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Investment Climate of Georgia after "Rose Revolution": Recent Improvements and New Challenges

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Abstract

The article focuses on effectiveness of Investment climate in Georgia after transition period. Investment climate is the institutional, policy and regulatory environment in which firms operate – factors that influence the link from sowing to reaping and I can say that investment climate itself is the process from sowing to reaping because you will reap what you sew. Investment climate is the opportunity and incentive for firms to invest productively, create jobs and expand. One of the major determinations of country's economic developments and wellbeing are the indicators of investment structure and volume. These indicators show attractiveness of economy for foreign investors and give clues for analyzing countries development process. Investment climate matters for the total factor productivity, average wage rates, the rate of return on fixed assets, growth rate of output, employment, corruption plus government regulations, taxes, political and economical stability, migration. A good investment climate is an essential pillar of a country's strategy to stimulate economic growth, which in turn generates opportunities for poor people to have more productive jobs and higher income. Hypothesizing that long – term effect of foreign investment will increased in increased employment and household income, poverty will be decreased and Georgian economy will be developed. The paper also includes the results of a survey conducted to find out the changes of investment climate after "Rose Revolution".

Keywords: *foreign direct investment, natural resources, employment, economic growth, political stability, taxes, corruption.*

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Introduction

Georgia is a small economy in transition (a population of 4.5 million and Gross Domestic Product (GDP) of US $ 10.2 billion in 2007) (Tsepliaeva, 2008), it is a developing country facing various problems in different areas, so investment climate is the opportunity and incentive for firms to invest productively, create jobs, expand and to have a positive influence on the country. One of the fundamental issues for countries progress is formation of financial sector, dynamic development of financial markets and creation of appropriate markets. Georgian investments are of a huge importance. For lots of people during market economy formation "nailed together" huge fortune. The long term effects of foreign investment will result in increased employment and increases in household income. It is very important how Georgia attracts foreign investors by its abundant tangible assets such as natural and mineral resources and the size of their large domestic, local market and how Georgia has generated the interest of international investors by improving its business environment and climate, especially after "Rose Revolution" (November 23, 2003, which represents "new era" for Georgian society (author)) proving that one country can become competitive internationally and attract Foreign Direct Investment (FDI) on a sustainable basis; what kind of business climate it offered to investors? (Investor.ge; 2008: 4).

On November 23rd, 2003 hundreds of thousands of Georgian citizens from all walks of life came together to demand a new future and an accountable, democratic government in events known today around the world as the Rose Revolution. The Rose Revolution marked a turning point in Georgia's modern history. By placing their faith in a newly elected government, the people of Georgia endowed us with a tremendous opportunity to change economic conditions in a better way in Georgia. Georgia's democratic transformation produced tangible results that have changed the way government functions and brought direct benefits for Georgian citizens. Georgia's state budget was over 500 million Georgian Lari in 2003 and now stands at 3.5 billion and rising (Georgia since the Rose Revolution, 2006).

Georgia is very rich of natural and mineral resources and as country has rich investment climate locations, for this reason more and more investors will be interested in this country. Georgian government should do everything for utilizing these resources. But investment in Georgia is a slow process, often hampered by basic shortcomings in infrastructure, electricity. Stability issues (establishing a stable macroeconomic environment, at least by regional standards are important for Georgia, so Georgian Government is fighting to get the stability in the country for FDI), business climate, macroeconomic and political stability, infrastructure, transport costs and human capital need improvement for attracting investors. Average income in Georgia remains low in comparison to other Eastern European countries so foreign investment is necessary to improve household income (Investor.ge; 2008: 6).

The Georgian National Currency, Georgian Lari (GEL) strengthened from 1.7 to about 1.6 per U.S. dollar over the course of 2007 and to about 1.4 per U.S. dollar in May, 2008, till the elections of new President of United States, Barak Obama, in the late September, 2008, influenced by global weakness of the dollar, inflows of foreign investment and increased focus on inflation by the Central Bank. Based on the economy's overall performance and the Georgian government's strong commitment to structural changes. Despite the political instability from Rose Revolution till today, Georgia received its first sovereign credit rating in late 2005 from Standard and Poors -- a B+ long term, and B short term rating. Fitch rating service has given Georgia a BB- rating (USA.Gov, 2008).

In the respected rating service gave the country's reform plans a thumb up and added that Georgia's “robust” foreign direct investment is “expected” to continue (Investor.ge; 2008: 6).

One of the major determinations of country's economic developments and wellbeing are the indicators of investment structure and volume (Economic development and poverty reduction program of Georgia 2003).

There are numerous aspects to take into account when analyzing the investment climate in Georgia. The World Bank called Georgia “the world's fastest growing economy” in 2007 and the 2008 report assigns Georgia the 18th place in the list of the countries where doing business is the easiest. In spite of all the positive sides about our investment climate, there are problems that need to be addressed and resolved – the infrastructure in rural areas needs improving, fairness in the legislative system has to be ensured, inflation has to be controlled more effectively, special tax incentives should be given to foreign investors, and other kinds of methods should be employed to directly address the problem of attracting FDI to Georgia (Investor.ge; 2008: 6).

The democratic change after Rose Revolution, 2003, which brought the current government to power, has reversed Georgia's economic and social malaise. Mikheil Saakashvili (Georgias' President) pointed to positive changes since 2003: an end to widespread government corruption, an increase in respect for the police, and the development of the necessary infrastructure to stimulate what he called "the emergence of a new class of entrepreneurs." He credited private enterprise for the success of the Georgian republic. Georgia is now attracting hundreds of millions of dollars in foreign investment. New sectors of the economy are emerging. Construction is increasing; more airports, roads, hospitals, and schools are being built today than were built in Georgia in the last twenty-five years (AEI Newsletter, 2006).

Actually, the dramatic change of government swept in by the 2003 peaceful "Rose Revolution" marked the start of serious political and economic reform in Georgia. Before 2003, Georgia's economic development suffered from a reputation for instability, violence, corruption, and unreliable supplies of energy. The picture has significantly changed for the better. Since 2003, the Georgian government has undertaken institutional reforms including the restructuring and downsizing of government ministries, privatizing large state-owned entities, increasing the pay of public servants and prosecuting corruption, reducing the number and rates of taxes and improving tax and fiscal administration, streamlining licensing requirements, deregulating, simplifying customs and border formalities, and undertaking many other efforts to make it easier to do business in Georgia. Among the specific achievements Georgia is strengthening investor protections by amendments to its securities law that eliminate loopholes that had allowed corporate insiders to expropriate minority investors. Georgia adopted a new insolvency law that shortens timelines for reorganization of a distressed company or disposition of a debtor's assets. It sped up the approval process for construction permits and simplified procedures for registering property. It made starting a business easier by eliminating the paid-in capital requirement. In addition, the country's private credit bureau added payment information from retailers, utilities, and trade creditors to the data it collects and distributes. (USA.Gov, 2008).

Since the Rose Revolution, attracting foreign investment has been the Georgian government's number one objective. Foreign investors are expected to bring well-needed capital inflow, and contribute to the building of new infrastructure, the transfer of management skills and the creation of jobs. Kazakhstan has gained a prominent position in the Georgian market in recent years and invested a total of approximately USD 300 million in 2006. New investors such as the United Arab Emirates (UAE) and the Czech Republic entered the Georgian market in 2007, and Iranian investments are anticipated later this year (Puppo, 2007).

Georgia has negotiated bilateral agreements on investment promotion and mutual protection with 26 countries, including the U.S., Armenia, Austria, Azerbaijan, Belgium, Bulgaria, China, Egypt, France, Germany, Greece, Iran, Israel, Italy, Kazakhstan, Kyrgyzstan, Latvia, Moldova, Netherlands, Romania, Turkey, Turkmenistan, Uzbekistan, the United Kingdom, Ukraine, Lithuania and Finland. Internal procedures have been completed and drafts are being negotiated with the governments of India, Bangladesh, Croatia, Denmark, Norway, Philippines, Cyprus, Indonesia, Malta, Czech Republic, and Iceland. Ongoing consultations are held with Belarus, Tajikistan, Slovenia, Estonia, Slovakia, Bosnia-Herzegovina, Switzerland and Jordan. A free trade agreement is in force with the Commonwealth of Independent States, and others exist bilaterally with Ukraine, Russia, Kazakhstan, Azerbaijan, Armenia, Moldova and Turkey. Agreements are signed but not ratified with Turkmenistan and Uzbekistan. Ongoing consultations are being held with the European Union, Belarus, Kyrgyzstan, Cooperation Council of Gulf Arab States and Tajikistan (USA.Gov, 2008).

Research Question: To what extent has foreign investment dollars in business development has translated into rising incomes and employment across Georgia since transition period? How FDI effects on economic growth of the country and does FDI contributes to economic growth when a sufficient absorptive capability of the advanced technologies is available in the host economy? What factors influence foreign investors to invest in Georgia and what are the effects of such investments and does economic growth rate influence positively the business climate for FDI as it reflects an improvement in economic performance?

