

Abuselidze, George

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## FISCAL POLICY DIRECTIONS OF SMALL ENTERPRISES AND ANTI-CRISIS MEASURES ON MODERN STAGE: DURING THE TRANSFORMATION OF GEORGIA TO THE EU

**George Abuselidze**

*Batumi Shota Rustaveli State University, Georgia*

### Abstract

The paper is aimed to determine the optimality of taxation, that can be used to plan and implement effective anti-crisis measures. Objective is not to define or diagnose crisis and suggest strategies, but to offer methodologies, that can be used to determine the influence of formal and informal institutions of company's ongoing activities. To develop recommendations for avoiding business crisis situation and support its development.

The theoretical and methodological basis of the research is the main provisions of the market economy, legislative and regulatory acts of Georgia and foreign countries, statistical data of Georgia, the global risks report, government bodies and business structures in this field. In the process of analysis of the actual material, together with the general scientific method of research, is used: systemic analysis, comparative analysis of scientific literature, statistical analysis, analogy and other methods.

As a result of researches it is established that developed countries emphasize the importance of fairness, while developing countries are mainly focused on mobilizing budget revenues and lesser consideration of fair taxation principles, since the tax system performs a fiscal function more effectively than developing countries. In our opinion, the main idea of tax policy should be the optimal distribution of tax literacy on the basis of a direct definition of income of taxpayers or progressive taxation.

Practical implementation of the proposed proposals will facilitate further improvement of the social climate in the country, revitalize small and medium businesses, and solve the problem of employment in the country.

Keywords: fiscal policy, financial crises, crisis management, small business, social stimulation.

JEL Codes: E62, G30, H30.

### Introduction

The most important is the stimulation of business for countries with open economies, including Georgia. According to the World Bank's "Doing Business 2018" year, our country occupies the 4th place in the simplicity of starting a business, which is 4 points ahead of the previous year (8th place in 2017). By 2019, we still have to move forward with ongoing reforms in small business, but, of course, it is extremely important to reflect the results of these ratings in the real economy.

During the perfect competition, in the market principle based society economy and social life is governed by administrative or bureaucratic methods, with direct interference of the state and by the instructions of its actors (with direct methods, or indirect), or based on market economy principles. In market relations one of the most important effects on country's economic stability has important segment of business activity – small-business. In the article, the importance of state intervention by social stimulation methods at the stage of market socio genesis is substantiated. Within this theoretical course, using tax policy can influence economic activity and production volume, as well as solve problems and regulate. In the concept of tax burden the important fact is the connection of tax burden with the Small Business Development.

On contemporary stage due to internal or external, objective or subjective factors business sector is not able to avoid financial-economic crisis, which is becoming more extensive and takes wider scale. In addition, world economy is in deep and protracted economic crises, characterized by decrease in absolute volume of production, a sharp disproportion between production and consumption, economic connection disorder, etc. (World Economic Situation..., 2017).

For countries with transitional economics, which are striving to become a European way of thinking, it is a good way to solve these problems by studying economic activity. Support and development of small business in this regard are directly related to the formation of the middle class. The society must believe that, in the context of the formation of an appropriate business environment, they can improve the material situation, manage their own managers, have the opportunity to hire others and participate in the formation of the welfare of society.

Therefore, the question arises: what should be done to bring down the business sector from collapse? The answer is of course business environment improvement, but how? What are the ways? What methods? What forms?

This issue is important due to reduction/ expansion of state role in business sector crises provoking/ avoiding process.

The main measure that the government must take to increase the GDP growth rate, to decrease unemployment, to improve living standards is the development of individual (separate) and priority sectors. Special attention should be paid to the improvement of the business environment, as it is the main condition for national farming development. Namely, this sector has decisive word in the complexity of economic development. Unfortunately, for the time being business has complications not only with the beginning of development, but also with escaping from deep depressive situation, caused by political, social or economic cataclysms.

It is generally known that entrepreneurship and business are the driving force for economic development for countries with open economy. Vital benefits are tax breaks, various state programs, access to capital, which require small business and increase its activity. We should pay attention to business contribution in the formation of GDP, which clearly indicates the need to focus on the development of financial and economic directions for the development of small enterprises. The effectiveness of these areas is the *subject of research* and Therefore the *purpose* of the work is to develop fiscal policy, especially tax policy, through the stimulation theory, which aims to ensure the implementation of the correct strategy of the business sector development, for micro, small and medium enterprises; formation of a mechanism to increase the competition in the business sector; identification of factors affecting the formation and development of business sector; determination of tax pressure on the business sector and forming optimal tax policies that will stimulate small business development.

Georgia's economy demonstrated a remarkable recovery after the 2008-2009 dual shock caused by the military conflict with Russia and the global recession. The average GDP growth in 2010-2012 recorded 6.5%, with a slight slowdown in 2012 due to political turmoil. These achievements were underpinned by sound macroeconomic policies, market-oriented reforms and significant donor assistance pledged by international donors in the aftermath of the conflict with Russia (EU support to SMEs...).

