



Investment Strategy of Georgia as a Country of Transition Economy: Trends, Problems, Prospects

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Abstract

Transition of Georgia to market economy is a complex and continuous process, closely related to both, economic growth and social challenges. In this regard domestic as well as foreign direct investments are one of the mechanisms of utmost importance. The country with economy in transition has many social-economic problems that make it essential for government to look for the most efficient ways of solving them implementing proper investment strategy. The paper considers the main trends and tendencies of investments from macroeconomic point of view, concerning the governmental investment policy aspects, investment climate, the dynamics of investments flows, capital revenues, investments' share in GDP, the structure of investments in term of countries, sectors, etc. The article considers the core issues of the investment policy in Georgia from pragmatic as well as conceptual point of view, where the role and importance of investment policy are presented, legislative base of investments are discussed, inevitability of transparency, measurability and effectiveness of investment process is reasoned, proactive investment approach is prioritized, the importance of privatization policy is given, forms of privatization and their effectiveness are analysed, complex utilization of investment marketing instruments, effective management of investment cycle, facilitation of post-investment activity, investigation of investment potential, Brown-field and Green-field investments and the PPI model and other topical questions are also characterized. Herewith, the author suggests some corresponding problem-solving recommendations which, as the author suggests, will help policy implementation persons at state, regional and local governmental levels of the country.

Keywords: Investment Strategy; Proactive Investment Policy; Post-Investment Activity; Investment Cycle; Infrastructure for Investments; Brown-field and Green-field Investments; Privatization Process; Investment Marketing

Introduction

In the modern stage of development, one of the most important determinants of economic growth is the private sector investments and contemporary economic effects. Since the level of savings in the economy of Georgia is relatively low, the investment activity is mainly stimulated by foreign direct investments (FDI). The main factors for investment attractiveness in the country's economy are the following: the favourable geostrategic location of the country and nearness to the markets, leading positions in international indices (the Index of Economic Freedom, simplicity of Doing Business, etc.), simple and effective taxes, liberal customs legislation, flexible logistical infrastructure, available labor resources, state programs for business promotion, free trade agreements (especially, a European Union Association Agreement), bilateral agreements on promotion and protection of investments (with more than 30 countries), free economic (industrial, touristic, technological) zones, developed financial sector, increasing participation of international financial organizations in economic projects and more. In spite of this, the significant challenges in the realization of investment potential of the country are observed, which requires the development and implementation of a correct and well thought investment strategy. The present paper, based on quantitative and qualitative analysis, identifies weak points of investment policy and provides relevant recommendation proposals.

The necessity of moving from the reactive to the proactive investment policy

As it's commonly considered the investment policy is one of the main underlying axes for the economic policy of the country and the central element of economic growth (Klump, 2015, p. 157) as well as the main circulating power of the macro and microeconomic processes and flows. The importance of the investments in the private sector on the macro level is mainly revealed by reaching the macroeconomic equilibrium, added value formation, creation of jobs, strengthening the national currency, generation of the additional budget-income flows, increase of the export capacity and others, while the technological update process of companies, saturation of the of consumer market, development of the adjacent and sub-sectors, improvement of the quality of production, increase of competition, promotion of reinvestment activity and more.

It should be mentioned that the efficiency of the investment policy and relevant strategy largely depends on the effectiveness of the reciprocal steps taken by the relevant state bodies towards investors, perfection of the investment cycle and

adequate assessment of investment trends. The dynamics and structure of the investment processes in the economy of Georgia completely and clearly are highlighted in the following table.

