dimensions of development (economic and political), focus on growth in economic terms as the main sign for development and view humans as human capital – one of the resources in the production process. Furthermore, such approaches can be grouped under those theorists who argue that development is a tough process and it cannot be achieved without sacrificing such “soft-headed” (Sen 1999:35) values as social safety and social services until the country achieves a certain level of development. However, these approaches are quite narrow, provide ready-made ‘success’ recipes without focusing on single country cases and ignore many dimensions of development. Therefore, the paper is based on a

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<sup>2</sup> W. Rostow – Linear Stages of Growth Model, D. Apter, S.M. Lipster, D. McClelland, E. Said

<sup>3</sup> R. Prebisch, H. Singer, C. Furtado, T. D. Santos, F. H. Cardoso, S. Amin, A. G. Frank, I. Wallerstein

broader understanding of development - sustainable development approach, (considering Sen's ideas), where development is understood as a "friendly process" (ibid.) with the special emphasis on the "soft-headed programs" (ibid.).

It is argued that (Adams 1993; Latouche 1993; Max-Neef 1992; Sacks 1992; UNDP; 1992) economic growth can be a misleading indicator for development as it does not always reflect the living conditions of the population (Estes 1993:2). There are countries that have experienced economic growth without major improvements in living conditions and those that reached high living standards without significant growth in GDP per capita (Anand/Sen 2000:2032).

The mainstream development measurement tools, such as GDP - have been widely criticized. Daly argues that GNP as a measurement tool does not differentiate sustainable and unsustainable capital consumptions. Furthermore it does not include the "informal" (Daly 1996: 40) economy. The household and volunteer sectors are also being ignored in the GDP (Cobb/Halstead/Rowe 1995:60). Bossel claims that GDP cannot be an adequate indicator for wealth and well-being as it only focuses on the transformation of resources into money, but ignores its influences on the society (1999:12).

However, several alternative indicators to GDP have emerged<sup>4</sup> that try to incorporate more dimensions: literacy, life expectancy, environmental and social aspects (Bossel 1999:12). The concept of sustainable development unites various theoretical perspectives and has therefore made a significant input in development studies. The approach takes into account more dimensions than just political and economic. According to Estes there are four main aspects: ecological, economic, political and cultural (1993:8); while Bossel provides a longer list and also includes material, social, legal and psychological dimensions (1999:2). As some scholars (Piel, 1992; WCED, 1987; Wheeler, 1992) argue, one of the advantages of the approach is its systemic character in contrast with other sectoral approaches to development.

The concept of sustainable development<sup>5</sup> is not a new idea as it has roots in philosophy among utopian writers<sup>6</sup> and is also strongly connected to environmental and social movements of the

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<sup>4</sup> For example: Index of Sustainable Welfare (ISEW), which transformed into GPI later. GPI – genuine progress indicator: household and volunteer economy, crime, other defensive expenditures, income distribution, resource depletion, loss of leisure (Cobb/Halstead/Rowe 1995:71-72).

<sup>5</sup> The term first appeared in the Swiss-based World Conservation Union report on World Conservation Strategy: Living Resource Conservation for Sustainable Development (1980) (Estes 1993:3)

<sup>6</sup> Dante, Sir Thomas More, Kant, Rosseau, William Penn, Woodrow Wilson



1960s<sup>7</sup> (Estes 1993:4). The emergence of sustainable development in the mid-1980s<sup>8</sup> was strongly related to the need of new development paradigm after the failures of UN, World Bank and IMF development strategies that led developing countries into further debt (ibid.:2). Interestingly, the proponents of free market criticized the sustainable development approach with the appearance of the Brundtland report and they even referred to it as "a euphemism for environmental socialism" (Cleaver 1997:4).

By now different understandings of sustainable development<sup>9</sup> have emerged. Therefore, it is important to review and specify the meaning of this concept for this study. The analytical framework of this paper is based on Amartya's Sen's understanding of development. Some might be skeptical about applying Sen's ideas to sustainable development as his name is rather connected to human development index, (Estes (1993) even considers human development theory as the only challenging idea for sustainable development), but this study argues that those two ideas are complementary and one does not exclude the other. Even though, the concept of HDI does not explicitly discuss the environmental dimension, there are authors (Haq 1995; Chambers 1992; Cosbey 2003) who work on combining human development and sustainability in their analysis and Sen (2000) himself also studies the relations between development and environmental sustainability (Harris 2003:6).

Amartya Sen pictures development "as a process of expanding the real freedoms that people enjoy" (1999:36). It means the increase in human capabilities, as they are "the ends of development, rather than the mere means" (Grasso/Giulio 2003:3). Sen claims that it is not most important what people own but "what a person *is*, or can be, and does or *can do*" (Rekvhiashvili 2012:7-8, italics in original). He opposes the utility approach and argues that only the commodities do not define well-being, but it is also crucial how these commodities are being used by consumers (ibid.). The main idea of the capability approach is to "achieve different combinations of functionings, and define the

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<sup>7</sup> Sustainable Development related movements from the 1960s: Environmental/ecological, Anti-War & Anti nuclear, "World Order", "Green", "Alternative Economics", Women, Indigenous People, Human Rights movements (Estes 1993:5-6).