Current political and economic stabilization process, the gradual improvement of the macroeconomic environment of production function has resulted in creation of real prospects for enterprise motion, which is reflected in the consistent improvement of the relevant economic indicators. In 2010-2016, the total turnover of business sector increased by 3.4 times and in 2014 amounted 50 billion GEL. In the same period, the business sector output grew 3.5 times and in 2014 amounted 26 billion GEL. The number of employed increased from 361 000 to 592 147. According to the 2014 data the largest share of employed in business was trade sector (23.5%), in industrial sector (19.6%), in construction (11.4%), in real estate (10.0%), in transport and communication (10.0%) and in healthcare (9.8%). The average monthly salary in this period was increased from 286 to 801 GEL. In 2006-2014 the value added by the business sector increased from 3.5 to 12.8 billion GEL, while investments in fixed assets increased from 2.1 to 3.6 billion GEL. In 2014, a large proportion of business sector turnover came on trade (50.5%), industry (18.0%) and transport and communication (10.3%), on manufacturing (31.5%), trade (17.1%), construction (15.7%) and transport and communication (13.8%) (Economic Review, 2017).

Despite the growth of the Georgian economy and employment figures, the SME sector still shows weak performance in terms of added value. SMEs account for 96% of all enterprises in the country, employing 44% workers; yet they account only for 19.3% of added value and 16.1% of turnover. Given these figures, SMEs do not play an important role on the economic policy agenda. There is no SME strategy per se, however, the State Strategy for Regional Development of Georgia<sup>1</sup> (2010-2017) states support for entrepreneurship as one of its objective. Georgian SMEs became beneficiaries of implemented economy reforms which considerably improved country's business environment, e.g. adoption of New Tax Code in 2005. These efforts were recognized by the World Bank, which estimated the country as a frontrunner in this area since 2005. The Bank ranks Georgia 8<sup>th</sup> among 189 economies in its Doing Business 2014 report in its ease of doing business rank. Georgia's first anti-corruption strategy drafted in 2005-2006 and a corresponding action plan adopted in 2007 (second strategy and plan were adopted in 2010) became an important instrument to support business: by simplifying regulatory practice and overcoming administrative hurdles. In the current Corruption Perceptions Index Tbilisi occupies 55<sup>th</sup> position out of 177. Significant progress was achieved as regards economic integration and deeper trade relations, as Georgia has initialed a DCFTA with the EU and signature is foreseen for autumn 2014.

Past period analysis shows that the new macroeconomic and legal basis of the enterprise functioning (laws to be indicated) is formed by the private entrepreneurs' corps new economic mentality.

Despite the positive changes, the situation in the country's business sector is unsatisfactory. The lack of proper investment drags out the process of structural transformations that is generator for enterprise motion and production capacity growth. Most enterprises fail to provide competitive product that is why it is not possible to return not only foreign segments, but also a number of domestic market sectors, where they used to have a good place. In this situation, special attention is given to the role of the state.

## Literature Review

Since long time causes of economic crisis and searching ways to overcome it was the main concern of scientists (not only economics) and practitioners. Despite that fact that programs for overcoming crisis differ from each other, we tried grouping their opinions and presented them as approaches.

In particular, the first approach is a conjunctive theory (Frank Hahn, Robert (Robin) Charles Oliver Matthews, Joseph Schumpeter). According to them crisis management is possible through credit interventions. The main views and provisions of this approach are formed in the following works: "On monetary theory" (Hahn, 1988), "On inflation" (Hahn, 1990), "The theory of economic growth: a survey" (Hahn and Matthews, 1964), "The crisis of the tax state" (Schumpeter, 1918), "Business cycles" (Schumpeter, 1939), etc.

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<sup>1</sup> Economic Development Agency of Georgia. Available at <<http://www.economy.ge/?page=ecoreview&s=44%29.&lang=en>>.

The second approach is indirect regulation theory, whose theorists are representatives of the second direction “flexible monetary policy” group: Barro, Gordon, etc. (Barro and Gordon, 1983). According to them exaggerated interfere can cause the same consequences, that occur during totalitarian regimes.

The nucleus of the third approach is created by “neoliberal” scientists-economists, most notably Friedman (Friedman, 1968), who declares that any short-term (fast) shifts and projects in economy are doomed to failure, if the monetary means are not considered. According to Yeager (1976), amount of money has a major impact on the flow of expenses in the economy. The state budget and other real factors in the economy, which are strengthening investments, have a secondary impact, if they are not provided with the issuance of additional cash in circulation.

It is also worth mentioning Keynes’ theory about influence of state on the production growth and economic activity. In particular government using fiscal and monetary policies can soften effects of economic decrease, depression and negative effects of peak (Keynes, 2016). And also Hansen’s approach to stabilizers, counter-measures of compensates and managed compensate programs (Hansen, 1964).

During stabilizers method, stabilizers operate automatically, without any special laws and resolutions, and automatically react to cyclical fluctuations and soften them. These stabilizers automatically operate in different phases of cycles. Their rates remain unchanged, but the volume of taxes or the total amount of payments during boom period increase, during crisis and depression – decrease. State allowances and taxes are decreased during boom period and increase during crisis, etc. this automatically adjusts the “efficient demand”.