According to official data from the Department of Statistics of Georgia, FDI in Georgia in the first nine months of 2007 (January - September) reached $1,063,000,000 (U.S. dollar), which is 60, 3% more than the same period during 2006. The biggest investments in 2007 were made by Danish, Dutch, Czech, British, Kazakh, Russian, Turkish and American companies. Investments were made in industry, agriculture, real estate construction and development energy sector, banking, insurance, telecommunications, services, etc. The government of Georgia is ready to provide maximum of assistance to local and foreign investors and business persons to make investments 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 decreasing the tax burden (Investor.ge, 2008:31).

Hypothesis: The long term effects of foreign investment will result in increased employment and increases in household income.

I used *Dependent* (Investment Climate) and *Independent* (Explanatory variables: Economic growth, trade openness, illiteracy rate, telephone lines, urban population, Gross Domestic Product (GDP), natural and mineral resources, location, employment rate, average household income, corruption free environment, privatization, regulatory environment (government regulations – Liberal Labor Code), political stability, inflation, taxes and tariffs).

The *Level of Analysis:* Macro and I will use quantitative methods. I collected data's from Ministry of the Economy , from the World Bank and United Nations bases (This required collecting existing data from foreign investors, resulted increase in jobs and compare foreign investment to Georgian business start – ups over 2-5 year period, interview foreign investor and discuss their responses).

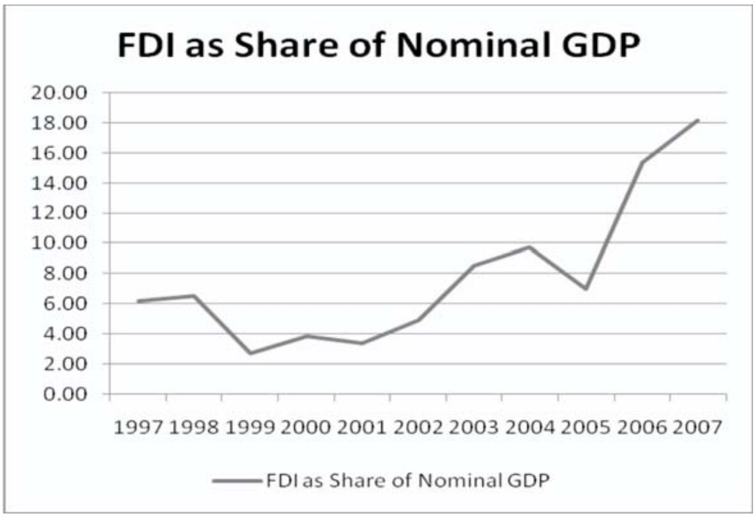
How variables are operationalized?

Economic growth	Economic growth rate increased and jumped from 4.0% in 2005 to 13.3% in 2008.
Trade openness	Trade openness ratio increased from 49% in 2005 to 60% in 2007, it caused reduction in tariffs and non – tariff barriers. Government rationalized and lowered the tariff structure, arounding 14%.
Illiteracy rate	Illiteracy rate has negative effect on FDI business climate, it is -0.39, so it should be inversely related to the availability of relatively skilled labor – a major factor in the location decision. FDI is 1.09.
Telephone lines (internet, mobile telecommunications)	Telephone lines has also negative effect on FDI business climate: -0.0404 and T – statistics indicator is -0.51, very far from 1.96, and FDI inflow is also -0.407, meaning that there is not good infrastructure and communications development in the country (The Department of Statistics, 2007 Report).
Urban population	Urban Population (as a percentage of total population) is -0.978 and consequently, FDI inflow is -0.228.
GDP	FDI inflow from GDP is 0.91 or by T – statistics it is very high 3.97. GDP growth reached 7% in 2007.
Natural resources	Natural resources T - statistical indicator is highest – 7.09, meaning that as Georgia is very rich of natural and mineral resources than Potential Foreign Investors will be interested to invest resources in the country
Inflation	Was reduced from 12.4% in 2005, to 4% in 2007 (Both the external account deficit and fiscal deficit were reduced and a prudent credit policy was pursued) (The Department of Statistics, 2007 Report).
Privatization	Reached $22 ml. in 2007 including several enterprises in the financial and manufacturing sectors.
Political Stability	In 2003 “Rose Revolution” brought new changes and stability in the country, but the Osetia – Georgian war destroyed newly build economy on 7^{th} of August in 2008.

Effectiveness Of Foreign Direct Investment For Georgia

Economic growth rate and GDP influences positively the business climate for FDI as it reflects an improvement in economic performance meaning that economic growth increases good business climate, GDP, and as the country has good business climate than more and more investors will be interested to invest their resources in this country. Globalization is characterized by the increasing integration of economics, markets and production chains in Georgia. FDI is an investment involving a long – term relationship and reflecting a lasting interest and control of a resident entity in one economy in an enterprise resident in an economy other than of the foreign direct investor. FDI has several advantages from the perspective of the host country. Since FDI typically consists of capital flows, it can contribute to the generally scarce capital resources of developing host countries. It can also work as a driving force to increase the transfer of technology, skills development and access to export markets for the host countries. It can increase employment and contribute to a higher GDP through higher levels of productivity than the national counterparts for small economy; too much FDI too quickly can also bring about an appreciation of the exchange rate, which in turn can have a negative effect on exports. Georgia actively try to promote and attract FDI. Continuous and persistent economic development is strongly connected with the adequate investment level in our country. To ensure the availability of sufficient investment funds, the country needs to have quite large amounts of savings. This is exactly where Georgia's essential problem lies: the level of both private and public savings in our country is fairly low and incapable of satisfying domestic investment needs. The importance of FDI inflows becomes tremendous, taking into account the scarcity of domestic investment resources so badly needed to spur economic development of a country like Georgia. The graph provided below depicts the dynamics of foreign direct investment inflows in the country in 2000-2007 . As the graph shows, there was quite a considerable amount of FDI coming in 1997 and even more so in 1998 due to the constructions of Baku-Supsa Pipeline and the Supsa Terminal (British Petroleum (BP) investments). In 2000 the amount of inflows dropped substantially, owing to the 2001 financial crisis, and the level of FDI has remained quite low until 2003, when it began to rise due to the changing environment in Georgia after the Rose Revolution. Then we had another drop in FDI inflows in the late 2004 and in the first half of 2005; however since then we have had an unprecedented rise in FDI inflows (Department of Statistics, 2007).

Graph 1. FDI Inflow Dynamics in 1997 - 2007

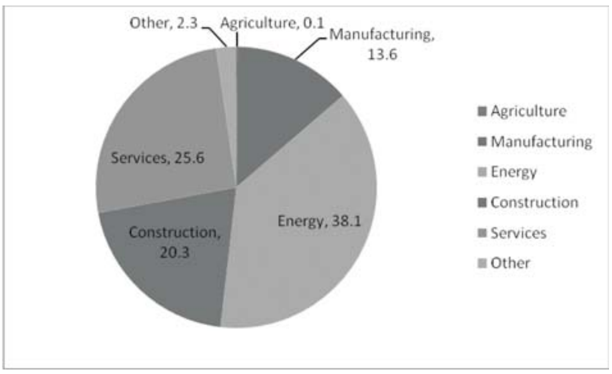


Source: Department of Statistics

Actually, FDI after three years decrease has started to increase in 2004 – 2006. If FDI decreased by 8% in 2003, it has increased by 29.6% in 2004 (“Business”, 2007, p: 27).

Countries that make major contributions to the growth of FDI inflow level are the following: Netherlands, Virginia Islands, Denmark, Turkey, the US, Kazakhstan, Czech Republic, Russia, Cyprus, and the UK. Aside from those, the World Bank and the European Bank for Reconstruction and Development also account for the increase in FDI inflows in Georgia.

Graph 2. FDI by Sectors (2007 data)



Source: Department of Statistice

Graph 2 demonstrates the distribution of FDI by sectors according to the data of 2007 2. Clearly, the greatest part of foreign direct investments is flowing to the energy sector (38.1%), which is then followed by services (25.6%), construction (20.3%), manufacturing (13.6%), and agriculture (0.1). However, the latter sector receives far less amounts of funds in the form of FDI than others. If we look at total FDI, 10% of it goes into the banking sector, 63.0% is consumed by companies, and 26.2% represents the share of privatization. It has to be noted, that the share of British Petroleum (BP) investments has been continuously decreasing since 2004 (from 72.1% in 2004 to about 10% in 2007). To evaluate the level of country attractiveness in terms of FDI, the UNCTAD uses several indicators and one of them is inward FDI performance index (UNCTAD, 2007). The point in using this index is that a country may be very well attractive regardless of what investment climate it has in fact. The driving interest of foreign investors lays not so much in policies that governments undertake but more in the market size itself. The above-mentioned index demonstrates how the country is performing in terms of attracting FDI relative to its market size. According to FDI performance index, Georgia ranked quite high in 2005 – namely the 14th place, as compared to the 45th place that it reached in 2002. 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 FDI potential index is rather low – the 98th place in 2004, however in 2000 it was even lower – the 121st place. A corollary behind this story is that Georgia fails to exhibit high FDI potential; however, it's attracting a lot more foreign direct investment than expected, hence its high ranking in FDI performance (Invest in Georgia, 2007).