Table 1. Dynamics and Structure of the Investment Characteristics in Georgia

	2010	2011	2012	2013	2014	2015	2016	2017 ¹
Foreign Direct Investments (Million US Dollar), Including -	845,1	1 129,9	1 022,9	1 020,6	1 818,0	1 652,5	1 602,9	1 861,9
<i>By Sources:</i>								
Foreign Economic Activity of Enterprises	678,0	866,3	841,3	765,9	1 700,3	1 510,6	1 479,3	1 533,8
Privatization	49,4	61,8	5,4	2,8	3,6	6,5	2,2	1,6
Financial Sector	117,7	201,8	176,2	251,9	114,1	135,4	121,4	326,5
<i>By Sectors (%):</i>	100	100	100	100	100	100	100	100
Agriculture	1,0	1,5	1,6	1,3	0,7	1,1	0,5	0,2
Industry/ Manufacturing	27,8	16,0	20,4	14,8	14,1	11,3	11,2	6,9
Energy Sector	3,2	18,8	17,5	24,0	10,5	7,5	7,3	10,1
Construction	1,1	7,0	9,0	7,8	17,9	8,7	8,6	15,8
Hotels and Restaurants	2,8	2,7	0,2	-0,7	7,3	8,6	3,6	4,8
Transports and Communications	25,4	11,6	8,2	13,9	23,9	35,5	42,3	28,3
Real Estate	15,0	14,1	5,6	6,1	8,2	5,5	6,1	8,6
Other Sectors	23,7	28,3	37,5	32,8	17,4	30,5	20,4	25,3
<i>By Country Groups (%):</i>	100	100	100	100	100	100	100	100
EU Countries	27,7	43,6	44,7	41,3	46,0	46,7	23,8	39,4
CIS Countries	15,8	13,3	9,6	14,2	25,1	38,3	38,8	28,1
Other Countries	51,1	34,7	39,5	38,5	34,6	12,2	35,0	32,3
International Organizations	5,4	8,4	6,2	6,0	-5,7	2,8	2,4	0,2
Investments in Fixed Assets (Million GEL), Including -	3 210,1	2 602,5	3 245,6	3 937,3	3 559,6	4 333,6	4 665,4	-
<i>By Enterprise Size (%):</i>	100	100	100	100	100	100	100	-
Large	71,2	58,5	54,2	49,1	44,5	58,6	53,2	-
Medium	15,5	19,6	22,3	27,5	15,7	19,1	22,6	-

¹ Preliminary Statistical Figures.

Small	13,3	21,9	23,5	23,4	39,8	22,3	24,2	-
GDP (At Market Prices, Million GEL)	20 743,4	24 344,0	26 167,3	26 847,4	29 150,5	31 755,6	34 028,5	38 042,2
Gross Capital Formation	4 477,7	6 368,0	7 575,4	6 652,9	8 688,9	10 004,3	11 136,6	12 133,3
Portion of Gross Capital Formation in GDP (%)	21,6	26,2	28,9	24,8	29,8	31,5	32,7	31,9

Source: National Statistics Office of Georgia; The Author's Calculations

Analysis of the investment parameters is important in several directions: 1. According to the sources – as the table shows, the component of the foreign activity of the enterprise is increasing in the dynamics, the share of privatization is significantly reducing while the data of the financial sector is relatively stable that can be explained by the increase of the foreign investments in the real sector of the economy compared with previous years; 2. According to the sectors – the foreign investment flows are concentrated mainly in sectors of the economy such as transport and communications, industry, energetics, construction, other sectors (including the financial sector as well). 3. According to groups of countries – the growth trend is characterized to the investment of EU and CIS countries which can also be explained by the enactment of the European Union Association Agreement. By 2017, the top three leading investor countries are United Kingdom, Netherlands and China. 4. Investments in fixed assets – the share of the total number of investments in large enterprises are significantly reduced, while the specific weight of the investments of the average and especially small enterprises is increasing which contributes to the implementation of relevant state programs to some extent. 5. Total capital formation – the share of this indicator is about a third of the Gross Domestic Product of the country which implicitly indicates the importance of the investment component in economic growth.