According to Sismondi, the contradiction between production and consumption inherent in capitalism also plays an important part in economic’ crises (Anikin, 1979).

According to Neo-Keynesians, during the compensated financial policies (the combination of second and the third approaches) government has to take responsibility to compensate breakdowns between production dynamics and solvency demand. To do this, it must use taxes (direct and indirect) and governmental expenses. According to Hansen such an approach to the issues ensures the abundance of budgetary funds during the boom period and deficit \_ during depression (Hansen, 1964).

The monetary and regulatory methods recommended by Keynes according to quality (Harris, 1981) are not considered to be sufficient and requires carrying out additional fiscal and tax arrangements.

Efficiency of production is in general not desirable when there are constraints on taxation. For example, according to Slemrod (1990, p.162) if a commodity tax cannot be imposed on some good, a tax on factor income earned in that sector may serve as a partial substitute. If certain commodities must be taxed at identical rates, then differential taxation on factors in those industries is generally desirable.

In contrast to earlier literature, according to Jacobs and Bovenberg (2010, p.453), an optimal capital tax balances structural distortion with the level of savings. Indeed, the government faces a fundamental trade-off between efficiency in human capital formation and allocative efficiency in the intertemporal allocation of consumption. The optimal tax rate on capital income is relatively large compared to the tax on labor income if aggregate saving is inelastic compared to learning so that learning distortions dominate saving distortions.

According to Silva and Vieira (2014), Fiscal policy has become an important economic tool in dealing with the consequences of the crisis. Advanced economies seem to rely more on this instrument, creating greater resilience to public spending than developing countries.

In our opinion, the stage of market sociogenesis is unique for the modern world and it implies intentional interference of the state into the formation of the entrepreneurs’ class and into the market stratification process. The theory that specifically refers to the company’s crisis is not found in the scientific literature. We have a “Social Stimulation” theory, which can be used to create conditions, that promote economic activity and create a strong class of entrepreneurs.

Our idea here is based primarily on the neoclassical theory. Business entities and results of their activities are a significant part of the country’s budget revenue, so development of private business and its protection from crisis is increasingly becoming important not only for entrepreneurs, but for government as well. In our opinion, by formation of the compensated (optimal) financial policy government can compensate crisis between production dynamics and solvency demand. This approach provides the optimal growth of production capacity and economic activity.

## **Materials and methods**

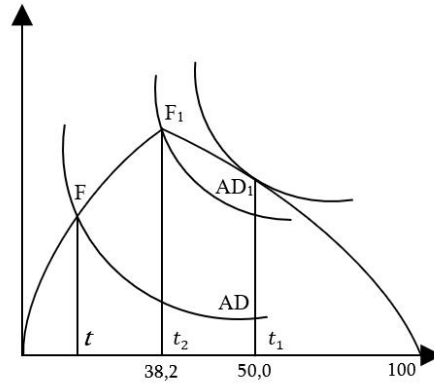
### *Modeling of Optimal Tax Policy*

The optimal tax burden linking to economic activity and production capacity is particularly important issue in compensated financial policy.

According to the concept, for tax burden critical value  $t=0$  and  $t=1$ , economic activity is reduced to minimum; at the same time, according to this concept there are tax burdens ( $t=0$  and  $t=100$ ) different  $t_1=50\%$  (Laffer) and  $t_2=38.2\%$  (Abuselidze) levels, where economic activity and production capacity are different.

First of all, let’s consider that F point is equilibrium of production volume and economic activity and  $t$  is tax rate corresponding them. Assume that for some reasons government expenditures has increased by some degree. In ceteris paribus this change will cause increase of economic activity and accordingly curve movement in new position ( $F_1$ ). In the given situation in order to establish a new equilibrium in parallel of increased expenditures government based on relevant legislation should increase value of  $t$  to  $t_2$ . The point is that on F point of the initial equilibrium, economy is on uprising curve of aggregate supply. In such situation among effects caused by increasing  $t$ , summary of

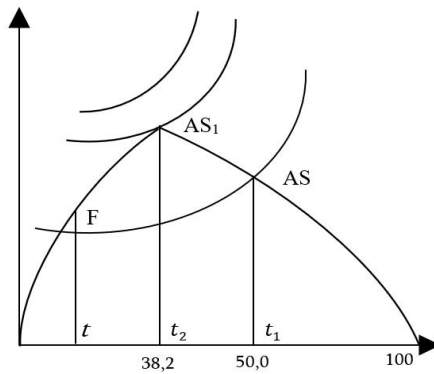
the effects of generating a positive environment and revenue have dominant role. That is why no matter how paradoxical it is, increase of taxes to  $t_2$  will help to increase supply of resources. In condition of using existing resources, aggregate output will increase and the equilibrium will be in  $F_1$  point (see Figure 1).