<sup>8</sup> The issue was raised in the Brundtland Commission report "Our Common Future" (1987)

<sup>9</sup> There are two main types of sustainable development: strong (Daly 1995) - <sup>9</sup> "substitutability between natural and manufactured capital is limited" and weak (El Serafy 1996) - "the total value of manufactured plus natural capital remain constant over time" (Harris 2003:4).

freedom to choose the life that she prefers” (ibid.:4). ‘A functioning is an achievement, whereas a capability is the ability to achieve’” (Sen 1987: 36 cited in Grasso/Giulio 2003:4). See Annex 1.

Thus, Sen understands development not in narrow terms of material wealth only but he opens up its meaning to guaranteeing certain freedoms for humans as tools and end results. Freedom has an essential role in the definition of sustainable development, as well. Furthermore, the mainstream approach does not admit the importance of examining the real opportunities of humans (Anand/Sen 2000:2031), while neo-classical theorists view sustainability only in the framework of maximizing welfare which is sometimes equalized to maximizing “utility derived from consumption” (Harris 2003:2). In addition, Anand and Sen put emphasis on the quality of human life as an end for development rather than picturing humans only as “[...] the means of production and material prosperity...What is to be sustained is the nature of the lives that people can lead” (Anand/Sen 2000:2039-40).

Interestingly, Amartya Sen does not accept the UN definition of sustainable development completely. (According to UN: “Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs” (1986:1)). For Sen, humans cannot be reduced to needs only, as there are also values that “cherish their ability to reason, appraise, act and participate” (Sen 2004 np; Grasso/Giulio 2003:3). Therefore, Sen raises the question about sustainability and environment in relation with sustaining freedoms to choose certain values and strive for their fulfillment, which goes further than simply meeting human needs (ibid.; ibid.:2).

Anand and Sen raise a very interesting point connected to intragenerational equity, which is otherwise very often missing in discussions. The concept of sustainable development mostly focuses on respecting the rights of future generations; it is also valid to think about the rights of other people in the same generation who suffer from poverty, hunger and other problems. “This is precisely where the significance of human development as a means comes in” (Anand/Sen 2000:2038).

Thus, Sen’s ideas offer multidimensional analysis of development. Here, development does not focus on economic growth only but also includes political, social, environmental and cultural factors; humans are not taken as simple production resources; sustainability is not limited to meeting only the needs but a very important topic of freedom enters as means and ends of sustainable development. This paper argues that economy shall exercise growth but the main question should be

*How does the growth happen?* - what matters most is the quality of growth. In other words, the main aim should not be the growth in absolute numbers but its quality shall be questioned based on accompanying changes in employment, income inequality, trade imbalances, production sectors and ecology.

### **Chapter 3. Does Economic Growth Equal Development?**

*“[...]economic growth cannot sensibly be treated as an end in itself. Development has to be more concerned with enhancing the lives we lead and the freedoms we enjoy” (Sen 1999:14)*

The Georgian economy has gone through many ups and downs since the break-up of the Soviet Union. Even though the focus of this paper is the period of Saakashvili’s presidency and thus only the reforms launched at that time, it is hard to understand those reforms and policies (employment, trade imbalances, income inequality, debt levels, FDI, production levels) without a short historical overview. Therefore, this chapter provides a very short review of the Georgian economy since independence and identifies the main issues and clarifies the choice of ‘neo-liberal’ policies by the government in the first years of independence and the ignorance of social and environmental issues.

Seventy years as a Soviet republic had a significant influence on further development of Georgia after the independence. Soviet Union economy was based on the following principles: priority was given to industrial development; member countries were specialized only in specific sectors and therefore were strongly interdependent, market was governed based on the command system and national interests were under the central Union interests (Herzig 1999:120). In the USSR, where corruption, clientalism and patronage were the basis of all types of relationships, economic sphere was largely based on “shadow economic elite” (Wheatly 2005:19) which functioned as a form of parallel state. The black market presented a big share of the national economy in Georgia also after the independence and reached 86% of the total economy by the end of 2003 (Tsikhelashvili/Shergelashvili/Tokmazishvili 2012:3-5).

