

Local Investment Climate and the Role of (Sustainable) FDI: The Case of Georgia

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Abstract—The article focuses on the role of FDI in Georgia's economic development for the last decade. To attract as much FDI as possible a proper investment climate should be on the place - institutional, policy and regulatory environment. Well developed investment climate is the chance and motivation for both, local economy and foreign companies, to generate maximum income, create new work places and improve the quality of life. FDI trend is one of the best indicators of country's economic sustainability and its attractiveness. Especially for small and developing countries, the amount of FDI matters, therefore most of such countries are trying to compete with each other through improving their investment climate according to different world famous indexes. As a result of impressive reforms since 2003, Georgian economy was benefited with large invasion of FDI, however the level of per capita GDP is still low in comparison to Eastern European countries and it should be improved. The main idea of the paper is to show a real linkage between FDI and employment ration, on the case of Georgian economy.

Keywords—Foreign Direct Investment, Sustainable Development, Corruption, Employment/Unemployment.

I. INTRODUCTION

GEORGIA is a small country in the east Europe with a population of approximately 4.5 mln people. Georgia is a bridge between Asia and Europe, Russia and Iran. With its location in the Central Caucasus Region it becomes a regional player for its transitional opportunities; however, sometimes it puts Georgia under hard pressure from the global political players.

Like other former Soviet countries, Georgia's economy initially suffered from the legacy of a centrally planned economy [14]. However, after the "Rose Revolution" of 2003, Georgia has undertaken a series of progressive reforms in different areas: anti-corruption, tax codes, infrastructure, governmental institutions, etc [1].

Georgia's economy is quite diversified. Agriculture is the sector with the most employed persons. Georgia has a manganese and copper mining industry, which is totally oriented to export [3]. Industries present in Georgia include aircraft manufacturing, bottled water wine production, chemicals, fuel and used car re-export, machinery, wood products, steel, shoes, textiles. A summary of key economic indicators is provided in Table I [13].

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TABLE I
A SUMMARY OF KEY ECONOMIC INDICATORS FOR GEORGIAN ECONOMY

	2007	2008	2009	2010	2011	2012
GDP (USD billion)	10.2	12.8	10.7	11.6	14.4	15.8
GDP growth (%)	12.3	2.1	-3.8	6.3	7.2	6.2
GDP per capita (USD Thousand)	2.31	2.92	2.45	2.62	3.23	3.52
FDI (USD Billion)	2.01	1.56	0.65	0.81	1.11	0.91
Inflation (%)	9.2	10.0	1.7	7.1	8.5	-0.9
Employment (Million)	1.70	1.60	1.65	1.62	1.66	1.72
Unemployment (%)	13.3	16.5	16.9	16.3	15.1	15.0
External debt (USD Billion)	3.3	4.9	6.0	7.2	7.8	7.8
Exports FOB (USD Billion)	1.2	1.4	1.1	1.6	2.2	2.4
Imports CIF (USD mln)	5.21	6.30	4.37	5.09	7.05	7.84
Reserves (USD Billion)	1.34	1.46	2.11	2.26	2.81	2.87

NB.* stands for the 11 month of 2013 year.

Source: WB, CIA World Fact book and National Statistics office of Georgia [17]

There are numerous aspects which should be taken in to account while evaluating the investment attractiveness of a country [12]. There are a lot of international indicators according to which one country could be in the top and another according to which the same country could be in the bottom, the same with Georgia:

- Georgia is amongst the leaders in the following ratings: Registering Property - 1st place; Starting a Business - 7th place; Dealing Construction Permits - 4th place.
- Tax Misery & Reform Index, released by "Forbes", says - Georgia is the fourth least tax burden country after Qatar, UAE and Hong Kong.
- According to the Heritage Foundation's 2013 Index of Economic Freedom, Georgia is ranked 21st out of 177 countries.
- In "Paying Taxes 2013" Georgia took 33rd (39 in 2012) place out of 185 countries for having the easiest tax structure.
- According to the World Bank report "Investing Across Borders" (IAB), Georgia is one of the most open countries to foreign equity ownership among 87 countries. The same organization in 2011 awarded Georgia as "Top Reformer" according to five-year measure of cumulative changes, saying no other country has made so many deep reforms in so many different areas so consistently [19].
- According to WB Georgia has improved its positions in

