THE EMERGENCE AND EVOLUTION OF ENTREPRENEURSHIP IN GEORGIA

RESULTS OF A TWO YEARS LONGITUDINAL SURVEY OF SELF-EMPLOYED, MICRO AND SMALL FIRMS

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2015

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GENERAL CHARACTERISTICS OF THE ENTERPRISE POPULATION SURVEYED

Little is known about the mode of activity of the self-employed except that they live mainly in rural areas and that some may de facto run micro-enterprises. By the same token, there is very few information on micro and small businesses. Yet, this portion of the Georgian economy amounts to more than 2/3 of the total employment and 20 percent of GDP. The purpose of the study is to know if that portion of the Georgian economy can give rise to organized and registered small and mid-sized firms.

It should not come as a surprise that about 60 percent of the self-employed surveyed are living from agricultural activities. Agriculture is the mainactivities for the self-employed in Georgia, but micro and small firms show already a more diverse picture. 20 percent of them are active in manufacture, 38 percent of are trading and 40 percent of them are in the service sector, which includes transport and communication, education and private household employing domestic staff.

While the majority of self-employed are "necessity driven entrepreneurs" at all age, the oldest segment of this study clearly differentiate itself from the youngest one when it comes motivations, confidence and attitude to risks. There is a higher percentage of younger self-employed who do plan to sell more the next 6 months to 2 years. By the same token, 74 percent of the self-employed below 39 would be ready to follow training courses to improve their business, while only 20 percent of those above 60 would agree to do so.

The level of education is lower among self-employed than among micro and small firms, where one can observe a web of linkages: education and growth; education and planning ahead; education and formality; education and risk taking. One should be cautious, however, not to isolate education as a uniquely important variable, as there are most certainly other ones weighting on entrepreneurial success.

WHAT HAS CHANGED IN TWO YEARS

The longitudinal research methodology made it possible to observe changes in perceptions of the self-employed and micro and small businesses over the course of 2 years., Betweem the first and fourth round, one can notice changes in the perceptions of the entrepreneurs with regards to the macroeconomic conditions and business environment as a whole. They are more pessimistic about the future economic prospect of Georgia. This change in perceptions is probably shaped by the worsened economic outlooks in the country. Other factors such business formalization, relationships with financial institutions, risk-taking behavior and material conditions did not see a dramatic change during this period.

ENTREPRENEURSHIP STARTS AT SMALL ENTERPRISES

The data produced by the project does not let one think that this an entrepreneurial process driven by opportunity is taking place among the self-employed and micro firms. It rather starts with small enterprises. Indeed, micro enterprises display many similar characteristics than the self-employed. If they differ in their activities and education - micro enterprises are better educated, have even university degree, more active in trade and services while self-employed are mostly active in agriculture - they display the same motivation, attitude to formality and attitude to risk.

Seizing opportunities is a motivation for only 5-10 percent of both groups. By the same token, around 35 precent of the self-employed and micro enterprises do what they do by default. Both among micro firm and the self-employed, 70 percent of the respondent does not have bank account and 90% of them conduct their business without written contracts. In other words, it is not only determined by tax compliance, but also by a certain way of organizing business activities.

INFORMALITY DOES NOT END AT BUSINESS REGISTRATION

From that point of view, self-employed and micro enterprises should be grouped together.

The ASCN dataset also provides information on another dimension of informality: the reach of official governance. Tax rates and licenses and permits are not viewed as a major obstacle. Self-employed, micro and small enterprises do not have any reasons to complain and do not report having any problems whatsoever with any state administration. Micro businesses in Georgia are exempt from taxes, licenses and permits are completely liberalized and brought to the minimum.

The informal sector can be viewed as a healthy distance that the state imposed between small businesses and itself. By not interacting anymore with it, it does not constitute a barrier. On the other hand, it has to face problems of economic integration.

1. PRESENTATION OF THE PROJECT

Little is known about the mode of activity of the self-employed except that they live mainly in rural areas and that some may de facto run micro-enterprises. Barely anything can be found about this portion of the Georgian economy in statistics. Yet self-employment amounts to about 2/3 of the total employment and according to our estimates generate about 18 precent of GDP. In other terms, this part of the population has a very low level of income per capita.