Thus, after the break-up of the Soviet Union Georgia inherited many socio-economic and political problems from the USSR: dependency on other republics, lack of cash and budget deficit, industries that were unable to meet the needs as they were dependent on other markets in the USSR, unemployment, inflation, energy shortages and rising prices (Peimani 2002:14-19). In addition, the political and management bodies were not capable to deal with all these problems adequately

(Herzig 1999:121). Since 1991 people were constantly emigrating (unofficial data – 80,000-1 000 000 emigrants) to different countries and therefore remittances represented one of the most important way of income for those who stayed in the country (Herzig 1999:144, Nichol 2013:11). In this desperate situation the Georgian government had an attempt to liberalize the economy. The Soviet regime and economic system heritage, as well as rapid terms of changes resulted into the situation where businesses didn't pay taxes, dependence on informal economy increased and consequently revenues decreased sharply. The Georgian government under Shevardnadze's presidency couldn't handle the issues of accommodation of global capital flows and the encouragement of market growth. Therefore, the overall result was recession. As Jones notes: "For two decades Georgia has not been 'marketized', but 'monopolized'" (2013:183).

Economic situation after the Rose Revolution (2003) was quite dramatic in the country. More than half of the Georgian population (52%) lived with an income which was below poverty line (Papava 2013:3). The debt level had reached 50% of GDP (Gursoy/Chitadze 2011:39) and the shadow economy represented 64% of GDP (Jones 2013:180). The new government decided to launch a number of reforms to liberalize and modernize the economy (Tsikhelshvili/Shergelashvili/Tokmazishvili 2012:3) such as: eradicating corruption, simplifying taxation system for business and investments, giving employers freedom and flexibility in relation to their workers. Consequently, these reforms were accepted as neo-liberal take-off (Papava 2013:4). Rekhviashvili refers to the Georgian state in 2004-2007 as a minimal state, when the main priority for the government was to modernize and Europeanize the country. Development was understood mostly in terms of economic growth based on liberalism principles, where the state is not involved in the economy and private sector has been encouraged to take over the economy, as well as social problems (2012:3).

However, officially declared goals and policies that could have been called 'neo-liberal', were not the guarantee of any success for the country from the beginning even in case of their fulfillment. Neo-liberal orientation for the state already meant getting rid of responsibilities to handle social problems, as well as disregard ecologic problems in economic decisions. "Many have recognized Neoliberalism as a whirling maelstrom of greed, hot money, narrow vision and brutal violence threatening to suck down and destroy all who come within its reach" (Cleaver 1997:6).

Furthermore, neo-liberal basic principles and postulates come into contradiction with the ones of sustainable development. The main development indicator for neo-liberals is economic growth. The Rose Revolution government also started launching new policies and reforms with the absolute focus on economic growth.

However, as the result of declared and well promoted 'neo-liberal' policies, Georgia even received the "top reformer" (Bodewig/Kurt 2007:np) title from the World Bank in 2006. Interestingly, in the same period of time Georgia was rated as "mostly unfree" (ibid) country by the Heritage Foundation and the Wall Street Journal. It should be noted that most of the economic reforms were implemented in specific spheres that were considered as most important: finance, energy, armed forces. However, these reforms with their sectoral focus were rather directed on gaining the good will of the Western institutions than addressing internal socio-economic problems. "The international focus has blurred the lens pointed towards the domestic scene" (Tatum 2009:168) and therefore income inequality and unemployment still represent significant problems for the country (Papava 2013:6).

The government mainly focused on encouraging the development of market economy and attracting as many foreign investments as possible (Bodewig/Kurt 2007:np). The investor oriented policies had resulted into the increase of foreign direct investments: since 2003 net FDI increased by roughly US\$200 million (reached US\$539.3 million in 2005) and almost doubled by 2006. Nevertheless, this trend in investments was not sustainable as it was mainly based on privatization revenues. After selling most of the major state-owned properties, investment could not increase unless it moved to Greenfield investment sphere (ibid.). Jones poses very valid questions: "Do these investments impact economic well-being or poverty levels? Do they lead to the retention of native skilled personnel and provide training for future industries? Does it help small businesses?" (2013:181-182). FDI itself does not guarantee positive impacts in all spheres. As an example, if in 2012 FDI increased by 188% in transport and communication, the employment in the same field fell by 1,9% (ibid.).

Saakashvili continued the process of privatization in 2004-08. Privatization process was launched with many misdeeds: plans were made too fast, people and institutions were not ready for rapid changes, rules were not always followed, the population was not consulted on selling the strategically important objects, private owners were hardly controlled after the purchase of the assets, there was a lack of information about buyers (Jones 2013:200).

The result of privatization was economic growth. In 2003-2008 – nominal GDP grew from \$4 billion to almost \$13 billion, GDP per capita - \$1,188 (2004) to \$2,925 (2008), taxes 13,95% of GDP to 24.9% of GDP (Jones 2013:184). Despite the fact that the Georgian GDP has grown and corruption has also been reduced, the development of the country cannot be considered as sustainable as poverty and income inequality still remained high, high emigration rates and loss of human resources presented significant problems (University of Gothenburg 2009:1-2). Almost 1.5 million Georgian emigrants are abroad and their remittances constitute almost US\$2 billion a year. These remittances comprise 20% of the country's GDP (Bodewig/Kurt 2007:np).