**Figure 1. The Optimal Tax Burden Linking to Economic Activity**

(source: compiled by the author)

The different situation will be if the starting point of the economy equilibrium is on production volume, aggregate supply downward slope curve, where the negative effects of taxes have dominant role. In such conditions reduction of tax burden is a natural way to encourage economic activity and production volume growth. Therefore, in this created hypothetical situation, if the state decreases the value of tax burden from  $t_1$  to  $t_2$ , then the economy will be able to move to a new equilibrium and to satisfy the increased aggregate demand (see Figure 2).



**Figure 2. The Optimal Tax Burden Linking to Production Capacity**

(source: compiled by the author)

At present situation, the opinion of scientists about optimal tax burden is diverse and it vary from 0 to 100, that in put opinion can be expressed as follows:

$$X_r = \{a, b, c, d, \dots, l\} \quad (1)$$

If we indicate that optimal tax burden is in  $X_r$  set, then we can express this attitude  $a \in X \Leftrightarrow X \rightarrow \alpha$  ( $a = 38.2$ ), in addition values in  $X$  are less than 100, which can be noted as  $\{x : x \in N, x < 100\}$ , where  $N$  is set of numbers and if we consider Bolzano's theorem, then for each  $N > 0$  number there is such number that inequality  $|f(x) - A| < N$  is carried out. If  $A$  is  $f$  function limit, when  $x$  is striving to point  $a$  from  $N$  set, then we will have  $f(x) \rightarrow A$ , when  $x \rightarrow \alpha$ ,  $x \in N$ , or  $\lim f(x) = A$ , instead of symbol  $x \rightarrow \alpha$ ,  $x \in N$ , we often use abbreviated form and instead of  $N \ni x \rightarrow a$  we write  $\lim f(x)$ .

Some may oppose, that the results of this record have the same advantage as the original Corlett Hague analysis (Corlett and Hague, 1953).

The survey of fundamental problem of aggregate demand and aggregate supply regulation demonstrated that the two main tools of control – monetary-credit and fiscal policies have different relative impacts on economic activities and on production volume of the country. That is why business sector development and the speed and scale of overcoming crisis depends on aggregate demand and aggregate supply response optimization to changes.

### *Business Sector Development and Overcoming Crisis*

Under the economic crisis, world economic processes showed that the policy oriented on supporting entrepreneurship development is particularly important for stable economic growth. Successful functioning of market economy and achieving optimal results is impossible without stimulating economic activity and small business development. From that point of view, it is obvious to rise following question: why is it a small business? Answer: Since the noticeable part of the population is employed in the small business sector that is why the orientation on small enterprises has a great role in business development. In addition, small enterprises based on different forms of ownership allow solving important socio-economic issues, such as de-monopolization of production and service manufacturing and selling, de-concentration of embedded enterprises, etc.

Sector development and determining the right strategy is unimaginative if we don't know who we are talking about. First of all, there is a need for proper explanation; who can be considered as a small and medium business. For example, micro, small and medium enterprises differ across the EU. The micro business status in EU has enterprise where less than 10 people are employed and annual turnover (or balance) does not exceed 2 million euros (See table 1).

**Table 1. Micro, Small and Medium Enterprises the EU**

Enterprise Categories	Quantity of Employed People	Turnover	or Balance
Medium	< 250	≤ € 50 m	≤ € 43 m
Small	< 50	≤ € 10 m	≤ € 10 m
Micro	< 10	≤ € 2 m	≤ € 2 m

(Source: European Commission [http://ec.europa.eu/growth/smes/business-friendly-environment/sme-definition\\_en](http://ec.europa.eu/growth/smes/business-friendly-environment/sme-definition_en))

According to U.S.A legislation, the economic subjects employing up to 500 people belong to small and medium-sized enterprise categories that are divided into three categories:

1. Micro Enterprises – companies, where the number of employees does not exceed 20 people.
2. Small Enterprises – companies, where the number of employees is from 20 to 100 people.
3. Medium Enterprises - companies, where the number of employees is from 100 to 500 people.

According to the EU's Small and Medium Business Annual Report, there are more than 20 million enterprises in the European Union, 99% of which are small and medium enterprises, where less than 250 people are employed. Majority (90%) in small and medium enterprise sector is micro enterprise, with an average of 10 people employed, while the share of average enterprises is 1% (Audretsch et al., 2009).

According to National Statistic Agency of Georgia classification of companies is based on the size and scope of their activities, which differentiates the following types of companies:

1. Micro Company (micro and small business individuals).
2. Small Company (belongs all organizational-legal form enterprises, where the average annual number of employees do not exceed 50 people and the average annual turnover does not exceed 12 million GEL).
3. Medium company (belongs all organizational-legal form enterprises, where the average annual number of employees varies from 50 to 250 people and the average annual turnover from 12 to 60 million GEL).
4. Large Company (belongs enterprise, where the averages annual number of employees exceeds 249 people or average annual turnover is 60 million GEL)<sup>2</sup>.

The small and medium enterprises in Georgia are all organizational-legal form enterprises created according to Law of Georgia on, where average number of employees and the annual turnover of the enterprise does not exceed the following margins:

- A. In the industry 40 employee and 500 thousand GEL.
- B. In construction 20 employee and 300 thousand GEL.
- C. In transport and communications 20 employee and 200 thousand GEL.
- D. In the agriculture 20 employee and 150 thousand GEL.
- E. In wholesale and retail trade 10 employee and 50 thousand GEL.
- F. In education, health care and culture 25 employee and 60 thousand GEL.
- G. In the course of implementation of other types of economic activity 15 employee and 100 thousand GEL.