Official statistics on Foreign Direct Investment (FDI) inflows during recent years are as follows:		
2000 -	USD	131,232,000
2001 -	USD	109,840,000
2002 -	USD	167,362,000
2003 -	USD	339,393,000
2004 -	USD	497,827,000
2005 -	USD	449,786,000
2006 -	USD	1,091,100,000
2007(Q1-3) –	USD	1,063,500,000

Source: Georgian Ministry of Economic Development. Note: Russian investments for 2004 are overstated, as they include investment deals that were later annulled.

Breakdown of investments by major countries (USD 1,000's):				
Countries	**2002**	**2003**	**2004**	**2005**
Total	167,362	339,393	497,786	1,091,140
UK	17,530	37,670	83,944	132,952
USA	82,271	72,132	77,550	15,033
Kazakhstan	0	0	0	0
Turkey	8,848	17,275	28,569	21,817
Norway	2,994	11,262	34,466	23,626
Azerbaijan	0	29,698	66,008	66,940
Italy	9,864	15,896	28,728	2,838
Cyprus	1,063	676	22,330	47,537
Russia	7,810	42,686	73,712	38,754
France	6,287	16,709	20,940	14,383

Source: Georgian Ministry of Economic Development. Note: Russian investmentsfor 2004 are overstated, as they include investment deals that were later annulled.

Countries	**2006**	**2007 1-3Q**
Total	1,091,140	1,046,267
UK	186,824	50,601
USA	182,651	80,095
Kazakhstan	152,310	74,475
Turkey	129,728	89,554
Norway	77,895	21,900
Azerbaijan	77,804	27,672
Italy	47,219	10,765
Cyprus	40,071	51,075
Russia	34,210	55,959
France	17,221	22,169

Source: Georgian Ministry of Economic Development. Note: Russian investments for 2004 are overstated, as they include investment deals that were later annulled.

The U.S. has been one of the largest foreign investors in Georgia since 1999. In 2000, the United States accounted for 30 percent of FDI in Georgia, annually contributing between 20%-34% of overall FDI in recent years. The completion of the Baku-Tbilisi-Ceyhan oil pipeline, expected by the end of 2005, and the Shah Deniz gas pipeline, which began in 2004, will offer opportunities for investors in the energy sector as well as related infrastructure, in 2001 for 25.7 percent of FDI, in 2002 -- 49 percent, in 2003 and 2004 these indicators were 21 percent and 16 percent respectively. In 2005 it accounted for only 4.1 percent and went up to 16.7 percent in 2006. The U.K., the U.S. and Kazakhstan were the top three investors in 2006 with USD 182 million, USD 181.9 million and USD 152 million respectively, followed by Turkey, Norway and Azerbaijan. Russia, with USD 27.8 million (USD 38.7 million in 2005) holds 11th place on the list of investor countries, while it's ranking was much higher in previous years. According to 9 month data of 2007, the Netherlands were topping the list of investors (16.6%), followed by the British Virgin Islands (11.6%), Denmark (8.8%), Turkey (8.6%), the United States (7.7%), Kazakhstan (7.1%) and Czech Republic (7.0%). (Source: Ministry of Economic Development.)

Econometric Analysis of the Relationship between GDP and FDI

Economists all over the world agree that there is a certain positive relationship between GDP and FDI inflows. Empirical results of numerous econometric researches have shown that foreign direct investments induce economic growth (Grybaite, 2007). It is interesting to investigate how the FDI inflows in Georgia affect the GDP growth and whether the relationship between these two variables is significant. If we take FDI as an independent variable while denoting GDP as a dependent variable, we get the following results: according to the correlation analysis, the correlation coefficient R equals 0.94, demonstrating a strong correlation between GDP and FDI (based on the data of 1997-2007). The regression analysis yields the following relationship: $\ln GDP = 10.98 + 0.37 * \ln FDI + u$; which means that a one-percent increase in FDI leads to 0.37 percent increase in GDP. The goodness of fit R-squared is 0.85, that is, 85% of GDP variability is explained by changes in FDI, and 15% - by other factors. The conclusion of this story is that FDI positively influences economic growth in Georgia and thus the increase in FDI inflows is of immense importance for the economic prosperity of our country. The greatest importance, when talking about FDI inflows in Georgia, pertains to the existing investment climate, which is the major determinant of the amount of FDI that flows into the country yearly. Since the so called Rose Revolution that took place in late 2003, Georgia has witnessed many substantial changes. Before that our country was immersed in such major economic problems as the lack of stability, surge of violence, rampant corruption, and unreliable sources of energy. The new government undertook some truly large-scale efforts to overcome these difficulties and thus enhance Georgia's attractability in terms of foreign direct investments. Government ministries have been restructured and downsized, the process of privatizing state-owned entities is ongoing, forceful steps have been taken to fight corruption, the taxing system has been altered substantially, and at the same time the tax and fiscal administration has become a lot more effective. In addition, licensing requirements have become less stricter, customs and border formalities have lost their rigidity and many other useful policies have been implemented in order to simplifying doing business in Georgia. It appears that all the above-mentioned measures have yielded the expected result – the World Bank called Georgia “the world's fastest growing economy” in 2007 and the 2008 report assigns Georgia the 18th place in the list of the countries where doing business is the easiest. It has to be noted here that this ranking is generally performed according to the normative basis existing in countries, not by the actual capacities of administrating the legal framework. This is why the mere rankings that Georgia has received are not telling the whole story about the investment climate. When considering Georgia's attractability with regard to foreign direct investment, it is essential to take into account the overall macroeconomic environment, which is an important indicator for investors abroad. The economy is growing currently in spite of the Russian embargo – it grew by 9.3% in 2005, 9.4 in 2006, and about 11% in 2007. Inflation in 2006 was about 9%, but it increased in 2007 reaching 11%. However, Georgian government has vowed to keep inflation under 10% in 2008 and subsequent years. There are far fewer concerns about the performance of the electricity system nowadays in our country. Georgia has made significant progress in terms of easing the process of starting a new business – it requires much less time to obtain construction permits and register property. In addition, there is no more obligation of paid-in capital as the initial step of establishing a new enterprise. Georgian legislation provides for substantial protection of foreign investors – the Law on Promotion and Guarantees of Investment states that no kind of legislation adopted after the investment will affect the investor's conditions for up to ten years. Expropriation of investment, according to the law, may happen only in extreme cases and has to be followed with necessary compensation. This compensation has to include not only the value of the expropriated property itself, but also that of losses incurred as a result of expropriation. No procedures are carried out for screening foreign investments except the official registration and licensing requirements. In 2005 the business registration process was fundamentally restructured – the timeline for registration was reduced to 8 - 10 days, there is much less paperwork to do and far less fees to pay in order to get a business established today. Money transfer has also been facilitated substantially – businesses operating in Georgia declare that it does not take more than three days to transfer money abroad. Very important is to take account of the fact that in 2000 Georgian accounting rules were streamlined with international standards. An essential part of Georgia's attractability in regard to foreign direct investments is that Georgian banking system is developing rapidly. Moreover, considerable amounts of FDI are flowing particularly in the banking system itself (e.g. Societe General purchasing stocks of Bank Republic, Private Bank acquiring Tao Bank, etc.). Only in 2007 the assets of commercial banks increased by 70%, with the profits growing by 65%. In 2006 total assets of the banks operating in Georgia (the majority of which have foreign capital) accounted for 45% of GDP. The development of the banking system largely depends on FDI – foreign investment made up 68% of total bank capital in 2007. One of the aspects bearing particular interest for foreign investors is the fact that Georgia possesses quite skilled labor force, the level of which is considered to be fairly high among other post Soviet republics. The labor market of Georgia doesn't have many restrictions and the new labor code has led to more liberal labor regulations. Employers have been absolved from the obligation to pay social security contributions for their workers (Invest in Georgia, 2007).

FDI has been a major channel for the access to advanced technologies by recipient countries and plays a central role in the technological progress of those countries.

The statistics show that foreign direct investment inflows have been rising significantly in the recent years with the main investor countries being Netherlands, Virginia Islands, Denmark, Turkey, the US, Kazakhstan, Czeck Republic, Russia, Cyprus, and the UK. The greatest part of foreign capital is invested in the energy sector, which is then followed by services, construction, manufacturing, and agriculture. Georgia ranks quite low by the FDI potential index according to the UNCTAD, however its ranking goes fairly high in terms of FDI performance index, which means that Georgia is virtually attracting more FDI than it is expected. The econometric analysis shows positive and strong correlation between the increase of FDI inflows and economic growth in 1997-2007. This fact emphasizes the utmost importance of attracting more FDI to Georgia (UNCTAD, 2007).

FDI will lead to significant positive spillover effects on the labor productivity of domestic firms and on the rate of growth of domestic productivity in Georgia.

FDI can play a key role in improving the capacity of the host country to respond to the opportunities offered by global economic integration.