The purpose of the study is to know if that portion of the Georgian economy can give rise to registered small and mid-sized firms. In other words, it is possible to express the research question in the form of a hypothesis: the unobserved part of the Georgian economy represents, for the country, a reservoir of "entrepreneurship" whose ways of materialization will be shaped by the socio-economic context, the resources and the opportunities, and the visions and motivation of entrepreneurs. We can expect to identify hidden obstacles to enterprise creation such as sociological, cultural and psychological barriers that may hinder the passage from self-employment to micro firms and, within SMEs, from small enterprises to mid-sized firms. To capture the emergence and evolution of entrepreneurship in Georgia, a longitudinal research study with observations on self-employed, micro and small firms' cohort over a particular period of time is here proposed. Indeed, it appears that the different studies of the observed Georgian economy do not allow for a proper understanding of "entrepreneurship" in an evolutionary perspective. "Entrepreneurship" in this study was covering the grounds between "intention to" and the actual "action of" creating and managing an enterprise or a business in the perspective of it becoming a lasting source of one's subsistence. This use of the word "entrepreneurship" refers to the process related to the "discovery and exploitation of profitable opportunities" (Shane and Venkataraman, 2000:217).

Household statistics of the National Statistics Office of Georgia (Geostat) recognizes a self-employed as a person who "worked 7 days prior to the interview process (for at least one hour) to generate income (salary, profit or other compensation in kind), or helped other household members for free." The Ministry of Finance of Georgia (according to the Tax Code of Georgia) defines micro-businesses as those with an annual turnover below GEL 30'000 (approx. 18'000 USD). Small firms are, for Geostat, those that employ less than 20 persons with an annual turnover of less than GEL 500'000 (approx. USD 300'000).

Within the scope of the study the first round of interviews was conducted in July 2013, altogether 350 self-employed 250 micro and small enterprises (250) were questioned, in three different regions of Georgia (Kakheti, Adjara and Tbilisi). The second round of interviews took place in March 2014, then third in October 2014, and the fourth in May 2015. 14 individuals from each group could no longer participate in the study due to various reasons. In 7 of the cases for self-employed, the interviewer was unable to contact the person, while in 6 of the cases for micro and small enterprises, business activity stopped.

On average the amount of population in the sampled regions for the self-employed group is from 50 to 100 thousand people, while micro and small business representatives are from larger cities, on average with the population of more than 500 thousand. The gender balance is better for the self-employed with approximately 50/50 representation, while for micro and small business representatives, the interviewed are predominantly male (around 70 percent). Education levels vary in between the groups, the majority of self-employed have general secondary education, while one third of the micro and small business representatives have a master's degree, only few representatives from both samples have attended any type of training courses.

2. GENERAL CHARACTERISTICS OF THE SELF-EMPLOYED, MICRO AND SMALL FIRMS

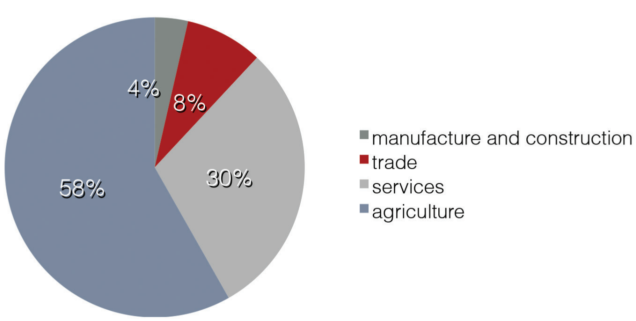
2.1. ACTIVITIES

2.1.1. Activities of the self-employed

It should not come as a surprise that about 60 percent of self-employed are engaged in agricultural activities. This is in fact the "default" activity for a majority of self-employed in Georgia. As we can indeed see on chart 1 below, only 8 percent of the self-employed are active in trade and 4 percent of them get revenue from manufacturing and construction. 30 percent are active in "services" which comprises activities such as private household employing staff, education, transport and communication. The overwhelming majority of interviewed are active in agriculture, thus reflecting the structure of the Georgian economy. This suggests that more information on the precise agricultural activities is needed. One needs to know what exactly this self-employed majority is harvesting, where and how. This is of an utmost importance for the coherence of agriculture policy, which cannot target the agricultural sector as if it was made of one unified coherent group of people with the same needs and problems. One needs to know, for example, if there are specific value chains of certain production better organized and structured than others.