Stephen Jones argues that it is not adequate to assess the Georgian economy based on GDP growth terms, good evaluation from the World Bank (Georgia was on the 15<sup>th</sup> place in 2009 in the Doing Business Survey) or construction boom in Batumi and Signakhi (2013:179). Furthermore, when one discusses the GDP growth it has to be analyzed in comparative terms. For example the GDP level in 2007 was only 50% of the one in 1989, foreign trade has increased but the trade gap has increased as well (Jones 2013:2013). In addition, GDP does not explain the production process and actors. In the Georgian case more than 70% of production is generated by industrial enterprises and only 15% comes from SMEs. The picture is absolute the opposite in the EU (ibid.:186-187). The Georgian economy is based on increasing consumption levels rather than producing; 30% of products exported from Georgia are not originated from the real sector of the economy (Papava 2013:4-5).

Interestingly, even though neo-liberal economy could not have been the guarantee for sustainable development, the declared neo-liberal principles were not followed by the government (violation of property rights, enabling monopolies to function through wiping out the anti-monopoly law and the emergence of elite corruption). Taxes and laws, as well as court system have been used as a changed face of government patronage. Deregulation policies resulted in the change of control mechanisms rather than free economy (Jones 2013:184). Therefore, the Georgian economy was referred as “Neo-Liberal Fancy” (Jones 2013:4 cited in Papava 2013:4); “Authoritarian Liberalism” (Jobelius 2011 cited in Papava 2013:4), or “Symbiosis of Neo-Liberalism and Neo-Bolshevism” (Papava 2009, Waal 2011:13 in Papava 2013:4).

Thus the economic development of Georgia since the Rose Revolution was mostly oriented on growth. Even though growth was achieved, it was temporary as it was mostly based on FDI through privatization. Furthermore, the productivity of the economy, trade imbalances, high unemployment and income inequality levels could not lead the state to sustainable development. In other words, the Georgian economic development did not follow sustainable development principles, as the declared understanding of development from the beginning was neo-liberal and growth-oriented, but in practice it even violated these principles in many aspects.

#### **Chapter 4. Economic Profits vs Environmental Losses**

*“Though you drive nature out with a pitchfork, she will still find her way back” (Horace)*

Economic development cannot be considered sustainable if it is not in harmony with the environment. Quite often it is tempting to neglect certain economic projects and consequently monetary short-term profits on the expenses of exploiting the environment. When it comes to environmental costs and benefits Georgian reality is quite dramatic. The previous chapter already raised the issue of growth oriented economic policies during Saakashvili’s presidency, where the most important variables of success and development were understood in terms of increasing numbers. Furthermore, these attitudes seem to be an overall political approach in Georgia and not the characteristic of Saakashvili’s party only. According to the analysis of Green Alternative based on political party programs and interviews with their representatives, ecological issues and sustainable development do not have significant importance for the parties. Some parties did not even mention the environment in their party programs (Green Alternative 2012:2; Kveliashvili 2012:np). Therefore, this chapter aims to present the importance of environmental factors in economic decisions and analyze the situation in Georgia by discussing two case studies: Forestry and Khudoni Hydro Power Plant. The choice of these two examples does not mean that environmental concerns are limited to these areas in Georgia, but the aim is to narrow down the problem in scope of this study and present one of the most disputed ecological issues in the country. These case studies will be analyzed across four interrelated issues: *privatization* with the aim of attracting *investments* and achieving *economic growth*, as well as the *ignorance of public opinion* in the decision - making process.

As already mentioned above, often economic growth and environmental issues contradict each other. Common and Peering (1992:7) argue, that on the theoretical level this is the mismatch between economic efficiency and ecological sustainability, i.e. ‘Solow-sustainability’ vs ‘Holling-sustainability’ (Harris 2003:5). Daly argues that the responsibility of ecological sustainability cannot be left up to the market, as economists are focused on maximizing their profit (1996:32). A very common problem arises in the cost-benefit analysis, where environmental factors or losses are not taken into consideration. For example, when the income from forestry activities are measured, the regenerating costs of the forest are being ignored and only the value of timber, as well as other products and the extraction costs are included in the analysis (UN 1986:10-11). There are different opinions about measuring environmental costs in economic decisions<sup>10</sup>. It is not the aim of this paper to discover the right methodology for this measurement but to show that it is possible to calculate ecological loss.

#### **4.1. Privatization of Forest Ownership Rights**

Deforestation is a serious problem in Georgia. Since the late 1990s logging activities have taken place on an unprecedented level in Georgian history. As a result, forest has lost its functions in terms of protecting soil, keeping water, etc., as well as the capability to recover itself. Deforestation creates such dangers for the country as: maintaining soil and water, as well as biodiversity. In particular, those forests that were under kolkhoz ownership in the Soviet Union are in bad condition. Very often poor population is involved in illegal logging activities which are part of illegal businesses (Georgian Parliament 2013:4-5). One more problem in the Georgian case is to acquire the accurate information about forestry and logging because of unregistered activities (WWF Caucasus Program Office 2012:5).