In terms of implementing rational investment policy at all levels of the state government, in our opinion, it is of utmost importance to create such a well thought out and effective mechanism, which by taking into consideration the specifics of particular investors, specific investment projects and the state property privatization forms will make the entire investment process transparent, measurable and effective. In transparency we mean procedural transparency of the full investment cycle in all phases of investment decision making, the measurement should include a complex assessment of the concomitant risks of the investment projects and complex assessment of the admissible effects, and the efficiency – the final fruitfulness of the investment process. At the same time, the right implementation of the privatization policy greatly depends on the state investment policy and the appropriate strategy, as well as the rational prediction of the capital income of budget and in total, the minimization the risks of investment environment. It should be noted that state regulation of investment activities in the country is mainly based on the following

legislative acts – special laws: "On Promotion and Guarantees of Investment Activity", "On State Support for Investments", "On Investment Funds", "On JSC Partnership Fund", in the section of state property management and disposal – Law of Georgia "On State Property", in the tax regulation section – Georgian Tax Code as well as the other laws and subordinate normative acts. In this context, we find it important to develop a single investment framework law based on modern investment challenges and existing experiences, which will unify and improve the regulatory norms of investment processes, old and unused norms, for example, through the annulation or change of the special investment status, investment deprivation, investment center, etc. (6, Article 9; 7, Articles 6, 7) and activation of guarantees for more effective protection of investors.

The efficiency of the investment policy can generally be evaluated by what approaches have the relevant state bodies, implementing such policy, have towards the potential investors and relevant investment flows. From this point of view, we can use the approaches, known in economic science as so-called "ex ante" and "ex post" (Tanzi, 2011, p. 184). In particular, the reaction of the state on the interest of investors and demand and initiated investment processes, can be considered as one of the determinants of conduct of investors. It also originates from how well prepared the potential investor or the group of investors are. Prepared can be called an investor who has an actually implementable project, has a clear investment concept, is well aware of the specifics of the local market, knows the nuances of the investment's laws, has some information about privatization facilities, etc. It should be mentioned that the investment policy of the country practically uses the "ex post" approach. This means that the investors are the initiator of the investment process and the state is only making "reciprocal steps" after the investment cycle is activated. The use of this approach can be regarded as just when the absolute majority constitutes the so-called "well aware investors". In cases where the opposite occurs, the state, in parallel with the wide use of investment marketing instruments, the state must ensure consideration of its investment proposals at all levels of governance and offer to investors, which means full systematization of objects of privatization and lease and their "investment packaging", creating and continuously updating the map of investment assets, the assessment of sectoral and sub sectoral investment attractiveness, based on sectoral research, preliminary feasibility study of the strategic objects (large investment land plots) and designing, that will facilitate transaction from the reactive (ex post) to the proactive (ex-ante) investment approach and increase the investment activity within the terms of the relevant privatization policy.

Investment policy and privatization mechanisms

At the current stage of the transition economy, the issue of formation and use of investment flows as one of the major macroeconomic and macrofinancial issues of the

country is under discussion, since dynamism of investment policy implementation is directly related to the efficiency of privatization policy. Based on the above, investment and privatization policy mechanisms are the most closely correlated instruments of financial-economic policy.

It should be mentioned that the basic primary interest of local as well as foreign investors in terms of transitional economy of Georgia, if we do not consider the investment environment, is mainly focused on the moment of real estate acquisition and further use, and in this respect, the state investment policy is ranked by the level of property ownership (state property, property of autonomous republics, property of self-governing units). Investment decisions are also made by the approaches of the discretionary authority. We should emphasize the fact that in implementation of the local and foreign investments, if the investor already has basic information about the investment environment, its primary interest is the investment object and the nuances related to it (condition, value assessment, investment conditions, etc.).

Thus, this approach is almost standard for state and private investment objects, the difference is reflected only in appraisal of the state-owned property and the use of disposal forms. From the macroeconomic point of view, both types of investments are equally positive for the state, because investment in both cases represent the component of the economic growth, while from the macroeconomic point of view, the investments made by the privatization or use of the right of privatization are more important, unlike the investments carried out on private property objects, as the state receives additional benefits as an income from privatization and lease.

The main goal of the privatization policy on the modern stage of the development of the country should be an increase of economic efficiency, which implies formation of an efficient private owner, creation of an environment of supporting initiatives and establishing the middle class of entrepreneurs. From this point of view, we consider the use the form of a conditional auction in privatization relationships, which, unlike the unconditional auction form, excludes privatized property "preservation" and ignoring its involvement in economic activity for speculative or other purposes. In parallel with the use of privatization forms, both – the short-term and long-term lease relationships should be activated, especially with regard to investment projects of the high capital capacity.