“doing business index” from 112th to 9th place in 2012 and it was even improved by one position (8th place) in 2013. Georgia is the only “new democracy” in the top ten and the best performer in the Eastern Europe and Central Asia (ECA) region. All above mentioned successes shows that Georgia should become more attractive for local and international investors. However, there are also some other researches which shows “not the best positions” of Georgia:

- According to "Forbes", in the "Best Countries for Business 2012" Georgia is ranked 50th out of 134 countries (61 in 2011);
- In 2011, "Fitch Ratings" so far has upgraded Georgia's IDR only to "BB-".
- According to World Competitiveness Index Georgia is only 72nd (see the Table II).

TABLE II
 GLOBAL COMPETITIVENESS INDEX – GEO (2013/14)

Basic Requirements - 57	
Institutions	64
Infrastructure	56
Macroeconomic Environment	60
Efficiency Enhancement - 86	
Higher Education And Training	92
Goods Market Efficiency	67
Labor Market Efficiency	40
Financial Market Development	75
Innovation/Sophistication - 122	
Business Sophistication	120
Innovation	126

Source: World Economic Forum [9]

Which indicators are more valuable for foreign investors? To answer this question we should look closer to the key factors. According to official data from the National Statistics Office of Georgia FDI's invasion was sporadic, however the distribution looks very reasonable if we take in to account the world financial crisis, Georgia-Russian war and a number local elections (see the Table III).

TABLE III
 INFLOW OF FOREIGN DIRECT INVESTMENTS TO GEORGIA

Year	Total	Q I	Q II	Q III	Q IV
2007	2 014.8	421.4	401.5	489.1	702.9
2008	1 564.0	537.7	605.4	134.7	286.2
2009	658.4	114.0	177.2	173.2	194.0
2010	814.5	166.5	208.3	225.6	214.1
2011	1117.2	209.7	248.3	316.6	342.6
2012	911.6	261.2	217.7	199.0	233.7
2013*	697.3	226.2	232.4	238.7	-

Source: National Statistics Office of Georgia [17]

II. FDI AND GEORGIA

Unlike remittances, FDI is considerable vulnerable to shocks and economic downturns, investors are thinking twice before making a decision to invest to any country, especially to the unstable country, while remittances are send even in a bigger amount during the hard times from the family members

living abroad to their family members stayed at home country. At the same time economic growth is one of the most significant determinants of external investment [5] – the shrinking of the world economy during the financial crisis dwindle the investment-making desire of foreign investors and as a result reduced FDI flows [2].

As a matter of fact the traditional FDI trend is that it increases from quarter to quarter and the following quarter data exceeds the previous one normally. This trend more or less was kept within all years in Georgia, except 2008 when the double crisis for Georgia occurred: a) war with its neighbor Russia and b) world financial crisis. It is also important to note that

In 2011 WB and OECD reported an improvement in global FDI trends, claiming ascend by 17% and forecasts for the end of the global recession [6]. Georgia at that time was on its uprising trend and also followed international trend with FDI inflows growing 27% as compared to the previous year. In 2012, however, Georgia again undergo by 28% downturn, experts say because of not stable political life for last year's (the ruling power has been changed).

Local experts and international organizations are simultaneously claiming that it is an alarm for Georgian policy makers. Georgia's domestic capital market is still weak, leaving economic development considerably dependent on external sources of finance, FDI in particular, and especially for large infrastructural projects that would otherwise be not possible to finance throughout the local banking sector [6].

