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# Stimulating Policy for Attracting Foreign Direct Investment in Georgia

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***Abstract*****—**Current state of foreign direct investment (FDI) in Georgia is analyzed and evaluated in the paper, the existing legislative background for regulating investments and stimulating policies to attract investments are shown. It is noted that in developing countries encouragement of investment activity, support and implementation are of the most important tasks, implying a consistent investment policy, investor-friendly tax regime and the legal system, reducing administrative barriers and restrictions, fare competitive conditions and business development infrastructure. The work deals with the determining factor of FDIs and the main directions of stimulation, as well as prospective industries where new investments are needed. Contributing and hindering factors and stimulating measures are analyzed. As a result of the research, the direct and indirect factors attracting FDI have been identified. Facilitating factors to FDI inflow are as follows: simplicity of starting business, geopolitical location, low taxes, access to credit, ease of ownership registration, natural resources, low burden of regulations, low level of corruption and low crime rates. Hindering factors to FDI inflow are as follows: small market, lack of policy for attracting investments, low qualification of the workforce (despite the large number of unemployed people it is difficult to find workers with necessary special skills and qualifications), high interest rates, instability of national currency exchange rate, presence of conflict zones within the country and so forth.

***Keywords*****—**Foreign direct investment, investment attracting policies, investor, reinvestment;.

## I. Introduction

THE economic growth and development of the country, increasing competitiveness of the economy are largely driven by the level of investment activities and the scope of investments. FDI level shows how stable the country is; what do its economic policy, investment environment and prospects for economic growth look like. It helps to solve problems related to employment and income growth, introduction of new technologies, export potential and increase of foreign exchange in the country, integration of the state into the international economic area, etc.

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FDI is a key factor in economic growth of Georgia, as well as for any other country. There are not many big corporations and companies in Georgia that can reinvest in the economy. Therefore, Georgia's dependence on foreign capital is sound. However, the negative consequences of foreign investors' activity, namely, foreign corporations that have competitive advantages can threat national companies in the local markets. Secondly, these corporations take the resources of the national markets themselves, including the finances, and therefore the concern should always be the protection of national interests.

In the state policy of attracting FDIs, marketing policy can be drawn up, namely, the image of the investment receiver country is being promoted based on the dissemination of advertising information that shows the potential of the given country. For this purpose, mass media, special editions, discussions and special meetings are held. All this provides information covering the investment conditions. This direction requires significant funds and is usually implemented at the state level. Often the state financial means are not enough. In this period, priority is given to the most important fields for economic development of a particular country.

Sound FDI in Georgia were made in 1993-1994. Investments were mainly directed towards mining industry. Growing trends in foreign investment continued in 1996-1998. In 1998, the highest level of FDI (288.04 million dollars) was reached in Georgia. However, in the second half of that year, the financial and budgetary crisis, the sharp fluctuation of the national currency rate and the inflation caused a severe blow to the country's resurgence, aggraviating social background in the state. The rise of political, currency and financial risks are followed by the deterioration of existing investment climate and the sharp decline in investment volume [1].

FDI reached record high in 2014 (see Fig. 1) [2], when the annual volume of FDI reached 1 billion 758 million US dollars, which is the best result since 2007 and shows increase by more than 87% compared to 2013. At the same period, share of reinvestment amounted to 19% of total FDI. The increase in FDI was triggered by an increase in investment in the construction sector, mainly related to preparations for the Youth Olympics. By 2014, the largest investor countries are: Netherlands - 21%, Azerbaijan - 19%, China - 12%.

In 2015, FDI amounted to 1564.5 million USD, which is 11% less than the corresponding figure in 2014. In the same period, share of reinvestment amounted to 9% of total FDIs. The largest investor country in 2015 is Azerbaijan - 35%, the United Kingdom - 25% and the Netherlands have moved from the first place to the third - 10% [1].

The volume of FDIs made in Georgia in 2016 amounted to

1565.9 million dollars and exceeded the 2015 figure by 0.1%. Reinvestment amounted to 32% of FDI. Azerbaijan (35%), Turkey (17%) and United Kingdom (7%) are on the top places for FDIs to Georgia in 2016. The Netherlands moved to the fourth place (6%) (see Fig. 2). In terms of investing, the first place is transport and communications, followed by energy and construction sector [3].