Therefore, the law on Support of Small and Medium Enterprises, which was classifying enterprises before 2006, was considering all organizational-legal form enterprises to be small enterprise, if total number of employees was less than 20 people and annual turnover 0.5 million GEL. For medium enterprises accordingly 100 employee and 1.5 million GEL. In addition, enterprise was not considered to be small or medium, if more than 25% equity belongs to a person or people, who do not meet the requirements of the above mentioned law, as well as those firms, whose main activities were banking, insurance and other financial services.

According to current tax legislation, the micro and small business concepts entered into economic circulation, according to which the micro business status is assigned only to a natural person who performs economic activity

<sup>2</sup> National Service of Statistics of Georgia. Business Statistics. Available at <[www.geostat.ge/index.php?action=page&p\\_id=212&lang=eng](http://www.geostat.ge/index.php?action=page&p_id=212&lang=eng)>; Methodology for Calculation of Key Indicators of Business Statistics. Available at <[www.geostat.ge/cms/site\\_images/\\_files/english/methodology/BS\\_Methodology\\_ENG.pdf](http://www.geostat.ge/cms/site_images/_files/english/methodology/BS_Methodology_ENG.pdf)>

without a hired labor and at the same time his total revenue does not exceed 30 thousand GEL. As for small business status, it is entitled to entrepreneur (sole proprietor) if his annual gross income does not exceed 100 thousand GEL. According to the tax code of Georgia, taxable income of a small business shall be taxed at 3% if an entrepreneur natural person having the status of a small business has documents evidencing the fact that his/her costs incurred in relation to earning gross income (except for the cost of salary paid to employees) amount to 60% of the gross income (Tax Code of Georgia, 2017).

Besides what is written in law there is no perfect model for the classification of companies in Georgia. We think that it is necessary to take into account the foreign experience, from countries where in business function in practice, the classification of companies are done according to the following criteria:

1. Number of Employees – for industry.
2. Annual Returns (goods turnover) – for trade-intermediate area.
3. Value of assets – for financial and banking area.
4. Profit – for other areas.

Naturally, the country's economic growth is determined by the business environment that includes a mixture of consumer and state institutions that are the defining factor for the success of specific activities. Consumers and the state are also influencing business entities (Abuselidze and Katamadze, 2017). A strong and well-developed small and medium enterprise sector significantly promotes export, innovation, creation of modern entrepreneurial culture and at the same time plays a special role in raising the welfare of the country. In developed countries (including EU countries), small and medium enterprises generate more than 50% of the total turnover of entrepreneurial sectors and two out of every three jobs in the private sector. In The Organization for Economic Co-operation and Development countries (OECD), more than 99% of companies represent small and medium enterprises and in average they create 2/3 of gross domestic product (GDP). In the developing and transition economy countries, small and medium enterprises represent more than 90% of the total number of enterprises, but their share is generally low in GDP –in many cases less than 20% (EC, 2010).

Small business has proven that under the deepest crisis it is the sector of the economy that contributes to the growth of economic activity and production volume growth.

International practice shows that small and medium business is the main driving force for business in developed countries. Over 99% of enterprises in EU have a small and medium business status, where 67% of employees are employed, and the added value created by small and medium enterprises is 57.5% of the total value added. These statistics show the role of small and medium enterprises in business development (Lukashvili, 2016). That is why we believe that it is necessary to stimulate small business to ensure the development of the business sector, because small business is the prerequisite for the improvement of socio-economic conditions of the country.

In this situation, the main direction of small business development policy has to be extension of economic reforms, which involves the creation of new intra industry structures and proportions, in order to be able to produce competitive industrial products. In addition, special attention should be given to solving the urgent problems and implementation of measures, such as increasing the attractiveness of investment and attracting foreign investment, permanent analysis and perfection of entrepreneurial and legal environment, increase volume of import substitute and export production, economic activity, work place restoration, stimulation of creating new jobs, etc.

In terms of increasing economic activity and production volume, it is crucial to create jobs for small enterprises and business development, which will in turn lead to economic growth of the country.

The poverty level, depth and severity in the modern world is growing annually, accordingly is increasing cost of consumer basket. As a result of the post-communist transition process, the social structure of the country's population looks like this: the rich are 5%, wealthy are 10%, middling wealthy are 10%, unlikely wealthy are 20 %, poor are 45 % and poorest are 10%. As we can see, the share of the poorest, poor and the ones under risk poverty is 85% of population. This situation economically is ineffective, socially-unjust and politically-very dangerous (Meqvabishvili, 2010). One of the fundamental reasons for this is the relatively low level of development of small entrepreneurship and therefore deficit of jobs.

As we can see, the correlated problems with regard to the business sector are varied, but in spite of this we can not cope with the problem of competition.

