

State Regulation of Foreign Investments: Tendencies and Challenges

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A necessary condition for the economic development is a suitable investment environment, investment activity. This will be achieved by establishing appropriate economic organizational and legal bases, involving the investment of resources in the economic circulation growth and efficient use of their way. The practice of developed countries shows that material prosperity and social welfare sectors producing investment promotes the country's GDP growth, reduces unemployment and improves the quality of life of the population and the economic life of the civilized involvement. Georgia's participation level in world economic integration processes represents usage of foreign investments. This indicator reflects the transformation of the national economy and the results of current trends in deepening integration processes. Foreign investments affect the conditions of competition in the country. Therefore, the country must have the strategy of investment usage, which predicts investments which will affect the national economy, macroeconomic proportions, and general stability. Developed countries experience shows that the "investment boom" starts with entering foreign capital and setting advanced technologies. In addition, there may be benefits for these favorable investment climates in certain sectors, production and promotion of the region's attractiveness. Therefore, Georgia should focus on attracting and developing foreign investments, creating favorable conditions, as well as the sovereignty of the national economy, which implies the use of foreign investments in the economy of Georgia.

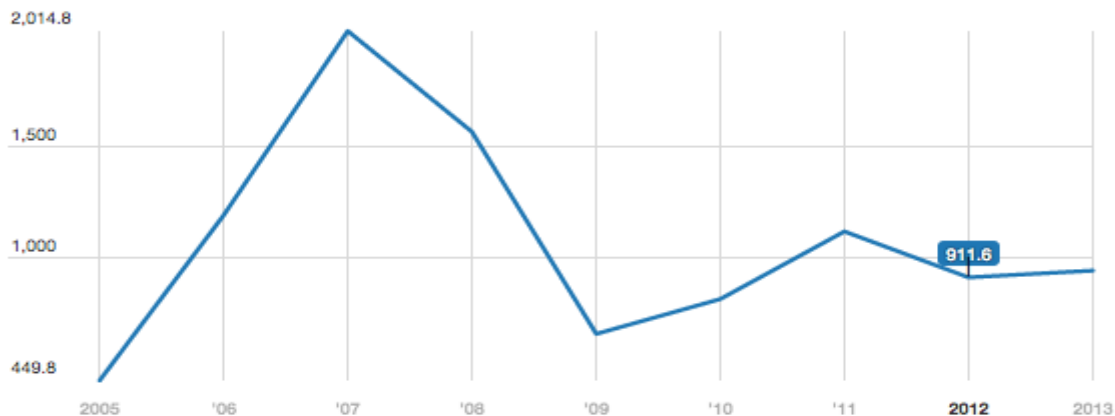
Attraction of direct foreign investments are important factors determining the stable political and macroeconomic situation, the openness of the national economy, the infrastructure and communication, forecasting legal and institutional environment. These factors represent the basis for the existence of favorable conditions for the formation of favorable investment climate for foreign direct investment. The process of attracting foreign direct investments means the introduction of new technologies, improvement of management practices, production stable sources of financing. Georgia's investment climate is being positively affected by the improvements that have occurred in recent years. For example: 1) Promotion of an attractive investment environment. A number of liberal reforms of recent years turned Georgia into an attractive economic climate country. In 2007 Georgia was named the world's number one reformer. With the World Bank ranking "Doing Business Survey" and moved from 112 to 37 place. In the same year, a significant progress happened according to terms of economic freedom index, Heritage Foundation", the country has risen from 52 to 35 place. According to World Bank and International Finance Corporation the economy of Georgia was on the 18 place (out of 178). Non citizens of Georgia have the right to engage in business activities in the country equally to real residents, without any restrictions. 2) Liberalization of tax legislation. Lately, the further liberalization of the tax policy interests took important steps to simplify the tax laws. As a result, Georgia has only 6 taxes. Georgia is a country with its liberal tax code which attracts investors. 3) Cooperation in order to avoid double taxation. Georgia paid particular attention to cooperation in tax matters at the international level. To avoid double taxation on income and capital Georgian government signed agreement with the different countries. 4) Simplification of customs procedures. From September 1 2006 new law on customs tariffs came into a force, which according to Georgia has the worlds most liberal and competitive trade regime.