According to the preliminary data of 2017, the volume of FDIs in Georgia amounted to 1861,9 million dollars, which is significantly higher than those in the previous years [3]. Azerbaijan is leader in investments to Georgia in 2017 (see Fig. 2), that is conditioned by one of the largest investment projects in the country, Shah-Deniz pipeline construction. Within the framework of the project, in 2013-2019, it is planned to invest about one billion in Georgia. Azerbaijan State Oil Company SOCAR is implementing the project together with international partners. The rating of the largest investor countries in Georgia is as follows: Azerbaijan ($482,1 million), Turkey ($279 million), United Kingdom ($250,4 million), Netherlands ($224.3 million), Czech Republic ($133.8 million), United Arab Emirates ($62.7 million), Panama ($54.0 million), China ($51.9 million). The offshore zone (Panama) has been included in the list of the largest investor countries, because Georgian businesses often use offshores for reinvestment.

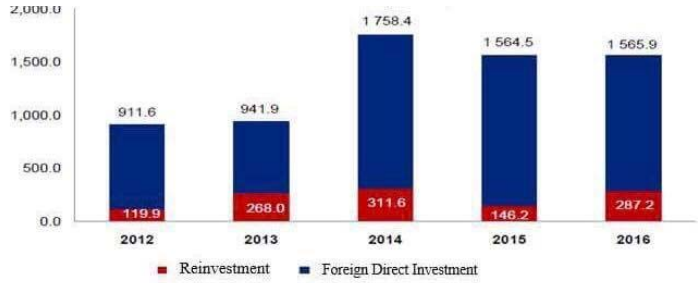


Fig. 1 FDI and Reinvestment in Georgia 2012-2016 (million USD) [2]

Part of large Georgian companies (Borjomi, Azoti and others) are registered in the European Union and part of their turnover is considered as investment [4]


Fig. 2 FDI in Georgia 2017 (million USD) [3]

According to the survey of foreign investors, the most promising sectors in Georgia are tourism, transport, communications and food industry. Relatively less support was obtained by banking, energy, trade and agriculture [5]. According to the conducted research, priorities of the need for the development of agriculture in Georgia are assessed in the following order: Development of farms and land market; provision of investments and long-term agro-loans [6]. The development of heavy industry and heavy mechanical engineering is not promising. However, it should be noted that in 2007, significant investments were made in banking and insurance, telecommunication, transport, hotels, energy and other areas, and in 2008, the largest investments were made in transport and communications, as well as in energy sector. In 2012, a large number of investments were placed in the processing industry, which is undoubtedly welcome. In other sectors, it has grown slightly compared to previous years.

By 2014, the largest FDIs in the sectors of economy are as follows: Transport and Communications - 27%; Construction - 23%, Manufacturing Industry - 13%; Energy - 8%; Real estate - 7%; Financial Sector - 6%; Mining industry - 3%; The rest of the sectors - 12% [2].

In 2015, FDIs have increased sharply in transport and communications compared to the previous year. This increase is linked to the construction of a gas pipeline that Azerbaijan carries out and has increased the inflow of FDIs in Georgia from Azerbaijan. A sharp increase in investment was observed in the health sector, as well as in the following economic sectors: mining industry; hotels and restaurants; financial sector; agriculture and fishing. Investments have been reduced in construction, processing industry, real estate, energy, [7].

Transport and communications together with the energy and financial sectors accounted for the largest share of investments in Georgia in 2016; however, the construction sector has the fastest growth rate in terms of investments.

As we can see, investments are less directed to promoting sectors such as agriculture (only 0.6% of total investments are directed to agriculture and the budgetary expenditures on agriculture constitute 3.0%, [8]) and textiles industry in which Georgia enjoy sound comparative advantages. They are less likely to increase job creation and productivity, but contribute to the long-term growth and economic development.

According to the preliminary data of 2017 (see Fig. 3) [9], among economy sectors, the most attractive for investments is transport and communications, followed by the financial sector, and the construction is in third place.

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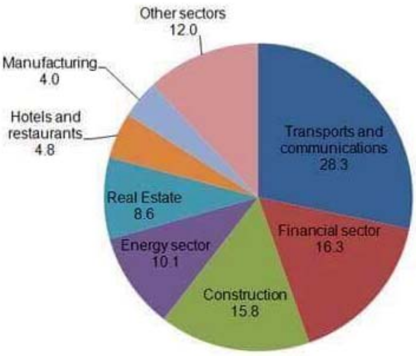


Fig. 3 Largest FDI in the sectors of economy in 2017 (%) [9]

Georgia is trying to attract as many foreign investments as possible, creating the desired investment environment in the country and offering cheap labor, but the cheap labour offered cannot build quality, service, repair, road construction, innovative product etc. Also, in the country it is problematic to own modern technology and create new technologies. Therefore, until the country has a systemic approach and is able to prepare qualified personnel in the labor market and provide it to investors, even if the significant increase in foreign investments will not cause a significant change in the employment rate of the local population. It should also be taken into consideration that all the countries around Georgia are trying to attract foreign capital, so the investor has a great choice and hence the competition is high.