It is not argueable that while discussing market economy, we willy-nilly imply free competition principles. According to Global Competitiveness Index (GCI) (Global Competitiveness Index..., 2017) ratings of countries are as follows: Switzerland (5.81), Estonia (4.78), Lithuania (4.60), Poland (4.56), Azerbaijan (4.55), Russian Federation (4.51), Latvia (4.45), Kazakhstan (4.41), Slovenia (4.39), Turkey (4.39), Georgia (4.32), Armenia (4.07), Ukraine (4.00). As we can see, Georgia's absolute lack of free competition is not really reason to be proud of, while in the developed countries exactly competition is the constant concern. Especially since the catalyst for establishing competitive environment is small business developments, that promotes modern standarts and lifestyle in the city or village. This in turn restricts the growth of large urban agglomerates and creates a solid foundation for the improvement of socio-economic development.

## Results

Competition quality and profitability of enterprises in business is one of the defining factors of the compensated financial policy. According to Sismondi, competition has fatal economic and social consequences,

particularly empowering the main part of population and economic crises. In our opinion, tough competition forces producers to deliver their products to consumers for the lowest possible price. Whereas the average cost of enterprises are almost equal, they do not have advantage over production cost, and the mean of reducing higher prices (due to taxes) is taking over the burden of these taxes by enterprises, i.e. competition pushes companies to lower prices, and their profitability is a key factor in the realization of a low price.

Therefore, if there is no competition in the business, this circumstance will decrease stimuli to lower prices and consequently tax burden will press down consumer. And if the enterprise profitability will be low, then they will have less opportunity to take over tax burden that increase price (Abuselidze, 2012).

All of the above can seem as some utopia, as for a person who was born and lives in a country where monopoly is supported, it is difficult to judge a monopoly and free competition.

There are many serious hindering factors in forming business in Georgia. The most important out of them are:

1. State's failure in business interest protection.
2. Bureaucratic approaches and corruption in state structures.
3. Internal market vulnerability.
4. Constant variability of tax legislation.
5. Not having a perfect model of the classification of companies.
6. Excessive intervention of state governance and control bodies in business.
7. High cost and difficult accessibility of credit resources.
8. Weakness of monetary policy, etc.

Therefore, the main obstacle to business activity is related to the inefficiency of managing the state apparatus as well as inefficiency and imperfection of fiscal and monetary-credit policies.

However, there are some step forward actions in promoting business development, but there are some problems, namely:

1. There are problems in terms of awareness and unfairness. This is a very difficult issue for beginners. In particular, small and new enterprises are imposed with huge sanctions on the first mistake. It is necessary that the auditor (the reviser) first of all to consider the specific company as a client and give a thorough consultation to the problematic issue. The system should not be oriented only on fines and sanctions, as the use of warnings on the first mistake will be good as recommendation.
2. For expansion small enterprises in Georgia use their savings, while credits for large entrepreneurs do not appear to be difficult to be taken. This fact underlines uncertainty of the credit system.
3. Although it is simplified to start a business (The doing business ranking also confirms this), but Georgia is probably the only country in the world, where newly established enterprises are start registering liquidation as soon as they start their activities.
4. The licensing process is simplified, but appeal process is ineffective.
5. Tax burden in the country is the hardest and we can say the catastrophic as well. High specific weight of taxes enforces manufacturers to reduce production volume, what causes job restriction and growth of unemployment.

In this regard it is interesting to discuss the nuances of the tax legislation of some foreign countries and issues related to small business, which will naturally allow us to make parallel with Georgia during analysis.

In general, with the liberal tax system is distinguished Asian countries: especially Hong Kong, South Korea, China, and Singapore. It is also known that United States and Great Britain are in the middle of the rating. As for the EU, small and medium enterprises can get two types of benefits:

- participate in business promotion programs such as: Financial Status Survey, Competitiveness Assessment, Innovation Funding and other similar projects supported by local governments;
- fewer requirements and reduced taxes determined by EU countries;

There is a practical approach in EU countries - the existence of a comprehensive framework for small and medium business policies of the Small Business Act. It aims at improving entrepreneurship approaches in Europe, simplifying the normative and political environment for enterprises and lifting barriers for their future development.

The main priorities of the act are:

- promotion of entrepreneurship;
- less regulatory burden;
- access to finance;
- availability of markets and internationalization; (European commission, "The small business act for Europe").

The implementation of the law should be carried out with us, if we want to adapt to European market standards, it should regulate any regulation of small businesses that will facilitate the internationalization of business. The five active strategic directions can be distinguished from the above mentioned act:

1. Further improvement of legislative and institutional business environment.
2. Improving access to finance.
3. Development of competitive human capital, entrepreneurial skills and modern entrepreneurial culture.
4. Promotion of export and internationalization of small and medium businesses.
5. Support for innovation and research and development (R & D).