Representatives of “Georgian Dream” (the ruling party in Georgia) believe that Georgia can attract up to \$2 bln investments next years. But, if take in to account the number of unemployed persons in Georgia (around 300 000 people) we can easily calculate that even \$2 bln investments each year are not enough for Georgia. Since creation of one workplace usually costs around 40 to 50 thousand US dollars, we need almost \$15 bln to employ all these people, consequently we need at average \$3-4 bln investments per year to solve the problem in comparatively short period of time.

Some of the local experts believe that, considering the positive correlation between FDI and global shocks, hence it was easy to guess that Georgia's declining FDI was the result of global trends. Also, it is important to remember, that all over the post crises period, the impact of the depression had different impacts on developing, developed, emerging and transition economies. While, economic expansion in 2011 was universal, in 2012 FDI turn down was spread unevenly being most tough to US and EU (most affected by the Eurozone crisis), and least negative, if not positive (for the first time, the developing world's share of global FDI inflows exceeded that of the developed) to the developing world [16].

TABLE IV
 FDI IN GEORGIA BY MAIN INVESTOR COUNTRIES (MLN USD)

Countries	2008	2009	2010	2011	2012	2013*Q I-III
Total	1563	658	814	1117	911	486
EU Countries	476	224	248	554	440	259
Germany	40	21	12	25	138	95
UK	148	72	58	54	93	25
CIS Countries	94	1	91	193	86	46
Azerbaijan	23	29	57	138	59	23
Russia	26	10	47	55	20	582
Other	968	390	429	275	321	339
Virgin Islands	156	35	40	42	19	-7
Saudi Arabia	-	-2	-	2	39	276
Turkey	164	97	91	75	81	31
United States	167	-10	135	28	20	35
Int. Organizations	23	30	45	94	63	48

Source: National Statistics Office of Georgia [17]

Countries that make major contributions to the growth of FDI inflow level are the following: Netherlands, Germany, Virginia Islands, Turkey, the US, Kazakhstan, Russia, Cyprus, Saudi Arabia and the UK (see Table IV). [17] The important fact is that investments from Virgin Islands has been decreasing year after year, ending with the 10 times less investments in 2012 compared to 2007. This numbers mean that offshore investments are not interested in Georgia any more. Meanwhile investments from Turkey, Germany and UK are more or less stable and with the tendency and possibility to growth.

TABLE V
 FDI DISTRIBUTION BY SECTOR

Sector	%
Financial	20
Transports and Communications	20
Energy	14
Construction	9
Manufacturing	7
Agriculture	5
Mining	4
Other	21

Source: National Statistics Office of Georgia [17]

Table V clearly demonstrates the distribution of FDI by sectors according to the latest data. Traditionally the leader sector taking the biggest share in the FDIs in previous years – energy, moved to the second place, letting forward a) Financial and b) Transport and Communications sector (according to Q3 2013). Other part of foreign direct investments were distributed to the following sectors: Construction (9%), Manufacturing (7%) and Mining (4%). One of the biggest disappointments in the structure of FDI inflow is the share of Agricultural sector (5%), which was traditional leading sector of the economy in Georgia, before the USSR braking down.

According to FDI performance index, Georgia ranked quite high in 2008 – given the 9th place, as compared to the 114th place that it reached in 1995. This is not the whole story,

though. Market size does have considerable strength of enticing FDI, but it is not the only factor by far. Georgia's ranking in market size is very low – the 103th place in 2013.

Economists all over the world agree that there is a positive correlation between GDP and FDI inflows. An empirical result of numerous econometric researches shows that FDI encourage economic growth, hence the GDP growth [11]. The same is for Georgia, the correlation does really exist and it is positive and hence it positively influences economic growth of the country [7].

III. FDI AND SUSTAINABLE DEVELOPMENT OF GEORGIA

Despite the tremendous experience gained by FDI beneficiaries, the most significant points: 1. to attach investment policy to an overall development plan in a way to guarantee the sustainable development and 2. to ensure investment policy relevance and effectiveness for building stronger institutions – most often are neglected [9]. In the majority of cases, the greed for increasing the amount of investment is dominant and calculation of future long-term outcomes is not taken in to a consideration [4].