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The law was abolished in 2007 and its provisions moved to the tax code. Developing an effective customs system, the reduction of administrative barriers, was aimed by the Ministry of Finance for a reform, which provides enforcement of customs risk management system. 5) Trade liberalization. Georgia has a liberal trade policy. The legislation does not provide any quantitative restrictions and other non-tariff barriers to trade. Except those cases when it is necessary for health, safety and environmental protection. Most of the trading partners are WTO members, therefore, these countries trade relations are based on the most favored nation treatment. Incoming investments level in the country answers to many questions - how stable is the country, what kind of economic policy it has, investment climate, economic and sectoral growth prospects and so on. In this regard, the National Statistics Office of Georgia expresses the volume of direct foreign investments. The data shows that from 2006 to 2012 „including foreign direct investments“ in Georgia was total of 8,270,9 million USD. The highest rate of of foreign direct investments - 2,015.0 million USD. In 2007 it was 69.3% which is higher than in 2011. High investment rate was maintained until August 2008. In 2012 in Georgia 911.6 million USD of foreign direct investments were implemented, which is 18.4% less than the 2011 data. In the second half of 2012 the amount of foreign direct investments was 432.7 million USD, which in comparison with the first half of the year is 46.2 million less. In 2013, foreign direct investments slightly increased and were 941.9 million USD. This is higher than the previous year with the rate of just 30.3 million. In 2014 the amount of foreign direct investments was about 1 billion and 272 million USD. That's 35% more than in 2013 and the highest index from 2008. During first three quarters of 2014 the amount of direct foreign investments in Georgia was 923.3 USD. This index is higher with 29% comparing with 2013. According to data of Statistical Bureau of National Statistics Office of Georgia the foreign direct investment in 2014 amounted to USD 151 million, in 2013 - USD 208 million, in 2012 – USD 218 million. Totally FDI amounted to USD 265 million in 2014”.³

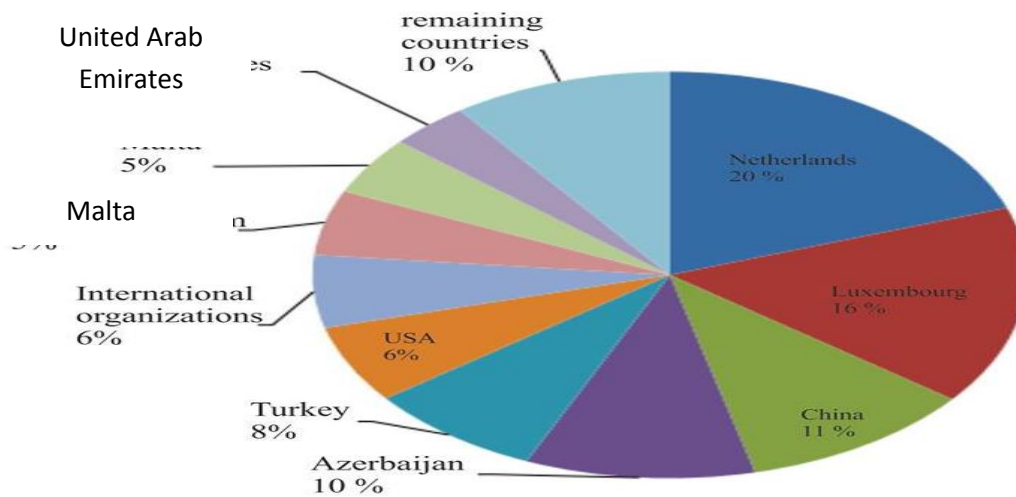
Graph №1 Foreign Direct Investments in Georgia (2005-2013)



Share of FDI by major foreign countries, according to preliminary data in 2013 was 90%. The country percentage structure implemented according to FDI is illustrated in the sector graph №2. It is obvious that the countries are in the following positions: first position - Netherlands 20%, second position – Luxemburg 16%, third position – China 11%. Due to investments the biggest investor country is Netherlands (26%), second and third are Azerbaijan 24% and China 15%. The share of these 3 countries was 65%. If we observe which sectors were mostly invested in 2011-2012, we will discover that the leading sector is the energy sector then comes manufacturing industry, financial, transport and communication sectors. Special reduction of investment expenses refers to all sectors in 2012, except manufacturing industry, transport and communications (basically state investments). There is little growth in agricultural, fishery and healthcare sectors.