It is necessary to share the practice and implement a “small and medium enterprise test” to assess the real impact of existing legislative norms. In the German Entrepreneurial Law, reforms are directed towards eradicating barriers to the activities of companies. Consequently, it does not apply to the simplification of entrepreneurial legislation, both at the EU and at national level. The reforms were aimed at strengthening the competitiveness of German corporate law and, over time, some simplification in some matters. By this regulation, it was possible for companies to be registered with German GmbH (Limited Liability Enterprise) or the legal forms of AG (Limited Joint Stock Company) in foreign countries. This is aimed at increasing and increasing the competitiveness of legal forms of the German enterprise and is a response to the spread of legal forms of a foreign enterprise. The idea of this reform is that German companies will maintain a legal form of German enterprise for foreign branches.

In addition, a simplified form of limited liability enterprise was created in Germany for a small start-up business - Limited Liability Company. It has no minimum requirement for equity capital.

Entrepreneurship in France entails the goal of liberalization, ethical regulation and technical aspirations, which are reflected in its legislative acts. The legislation also aimed at promoting small and medium enterprises and is aimed at simplifying business regulatory rules, making it possible to establish a limited liability company with just 1 euro. The main objectives of the French legislation on entrepreneurship are to simplify the business environment and promote the transformation and development of enterprises and expand access to all;

The Danish plan for de-bureaucratization meant a reduction in uncertainty and bureaucracy and the creation of better conditions for business. This plan included initiatives relating to the creation of better conditions for business, simplification of regulatory bodies with regulatory authorities; Simplified reporting, conducting effective and oriented examinations, and so on.

In Latvia, amendments have been made to harmonize the European Entrepreneurial Law and their National Legislation. It included general norms related to commercial activities, reorganization of commercial organizations and commercial organizations (Koberidze, 2015).

This chart takes into account the total taxes, including “stealth” taxes (green and carbon taxes, for example) imposed by a country at all levels, national and local, as a share of GDP. It includes as well overall government spending, which will only get worse in reaction to the economic meltdown and contracting economies around the world (Andersen, 2009a). For example, Danish and Belgian citizens are taxed with more than half of their income. Some countries, such as Norway, are running large surpluses because of North Sea oil taxes. Others, such as France, are spending more than they’re taking in. The resulting deficits are covered by public debt repaid through future taxes and stealth taxes. According to Forbes 2009, “Tax Misery and Reform Index” (Andersen, 2009b) - Georgia according to low tax rate is on the fourth place after Qatar, the United Arab Emirates and Hong Kong.

Currently 6 taxes operate in Georgia, instead of 21 that were before 2006. In our opinion, tax burden severity determines not the number of existing taxes in the country, but what taxes is each payers paying and what its burden.

Of course, it is not controversial that any tax burden on its own includes a combination of different tax rates, which can be imposed as follows:  $A \subset A$ .

If there are different types of taxes in the state and we will take rates according to profit (margin) of entrepreneurial activity, we may write it as following:

$$\begin{matrix} a_{11} & a_{12} & a_{13} & a_{14} & \dots & a_{1n} \\ a_{21} & a_{22} & a_{23} & a_{24} & \dots & a_{2n} \\ a_{31} & a_{32} & a_{33} & a_{34} & \dots & a_{3n} \end{matrix} \quad (2)$$

$a_{ij}$  points  $i$  entrepreneurial activity break down, while  $j$  indicates taxes, which individual entrepreneur should wait.

If we also consider how economic activity and production volume will be distributed under the current tax burden, then we will have:

$$\begin{matrix} T_{11} & T_{12} & T_{13} & T_{14} \\ T_{21} & T_{22} & T_{23} & T_{24} \\ T_{31} & T_{32} & T_{33} & T_{34} \end{matrix} \quad (3)$$

Which shows  $T_{ij}$  ( $i, j = 1, 2, 3, 4$ ) economic activity and production volume, that can be achieved under optimal tax burden.

Our approach of tax burden optimization is confronting Sandmo (1990), which considers tax figures fixed. According to Krueger and Ludwig (2013) the substantial increase in labor income tax progressivity induces a gradual reduction, over time, in earnings, consumption and wealth inequality, in the order of about 2-3 points for the Gini coefficient, depending on the variable. In our opinion tax rates should be progressive and tax burden should be totally determined in terms of entrepreneurial activities, i.e. differentiated between large, medium and small entrepreneurship (by economic activity).

This function can be displayed by the following formula:

$$\begin{aligned}
\int a_{11}x_1 + a_{21}x_2 + \dots + a_{1n}x_n &= b_1 \\
\int a_{21}x_1 + a_{22}x_2 + \dots + a_{2n}x_n &= b_2 \\
\int a_{n1}x_1 + a_{n2}x_2 + \dots + a_{nn}x_n &= b_n
\end{aligned} \tag{4}$$

where  $b_1=b_2=b_n=38.2\%$

Such optimization of tax system, in our opinion does not violate the principles of fairness and effectiveness. Despite the fact that it is difficult to determine fairness or unfairness of the state tax policy.

Economically strong state is based on efficient tax system operation, for which is necessary not only optimal tax rates, but high tax culture of taxpayers, such as: understanding of tax collection principle and importance of its payments, high liability of each entrepreneur, taxpayer and administration quality (Abuselidze, 2013).