Georgia has received record amounts of foreign direct investment over the past two years and the trend keeps growing. According to Prime Minister of Georgia, Lado Gurgenidze's five – year plan to eradicate poverty, $10 billion in additional foreign direct investment is needed to create 200,000 jobs by 2013. Every type of investment comes with its own unique employment demands, so the dollar amount does not directly correspond to the number of workers required to do the job. (Investor.ge, 2008 : 26).

According to the Economist Glade, FDI – even if the original investor leaves – generally has a positive effect on the country's labor force, paving the way for even more investment in the future and a more highly trained work force. He notes, that investors coming here are thinking more long term, which is very important because that means they are going to invest in infrastructure, in things that will teach people how to work – and introduce more work places which is really needed for investment purposes: “It is better to teach someone to catch the fish than to give him the fish.” (Investor.ge, 2008 : 28).

It is very important to fight with unemployment problem, because according to a public opinion poll taken by the International Republican Institute in Georgia during the autumn of 2007, unemployment is still the nation's most troubling issue. If the country truly received more than $1 billion in investment in 2007 – and over a half a billion dollars in 2006 – where are all the jobs? What are these investors doing? (Investor.ge, 2008: 27).

The government is projecting $2 billion in foreign direct investment for 2008 – in part due to two major privatization projects, the railroad and Poti port. More foreign direct investment (FDI) is needed to fuel the government's new push to create more jobs. International slow down in markets – coupled with lingering concerns about the country's democratic orientation – might affect Georgia's investment potential, officials are still hopeful that FDI will increase this year. They are confident that foreign direct investment will increase over the next five years to $10 billion. The Head of The Ministry of Finance, Irakli Kovziridze noted that an important indicator of the quality of the Georgian market is not just how much is being invested, but who is investing. Half of the FDI coming into the country is from companies registered in the European Union. The port is one of the first biggest deals to attract interest from the United Arab Emirates. Most major privatization projects have already been completed in energy, communication, tourism and transport sectors. The government's aggressive privatization program brought about 450 million lari. Other planned hotel projects include other well known brands like Marriott, Radisson, Intercontinental and Kempinski (Nina Akhmeteli, Investor.ge, 2008: 38).

According to Lado Gurgenidze , 200,000 jobs are needed to push the population above the poverty line. Georgia's achievements in attracting investors had been impressive. A country with almost no FDI coming for more than thirteen years was able to attract more than $1 billion in investments in 2007. Georgia's fast paced economic reforms, which included new tax and custom codes, reducing the level of corruption and aggressive privatization, have created one of the most attractive business climates in the world (Nina Akhmeteli, 2008: 39).

The developing world contains both the fastest – growing and slowest – growing economies on earth. If the local government is highly bureaucratic and corrupt and if government's own provision or regulation of infrastructure and financial services is inefficient so that firms can not get reliable services, then returns on potentials investments will be low.

Privatization of state-owned property is increasing investment and improving Georgia's competitiveness. Investors may initiate an expedited, competitive process to privatize assets needed for an investment project.

Tough anti-corruption measures have significantly improved tax and customs administration and increased state revenues, scaled back Georgia's shadow economy, and produced a significant decrease in corruption in the public and private sectors as measured by international ratings.

Economic growth rate and GDP influences positively the business climate for FDI as it reflects an improvement in economic performance meaning that economic growth increases good business climate, GDP, and as the country has good business climate than more and more investors will be interested to invest their resources in this country.

Stability issues are huge importance for investors. "Georgia is doing a great job of opening up its economy and its government and its future to integrating with Europe and more intense democratic standards" (Investor.ge, 2008: 39).

Major Problems of Attracting FDI to Georgia

Notwithstanding the fact that the Georgian government has contributed much effort to improving the investment climate in the country, there are still a number of drawbacks existing in the economy that might discourage foreign investors from starting business in Georgia. In spite of the significant progress in the infrastructure, much work remains to be done, especially in the rural areas – this is rather important for the investment projects that are going to be implemented in the regions of the country. Georgia is still dependent on other countries in terms of natural gas and electricity and the country's leadership should strive for diversification of energy resources. Problems with legislation have become less severe since the adoption of the Law on Promotion and Guarantees of Investment, but there is much concern about objectivity and fairness of judges both in lower and higher courts. Property rights have been disregarded in many cases. There are examples when Georgian courts virtually patronized Georgian companies and discriminated against foreign ones. These kinds of actions may turn out major impediments for FDI inflows in the future if no appropriate steps for ensuring fairness in the legislative system are undertaken in time. Another problem that usually makes foreign companies wary of investing in a country is inflation and this issue is relevant for Georgia as well. An intricacy here is that FDI inflows might themselves lead to an increase in price levels. This is how it works: when coming to Georgia, foreign business owners buy Georgian Lari (GEL-Georgian national currency) to operate their businesses here, thus causing the appreciation of GEL. National Bank of Georgia (NBG) then buys the excess foreign currency, building up its stock of international reserves, and sells GEL, thus leading to inflation. The intention of NBG is to alleviate the effects of GEL appreciation and to prevent it from even higher appreciation; however, the results are not very favorable: prices are rising and at the same time GEL is still appreciating, due to increasing inflows of FDI (it has to be noted that rising FDI is not the only cause of GEL appreciation). The appreciation of real exchange rate, stemming from the appreciation of nominal exchange rate, is hurting Georgian exports. However, having inflation in the country can make foreign businesses reluctant to investing in Georgia. Therefore, in my opinion, the policy should aim at reducing the price level by allowing for some further GEL appreciation. At the same time, special emphasis should be laid on providing incentives for exporting companies to balance the effect of GEL appreciation. In fact, opting for export-oriented policy is of huge importance when it comes to attracting FDI into the country. Empirical researches have shown that FDI turn out to yield much better results in export-oriented economies than in import-oriented economies. On the other hand, most foreign companies are interested in expanding their market access when coming to Georgia and plan to export the goods and services produced in our country. Thus, establishing free trade agreements with other countries and especially with EU members is vital for Georgia in terms of attracting more FDI to the country. A fruitful way of inducing foreign companies to invest in Georgia can be a direct tax policy. Georgian legislature currently offers no special incentives to foreign investors – a policy that, to my belief, has to be abandoned. There are counterarguments to this idea, stating that a tax policy favoring foreign investors will lead to budgetary losses. However, nowadays it will rather hard to attract FDI without suggesting tax privileges. Such privileges may take the form of a "tax holiday" – exempting a foreign enterprise from paying taxes for a certain period, or the so called "investment tax privilege", which implies privileges for investments in fixed assets. It's important to bear in mind that Georgia's internal market is quite small and attracting large companies is a complicated task. Thus we have to orient mainly on enticing smaller and medium-sized companies, and for these types of companies tax privileges play much greater role than for big companies. On the other hand, if large companies still come to Georgia, they will mostly be occupied with exporting products created here, and the effects of tax privileges on investment decisions are more apparent in export-oriented company. Hence, providing special tax treatment to foreign investors does make sense (Investor.ge, 2007).

Reasons to Invest In Georgia

1. Georgia is the world's number 1 reformer: Georgia's progress in improving the business climate has been well documented in a number of international indices, including the World Bank's Doing Business in 2007 survey, which hailed Georgia as the world's number one reformer.

2. Georgia has good strategic geographic location: Located at the crossroads of Europe and Central Asia, Georgia's three major oil and gas pipelines, Black Sea ports, well-developed railway systems, together with its airports are playing an increasingly important role in linking East and West.

3. Georgia has stable macroeconomic environment: Consistent macroeconomic policies are producing strong economic growth, with GDP increases of close to 10% in 2005 and 2006.

4. Good Competitive Trade Regimes: Georgia has low tariffs, streamlined border clearance procedures, and preferential trade regimes with major partners, including the EU, CIS countries, Turkey and the U.S.

5. Low Taxes: Fewer taxes, and lower rates, including flat tax rates on personal income (12%) and corporate profits (20%), make Georgia the most attractive tax regime in the region.

6. Most Liberal Labor Code: Georgia's new Labor Code, hailed as one of the world's best in international rankings, reduces labor costs, and gives greater freedom of contract to employers and employees.

7. Simplified Licensing Procedures: The total number of licenses and permits required in Georgia has been slashed by 84%, and statutory deadlines imposed for government to respond to applications. The "one-stop shop" and "silence is consent" principles were also introduced.

8. Aggressive Privatization Policy: Privatization of state-owned property is increasing investment and improving Georgia's competitiveness. Investors may initiate an expedited, competitive process to privatize assets needed for an investment project.

9. Dynamic Banking Sector: The banking sector, which is completely private, is growing rapidly, as foreign investors enter the sector and Georgian banks tap international capital markets.

10. Corruption-Free Environment: Tough anti-corruption measures have significantly improved tax and customs administration and increased state revenues, scaled back Georgia's shadow economy, and produced a significant decrease in corruption in the public and private sectors as measured by international ratings (Usaid /Business climate reforms).

The World's Number 1 Reformer

Georgia's aggressive reforms are reflected in significant increases in its ranking on international indices that measure various aspects of the business climate.

