

The Role of Institutional Reforms in the improvement of the Georgian Investment Environment

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Abstract

The Paper consists of a wide range of informative materials demonstrating the improvement of economic and social state of the transitional countries. Institutional reforms are of a great importance, as successful institutional reforms encourage a greater investment inflows in the country. The only way to overcome unemployment, poverty and promote the significant economic growth is an implementation of institutional reforms along with the increase of investment activity. From this point of view, the possibilities of local funds in transitional countries, particularly in Georgia, are small. That is why the main priority is an attraction of foreign investments. But these actions are based on important institutional changes. Foreign investments are one of the driving forces of the process of globalization and are a significant element of the modern world economy. They promote restructurization of a industry at the regional and global levels and thus ensure the integration of national economy in the world economy more effectively than trade. Foreign investments stimulate economic growth and development, providing economies with not only financing for development, but also with new technologies and better management techniques. In addition, Foreign Investments integrate production systems with one another. In this way, Foreign Investments can play a key role in the development of transitional economies and in their rapid integration into the world economy.

The Paper gives a clear picture of the Georgian economy and fields where foreign direct investments are made to illustrate how institutional reforms can create attractive business environment and promote economic growth. The study overviews the reasons of making investments in Georgia, the main tendencies of FDI in Georgia. The Paper emphasizes the following reasons why Georgia remains the attractive country for foreign investors. These reasons are: the adequate institutional reforms and free market oriented economic policy, attractive macroeconomic environment, competitive trade regulations, liberal tax code, aggressive privatization policy, modernized business licensing system, adequate technical regulation system, strategic geographic location, competitive and dynamic banking sector, Georgia is a country of ancient culture and traditions, with diverse investments sectors. The report argues, that despite the current global financial crises and Russian –Georgia War in 2008, the country remains an attractive place for foreign investors.

Keywords: economic growth, foreign investment, globalization, institutional reforms, transitional economies.

Introduction

At the present stage of development of Georgia the main purpose is integration into the united European economic system, which can be achieved through the harmonization of the activities of the political and economic institutions of the country with the European establishments. The historical experience of development of some states witnesses that reduction of unemployment and poverty in the country can be reached at the expense of institutional reforms and expansion of the investment activity. Proceeding from all this, the role of the Georgian investors in this direction is quite modest, so the priority declared by the government is the attraction of the foreign investments to accelerate the economic development of the country. Thus, the country declared the course aimed at liberalization of some economic institutions, implementation of the economic policy.

In November 2003, after the “Revolution of Roses”, the main question in Georgia was as follows: Will Georgia turn into a democratic country with the prospects of development till the middle level of the EU countries? Unlike many post-Soviet powers, being at the crossroad, the post-revolution Georgia did not delay with starting the reforms in all the fields simultaneously: a decision was adopted to conduct the constitutional and administrative reforms, 100% privatization, reduction of taxes and duties, arrangement of the wide-scale deregulation, implementation of the educational, healthcare and pension reforms. Wide world experience of economic reforms enabled Georgia to choose the most appropriate directions for the quickest development of the economy of the country. The acceleration of liberalization of economy and formation of the institutional prerequisites for development of the private sector have become the clear priorities.

The first real reform, from which the new economic life of Georgia started, was quite unusual. All the police workers were discharged and new people were hired on their positions. The road police was abolished at all. The police patrol of the American type was formed, which also executed the functions of the regional police. In March 2005 the state program of economy deregulation was adopted. It postulated the following reforms: the number of ministries was reduced from 18 to 13; the amount of state services – from 52 to 34; 35% reduction of the personnel, engaged in the ministries and 50% reduction – in the public sector (M. Melashvili, 2012).

A positive role in the private business development was played by the reform, which postulated reduction (in 2006) and full abolishment (in 2007) of the authorized capital. Georgia has become the only country of the post-Soviet space, in which it takes 1 day to register the enterprise of any type. Instead of the traditional antimonopoly legislation the Georgian government has adopted the law “on free and competitive trade”, which enables to prevent transfer of the monopoly right by the state to the private or state company. In summer 2006 the new rules were adopted for the work at the financial and exchange markets, which opened them for the international competition. The same summer the new Code of Labor was adopted, which enabled the employees and employers to conclude the contracts on their own consideration and consent. From that period the private companies are not obliged to pay allowances on motherhood.