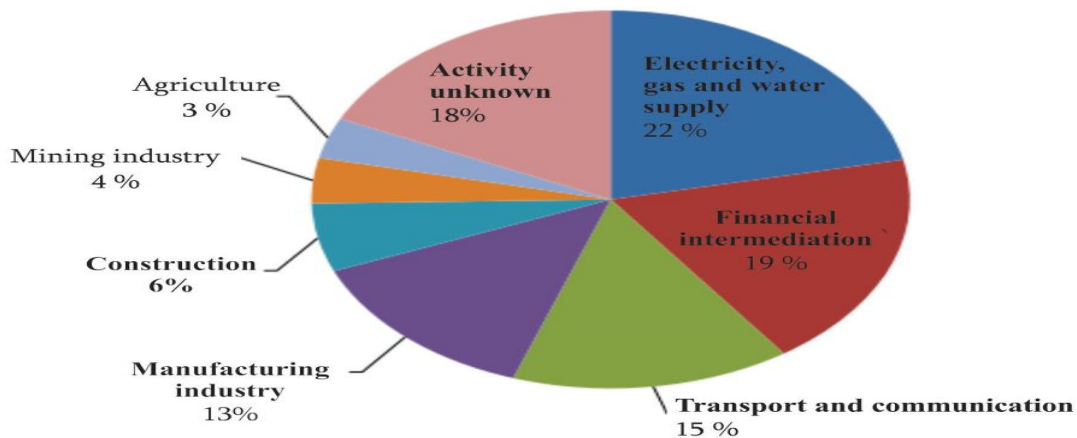
³. National Statistics Office of Georgia

Graph №2 Major investor countries' share in 2013



Share of major sectors by FDI was 82% in 2013. The largest share of FDI was allocated in the energy sector, reaching USD198 ml. That is 22% of the total FDI. Then comes the financial sector – USD 170 ml and the transport and the communication sectors – USD 138 ml. In 2014 taking into account sectoral share 27% 343 ml USD was spent in transportation and communication. The second is construction 295 ml USD. And the third is industry 174 ml USD. Percentage allocation of FDI by economic sectors in 2013 is given in graph №3. Stable economic development, liberal and free market economic policies, reduced tax rates, few amount of licenses and permits, simplicity of administrative procedures, preferential trade regimes with many foreign countries, favorable geographical location, well-developed and integrated transport system, educated, skilled and competitive labor force and many other factors represent a solid base to start-up and develop business in Georgia. If compare existing foreign investment index between Georgia, Armenia and Azerbaijan during last period, we will see that the fewest amount of investment was in Georgia. In the first quarter of 2010 the totally amount of foreign investment was 405,8 million Manatin Azerbaijan, it is approximately 494,8 million USD. In Armenia, in the first quarter the totally amount of foreign investment was 116,9 million USD. In 2010 the Arabic Investment was seriously reduced. The British, Americans and Japanese were leaders in Azerbaijan, but in Georgia Arabic and offshore companies.