The individual farmers interviewed for this study constitute an overwhelming majority in Adjara and Kakheti, where they represent 50 and 70 percent respectively. On the other hand, 90 percent of self-employed interviewed in Tbilisi are active in services and trading. For the majority of the interviewed, the activity that they are pursuing is their first and only business endeavor and none of them are members of any kind of business associations. Due to high levels of unemployment in the country, unsurprisingly, "survival entrepreneurship" is the major type of entrepreneurship in Georgia. Indeed, 67 percent of self-employed state that they started their activities since there was nothing else to do. Agriculture then becomes the default activity of "default entrepreneurs". 60 percent of those stating that they were doing that by lack of better choice are farmers. Finally, more than 70 percent of the self-employed have more than 5 years of experience in doing what they do. Half of them earn 200 GEL (100 USD) or below on a monthly basis and one third earns approximately between 200 and 1000 GEL.

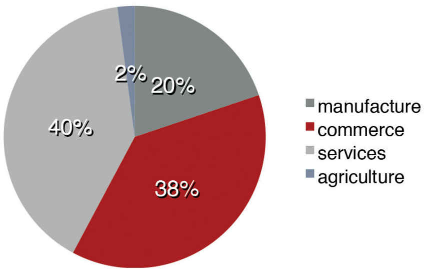
Chart 1. Activities of the self-employed



2.1.2. Activities of micro and small firms

If agriculture is the default activity for the self-employed in Georgia, micro and small firms show a more diverse picture (chart 2). 20 percent of them are active in manufacturing, 38 percent are engaged in trade and 40 percent of them are in the service sector, which includes transport and communication, education, private household employing domestic staff. For micro and small firms, geographical location is not connected with activities at all (agriculture is not the main activity of small and micro firms and one finds micro and small firms trading and manufacturing in Adjara and Kakheti). It is important to know what exactly falls under the manufacturing activities. Moreover, since 57 percent of the micro and small firms have more than 5 years of experience, it will be interesting to know if the manufacturing sector is a remnant of communist infrastructure or if it is newly created firms from scratch?

Chart 2. Activities of micro and small firms interviewed



It is difficult to identify one single category of motivations of micro and small firms for doing what they do. The "entrepreneurship by default" is still a prevalent answer, but, contrary to self-employed, it is equally mixed with the desire to make more money. Taking advantage of possible opportunities is still not a very common response.

2.2. Revenue

Revenue of self-employed reflects the fact that their activities is by default. Entrepreneurship for survival is the appropriate term in the light of the self-employed's earnings. 70 percent of the micro and small firms earn less than 30'000 GEL of turnover per year, which corresponds more or less to 1500 USD per month. By the same token, 70 percent of micro and small firms do not reinvest their revenue. Earning more seems to increase the likelihood of reinvesting as the table below shows.

Turnover per year and reinvestment			
Percentage of those who reinvest their profits in their business, by earning category	Those earning less than 30'000 GEL	Those earning between 30'000 and 100'000 GEL	Those earning above 100'000 GEL
	25	33	50