Table 1. Georgia's reforms measuring aspects of business climate

Economy	Starting a business	Dealing with licenses	Employing workers	Registering property	Getting credit	Protecting investors	Paying taxes	Trading across borders	Enforcing contracts	Closing a business
1. Georgia	*	*	*		*			*	*	
2. Romania		*	*		*	*		*		*
3. Mexico	*					*	*			
4. China	*				*	*		*		
5. Peru	*				*	*			*	*
6. France		*			*			*	*	*
7. Croatia	*			*					*	
8. Guatemala	*	*		*						
9. Ghana				*			*	*		
10.Tanzania	*			*				*		

Source: World Bank Doing Business 2007.

* The World Bank's Doing Business in 2007 report ranked Georgia as the number one reformer in the world in improving the ease of doing business. The country leaped forward an unprecedented 75 places, moving from 112th to 37th place out of 175 countries surveyed.

* The Business Environment and Enterprise Performance Survey (BEEPS), a joint initiative of the EBRD and the World Bank, states that Georgia saw the largest reduction in corruption among all transition countries in 2002-2005.

* According to the Heritage Foundation's Index of Economic Freedom for 2007, Georgia ranked 35th out of 161 countries (20th out of 41 counties in the European Region). Georgia scored above world average in 7 out of 10 indicators, with particularly high ratings in business freedom, fiscal freedom, freedom from government, and labor freedom. Georgia's overall rank is expected to improve even more in 2008 (Table 2) (Invest in Georgia, 2007: 6)

Strategic Geographic Location

Located at the crossroads of Europe and Central Asia, Georgia is a bridge connecting several important economic regions with a total of 827 ml. people, including the EU (495 ml.), Turkey (73 ml.), and the Caucasus Region (16 ml.). It is a key link in the shortest transit route between Western Europe and Central Asia for transportation of oil and gas as well as dry cargo. Georgia's oil and gas pipelines, Black Sea Ports, well – developed railway systems, together with its airports and playing an increasingly important role in linking East and West.

* Oil and Gas Pipelines: Georgia plays an important role as a strategic crossroad for hydrocarbon transit in the Caspian region. During the last ten years, $5 billion was invested by BP and its partners to develop the three major oil and gas pipelines that cross Georgia:

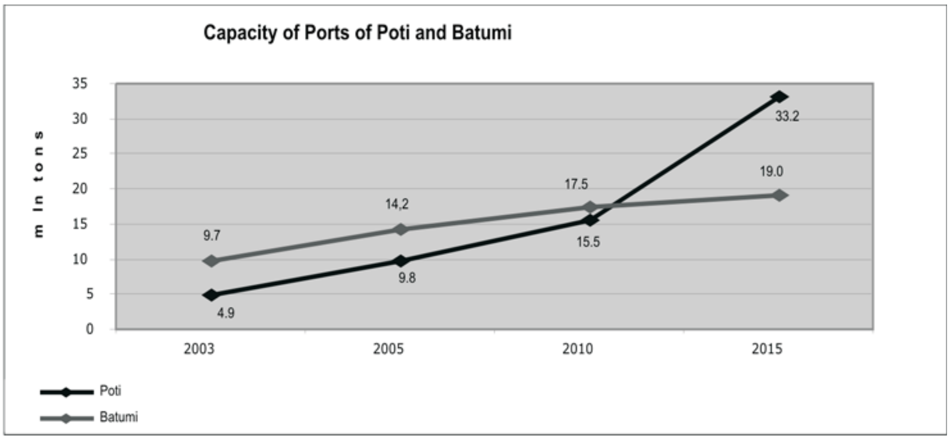
* The Baku-Tbilisi- Ceyhan (BTC) pipeline, completed in 2005 at a total construction cost of nearly $4 billion, can transport up to a million barrels of oil a day from the Sangachal terminal in Azerbaijan to a newly constructed marine terminal in Ceyhan on the Turkish Mediterranean coast. One of the longest pipelines in the world, it generated total profit tax payments (throughput profit tax) to the Georgian Government of $7.8 million in 2006. Estimated profit tax payments for 2007 will be around $25 million, rising to $50 million a year in the future.

* The South Caucasus gas Pipeline (SCP), completed in 2006, will carry natural gas from the Shah Deniz field in the Caspian Sea to customers in Georgia, Turkey and Azerbaijan. The gas supplied through SCP represents a source of future energy security and supply diversity for Georgia. SCP brings benefits of gas 'in kind' in lieu of tariff. Under current sales agreements, Georgia's volumes will build up to 800 million cubic meters of gas at peak production.

* The Western Route Export Pipeline (WREP), also known as the Baku-Supsa pipeline, has brought valuable transit fee revenues to the government of Georgia since it was completed in 1998 (Invest in Georgia, 2007: 6)

* Georgian Railway, one of the crucial links in Eurasian transit, serves as a short-cut between Europe and Central Asia, carrying 3.9 million passengers and 22.6 million tons of cargo in 2006. Georgian Railway now directly links to the railway systems of Armenia, Azerbaijan and Russia. The governments of Georgia, Turkey and Azerbaijan have agreed on a new Baku-Tbilisi-Kars railroad that is expected to carry 8-10 million tons annually for 2010-2012.

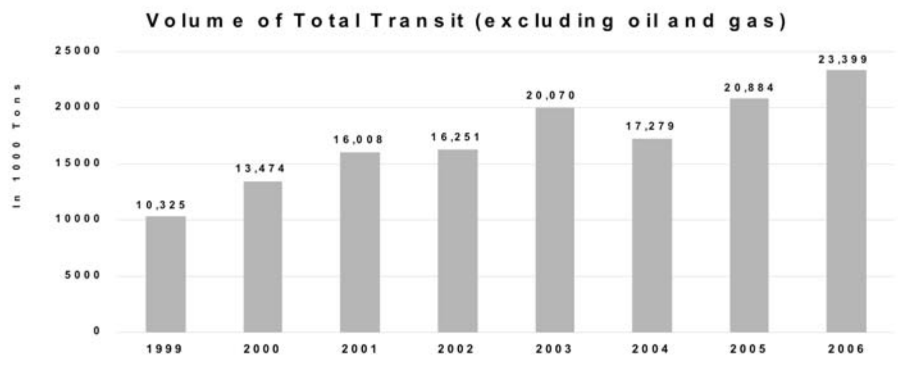
* The Black Sea ports of Poti and Batumi are key links in the TRACECA (Transportation Corridor – Europe, Caucasus, and Asia) trade route.



Source: Georgian Customs Department

* Road Transport: Georgia has allocated 181.3 million GEL from the state budget to improve the quality of its 20,229 km of public roads, which include 1,474 km of international, 3,326 km of state and 15,439 km of local roads.

* Poti Port Free Economic Zone: Georgia is developing a free economic zone on the territory of Poti Port and surrounding area to allow investors to leverage Georgia's strategic location and competitive trade regimes (Invest in Georgia, 2007: 6).



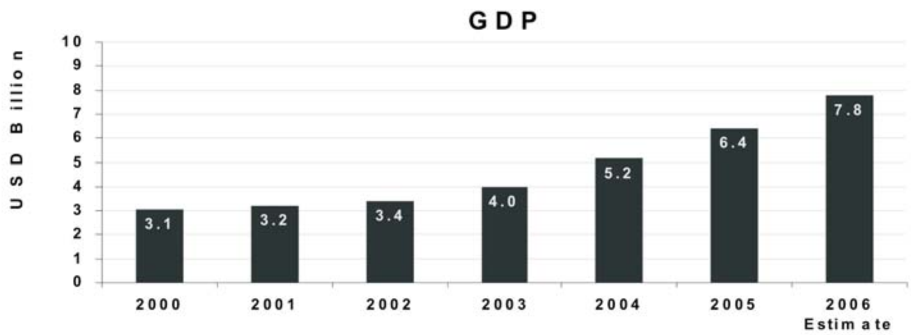
Source: Georgian Customs Department

Stable Macroeconomic Environment

Consistent and sustainable macroeconomic policies pursued by the Georgian Government have produced positive results as evidenced by strong economic growth trends. During the first nine months of 2006, trade (13.2%), agriculture (11.7%), transport (8.4%) and manufacturing (8.3%)

accounted for the largest shares of GDP. The highest growth rates were registered in the sectors of finance (46.6%), mining (29.3%), manufacturing (25.8%), trade (20.7%), and transport (18.2%). (Invest in Georgia, 2007: 9)

Table 2. Estimated GDP



Source: Department for Statistics of the Ministry of Economic Development of Georgia

FDI in Georgia							1000 USD
	2000	**2001**	**2002**	**2003**	**2004**	**2005**	**2006Q1**
Agriculture	1 176,5	620,3	890,2	784,4	967,3	5 041,5	151,4
Manufacture	43 787,9	27 428,4	29 523,4	49 488,6	66 183,0	110 175,3	27 402,2
Service	86 267,5	81 791,2	136948,8	289797,1	431956,2	334 568,1	106 279,2
Total	**131231,9**	**109839,8**	**167362,5**	**340070,1**	**499106,5**	**449 784,8**	**133 832,8**

Source: Business Information Center

Competitive Trade Regimes

Georgia's foreign trade has been growing rapidly since 2003 as a result of aggressive policy reforms to make it easier and less expensive to trade across borders. In 2006, total trade turnover increased by 39 %, reaching $4.7 billion USD, with exports increasing by 15% and imports by 48%. For the last few years, there has also been an upward trend in the number of Georgia's trading partners, now standing at 132 countries.