Graph №3 FDI by major economic sectors in 2013



Major investor countries are: Turkey - 20.3 mln. USD (26.8% of total amount), Czech Republic - 19.8 mln. USD (26.1% of total amount), Egypt – 18 mln. USD (23.8% of total amount), Japan – 15.2 mln. USD (20.7% of total amount) and other countries - 2 mln. USD (2.6% of total amount). Now let's review situation in Azerbaijan, where Great Britain is in the first place investments – 203.1 mln. Manat, which approximately is 246.7 mln. USD, in the second place is USA – 73.2 mln. Manat, (89.3 mln. USD). In the third place is Japan – 38.3 mln. Manat, (46.8 mln. USD). The next one is Norway – 23.8 mln. Manat, (29 mln. USD). Turkey – 18.9 mln. Manat (23 mln. USD), Korea - 8.1 mln. Manat (9.9 mln. USD), Russia – 1.9 mln. Manat(2.3mln. USD). At the same time from total amount of investment the leader country in Armenia as expected was Russia - 51.9 mln. USD, then France – 33.7 mln. USD, Holland – 31.4 mln. USD⁴ Whole South Caucasus economy (GDP-Gross domestic product) in 2011 was increased by 162%, compare in 2003. 78% of South Caucasus economical growth came from Azerbaijan (from Georgia -12% and From Armenia - 10%). Because of all mentioned after 2013 share of GDP in Georgia was divided in South Caucasus, while share in Azerbaijan was increased by 1,5 times. In South Caucasus region about $\frac{3}{4}$ (73.3%) of direct foreign investment goes to Azerbaijan. In 2006-2011 direct foreign investment in Azerbaijan was 42 milliard USD, while in Georgia it was only 7.3 milliard USD and in Armenia 7.6 milliard USD.

We can use 10 reasons why to invest in Georgia:

1. Political and liberal economic reforms;
2. Attractive macro economical environment;
3. Competitive trade rules;
4. Liberal tax code;
5. Privatization of state property;
6. Modernized business licensing system;
7. Reformed Technical system;
8. Strategic geographical location;
9. Concrete banking sector;
10. Georgia is a country with an ancient culture and traditions.

Governmental measures in order to attract foreign investment can be divided into two groups:

- Inflation rates, actions to reduce foreign investment risk and guaranteed payments according to the foreign debts.
- Events, that reduce taxes and simplifies custom conditions for foreign investors.

The investor takes into account such factors as ideology and policy, economy and culture of the country. Improvement of tax code is an important issue. Frequency of changes in tax code and generally in regulations is unacceptable for investors. In order to attract investment it is necessary to:

1. Reduce the fields where activities of foreign investors are forbidden;
2. Those requirements should be simplified which are limiting participation of foreign capital in the company capital;
3. Give foreign investors the right to found the companies with 100% share owning;
4. Make possible to take profit and dividends abroad;
5. Stable and predictable legislative process is significant for the investment field, therefore all those stakeholders should be involved and informed about the reforms planned by the government which these reforms concern;
6. It is desirable that reform processes of important fields are not long lasting in order to make it easier for the target groups to overcome this period and adapt to a new reality;
7. The government should try to avoid from adoption of such regulations which make unfair limitations for the local and foreign investors and hinders their development; or such regulations limits the competition on certain markets and prioritizes some companies.

⁴ R. Tsinaridze: „Regional investment processes to improve mechanisms of regulation of financial and economic issues“, Tbilisi 2013, 112-115

Hence from experience of foreign investment field and reality of Georgia, formation of relevant environment for attraction of foreign investment is still important but it will not be right to rely only on foreign capital in foundation of new companies. Use of foreign investment is important as a factor of development – for mobilization of natural, industrial and labor potential. Favorable geographical location of Georgia, as an optimal point connecting the world markets, supports investment attraction. Georgia shall not have only the transport-transition function. Faster increasing attraction of investment in the field of the industrial processing sectors is necessary. Together with foreign investors so called portfolio investment are also important and factor for their attraction should be development of securities' secondary market. Today Georgia as unit of the international law and sovereign nation due to its geopolitical location again has an effective chance to be actively involved in modern world economy field with current negotiations, scales and potential possibilities maintaining national identity and self-maintaining. One of the goals of Georgian reforms is attraction of foreign investments. Considering technological backwardness in the most positions of state economy foreign capital is significant for Georgia which will support and promote implementation of modern management methods and advanced technologies for new capital of the country and encourage internal investments.

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