2.3. AGE

The correlation between age and entrepreneurial motivation

The sample of the self-employed interviewed is made of about one-third of people above 60 years old. 24 percent of them are less than 39 years old and 44 percent are between 40 and 59 years old. The age variable in this study is independent from activity. One finds self-employed younger than 39 and older than 60 years old who are also involved in non-agricultural activities. Age is also independent from "formality variables" such as having a bank account, keeping accounting and dealing with written contracts. While the majority of self-employed are "necessity driven entrepreneurs" at all age, the oldest segment of this study clearly differentiates itself from the youngest one when it comes to motivation, confidence and attitude towards risks. There is a higher percentage of younger self-employed who do plan to sell more of their products and services during the next 6 months to 2 years. By the same token, 74 percent of the self-employed younger than 39 would be ready to follow training courses to improve their business, while only 20 percent of those above 60 would agree to do so. Similarly, 57 percent of those below 39 are willing to take more financial risk for a chance to produce more. Only 14 percent of those above 60 would take that risk. Half of the self-employed below 39 feel confident to start another activity with the skills they have, against 32 percent of those above 60. By the same token, fear of failure would prevent 39 percent of the young self-employed to start another activity, while it would prevent 60 percent of the old ones.

The influence of age on motivational variables of entrepreneurship

	YES less than 39 years old	YES more than 60 years old
Would fear of failure prevent you to start another activity?	39%	60%
With the skill you have, do you feel confident to start another activity	50%	32%
Would you be ready to take financial risks to improve your business	57%	14%
Would you be ready to follow training courses to improve your business	74%	20%

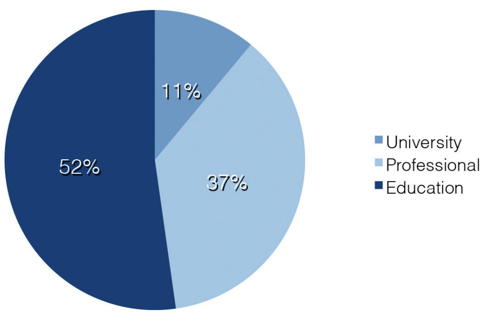
Age poses a dilemma to policy makers: Government initiatives that promote training are likely to disappoint if established for a population older than 50 years old. Old ways are harder to unlearn, new skills more difficult to acquire above a certain age. One could wonder if there is any hope to see a 60 year old self-employed in rural Georgia responding to productivity driven policies that do not take these factors into consideration. Strategies supporting the production of niche agricultural goods, like hazelnuts, mulberries and blueberries, which employs more labor than other goods, might provide an answer.

2.4. EDUCATION

2.4.1. Education of self-employed

If, for obvious reasons, agriculture is not the main activity of an urban environment, educational level on the other hand does not offer such a clear picture when crossed with regions and sectors. Chart 3 shows the general educational level of the self-employed. 11 percent hold the Soviet equivalent of a bachelor or master degree (as explained later, 78 percent of the self-employed with a university degree are above 40 years old) and 52 percent have primary education.

Chart 3. Education level of self-employed

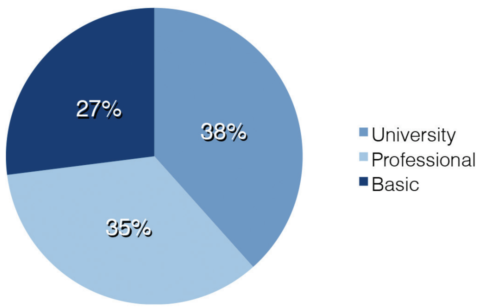


However, education is an independent variable from activities and geographical location. 27 percent of the self-employed in Tbilisi hold a university degree. That percentage, even if higher than in Kakheti and Adjara, is not that large enough so as to bind education and location together. The percentage of those who benefited from professional education is higher in Kakheti than in Tbilisi for example.

2.4.2. Education of micro and small firms

The level of education of micro and small firms is higher than for its self-employed counterparts. As we can see on chart 4, 38 percent of them have bachelor, master or PHD degrees and represent the largest part of the sample. Basic education comprises here primary and secondary education. None of the micro and small firms owners did not go to school at all, which is not the case in the self-employed category.