The idea of Sustainable Investing/development, which has grown extremely in the past decade in developed countries means to reduce of environmental risks and ecological scarcities, for the prosperous future of our decedents [8]. However, official position to restrict all “non sustainable” investments in Georgia is not yet achieved and to think rationally almost impossible to achieve in a country with almost 20% of unemployment, a big muss of people under the poverty line and one of the smallest GDP per capita income [15].

However, it does not mean that Georgia should welcome any investment; vice versa it should force the government and NGO sector to work harder in this way. Some of the global partnership examples for Georgia, like Association Agreement projects with EU, will provide Georgia with an opportunity for its sustainable development [10]. Despite the fact that compliance with EU standards in short period of time will be expensive as for the Government of Georgia so for the business, it will be really profitable in a long run prospective from the sustainable point of view.

IV. MAJOR PROBLEMS OF ATTRACTING FDI TO GEORGIA

Despite the fact that Georgian government has contributed much effort to improving the investment climate in Georgia, yet there are a number of trash wholes, which might dampen foreign investors positive incentives related to the country. It comes out that corruption free economy and friendly atmosphere are not enough components for significant FDI inflow formation.

The main problems existing today in Georgia in relation to the business climate are:

- Infrastructure. Despite the significant progress in this area, much remains to be done, especially in the rural areas;

- Georgia is still dependent on its neighbor countries in terms of energy resources (natural gas, oil and electricity);
- There is a concern for objectivity and fairness of judges both in lower and higher courts.
- Georgia is a relatively small market and attracting large companies is a difficult mission.

V. MAJOR ADVANTAGES OF ATTRACTING FDI TO GEORGIA

- **Strategic location** of the country, which gives a opportunity to reach hundreds of millions of customers in its neighborhood, with opportunity to rise this number to 1 bln after signing an Association Agreement with EU.
- **Corruption-Free Environment.** According to all surveys done by Transparency International, Georgia is one of the leading corruption free countries in the world outperforming many EU member countries.
- **Minimum number of Taxes.** According to "Forbes", Georgia is the fourth least tax burden country after Qatar, UAE and Hong Kong.
- Existence of **Free Trade Zones** with special beneficial conditions for investors exists in different parts of the country.
- **Free trade regimes** with the neighbor countries and opportunity for EU market free entrance after the Deep and Comprehensive Free Trade Agreement (DCFTA) will be signed with EU.
- Georgia is the world's **top reformer** and has increased its positions in a variety of international indexes giving a promise for farther impotents;
- **Simplified Licensing Procedures**, which takes the less effort, time and money than anywhere else in the world. [18].

VI. CONCLUSION

Attracting FDI to Georgia is an issue of major importance nowadays. Georgia is not short of local dynamos of economic enlargement that could potentially catch the attention of investors; however, the small efforts done for the promotion of local savings to transform it to the investments is hinder the economic development of the country.

Foreign Direct Investment works as a locomotive to enlarge the transfer of technology, skills and access to export markets. It can decrease unemployment and increase employment; contribute to a higher GDP through higher levels of productivity.

While empirical analyses show the institutional factors as a key challenge for FDI inflows, less attention is given to the relationship between political risk and investment decision. Many of transition economies of Eastern Europe and the CIS have practiced an enormous progress in FDI inflows during the past decade. Meanwhile, other countries in the region especially with low democratic characterizes – have been usually ignored by international investors. Fortunately Georgia has overcome this negative factor.

The government of Georgia is ready and willing to provide greatest assistance to investors in the Georgian economy. Particular attention is paid to improving the business climate

through further streamlining the business regulation procedures, liberalizing the financial sector and even more decreasing the tax burden. It would be great for the future of Georgia if reforms will be done taking in to a consideration very important parameters of growth in a sustainable way.

Despite the political and economic difficulties Georgian government in last years has devoted a large amount energy and effort to give the second breath to the investment climate and more FDI's than in previous years are expected.

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