The reforms also tackled the sphere of foreign policy and foreign trade relations, which were conducted here as unilateral. Firstly the visas were abolished for the citizens of practically all the countries. The Georgian authorities gave such opportunity to all those wishing to have the double citizenship, understanding that this will have positive influence on the economic activity of the

citizens. An important step was liquidation of all the barriers on the way of capital inflow into Georgia. The foreign banks of A+ category and higher can enter the Georgian market without any limitations.

The system of management in the energy sector was completely renewed. 100% privatization was planned and started and mass practice was introduced of the long-term contracts with the right of their re-sale to such type of property, as: agricultural, municipal and industrial lands; fishing, forest and water resources; marine fleet; railways together, etc. The reforms yielded the tangible results. The aggregate growth of GDP in the period of 2006-2012 was 39%. GDP per capita in 2012 made up \$3 800, investments – 30% of GDP (T. Shengelia, 2013). All this is in the background of the Russian unilateral embargo on the Georgian produce and prohibition on transport carryings and labor migration.

At last Georgia appeared in the world researches, conducted by different expert institutions. In the report of World Bank “Doing Business 2012” the country occupied the first place in the world by the rate of reforms being conducted – instead of the second position in the report of 2011. In result, by all the positions in the present research Georgia occupied 14th place – instead of 112nd in 2006. In the rating of economic freedom of the fund Heritage Foundation Georgia occupied 35th place with awarding the status “almost free” instead of the status “almost not free” (T. Shengelia, 2013).

The institutional liberalization does not mean that all the goods of the reform have already reached each citizen of Georgia. Many of them have not understood the essence of changes, not all of them have “the market acumen” and readiness to change the habitual mode of life. Georgia, surely, faces the problems. Despite expectations, the centralized bureaucracy still has influence, and the amount of the state debt does not practically reduce and even increases (by the beginning of 2012 it is 35% of GDP). Growth of state revenues enables to develop new, not quite liberal, social initiatives of the state on forming the work places and programs for assistance to business, such as, for example, the programs “cheap credit”: in Georgia there still exists a strong wish to get privileges at the expense of others and with the help of the state treasury. The tough centralization of power and, correspondingly, of reforms and regional policy gives no will to real competition in searching the most appropriate decisions; supremacy of law and guarantees of the right of ownership are not yet provided at the proper level. The events of October 2012 – the new parliamentary elections – made the government to recognize their mistakes and to think about their corrections.

Not enough attention is attached in Georgia to the issues of corruption and its analysis. In addition, there exist dangerous tendencies of such type, as excessive belief of people in the state assistance, high level of politicization of business, great dependence of the Georgian NGOs on the foreign subsidies. Despite strict power vertical the economic liberalization gives an impulse to revival of democracy: people gradually possess property, which they want and try to protect, with time they will also vote with the greater responsibility. The reforms then will become irreversible. The Georgian authorities, even after last presidential elections do not stop on the achieved. In the nearest time the reforms will be conducted to strengthen the guarantees for the right of ownership. The development of infrastructure is planned in the country: construction of new airports and railway stations. The taxation and customs base will be turned into the electronic format. The foreign companies will have the opportunity to simplify the access to trade at the local securities market without the need to open a branch in Georgia. The new initiative is thought for turning Georgia into the competitive country of the global scale.

The reforms, being conducted in Georgia, presented the country to the world community as one of the rapidly developing state in the world scale. The successes of its economic development are made of several components: economic reforms are of systematic character; the strategic geopolitical position enabled to use this resource for acceleration of the economic development of the state; the efficient taxation reform is conducted in the country; the procedure of licensing is simplified; anticorruption atmosphere is formed; the mechanism of obedience to the law and legality in business started operation.