Chart 4. Education level of micro and small firms



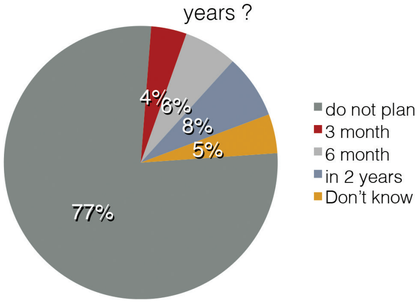
Education is independent from geographical location. The respective percentage of those with a university degree is as high in Adjara and Kakheti as in Tbilisi. It is also independent from activities. There isn't a sector in particular that is linked to higher or professional or primary education. However, one can observe a web of dependences between education and several variables.:

1. Education and growth
2. Education and planning ahead
3. Education and formality
4. Education and risks

23 percent of the micro and small firms interviewed declared that their businesses were growing, without knowing by how much and 5 percent who can specify in percentage the growth of their firm. This perception of growth expressed precisely in numbers or not, is linked to the level of education. Individuals with university degree account for half of those whose business was growing. Those with professional education account for one third and those with primary education for 17 percent. The Pearson chi-square result is 0.41 which is not the most significant, but still low enough to assert that these two variables are dependent from one another.

Education is also related to the motivation of growing and develop ones company . As shown in the Chart 5 below, more than two thirds of micro and small firms do not plan to sell more products or services. But the 18 percent of those who do plan to sell more are better educated than the other categories. University graduates account for 57 percent of those who plan to sell more and professionals for 37 percent. As Pearson's Chi-square is 0.00 it is clear that these two variables are not independent.

Chart 5. Do you plan to sell more of products or service in the coming 3 months, 6 months or 2 years ?



Thus education seems to play a key role with regard to past and expected performance. One should however be cautious as there might be other variables weighting on entrepreneurial success. Past performance and future ones are closely related. Those able to notice growth might tend to plan more and those whose enterprise did not developed since its creation account for 73 percent of those who do not plan. Whereas, those who noticed growth - account for 19 percent and those able to specify by how much it grew make up only 6.7 percent. With a Pearson's Chi square of 0.07 it does not pass the test of independence. The direction of the relationship is however not known at this point. Is it that success breed success and noticing the growth of one business gives incentives to plan to sell more? Or that planning ahead, projecting current activities in the near future is an important element of enterprise growth?

By the same token, education is also linked to formality. Formality variables in this study are the following: holding of accounting record, having a bank account and operating with written terms of transaction. Might it be that these elements are the most crucial ones directly responsible for good entrepreneurial record?

As table 2 below shows, having received university education seems to be related with having a bank account, with holding a record and operating with written terms of transaction.

Table 2 - University degree and formality variables

University degree (107 out of 237)	Yes	No
Having a bank account	68.2%	31.8%
Holding accounting record	84.1%	15.9%
Operating with written terms of transaction	59.8%	40.2%

On the other hand, primary education shows a different picture. Primary education seems to be associated with a higher level of informality. Most of those with primary education do not have bank account, do not hold accounting records and tend to operate mainly orally.

Table 3 - primary education and formality variables

Primary education (63 out of 237)	Yes	No
Having a bank account	17.5%	82.5%
Holding accounting record	33.3%	66.7%
Operating with written terms of transaction	7.9%	92.1%

Having regular employees is also linked with higher education. 93.7 percent of micro and small firms whose owners have basic education work alone, while more than half of university graduate do have regular employees. Thus, it is not a surprise to note that the characteristics of formality listed above are also associated with firms with regular employees. Formality and the capacity for employing people appear to be logical (size seems to demands certain formal rules), it is nonetheless interesting to identify education in that web of dependent variable.

Two other variables, also associated with that group should be added: Confidence and the approach to risk.

The following question was asked to estimate how confident entrepreneurs felt: Do you feel you have the knowledge, skill and experience required to start a business different from the one you are running now?

75 percent of university graduates answered positively, while only 40 percent of those who received basic education answered in that way. Confidence to start new activities, measured by that question only, seems to be positively associated with the level of education. By the same token, the approach to risks is captured by two questions: would you be ready to take more financial risks to develop your business and would you be ready to follow training or courses if it could improve your business? For both of these questions, the same the percentage of those ready to risk time and money is to times more important in the case of university graduate than for those with basic education.