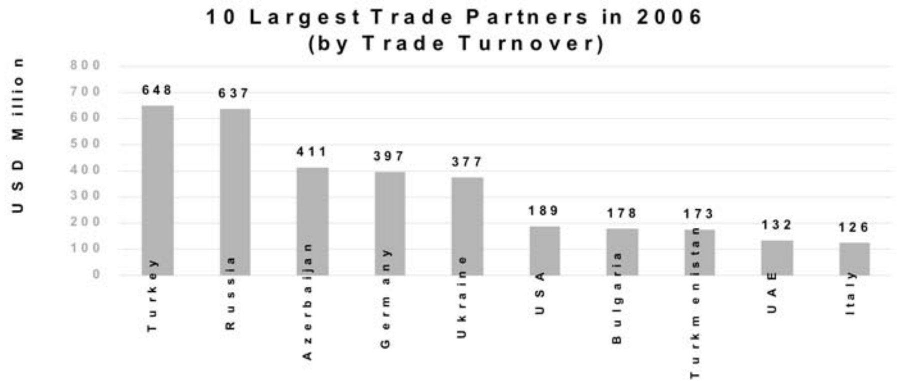
* MFN Tariffs with WTO Members: Most of Georgia's trade partners are members of the World Trade Organization (WTO). Trade relations with them are based on Most Favored Nation (MFN) trade status, which provides lower tariffs for WTO members.

* Preferential Tariffs with the USA, Canada, Switzerland and Japan: Georgia benefits from a Generalized System of Preferences (GSP)

when trading with the USA, Canada, Switzerland and Japan. Accordingly, lower tariffs are applied on goods exported from Georgia to those countries.

* GSP Plus with the EU and Turkey: Georgia is one of the only two CIS beneficiaries (besides Moldova) of the new EU GSP Plus trading regime, and one of only 15 beneficiaries worldwide. GSP Plus status allows Georgia to export 7200 products to the 495 million EU market duty free. From January 2006, Georgia also enjoys GSP Plus status with Turkey as well.

* Free Trade with CIS Countries: Georgia has a free trade regime with CIS countries resulting in duty free trade of goods and services. CIS countries account for 39% of Georgia's foreign trade turnover and 40% of Georgia's exports are to these markets (Invest in Georgia, 2007:12)



Law Taxes

In 2005, Georgia enacted a new Tax Code that introduced lower, flat – tax rates and significant procedural and institutional innovations:

1. The total number of taxes was reduced from 21 to only 7 - This seven are State Taxes – personal income, corporate profit, social, exercise, value added, and Customs import duties.

2. Personal income is taxed at 12% - Dividends and interest received by individuals are taxed at 10% at the source of payment. Income tax is paid by resident individuals on their income and non – resident individuals on their Georgian sourced income.

3. Corporate profits are taxed at 20% - Dividends received by Georgian enterprises are not subject to taxation at the source and are exempt from any further profit tax. Profit tax is paid by Georgian enterprises on their worldwide income and foreign enterprises on their Georgian – sourced income.

4. 18% value – added tax – is paid by taxpayers whose turnover exceeds 100, 000 GEL in any 12 – month period and by importers. Financial and insurance services, oil and gas operations, and certain other operations are also exempt from Value Added Tax (VAT).

5. Employers pay a social tax of 20% (Invest in Georgia, 2007: 14).

Most Liberal Labor Code

Georgia's new Labor Code has been hailed as one of the world's best. The Heritage Foundation ranks Georgia first in the World in the Labor Freedom category of the Index of Economic Freedom, and World Bank ranks Georgia sixth in the world on the Employing Workers indicator of its Doing Business Survey. Key features of the new Labor Code, which took effect in May 2006, include:

* Only 1 month of severance pay is required when an employer terminates a labor contract.

* No severance pay is required if the employee is terminated during a probation period (up to 6 months).

* An employee must give 30 calendar days notice to an employer upon termination of a labor contract.

* No limits on overtime work are specified, except for pregnant women, new mothers, or disabled persons.

* Salary is subject to agreement between the parties.

* An employee has the right to refuse to perform a job only if it endangers her/his life.

* The employee is entitled to 24 working days of paid annual vacation only after 11 months of employment with their current employer.

* If the statutory holidays stipulated by the Georgian Labor Code occur on weekends, they are not transferred to the next working day (Invest

in Georgia, 2007:15).

Simplified Licensing and Permitting Procedures

Georgia has simplified licensing and permitting requirements to ease constraints on business. The total number of licenses and permits was reduced by 84%. Georgia's new licensing and permitting regime now provides

* Licenses and permits may be required only for:
Safety and health protection
Security of living conditions and cultural environment of individuals
Protection of state and public interests

* Reduced statutory time limits for government action is taken within statutory time limits (Invest in Georgia, 2007:16).

Aggressive Privatization Policy

Key features of Georgia's privatization policy include:

* Flexibility – Use of Various Methods of Sale: To promote an efficient privatization process, the Government of Georgia utilizes various methods to privatize state – owned property such as tender, auction, lease, redemption and direct sale. Transparency – To ensure a high level of fairness and transparency, the Government actively works towards establishing international contracts with interested organization and potential investors

* Fairness – Equal Opportunities for all Potential Buyers – Any Georgian or foreign person or company has the right to take part in the privatization process in compliance with the laws of Georgia.

*Investor – initiated privatization: Investors can initiate an expected, transparent and competitive privatization of particular assets necessary to an investment project (Invest in Georgia, 2007:17, (www.privatization.ge).

Dynamic and Competitive Banking Sector

The dynamic increase of the banking sector is determined by macroeconomic stabilization, improvement of the investment environment in the country (Investor.ge - Gotsiridze, 2006:34). Following banking reforms enacted in Georgia in 2000 – 2007, state banks were completely privatized and restructured. Today 100% of the banking sector is private and it is one of the most dynamic sectors of the Georgian economy. During last years, the number of banking customers has increased rapidly, with deposits by individuals and companies increasing 25 – 35% a year. Banks are experiencing an average return on assets of 3 – 5% and return on investment of 14 – 18%. Residents and non – residents of Georgia may make investments in commercial banks based in Georgia under equal terms and conditions.

* In January 2005, VTB bank of Russia acquired 51 percent of United Georgian Bank, one of the top three banks in Georgia.

* Ukrainian “Privat Bank” acquired 75% of “Tao Bank” (currently the bank operates under the name of “TaoPrivat Bank”) (Investor.ge, 2008:31)

* HSBC, one of the largest banks of Europe, entered Georgia and is due to start full scale operations in 2008.

* In October 2005, Kazakh bank Turan Alem, one of the largest banks in the CIS, acquired the controlling stake in Silk Road Bank.

* Open JSC TransCaucasus Development Bank, an affiliated bank of the partially state – owned International Bank of Azerbaijan (IBAR) officially launched operations in Georgia after it was granted a license by the National Bank of Georgia (NBG).

* Group “Societe Generale” acquired the controlling stake in Bank Republic in March 2006.

* New commercial bank “Progress Bank” entered the banking sector market.

* In November 2006, Bank of Georgia became the second bank from a CIS country to be listed on the London Stock Exchange when it successfully placed its shares in the form of Global Depository Receipts on the LSE.

* “Core Bank” will start operation on banking market in 2008.

* Subsidiaries and branches of commercial banks from Greece, Turkey, Azerbaijan, and Germany are operating in the Georgian market

(Invest in Georgia, 2007:18).

I want to add here other most notable investment news in 2007:

Telecommunications:

* The new cellular communication operator “Mobitel” LTD, subsidiary of the United Joint – Stock Company “VimpelCom” (Russia), started operating on the Georgian market under the name of “Beeline”

Insurance:

* The European Bank for Reconstruction and Development (EBRD) purchased 34% of the insurance company “Imedi L”. This is the first investment of EBRD in the Georgian insurance sector.

Hotels:

* The construction of the hotel “Park Hyatt” has started in Tbilisi. The project is worth $200 million and will be complete in the end of 2009.

Energy:

* The Czech company “Energo Pro” has purchased six hydropower plants and two electricity distribution companies. “Energo Pro” will spend $85 million for the rehabilitation of hydropower plants and $15 million for the rehabilitation of electricity distribution companies. The company will also spend $100 million on the construction of a new hydro power plant with a capacity of 100 megawatt hours. The total investment will reach $417 million.

Water supply / distribution:

* The Swiss company “Multiplex Solution” has purchased the Tbilisi water distribution company for $85,662,000. The company will invest $350 million on the rehabilitation of the water distribution network.

Visas:

* Georgia introduced a visa – free regime for the citizens of United Arab Emirates, Qatar, Bahrain and Oman. Georgia already has visa – free regimes for the citizens of European Union states, USA, Japan, Canada, Switzerland, Island, Norway, San Marino, Lichtenstein and Turkey (Investor.ge, 2008, p: 31).