For the above purpose, adequate selection and use of the forms of privatization and property in respect to investor requirements is also a noteworthy, based on the specific investment project and specificity of the object (of the land). We mean the auction or direct sale sub-forms. In particular, unlike the conditioned auction, which is mainly used for "strategic" investment objects, from which the state is waiting for various investment effects, unconditional auctions can be applied to relatively peripheral or small investment plots and aim to ensure potential involvement in the economic turnover of "inactive assets" owned by the state. As for the direct sale on

the basis of a competitive selection, which provides "infiltration" in case of several alternative investment projects, is relatively rarely used, because one investment project often involves one investment project, unlike to direct sale, which is a governmental exclusive right, however, its lawful formulation, we think, should be improved. In particular, according to the Law of Georgia "On State Property", "Privatization of state property through direct sale is aimed to transfer ownership rights to the buyer who fully and honestly fulfils the term (-s) of direct sale of state property (5, Article 10.1). In our opinion, we consider it unjust, the future probably implementable activity to become the basis for making the present decisions and at the same time, it is advisable to be associated with certain criteria selected in advance.

In order to increase the investment activity, together with the privatization process, control over the fulfilment of the contractual obligations under the so-called conditional investment projects is also very important which is known under the name of Investment Monitoring Agreement and somehow represents the continuation of the privatization / lease process. In terms of revising the investment conditions, may be due to the reasonable necessity, and in relation to the investor, in the best case, to change the terms of investment or, at worst, exemption from the sanctions imposed for non-compliance with the terms. In turn, the change of investment-privatization conditions may be due to the necessity of extension of investment terms, request of the investor for additional land plots or other factors, which should be based on the principles of public and private interests. The relatively delicate issue is exemption of the investors from the imposed sanctions which should be based on a fair approach as well as on the objective approach of the decision-makers and be originated from stimulating specific investment projects, task of generating future investment effects with maximal consideration of state interests. In addition, the purpose of investment monitoring, in our opinion, should not only be the "technical" control and "technical" control of its implementation, but also the governing entity of the property and, in general, the state should also be interested in the "post audit" of the investment projects, i.e. what macroeconomic effects have brought to the country, specific region or self-government unit by the privatization process and specific investment project (Roland, 2008, pp. 55-60), did the post-investment activity take place with regard to the reinvestment, how much did the specific investment project reach to the implementation phase and whether or not the predetermined effectiveness was achieved. In this regard, the post-investment activities, must be activated, the so-called post-privatization studies can be used as one of the most important instruments.

For increasing the investment activity with regard to privatization, the issue of transformation of property relations into the context of the privatization rate remains as an urgent issue that is a complex phenomenon. Here, naturally, we do not mean the "aggressive" approach to such a delicate and consistent process, as privatization, however, it is advisable, the state to ensure speedup of the irreversible process of

involving assets in the economic turnover, at all levels of governance incorporating assets of its assets into the economic circulation by taking into consideration the phase of the transition economy of the country, that will enable it to promote private sector to create more value added through the use of unused assets, and on the other hand, to ensure “diminishment” of the privatization process within the midterm perspective and moving to the “spot” privatization (which is an approbated western practice) (Pavliashvili, 2009, pp. 16-17), resale of the returned property or through “secondary” privatization due to non-fulfilment of investment liabilities in some cases. From this point of view, the timely implementation of relevant lawful measures against the enterprises subject to liquidation and bankruptcy, privatization of the state shares and stocks in inefficiently functioning enterprises established by the state participation are also very important.