3. WHAT HAS CHANGED IN TWO YEARS?

EMERGENCE OF ENTREPRENEURSHIP – CHANGE IN BETWEEN THE ROUNDS

The longitudinal research methodology made it possible to observe changes in perceptions of the self-employed and micro and small businesses over the course of 2 years. Looking back at the first round and comparing the answers received during the fourth round, one sees changes in perceptions of the entrepreneurs with regards to the macroeconomic conditions and business environment as a whole.

Major changes have taken place on the level of external environment. This is to say, internal factors that depend solely on an entrepreneur (such as levels of business formalization, relationships with financial institutions, risk-taking behavior, etc.) did not see a dramatic change during this period. Thus, perceptions regarding the external environment, the governmental agencies, future forecasts, awareness and level of participation in the state-funded direct support programs have changed quite a bit.

If the majority of the micro and small business representatives state that they are aware of the program, however do not qualify for the program, on the positive side, half of the self-employed respondents stated that they are benefiting from the agriculture development program run by the government of Georgia.,. Moreover, the number of respondents who stated that they have heard of people benefiting from aid programs and are now growing a business has increased. Notwithstanding the positive shift, a number of indicators, such as outlook for the future projections and assessment of the state administration have seen a negative trend. For clear distinction we present results for the self-employed and micro and small business representatives separately.

SELF-EMPLOYED

The number of self-employed who stated that their revenue is more or less stable has decreased; moreover, up to 60 percent of the respondents believe that their business activity is stagnating, as compared to the 43 percent during the first round. The situation has not improved for 71 percent of the respondents as compared to 6 months ago . Future outlook is not promising either, absolute majority state that they are not planning to sell new services, or hire new employees any time soon.Perhaps reflecting too hight expectation of the change of government and the end of the Sakaashvili era, 115 self-employed though the general situation would get better, 2 years later, they are only 33. .

The surveyed self-employed seem to be a bit more skeptical regarding the abilities of the government to undertake quick, impartial and fair administration. Those that agreed to the statements, that the government was responding quickly, fairly and impartially to their needs have decreased by roughly 10 percent. There has been a 10 percent decrease in the number of respondents who believe that the government is clear and predictable in its decisions.

Regarding the governmental policies, 43 percent of the respondents as of the final round (a 4 percent increase as compared to the first round), believe that the state did not take actions to promote micro and small enterprises over the course of the past 6 months. This answer could be considered as inconsistent, if we take into account that around 46 percent actually benefits from the state funded programs. One explanation can be that the respondents believe that the existing state run programs are not enough and more should be done for supporting entrepreneurship.

MICRO AND SMALL ENTERPRISES

Slightly less micro and small entrepreneurs believe that the revenue generated from their business activity can be called a "stable" one. Only 13 percent of the respondents believe that the general situation for doing business will get better in the nearest future, this is a substantial decrease as compared to the first round, when almost 43 percent of the respondents were optimistic about the future outlook.

It is an interesting observation that less entrepreneurs think that the way their business develops is not so much dependent on themselves, but rather on other factors. The number of entrepreneurs who believe that business outcomes depend solely on themselves has decreased.

When it comes to assessing the public administration, 60 percent of the surveyed entrepreneurs state that their companies were not inspected by state authorities (which represent a decrease from 74 percent observed after the first round of interviews). Just like the self-employed, this group of respondents is also less positive when assessing the state administration, as well as their ability to provide fair grounds for competition.

To conclude, the perceptions and answers of the respondents were shaped and determined mostly by the worsened economic outlooks in the country. The volatility and depreciation of the exchange rate has resulted in a decrease of the disposable income of the population, decreased their purchasing power and ultimately demand. Decreased economic growth projections for 2015, also contributed to the less positive responses from the side of the entrepreneurs. Worsened economic outlooks translated into discontent towards the state administration and less optimism towards the future.

Moreover, the first round took place amidst a period ofpolitical change and change in the government. The first round showed increased expectations among the respondents trust in drastic changes with optimistic outcomes. The results of the fourth round show that the decrease in optimism is due to the fact that the expectations did not materialize quickly enough.

The data produced by the project shows barely any movement from the status of self-employed to micro and small firms. There is very little mobility between different status of economic occupation (Bernabè and Stampini, 2009), which is an indication of a segmented labor market.