The new (2013) strategy of the Georgian parliament identifies the following problems in forestry: improper legal framework, weak institutions and the violations of law, ignorance or inadequate assessment of forest values in the decision making process, the absence of experience to assess environmental protection. Since 1982 there has been no inventory in the forests (Inasaridze 2013:8) and therefore the government does not have adequate information about the current condition of Georgian forests that represent 40% of the total area (Georgian Parliament 2013:4-5). Furthermore, there has not been any categorization of forests done, which is quite important as different types of

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<sup>10</sup> Conventional Market approaches, Hedonic Pricing, Experimental Methods, Contingent Valuation Methods, Household Production Functions (Gatto/De Leo 200:348)



forests require different management strategies (Getiashvili 2011:np). The awareness about these issues is very low (Georgian Parliament 2013:4-5). Getiashvili R. (the coordinator of Caucasus Environmental NGO Network) argues that there is this overall attitude in Georgia that ecology and environmental protection is a barrier for economic development. Even though government officially admits the importance of sustainable development, there have been hardly any projects implemented in this field (interview with Getiashvili by Tsotsoria 2011).

Before the Soviet Union forests were in the ownership of state or communities, villages, churches and other private owners. With the creation of the Soviet Union in 1921 all the forests were assigned to the state ownership under the governance of Commissariat for Agriculture. Since 1923, part of the forests stayed under State management, while the other part was given to local or collective farms in the form of permanent tenure, referred as kolkhoz forests. The first forest code of independent Georgia was adopted in 1995 (“On Changes and Amendments to Forest Code of Georgian SSR”) which declared forests (allocated forests, nature reserves) as state ownership. However, until 1999 the forest was still regulated in Soviet style (Matcharashvili 2012:4).

According to the Forestry Codex of 1999, the protection of Georgian forests and its sustainable management principles are based on the constitution<sup>11</sup>. However, no official forestry policy and strategy document exist. Furthermore, the existing laws about forestry do not guarantee the protection of forests (The Parliament of Georgia 2014:36-37). The problem in Georgia is not the absence of legislation on forestry but rather its implementation. In addition, current need and necessities are not studied well enough and local legal documents are not easily accessible (Uni of Gothenburg 2009:11). Thus, legally and officially the legislation is in place and the country has ecological responsibilities on national and international levels, but the spoken and written words stay far from the fulfilled practices.

The Rose Revolution government decided to ‘take care of the environment’ but the attitudes towards the environment turned out to be ignorant and focused on economic profits only. In 2003 the “Forest Development Project” was adopted (with the help of World Bank) which was soon stopped because the Georgian government did not meet its obligations and requirements included in the agreement (Matcharashvili 2012:5-6). In 2005 the Strategy and Action Plan of Biodiversity (under Gov. Resolution 19.02.05 No.27) was adopted. The document highlights the importance of sustainable

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<sup>11</sup> Georgia has signed the following agreements on: Air Pollution, Biodiversity, Climate Change Protocol (Kyoto Protocol), Desertification, Endangered Species, Hazardous Wastes, Law of the Sea, Ozone Layer Protection, Ship Pollution, Wetlands (CIA) (Inasaridze 2013:1)

development in general and sustainable forestry management in particular (It includes a chapter on Sustainable Forestry). However, the plan represents more or less a repetition of the World Bank project and does not apply to Georgian reality.

The resolution of 2005 (August 11, N132) also regulated the licenses about logging and hunting; private companies were allowed to get the use of forests from 1 up to 49 years (The Parliament of Georgia 2014:37). Even though forests still remain in the state ownership, the rights over these forests have been transferred to private entities, which is also one of the forms of privatization (Inasaridze 2013:3). However, no inventory was done before leasing this type of regulation and most obligations were put on investors. By now 5% of forest is given to the private sector in the framework of this regulation (The Parliament of Georgia 2014:37). Because of the absence of data and exact information about forests, the prices of ownership rights were not determined correctly. In some cases, investors paid more money than the actual cost (for example Chinese received 30-40% less forest than they were supposed to) while in other cases ecologically sensitive forests were given to investors because of absence of categorization (Inasaridze 2013:5). Furthermore, in some cases population was left without the access to forests near their villages, this affected their income and living conditions (ibid. 7).