Corruption – Free Environment

Eliminating corruption has been a key priority of Georgia's new government, which was swept into power by the Rose Revolution of November 2003. The new government's efforts have significantly improved fiscal administration, produced a significant decrease in corruption in the public and private sectors as measured by international standards (Invest in Georgia, 2007: 19)

Benchmarking Georgia against its Competitors.

To successfully develop and communicate a competitive investment package requires that Georgia identify:

* Which countries are its key competitors for mobile investments?

* What factors are important to investors in deciding where to locate; and

* How Georgia compares with its competitors on the factors investors use to make decisions (USAID/Business Climate Reforms)

Developing this information, which is critical to prioritizing reforms to attract investment, requires ongoing dialogue with the business community to identify and address concerns that hinder investment in Georgia. As an example of how to begin the process, Table 1 identifies eight countries in the region that compete with Georgia for FDI. The list should be further refined and modified to identify Georgia's biggest competitors not just in the region, but around the world. However, this list provides a good starting point to assess Georgia's performance. The discussion that follows compares Georgia's performance to those of its regional competitors using three well-known international indices. Some caveats about the use of such indices (Business Information Center/ www.bic.ge).

* They are often outdated, relying on information that is a year or more old. For example, the Economic Freedom Index gave Georgia a very poor score in the area of regulation. This rating fails to take account of recent, dramatic reforms in the area of licenses and permits that reduced the 900 previously required by 85%, introduced greater transparency, simplified the process, and mandated deadlines for issuance. It is critical for investment promotion officials both to know the ratings and the reality

so that they can point out the discrepancies to interested investors.

* It is very important not only on what reforms have been accomplished, but what reforms are underway. For example, although Georgia now compares poorly to its neighbors on the “starting a business” and “hiring and firing” indicators of the World Bank Doing Business survey, potential investors need to know that the Government is actively pursuing reforms in both areas.

* Weak performance on international indices can eliminate Georgia as an option. For example, investors interested in a low-cost platform to manufacture goods for other markets will be unlikely to consider Georgia seriously as long as it remains almost at the bottom of the “Trading across Borders” indicator on the World Bank's Doing Business rating system.

* Many of the subtle factors most important to investors don't show up in international indices. For example, the Business Information Center (BIC) of the Georgian National Investment Agency (GNIA) recently assisted an investor considering a $5-10 million investment in either Georgia or Armenia. He was enchanted by the beauty and ambience of Tbilisi compared to Yerevan; the friendliness of Georgians on the street impressed him; he was very pleased to hear that Georgia has eliminated the practice of corrupt police stopping trucks to elicit bribes; and he was impressed by the lengths to which BIC team members went to assist him as compared with their Armenian counterparts (USAID/Business Climate Reforms).

Research Results:” Investment and Foreign Direct Investment in Georgia”

Table 3. Mean Scores for Investment Climate in Georgia

Factors	Mean Scores
Skills and Education of available workers	2.3
Crime, theft and disorder	1.97
Economic and Regulatory Policy Uncertainty	1.92
Cost of Finance (interest rate)	1.66
Electricity	1.53
Anti-competitive or informal practices	1.44
Customs and Trade regulations	1.36
Tax administrations	1.35
Macroeconomic instability(inflation, exchange rate)	1.34

Tax rates	1.32
Corruption	1.20
Access to Finance	1.04
Transportation	0.97
Labor Regulations	0.79
Business Licensing and Operating Permits	0.68
Access to Land	0.64
Telecommunication	0.45
Overall Average	**1.29**
Mean scores are based on a five-point scale ranging from 0= No Obstacle to 4 = Very Severe Obstacle.	

Table 3 displays the results of mean scores for each environmental impact statements used in the study. The statements in Table 3 have been arranged in order of the magnitude of the mean score. The highest mean score (2.3) was for the statement that the biggest obstacle for investing in Georgia is skills and education of available workers. This is the major obstacle for the investor to operate and grow their business. Specially, firm's managers indicated that they have lack of skillful worker in technical jobs. When Georgian roads and building were adjudicated, there were only foreign companies ready to compete. This is a good indicator that in Georgia there is lack of skillful worker, mostly in technical jobs. Although crime, theft and disorder levels decrease recently, investors still do not feel safety (1.97). They think that economic and regulatory policy uncertainty is moderate obstacle (1.92). It is a great success of the new government that this issue was before among severe obstacle.

Cost of finance (interest rate) is another difficulty to operate and grow business (1.66). Some respondents argue that interest rate is reasonable when we compare it with the risk factor. Some of international investors even stated that because of high interest rates, they get credits from banks in Europe. Electricity is no longer a major problem (1.53). Most of the investors who indicated electricity as an obstacle have branches in different regions of Georgia. That is to say, it is mostly a regional problem. An anti-competitive or informal practice seems to be a problem that we have to fight with (1.44).

Another issue for foreign investor for importation or production of different goods in the country is the problem of poor performance of the official at the customs (1.36), which also corresponds to the findings of the other researches. Some investors suffer from the officials who are not experienced enough at their fields and they waste time at the borders. Tax administrations (1.35) another serious issue stays on the table, especially finance police makes it difficult to operate business.

Most of the comments made by our respondents' show that macroeconomic instability (inflation, exchange rate) are a minor obstacle (1.34), they are stabile. Tax rates (1.32) are reasonable after the enacted new tax code in 2005 that significantly reduced tax types and rates.

Previous studies showed that corruption used to be the number one problem of Georgia (1.20). Thanks to new government's considerable efforts against corrupted officials, it is no more very severe obstacle (Department for Statistics of the Ministry of Economic Development of Georgia).

Investors do not think that it is difficult to ``access to finance`` (1.04). But some of them stated that it is difficult to get the amount of money that they demand. That is why; they have to work with several banks to get the amount that they want. As we see from the numbers, transportation (0.97), and labor regulations (0.79) are not serious issues for the country anymore.

The number of business activities subject to licensing and permitting regimes was reduced by 84 %. Due to successful reforms in ``business licensing and operating permits`` (0.68), Georgia has favorable investment climate for doing business.

Access to land (0.64) and telecommunication (0.45) values, according to our corresponds, are very close to no obstacle. But I should indicate that some investors have problems of telecommunication in the regions, to contact head quarters with offices in the region (USAID/Business Climate Reforms).

Table 4. Mean Scores for Government Intervene in the Economy

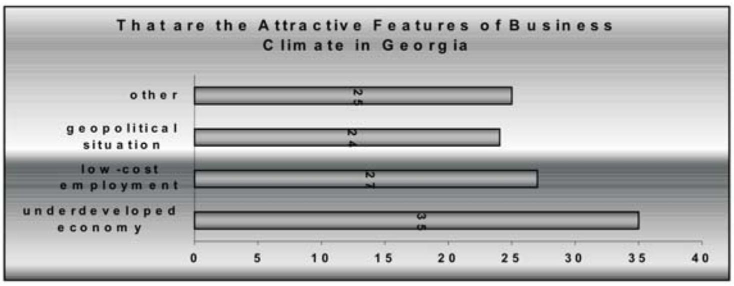
Factors	Mean Scores
Sales	0.35
Employment	0.34
Wages	0.29
Pricing	0.27
Investment	0.23
Mergers	0.21
Dividends	0.15
Overall Average	**0.27**
Mean scores are based on a five-point scale ranging from 0= Strongly disagree to 4 = Strongly agree.	

Table 4 displays the results of mean scores for each environmental impact statements used in the study. The statements in Table 3 have been arranged in order of the magnitude of the mean score. As we can see from the values Georgian Government does not intervene to the economy. The highest mean score (0.35) was for the statement for sales. Employment means score is 0.34, wage is 0.29, pricing is 0.27, investment is 0.23, merger is 0.21 and the last one is dividends (0.15).

The values are parallel with the aim of the new government. The aim is to establish the free market economic conditions in Georgia as it was stated by president and the minister of the Economic Development of Georgia. The responds of the 65 companies shows that Georgia is on the right way in order to have free market economy (USAID/Business Climate Reforms)

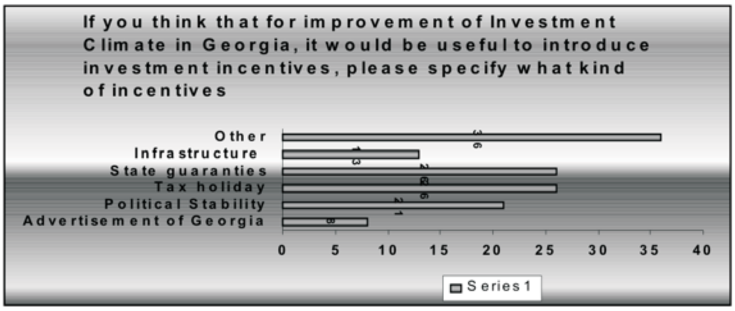
What are the Attractive Features of Business Climate in Georgia?