It was found that international experts have recognized Mexico as the most optimal state for small and medium enterprises. Puerto Rico is on the second place and the US and Australia on the third place.

In terms of small and medium enterprises, Georgia has nothing to be proud of compared to foreign countries, because if Mexico is on first place, our country is probably next-to-last, that is regrettable.

Research conducted under G4G (Governing for Growth..., 2016) shows that most surveyed enterprises have expressed desire to improve tax legislation. Two third of them require the simplification of the tax code – in particular to change ambiguous regulations, so that there was no chance for several interpretations. Only 5% of surveyed companies consider that tax legislation should not be changed.

As we see, one group of business sector believes that systematic legislative amendment is necessary for perfection, since Georgia is still in the process of reforming market economy. In our opinion, Georgia is already an open market economy country and introduction of different nuances in legislation, naturally in some cases will have positive and in some cases negative results. The words of Osman Chalikshan-Mzhavanadze, head of International Investors Association of Georgia about lack of qualification says: “Business in Georgia is free, but investors face problems with low qualification of staff” (Chalikshan-Mzhavanadze, 2017).

Awareness and unskilled syndrome derangement is important, which was described in G4G study, which states that “small and medium-sized individual entrepreneurs, are less involved in the tax legislation change processes. On Revenue Service open door days was revealed that they are the least likely to complain fines and for their employees trainings and seminars about tax issues are less accessible”. 45% of surveyed companies under G4G survey indicate that their employees are always available to participate in meetings, conferences and training programs. These are mostly large companies. And a small part (10%), which claims that such activities are not available for small and medium-sized companies and sole proprietors are operating in service and trade sectors.

The USAID study states that changes are not always clear and easy to understand. This may become the basis for unintentional infringement of the law and fines. In conclusion, we can say that despite having internationally recognized liberal tax policy, companies’ attitude to the country’s tax legislation is more negative than positive. The reason for this is the frequent changes of tax code and obscure records, as well as heavy tax burden.

Minor changes in the certain segment of the economy, including in the tax system, as well as piece by piece transformation of economic segments does not give the desired result. According to the economic theory of supply with the view of resolving the problem of country’s economy tax decrease is necessary. With low tax rates business owners have opportunity to accumulate, which provides complete utilization of business potential and increase of GDP of the country. According to Angeletos (2003) monetary policy is intrinsically more effective as an instrument for managing the business cycle, I believe that we should carefully investigate the alleged asymmetries between fiscal and monetary policies. Therefore, in our opinion, a new complex program of economic reforms should be developed, which will balance compensated financial policy, to comply all its composite elements.

In order to analyze the impact of tax burden on macro-micro economics, on any type of economic activity, it is important to understand how fair taxes are distributed among different farmers, producers and consumers on different social classes (Abuselidze, 2015).

The socio-economic level of the country is substantially stipulated by strengthening financial sphere, which can not be implemented without optimal and reasonable financial policy. Nevertheless, it is not arguable that it is a very difficult problem to develop and implement in practice compensated financial policies.

In fact, peak of compensated financial policy can be considered condition, when favorable economic environment is reached for the best functioning of economy, when enterprise activities in the country will expand. i.e. on the one hand tax should be optimal for both government and individual entrepreneurs. This condition should be considered situation, when budget revenues and volume of economic activities and production increase simultaneously. On the other hand, the country’s monetary policy will be oriented on promoting economic activity and business sector development.

## Conclusions

Analysis of conducted research reveals political recommendations for practical use of fiscal policy. By using the method of “social stimulation” the state can establish order in the process of market stratification and establish a strong class of entrepreneurs. In particular:

- an environment in which family business will be successful;
- protect the principle “first of all”;
- give a guarantee to honest entrepreneurs who have recognized the bankruptcy to get another chance soon;
- state administration needs to meet the needs of small and medium businesses;
- have support for participation in state procurement and effective implementation of state support;
- ensure the availability of funds for them and develop a legal framework for timely settlement in commercial operations;
- have support for innovations;
- involving entrepreneurs in the opportunities of economic problems, transformation;
- let’s get support from the market growth. If dosage of the combination of measurements is correctly selected, we will get the best result: full employment, stable prices, tax balance equilibrium, decrease of money supply, elimination of budget deficit, high interest rates. Such situation will prompt the economy to stabilize and develop business activities.

The improvement of the business environment, is the main condition for national farming development.

By “Social stimulation” theory it is possible to stimulate economic activities and create a strong class of entrepreneurs.

Small enterprises allow solutions to the problem of de-monopolization and decentralization of producing and selling products and services.

Tax severity and difficult tax regulations affect the success and development of the business sector.

The quality of compensated financial policy performance is determined by condition how transparent and impartial is the operation area and how successful it is to regenerate income, for farther stabilization of the economy.

The economically strong state is based on the efficient functioning of the tax system, for which is necessary not only optimal tax rates, but also high tax culture.

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**Contact person:**

George Abuselidze, Batumi Shota Rustaveli State University; Ninoshvili street 35, 6010 Batumi, Georgia; e-mail: abuseri@mail.ru, george.abuselidze@bsu.edu.ge

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