## II. Methodology

Works by local and foreign scientists, Ministry of Economy and Sustainable Development, as well as various organizations' studies and reports were used as a theoretical basis for research and variety of laws, government decrees and orders and the publications of the National Statistics Office of Georgia were used as a an informational basis.

## III. Discussion

The state should take effective steps to maintain an attractive investment environment. However, it should be noted that work in this direction has been continuously going on and is going on [10, p. 177].

The Law on Investment in Georgia was adopted on 25 July, 1991, which was invalidated after the 1995 Law on Foreign Investments. This law has significantly contributed to the inflow of foreign investments in the country.

In 1996 the Law on Promotion and Guaranteeing of Investment Activities was adopted, aiming at bringing more stimulus to the foreign investors. The law defined the legal basis for local and foreign investors and guarantees for their protection in Georgia.

In 2002, the Law on "National Investment Agency of Georgia" was adopted, aiming at regulating state production and investment policies. National Investment Agency provides the investor with all the necessary licenses for investment activities, obtaining a permit or other representative authority.

The 2006 Law on State Support for Investment aimed at promoting investment through improved procedures and creation of additional legal regimes. This law allows the investor to grant capital investment the status of a special importance, which will create a way for a more simplified relationship with the government. A law shall apply to any foreign and local investments which will be placed and used in the territory of Georgia. This law establishes special norms and additional supportive measures to encourage special importance investments.

In 2013, the Law on Investment Funds was adopted, which regulates the definition of the investment fund, its goals and the determination of the activity. According to the law, there is a resident investment fund (open, interval, closed); investment fund of the knowledgeable (experienced) investors; equity investment fund, etc. which are governed by the legislation of Georgia. The Investment Fund is prohibited from entrepreneurial activities; it cannot have assets other than money, money equity assets and financial instruments. It is also noteworthy that two special statuses were introduced into the Tax Code for stimulating investors: the international enterprise and the foreign company branch, tax relieves for foreign investors were introduced.

It is also noteworthy that the Georgian Social Development Strategy (Georgia 2020) directly indicates that the Georgian government will be the main guarantor for property rights and harmonization of customs legislation with EU legislation within the EU-Georgia Deep and Comprehensive Free Trade Agreement. Amendments in the Tax Code of Georgia envisage minimization of taxes [11].

From July 1, 2017, a law has been enacted to prohibit the sale of property and services in dollars. This regulation is part of the governmental program of dedolarization and is mainly aimed at switching the construction and automobile market from USD to GEL.

In order to encourage the construction sector, the government liberated suspended projects due to the 2008 financial crisis from VAT till 2020.

As shown above, the government promotes legislative regulations to attract foreign investments in Georgia, but in many cases, the risk factors for investors are the relationship with the local population. Often there are conflicts between the investor and the population, which often leads to the discontent of investors and in some cases the failure of a project. The main direction of stimulating foreign investments in modern conditions is the introduction of various benefits. The benefits should be provided for both foreign and local investors. The benefits include fiscal, financial and other forms. However, it is noteworthy that foreign investor's decision on investing in the country depends on a number of factors and various benefits are not often important ones. Political and economic stability, legislation in the country, infrastructure, working on financial institutions, labour force qualifications, etc. are considered as crucial. According to these criteria, the political and economic ratings of all countries around the world are made, which are of great importance to foreign investors while making investment decisions.

## IV. Recommendations

The following recommendations have been developed based on the research:

- The study of the trends and directions of international business development to determine their impact on the potential of attracting investments in Georgia;
- Creating a comprehensive bank of investment projects and providing information to potential investors about the real situation existing in Georgia.
- Improving the legislative basis, simplify the trial process and transparency;
- Development of infrastructure for investment activities;
- Development of investment projects based on common state interests, as well as peculiarities and requirements of regions. For this purpose, it is necessary to develop marketing tools for stimulating investments;
- Preparing and retaining workers with demanded specialisations in the labor market, which will increase employment.
- Development of the mechanisms for promoting employment groups with lower competitiveness (promoting employment of people with disabilities);
- Further work on tax benefits for investors.

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