4. ENTREPRENEURSHIP STARTS WITH SMALL ENTERPRISES

The most recent estimate of the size of the informal sector[1] indicates that it amounts to approximately 30 percent of Georgia's GDP (Abdih and Medina, 2013). It corresponds indeed to the 50 percent of the labor force considered self-employed and non-observed (which is another label for the informal economy) and contribute approximately to 20 percent of GDP.[2] This study on the emergence of entrepreneurship[3] in Georgia tried to determine to which extent the informal sector, represented by the self-employed, constitute an entrepreneurial resource. The interplay between available resources, perceived opportunities and socio-economic institutions, in conjunction with the motivation and vision of entrepreneurs, together shape entrepreneurship as it is emerging in Georgia.

Entrepreneurship, in this study, is considered as the "process of discovering and exploiting profitable opportunities" (Shane and Venkataraman, 2000:217). It is the road from intention to action. From this point of view, "entrepreneurs by default" do not really represent an entrepreneurial community. Indeed, the data produced by the project does not let one think that this process is taking place among the self-employed and micro firms. It rather starts with small enterprises.

Indeed, micro enterprises, which are made up of individual entrepreneurs but registered as such to benefit from a special tax regime, display many similar characteristics as the self-employed. If they differ in their activities and education - micro enterprises are better educated, have even university degree, more active in trade and services while self-employed are mostly active in agriculture - they display the same motivation, attitude to formality andattitudes to risk. The holding of accounting books stems from being registered, so half of the micro firms keep accounting records of their business, while only 4 percent of the self-employed do that. However, like the self-employed, 70 percent of the respondents do not have bank account and 90 percent of them conduct their business without written contracts. By the same token, around 35 percent of the self-employed and micro enterprises do what they do by default. Seizing opportunities is a motivation for only 5-10 percent of both groups. Fear of failure would prevent more than 50 percent of both group to start new activities or propose new services or products. Half of the self-employed and micro enterprises would not be ready to follow training courses, even if it could improve their businesses. 70 percent of them would not be ready to take more financial risks to develop further their activities.

The low score of the self-employed group for these variables should not come as a surprise. However, one can notice that registration did not make the business operation of micro enterprises more formal. Indeed, registering a business activity is one step that entrepreneurs can take in order to formalize the way they operate, but is certainly not the

1 Defined as "those economic activities that circumvent the costs and are excluded from the benefits and rights incorporated in the laws and administrative rules covering property relationships, commercial licensing, labor contracts, torts, financial credit, and social systems"

2 According to Geostat and own calculation

3 "The emergence and evolution of entrepreneurship in Georgia", Academic Swiss Caucasus Net, unpublished results.

only one. Holding accounting records, operating with written terms of agreements, transacting via bank accounts are also features of formality. Informality does not end at registration. In other words, it is not only determined by tax compliance, but also by a certain way of organizing business activities. From that point of view, self-employed and micro enterprises should be grouped together. Entrepreneurship and formality then starts with small enterprises, which show very distinct characteristics than the self-employed and micro firms. They all hold accounting records, have bank accounts, tend to plan the development of their activities, show more willingness to take risks and are better informed.

One can conclude that the drastic reforms that followed the rose revolution did not manage to better integrate the informal sector into the formal one. Taxes and procedures have been reduced and streamlined without increasing the level of tax compliance of the self-employed (Torosyan and Filer, 2014). The data shows that self-employed and micro enterprises are organized the same way: informally. This is the "organizational" dimension of informality which can be completed with the another dimension of informality: the reach of official governance (Guha-Khasnobis et al., 2006).

5. INFORMALITY DOES NOT END AT BUSINESS REGISTRATION

The ASCN dataset also provides information with the other dimension of informality: the reach of official governance. Tax rates and licenses and permits are not viewed as a major obstacle. Self-employed, micro and small enterprises do not have any reasons to complain and do not report having any problems whatsoever with any state administration. Micro businesses in Georgia are exempt from taxes, licenses and permits are completely liberalized and brought to the minimum. Likewise, the labor code is quite liberal and is not thoroughly enforced. Low enforcement level and the fact that micro and small businesses rarely employ hired workforce can explain the fact that the respondents believe that the amendments made to the code in 2013 do not concern them.