By the World Bank data Georgia, according to the indicators of economic development, occupied 11th place among the world countries. The conclusion of the experts of this organization says that not a single state in the world in 2006-2012 has conducted the economic reforms as consequently as it was managed in Georgia. The Fund for the world economy research “Heritage Foundation” published the annual report “Index of Economic Development 2012”, according to which from 179 countries of the world Georgia occupied 11th place by the level of economic development. Among the former countries of the CIS, Georgia by this indicator lags behind Estonia only. The indicators: of “Economic Freedom” of business, trade, fiscal, independence from the government, monetary policy in 2010 relatively make up from 57 to 99% (International Finance Corporation, 2012). Despite the fact that these indicators are rather high, by the evaluations of the experts of the same fund the indicator of private property security is still low in Georgia. The local and foreign investors doubt the role of the judiciary system in relation to the private property security.

Georgia is at the crossroad of Europe and Asia. Its transport highways are the bridge, which unites Europe, the population of which makes up 495 million people, the Black Sea coastline countries (243 million), Turkey – 73 million and the Caucasian region with the population of 16 million. The shortest way between Europe and Central Asia passes through Georgia. Within recent years the transport communications and main pipelines developed considerably in the country. In 2005 the English company “British Petroleum” invested into the oil and gas pipeline rehabilitation USD 5 billion. In 2005 the construction of “Baku-Tbilisi-Ceyhan” oil pipeline was accomplished, on construction of which USD 10 billion were spent and it can transport up to 15 000 barrels of oil per day. By today Georgia has become the energetically fully independent country from Russia. By the agreement of the governments of Georgia, Azerbaijan and Turkey, the railway line Baku-Kars-Tbilisi is being built, which will connect the railway of the country with Europe.

Georgia acquires relative advantage in the foreign trade by means of developing the system of liberal trade policy. The following reforms were implemented in this sphere: tariffs are liquidated on 90% of imported goods; import-export quotas are liquidated; the excise taxes on the Georgian and imported goods are identical; the number of export-import licenses is reduced from 14 to 8.

From 2010 the new Code of Tax started operation. Considerable institutional changes took place in the system of taxation: the amount of all taxes reduced up to 7; those taxpayers, the annual turnover of which makes up GEL 300 000, are not taxed; i.e. the “honest taxpayers” are taxed with liberal taxes.

Up to 2004 one of the factors impeding the business development was corruption. It can be said today that the problems of system corruption in Georgia are being settled. In 2011 in the report “Anticorruption Changes” the World Bank welcomes the anticorruption process in Georgia; the World Bank mentions that at the level of companies the corruption reduced from 60% to 10%, in result of which taxation and other controlling bodies in Georgia practically do not take bribes; in its report “Doing Business” of 2012 the World Bank stresses that the problem of corruption has practically settled in Georgia; according to the sociological research, conducted by the Republican Institute of the

USA (IRI) 97% of the population of Georgia stress that in 2012 they were not given bribes. Despite clear promotions, the problems still exist in this direction. Thus, for example, according to the data of the international organization “Global Honesty” the problems still exist in Georgia with respect to execution of laws, the symptoms of “elite corruption” appear (M. Melashvili, 2012).

Despite achieved results in the sphere of business, the problem of unemployment is still quite acute. By the data of the Georgian state statistical department, unemployment in 2011 increased by 0, 3% and made up 16, 3%. By the official statistical data, at present there are 329 000 unemployed in Georgia. The economically active part of the population makes up 2 million and their 65% are engaged. By the level of unemployment Georgia is the leader in the region. Thus, for example, in Azerbaijan the level of unemployment makes up 6, 1%; in Armenia – 12, 6%. (Statistical Collection, 2013).