In May 2011 in the framework of the Law No.4677 (“On Changes to Georgian Forest Code”), significant changes were made in law as the concept of social cutting<sup>12</sup> has been introduced. Furthermore, log transportation, processing was regulated and the period of using the forest was increased from 29 to 49 years (Matcharashvili 2012:9). In July 2011 the ministry of Energy and Natural resources adopted new regulations for leasing all forests in Georgia for the period of 49 years with the perspective of permanent ownership in case of no violations of the agreement; this omitted the possibility of creating protected areas in the country. This decision was criticized by NGOs. The justification of the minister Alexander Khetaguri was based on economic growth. According to him “it was better for Georgia to use its resources for income and not just preserve them”. Even though investors had to fulfill certain obligations (like protecting the forest from fire and erosion, allowing social logging, planting new trees for cut trees etc.), the Georgian government avoided the responsibility to inventory the forest before it would be leased with the excuse of lack of time and barriers in the leasing process. Thus the inventory became the responsibility of investors

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<sup>12</sup> “implementation of appropriate arrangements of providing wood for noncommercial purposes to population, budget organizations, legal entities of public law and Georgian Orthodox Church” (Matcharashvili 2012:9)

through certified professionals approved by Forest Stewardship Council. The ministry announced incredible trust to investors with the belief that they would not be interested in falsification (Gvelesiani 2011:1-3).

As the licenses have been abolished and forests can be leased, investors are allowed to use any type of natural resources without a special license in the framework of leasing and they can even change the features of forests and organize it according to their will (interview with Getiashvili by Tsotsoria 2011). As a result of private ownership reforms, the revenues from timber harvest increased, but however the environmental costs that would have been more than profits have never been measured (Inasaridze 2013:5).

Thus, the policies implemented in the field of forestry during the Saakashvili government were oriented on short-term economic growth and lacked the dimensions of sustainability. The absence of adequate action plan, the lack of information about illegal activities, no inventory or categorization of forests for the last several decades, privatization of forest ownership rights for up to 49 years and allowing investor to use the forest according to their priorities, no monitoring system on investor activities and excluding public opinion in all these decisions indicate the unsustainability of the policies. Furthermore, violation of property rights, corruption and transparency issues in the process of privatization makes the declared neo-liberal character of policies questionable.

#### **4.2. Khudoni Hydro Power Plant**

The Khudoni HPP is planned to be built in West Georgia (2010 m above sea level) on the Enguri River. According to the Saakashvili government the construction process should require 4-5 years and USD 500 million. The power plant is expected to produce 1.7 billion kw with the installed capacity of 700 MW<sup>13</sup> (Barbakadze 2012:36).

The idea of building Khudoni HPP appeared in 1979. The actual construction process was started in 1986. After the earthquake in Armenia (1988) the danger of seismic risks appeared and shortly afterwards with the dissolution of the Soviet Union and protests against Khudoni, the project was stopped. In 1990 the Shevardnadze government raised the idea of Khudoni HPP again in the context of energy crisis (Kvnachalishvili 2013 np). This idea was widely criticized because of its possible

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<sup>13</sup> The project envisages the construction of an arch dam at crest with columns, with a height of 170metres, including 141 arch part. The length of the dam would make a reservoir with a volume of 230 million cubic metres (<http://greenalt.org/themes-2/energy/khudoni-dam/>)

negative impacts on the environment and the need to resettle several villages. (The region – Zemo Svaneti – where the construction should take place - has been UNESCO heritage since 1996). The construction process will require flooding of quite a big area, where forests and endemic species will be endangered<sup>14</sup> (Green Alternative np nd). In total, 530 hectares will be flooded, which includes 27 villages (525 families – around 1500-2000 people), the Jvari-Mestia motorway, farming lands, cemeteries, church, historic monuments and furthermore, many species will be endangered (Barbakadze 2012:36). Most of the families are totally against the construction process because of unspecified compensation and the fear to lose graves, churches and cultural monuments as a result of flooding. The environmentalists are concerned about the project as the region is seismic active and there is also the danger of landslides, as well as possible threats to the health of the local population (Kvanchilashvili 2013 np).

As a result of critique and protests against Khudoni, the construction process did not proceed significantly until the Rose Revolution. The Rose Revolution government brought up the idea of Khudoni HPP shortly after the revolution. In 2005 World Bank got involved in the project and offered the Georgian government USD 5 million for the preparatory works for HPP with the aim to contribute to Georgia's energy independence, even though the project is export oriented and the energy is supposed to be sold to neighbor countries (Green Alternative np nd, Kochaldze/Getiashvili 2007:11). In 2009 WB published its results that claimed that those risks were not significant (Kvnachalishvili 2013 np). This report became a good justification for Georgian officials and experts to promote the idea of building Khudoni (Georgia Today 2014:9).