The gap between the reality of the socio-economic fabric in Georgia and the economic policy of the government reflects the dilemma of economic reforms in transition. The imperatives of reforms demanded non-interference with the economy to avoid supporting any particular actors, but which actually prevents the development of SMEs. The "policies vacuum" created by the retreat of the previous government gave rise to numerous measures and development project sponsored by national and international agencies and NGOs. These measures significantly enhanced the business environment but they are of tactical nature and cannot replace strategic and comprehensive economic policies that are needed to integrate the informal economy into the formal one. In other words, dismantling the old soviets bureaucracy is only half of the challenge. The other half is institutional building, which is still problematic in Georgia.

A quick look the Caucasus Barometer database spanning from 2008 to 2013 tells us a lot about the relationship between state institutions and its citizens. By focusing only on the percentage of respondents that "fully trust" some Georgians institutions, one can classify them in three categories:

1) Institutions fully trusted by more than 50 percent of the respondents from 2008 to 2013, even if that percentage slightly decreased.

2) Institutions fully trusted by less than 50 perecent of the respondents, but have seen their "trustworthiness" increased from 2008 to 2013

3) Institutions fully trusted by less than 50 percent and have seen their "trustworthiness" decreased from 2008 to 2013

The following table is the result of that categorization:

TRUST TOWARD INSTITUTIONS		
High trust (above 50%) even if slightly decreased or increased	"Trustwhorthiness" below 50%, but slightly increased	"Trustwhorthiness" below 50%, and decreased
Religious authorities (86-81%)	Executive government (31-39%)	Health care system (62-44%)
Army (75-72%)		EU (54-33%)
Police (53-58%)		UN (48-30%)
Educational system (55-55%)		Media (50-24%)
		President (50-24%)
		NGOs (35-23%)
		Local government (36-28%)
		Parliament (35-28%)
		Court system (27-22%)

The table above allows one to see that the institutions most appropriate to carry out reforms and policies to integrate the informal economy into the formal one are not trusted by Georgians and that this trust has actually dropped down between 2008 and 2013. The only relevant institution with regard to the establishment of more inclusive market economy that has enjoyed increasing trust from respondent is the executive government. But local governments, which could be instrumental in formalizing the economy, is trusted by only a quarter of the respondents.

The lack of trust that characterizes these institutions is a barrier to the creation of a more inclusive market economy. The policies, the efforts, the programs and the communication of these authorities suffer from a trust deficit and it can be that this has less to do with the quality of institutions than the implementation style of the policies and the lack of mechanisms to consult and include private sector actors and civil society within the policy making process.[4]

Such an interpretation of these empirical evidences suggest that informal economy is not related to economic development only, but to institutional and state building also. That would also explain why, in many transition countries, the informal economy has grown in spite of many reforms (Krstic and Sanfey, 2011, Lukiyanova, 2015) and why it is also an issue in developed economies as well. According to some estimates, the informal sector reached an average of 21 percent of GDP in Belgium and Portugal and 25 percent in Italy between 1991 and 2005 (Schneider and Buehn, 2012).

In Georgia, the informal sector can be viewed as a healthy distance that the state imposed between small businesses and itself. By not interacting anymore with it, it does not constitute a barrier. On the other hand, it did not succeed - in comparison with western standards - to establish the elementary platform for the development of a true liberal market economy. It is as if the state interpreted "not interfering" with the economy by "not caring" about it. This misinterpretation is all the more visible when looking at the official status of self-employed. They are out of reach of the state, for better or for worse.

4 The link between the design and the quality of institutions and the size of informal sectors has been established, with perhaps too much focus on the tax and regulatory environment (Jonson et al., 1998, Hibbs and Piculescu, 2005, Schneider et al., 2010). On the other hand, the lack of trust that impede the institutions mentioned might also be due to a lack of inclusion of the broader civil society into the policy making process.

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