At the present stage of development of economy, the issue of correct elaboration and realization of the investment macroeconomic policy remains to be very topical. Theoretical and methodological problems of intensification of the investment activity, increase of its efficiency acquire a special acuteness. Restructuring of economy and change of forms of ownership, wide transformations in the system of economic relations, cardinally change the mechanism of settling the problems mentioned above, both at macro and micro level, which in its turn causes the need for the new approach to the management over the investment processes, determination of their influence on the economic and social efficiency, to the prognostication and stimulation of these processes. To increase the efficiency of the investment policy of the country it is necessary to provide the rational distribution of investments by the branches of the national economy proceeding from the economic priorities, expediency of the investment cycle, increase of activity of the investment processes, intensification of the relations of the investment and innovation processes, etc. The potentials of increase of the efficiency of economy in Georgia are not great yet, but they increase mostly at the expense of foreign capital, that’s why the issue of efficient use of these resources is especially urgent. Unfortunately, by today, the investment processes in separate spheres of national economy are ongoing very chaotically. In conditions of market relations, the problem of further development of economy should be related with increase in the standard of living of the population, their engagement, and also with the settlement of some other socio-economic problems. With the present limited resource potentials to reach high level of development of the production forces, economic development depends on how quickly the new factors involve into the economic turnover. Preference here is given to the intensive investment activity. The reforms showed that the economic policy of the country should take into consideration the nationwide and foreign economic characteristics of development, tendencies, regularities of economic growth, use of investment potential proceeding from the objective terms of the state. At the present stage of development of economy, it is clear that more decisive transformation of traditionally formed scheme is required to provide financing of the investment project, of the scheme, which was based on the budget, on its own resources in the form of amortization and profit, and also on the loaned resources. In these conditions, it is necessary to attract the foreign investments. In addition, it’s impossible not to share the worries of those persons, who consider that uncontrolled, unorganized attraction of the foreign resources will form a definite danger for the national economy. In our opinion, the state regulation of investment processes is necessary at the macro-level. The government should take care of forming the healthy investment climate in the country.

The investment activity in Georgia is regulated both by the state legislation, and the system of special normative acts. Of the special importance are such laws, as the Constitution of Georgia, Civil

and Tax Codes, the laws on joint-stock companies, on property, on privatization, on foreign economic activities, on tariff control and currency regulation, etc. Special laws, resolutions, normative acts, which directly regulate the investment process, are also adopted in the country. To them should belong the Law “on state support to investments”. The present law specifies the legal, economic and social terms, objects and subjects of the investment activity, independent of the form of ownership. The National Investment Agency delivers the state support to investment and investment activity. It is the representative of the state in the relations with the investors. The essence of agency formation aims at increase of the role of the state investment and structural policy, stimulation of the process of foreign investments attraction, formation of conditions favorable for the investment policy and further development of the initiative of private investors on implementation of the investment projects of high efficiency.

Judging by the scales of investments in 2006-2012, it could be supposed that Georgia becomes more attractive for the investors. In the structure of sector investments dominates the sphere of services. For correct determination of the investment potential and elaboration of the adequate policy for attraction of a great amount of capital, it is of great importance to analyze the motivation of those companies, which invest their capital into the country. It should be mentioned that a great part of the capital is invested into the oil pipeline “Baku-Tbilisi-Ceyhan”, later into the construction of the South-Caucasian gas pipeline.

In our opinion, to expand attraction of the international capital into the country, it is necessary: to form politically and economically stable investment climate in the country, which can be achieved at the expense of removing the political instability, economic misbalance, bureaucracy, etc, to comply the legal and legislative acts of the process of investing with the world standards; to form the firm legislative base, which will provide certain guarantees and stimuli for attracting the international capital; to bring into compliance the banking and monetary-credit system, to conduct the banking sector concentration; it is of great importance in this to form the investment funds, the network of leasing companies. To bring the investment requirements into compliance with the concrete socio-economic situation, it is necessary to determine the differentiated tax from the investment, to specify the term for releasing from its payment.

Summary

Foreign investments are one of the driving forces of the process of globalization and are a defining element of the modern-day world economy. They promote restructuring of industry at the regional and global levels and thus ensure the integration of a national economy in the world economy more effectively than trade. Foreign investments stimulate economic growth and development, providing economies with not only financing for development, but also new technologies, better management techniques, and access to international markets. In addition Foreign Investments integrate production systems with one another. In this way, Foreign Investments can play a key role in the development of transition economies and in their rapid integration into the world economy.

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