Thus, the investor (Trans Electrica) was found and in 2009 the Memorandum of understanding was signed with the Georgian government (Trans Electrica). In 2011 the ministry of Energy, Khetaguri signed the official agreement with Trans Electrica. The main declared reasons behind Khudoni are economic profits and energy security. However, these two points are highly disputable. According to the official information, Trans Electrica will invest 1.2 billion dollars in the project and will pay more taxes than now after the exploitation of the HPP. “During the operation of the Khudoni HPP, the company will pay 20 million GEL in the form of annual profit tax; an income tax worth 20

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<sup>14</sup> “This includes different forest bird species, a community of large raptors (golden eagle, griffon vulture and lammergeyer), and endemic birds including the Caucasian black grouse, the Caucasian snowcock and the Caucasian chiffchaff. Mountain goats, chamois, brown bear, wolf, lynx, roe deer, and wild boar are quite common”. <http://greenalt.org/themes-2/energy/khudoni-dam/>

million GEL will also be paid during the construction of the plant and an additional 4.5 million GEL after the completion of the construction when some 350 people start working on the plant, each receiving an average salary of 1,700-1,800 GEL...the country's Gross Domestic Product will increase by 1.1 percent” (Kvanchilashvili 2013 np). Chipashvili D. argues that even this main argument of the government based on economic growth is not based on true calculations as budget revenues will not be as high as claimed in the official document. The mismatches have been detected not only in terms of revenues and GDP growth but also in the number of potentially employed people (Chipashvili 2014). Based on the leaked WB document the construction costs will be way higher than declared (USD 780 million) and the economic profit will be only 5% (Green Alternative np nd).

As for the energy security, it is vague how Khudoni will contribute to increasing Georgian energy security, when most of the energy is meant to be exported. The World Bank also declares that the energy produced by Khudoni HPP will be exported and this is supposed to encourage Georgian participation in energy trade on the regional level. Therefore, it is unclear how the project approaches the existing issues in Georgian energy sector domestically (Kochaladze/Getiashvili 2007:20). The main argument behind Khudoni is cheap electricity that should encourage the competitiveness of Georgia on international market (Kvnachalishvili 2013 np). This argument has also been questioned; as a result of big investment in energy the price for electricity will increase for Georgians (Green Alternative np nd).

The transparency of the project is questionable. There are many questions (who is the investor? What experience do they have?) about the investor who has been trusted to take over such a big responsibility of constructing a huge HPP in a vulnerable environmental place. It is only known that the investor company is called Tran Electrica which is registered on Virgin Islands is not experienced in constructing hydro power plants (Chipashvili 2014). The officials usually avoid extra questions about investors and declare the information to be confidential (Chipashvili 2014).

Furthermore, the agreement ignores the environmental and social aspects of the project. The Ministry of Environment has criticized the official document about environmental influences of the HPP. The detailed ecological and economic cost-effective analysis of the project is not provided. There are some mismatches in figures about forest area that will be flooded. However the governmental document mentions less amount of forest being cut as it actually should be. In

addition the document lacks the information about the reaction of the society, their involvement in the project (Netgazeti 2013).

Private property rights have been clearly violated; from the beginning the whole area for the HPP was given to the investor for USD 1, basically for free (Barbakadze 2013:37). Part of this area belongs to local inhabitants where they live or fields where they work. Furthermore, the issue of compensation remains unanswered. According to the law the private property cannot be expropriated without the agreement about the compensation with the owner. In addition, there is no developed settlement plan for the population who lives in the area, as well as no details are provided about socio-economic rehabilitation of these people (Netgazeti 2013).

Last but not least, wider public as well as local population of Svaneti have been excluded from the participation in planning and decision-making process. According to one of the local inhabitants of Khaishi: “If everything is for public, first they should ask the same public. When they decide to take the loan [for Khudoni HPP] , this would be again the burden on the people’s shoulders... Before you sit somewhere and bring the verdict against the people, ask the same people what they think, what ails them and why” (Kochladze/Getiashvili 2007:16).

Thus, Khudoni HPP is a project that totally ignores the environmental and social effects. This underlines once more the growth oriented policies of Saakashvili’s government. However, as in the case of forestry issues, here even the economic profits are questionable.

Summing it up, such decisions by the government can only be justified through the growth-oriented understanding of development but it is no way in compliance with sustainable development principles. According to Sen, the active participation of citizens has a crucial meaning in the environmental protection and is directly connected to the freedom of participation (Sen 2004). “[...] the liberty of political participation...[is] among the *constituent components* of development” (Sen 1999:5). Besides the freedom to participate these issues can be directly connected to some of Sen’s instrumental freedoms: political freedom and transparency. Political freedoms include the freedom of political participation and expression, along with other aspects. While, transparency guarantees shall prevent “corruption, financial irresponsibility and underhand dealings” (Sen 1999:39-40).

As citizens, public has rights to exercise freedom of political involvement, as well as the right to acquire the transparent information from government bodies. In case of forestry reforms and

Khudoni HPP all these freedoms have been violated and therefore the process of development as freedom has been hindered by the government.

Thus, the environment reforms and policies during Saakashvili's presidency were based on 'neo-liberal' understanding of development and therefore focused on economic growth. Quite often environmental factors were neglected and losses or costs were ignored. However, it should be highlighted that even these neo-liberal policies were not fulfilled sufficiently and there were many issues with private property rights, auctioning and corruption. Furthermore, the freedom of public to participate in such decisions has been absolutely neglected and therefore the political and transparency instrumental freedoms have been violated.