Graph 3. Mean Scores for Attractive Features of business Climate in Georgia



As we can see from our responders the most attractive feature of business climate in Georgia is undeveloped economy of Georgia (31%). That generates some obstacles for business operation and development in Georgia. But while answering to this question they have mentioned that the economy environment in Georgia is improving time by time since 2003. There is economic grows inside of the country, many reforms have been implemented by new government of Georgia, all these dramatic changes are affecting business climate of Georgia. Second attractive feature of business climate in Georgia is low-cost employment (24%). The employment cost in Georgia is less, in comparison with European Countries. This is one of the main reasons why foreigners are coming in Georgia, in order to start their businesses here, as soon as the labor cost is heaper, the minimum salary level is low, it's less cost full for businessmen to operate in Georgia either in European countries. Other attractive features of business climate in Georgia take 3rd place (23). Fourth attractive feature of business climate in Georgia is geopolitical situation (22%). From view of our respondents geopolitical situation is least attractive feature of business climate in Georgia. From their point of view geopolitical situation takes least impact into business climate of Georgia (USAID/Business Climate Reforms)

Graph 4. Mean score for investment Incentives



The democratic roots of the Rose Revolution gave hope to Georgia's citizens and allies alike that the country would develop on the basis of democratic values, respect for human rights, and economic reform. The fact that many of those expectations have not yet been fulfilled has caused much disappointment among the revolution's supporters. The new government is a kind of mixture of democratic and authoritarian elements. Such hybrid regimes are not a novelty; they are characteristic of many post communist countries that have not had "color revolutions". But it is regrettable that Georgia could not avoid the populist tendencies manifested in deprivatization, another attribute of authoritarian regimes. For now, its antidemocratic tendencies are impeding its prospects for integration with Europe and possibly blocking its economic development. But there is still time for international organizations and Georgia's allies to help Georgia's government return to a democratic path (Papava, 2007).

Despite the public declarations of Georgia's leadership after the "Rose Revolution" the working conditions in this country do not ensure that existing risks will be redeemed. Moreover, a direct extrusion of foreign investors is going on. They are being deprived of their property via nationalization, bankruptcy or re-sale of projects. As a result, last year in Georgia the value of foreign investments fell almost by 20 %. Several countries formulate recommendations to their businessmen to refrain from investing in the Georgian economy (Corna, 2006).

Findings:

* Firms in the best investment climate can be nearly twice as productive as those in weaker environment. Good and improved investment climate will lead to wage rate increases, higher returns to capital and the higher return to capital should lead to faster accumulation and growth for the typical firm in sectors that should be expanding as the country accumulates capital. As capital is accumulated diminishing returns reduce profitability and the growth rate slows down. (David Dollar).

* If the return to capital will be very high in Georgia, then some capital will flow from rich countries to Georgia and accelerate the growth process (David Dollar).

* Government's role in providing a good regulatory framework for infrastructure, access to the international market and financial services is particularly important for foreign investors (David Dollar).

* High Gross Domestic Product (GDP) will increase employment and this will attract foreign investors in the country.

*All investment would be unprofitable and lost if a product in which money was invested will not result from the efficiency.

* Using push strategies reduce risks and costs of investment

(strengthening capacity in developing countries); Pull strategy assuring a future return in particular investment) (Amie Batson & Martha Ainsworth).

* The elasticity of FDI inflows to changes in GDP and natural resources are both equal to unity (a = 1) (Dicko Mahamet).

* Economic growth rate influences positively the business climate for FDI as it reflects an improvement in economic performance meaning that economic growth increases good business climate and as the country has good business climate than more and more investors will be interested to invest their resources in this country.

* Degree of openness as measured by the trade share in GDP will have positive relationship with foreign investors through trade liberalization and higher competitiveness (Dicko Mahamet).

* GDP growth rate and trade openness will be positively and significantly correlated with the investment climate in Georgia (Dicko Mahamet).

* Positive impact of trade openness shows that trade liberalization leads to a more general reduction in administrative barriers and improve the business environment in the host economy – countries (Dicko Mahamet).

* Business climate, macroeconomic and political stability, infrastructure, transport costs and human capital need improvement. There is a need in implementation of actions essential in the strategy of attracting FDI and till these problems will not be overcome FDI will have no effect on countries welfare.

* Illiteracy rate has negative effect on FDI business climate, it is -0.39, so it should be inversely related to the availability of relatively skilled labor – a major factor in the location decision. FDI is 1.09 (Dicko Mahamet).

* FDI inflow has positive effect on GDP, FDI inflow from GDP is 0.91 or by T – statistics it is very high 3.97, meaning that as high Gross Domestic Product in the country as high will be inflow in the country and many investors will be interested in investing resources in such country, so GDP growth rate has been positively and significantly correlated with the investment climate (Dicko Mahamet).

* FDI has been a major channel for the access to advanced technologies by recipient countries and plays a central role in the technological progress of those countries (Borensztein et. Al, 1998).

* FDI has led to significant positive spillover effects on the labor productivity of domestic firms and on the rate of growth of domestic productivity (Blomstrom and Wolf, 1994; Kokko, 1996).

* Direct investment may in encourage export promotion, import substitution, or greater trade in intermediate inputs, especially between parent and affiliate producers (Goldberg and Klein, 1998).

* Foreign investment can increase the speed with which a host economy can become integrated within a global production network in sectors in which it may have had no industrial experience. (OECD, 1998; Rodriguez Clare, 1996; Calderon, Mortimore and Peres, 1996).

* Trade liberalization leads to a more general reduction in administrative barriers and improve the investment environment in the host economy – countries with low trade barriers also tend to have low barriers to FDI – as well as conveys the right signal to the international business community (Lall, 2000).

* Free trade zone has been major determinants in the investment climate for FDI in this region and have been much successful in attracting FDI with stable, growing economic environment and trade liberalization. (Madani, 1999).

* Low tax rates are good and acceptable for foreign investors.

Assessments and Recommendations

Georgia is very dependent on foreign investment. As there are major problems in attracting FDI such as Underdeveloped infrastructure in regions, foreign dependence in terms of natural gas and electricity, concerns about the fairness of the judicial system, inflation with FDI being one of its causes and real exchange rate appreciation hurting exports, then recommendations will be:

* Improving infrastructure in the rural areas.

* Diversifying energy resources.

* Enforcing property rights and ensuring the objectivity of the courts.

* Allowing for further GEL appreciation if it is necessary for curbing inflation.

* Providing particular incentives to exporting companies.

* Providing special incentives to foreign investors ("tax holidays", "investment tax privileges", etc).

Conclusion

Foreign Direct Investment works as a driving force to increase the transfer of technology, skills development and access to export markets for the country. It can increase employment and contribute to a higher GDP through higher levels of productivity than the national counterparts for small economy. Attracting FDI to Georgia – a country with low national savings and insufficient capabilities of establishing new capacities for boosting economic prosperity – is an issue of major importance nowadays. The Rose Revolution opened a new chapter in the history of modern Georgia. Despite the political and economic difficulties faced by Georgia after "Rose Revolution", Georgia has managed to demonstrate to the international community that the Georgian government has committed much energy and effort to ameliorating the investment climate in the country and FDI inflows are increasing year in year out; Georgia's major achievement to attract FDI , together with economic recovery, is the establishment of close political, economic and cultural relations with its neighboring countries; however, there are specific problems concerned with attracting more foreign capital and these issues need to be addressed as soon as possible to ensure further rapid economic development of Georgia. Despite the foregoing improvements in the economy, more than 25 percent of the population lives below the poverty line, and many people still rely on subsistence agriculture. After the " Rose Revolution" in Georgia, the country was coming up, and it became more developed, we have lots of new buildings, houses, offices, and people time by time were getting richer, and background for the investment was getting more stabilized, lots of world known companies came to make their businesses here. Georgia attracts Foreign Direct Investors but still needs improvements in the business and investment climate for the implementation of a few visible actions in the strategy of attracting FDI, especially after Ossetia – Georgian war (7th of August, 2008) as a result of what investors are afraid to invest in Georgia and the process is somehow stopped. The main source of sustained future growth that reduces poverty and increases employment will have to be private investment, both domestic and foreign. So Georgia is extremely open to foreign investment after Osetia-Georgian war and is eager to welcome new investors.

Abbreviations:

BP	British Petroleum
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GEL	Georgian Lari; Georgian National Currency
UAE	United Arab Emirates
USD	United States Dollar
FDIBC	Foreign Direct Investment Business Climate
NR	The value of natural resources.
IR	Illiteracy rate
TM	Telephone Mainlines
NBG	National Bank of Georgia
BEEPS	The Business Environment and Enterprise Performance Survey
EBRD	European Bank for Reconstruction and Development
BTC	Baku-Tbilisi- Ceyhan Pipeline
WREP	The Western Route Export Pipeline
TRACECA	Transportation Corridor – Europe, Caucasus, and Asia
SCP	South Caucasus gas Pipeline
WREP	Western Route Export Pipeline
WTO	World Trade Organization
MFN	Most Favored Nation
GSP	Generalized System of Preferences
VAT	Value – Added – Tax
IBAR	International Bank of Azerbaijan
NBG	National Bank of Georgia
LSE	London Stock Exchange
BIC	Business Information Center
GNIA	Georgian National Investment Agency

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