### **Chapter 5. Conclusion**

To sum it up, this study has addressed the issues of development of Georgia during Saakashvili's presidency. It aimed to investigate whether the government has followed sustainable development principles in the environmental context or not. The study focused on the following aspects of economic policies: privatization, foreign direct investments and property rights, as well as public participation in decision-making processes. As long as the concept of sustainability is quite broad, this paper reviewed the environmental aspect of sustainability on two case study examples: the privatization of forest ownership rights and the construction of Khudoni HPP. The main findings of the study can be summarized as following: the Georgian government under Saakashvili's presidency perceived development mainly in terms of economic growth in line with 'neo-liberal' principles. However, neo-liberal postulates were not followed by the government as there were many cases of violation of property rights, corruption, insufficient transparency in auctions and so on. The main focus was made on growth of GDP and the increase of FDI levels through privatization. Economic growth is necessary and especially for such developing countries as Georgia, but focusing only on growth without paying attention to accompanying factors (trade imbalances, unsustainable character of FDI, high levels of unemployment, income gap and the lack of social security network) or the result of this growth on the population cannot be a guarantee for sustainability or even economic success. Furthermore, environmental factors have been neglected in favor of short term economic profits. In addition, all these reforms were implemented without public involvement about common or private property. Thus, the government violated political and transparency instrumental freedoms and did not follow sustainable development principles along its economic development policies.

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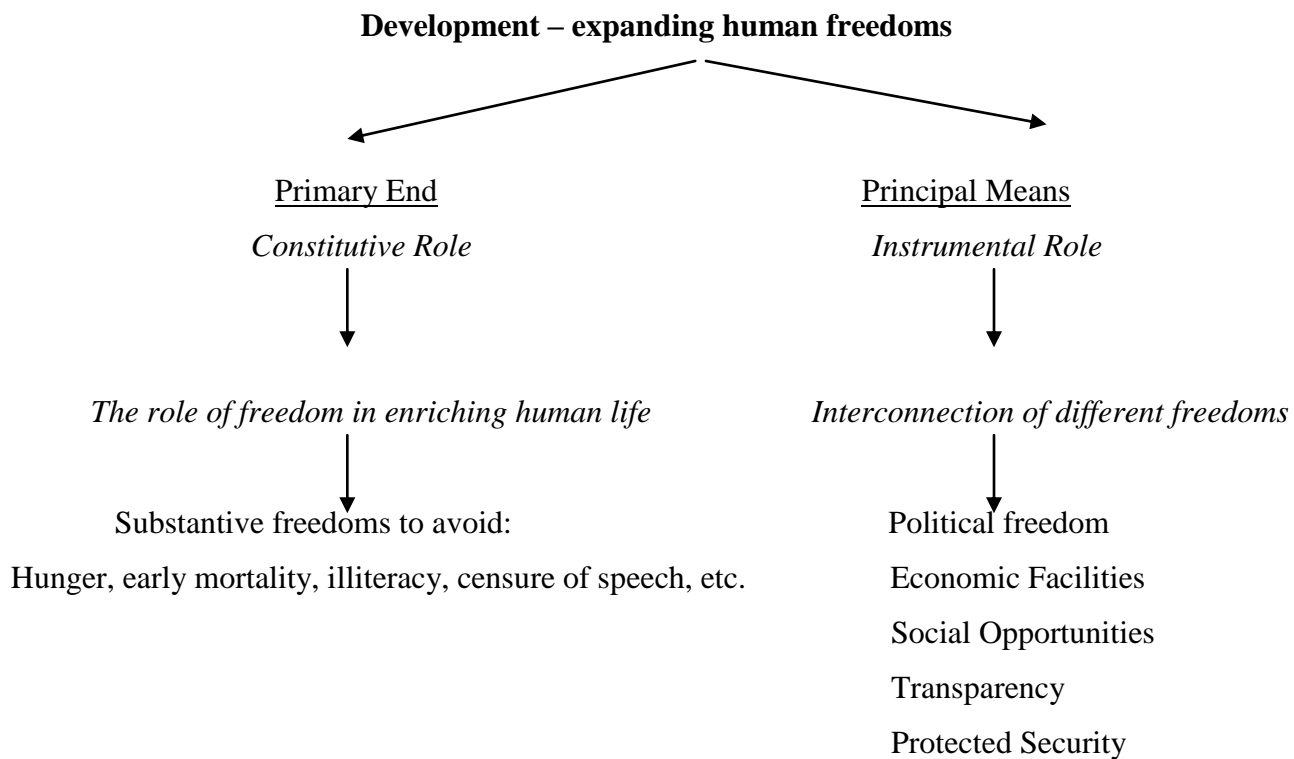
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## Annex 1



(Own graph based on Sen 1999:35-36)