The balance of short-term and long-term goals represents one of the important and problematic issues in the context of investment and privatization policy which is revealed during decision making process of implementation of large investment projects. The latter is connected to the moment of paying a large amount of privatization fee, which is a short-term fiscal source for the state, and an additional source of investment activity for the investor, in case of graduated payment. We mean that the forms and terms of payment of the privatization fee are determined by law (5, Article 19), which envisages payment of the appropriate fee both in lump and in instalment. Due to the long-term goals of the investment project specificity and investment process, especially when using a conditional auction and direct sale forms of property, the relevant authorized privatization bodies have to take into account the interests of investors in order to stimulate long-term investment dynamism by using the optimal schedule of graduated payment of privatization fee.

The issue of using the state-owned large land plots for investment purposes also needs the special approach. From this point of view, the relevant state investment policy implementing subjects may use the complex or selection approach, in particular: 1. Due the large territories, conduct their feasibility study, form a successful investment concept on the basis of the relevant research and invite potential investors through expression of interest, which will form the basis for the complex-integral use of the given investment plot. 2. In order to avoid the use of large investment area, they may be “split” into small investment plots by providing the appropriate minimum infrastructure, which in turn will increase the market value of the asset and its investment attractiveness.

4. Key areas of investment policy improvement

Sustainable implementation of the investment policy, along with efficient privatization policy, in our opinion, should also integrate the realization of investment issues and the launch of appropriate leverages, such as: complex use of investment marketing tools, effective management of investment cycle, raising post-investment

activity, research of investment potential and complex analysis of investment indicators, which will facilitate minimization of investment risks and stimulate growth of investment flows. For implementation of the proactive investment policies, the appropriate policy implementers must have the relevant investment marketing instruments at all levels of management, as well as the relevant means of financing, pre-specified plan-schedules of investment activities. Thus, during the planning and implementation of such investment activities, for increasing efficiency, the tight coordination between the relevant state agencies has the great importance (profiled ministries, agencies, funds, trade and industrial chambers, etc.). Along with this, it is also noteworthy that in many cases, solving of the problem of duplication of the separate issues of investment policy between the different state authorities, agencies and departments is of not less importance.

The instruments of the investment marketing should be based on and support on the investment strategy, developed at all levels of governance, as well as on already existing investment experience and local trends. It should be at the same time complex and flexible system, which will be subject to permanent improvement of investment marketing instruments. Such investment activities should include: preparation of a comprehensive investment package and systematic updating; permanent refinement and promotion of investment web-pages; organization of internal and external investment forums, conferences and exhibitions; using different formats of investment meetings (G2B, G2G, B2B) for demonstration of the investment potential on the one hand, and on the other hand to establish economic ties between local and foreign business entities; formation of a unified base of foreign investment funds/companies and active communication with them; planning and organizing investment tours based on the preliminary analysis of the targeted investment markets and using the involvement of national state representations abroad; to highlight the activities for attraction of the so-called “diaspore” investments and purposeful implementation.

It is noteworthy that the efficiency of the investment policy is significantly determined by the fact whether the investment cycle related to each investment proposal is consistently and perfectly implemented, on which the possibility of turning the potential investor into the real investor and planned investment into the real investment is largely depended as it includes all phases from attracting investments to its implementation. In this context, special attention should be paid to providing the potential investors with all investment nuances on the one hand and, on the other hand, to the integral consideration of the anticipated investment effects (general, fiscal, employment, cross-sectoral, etc.) and reliable assessment of sustainability of investment projects, which will promote not only the “hot money” but also movement of the strategically well thought out investment flows and their implementation in the economy. The state actions targeted to increase of the investment activity should not only involve interesting of the internal and external

potential investors with the investment potential of the country and its separate regions, but also the development of post-investment (reinvestment) component through constant and systematic communications and dialogue with existing investors, that will enable the state to increase the investment "importance" of its assets and the acting investors - to expand and/or diversify their activities.

In order to implement an efficient investment policy, the investment-based quality studies by using the internal, as well as the outsourcing resources, should gain the weighable importance which will be linked to analysis of the investment potential of the country and its individual regions, assessment of investment attractiveness of individual sectors and subsectors of economy, interfiled multiplication effects of investments, post-privatization and post-investment evaluations, trends of investment flows, etc., which will help investment policy implementers to make investment sectors, on one hand, diversified, and on the other hand, to form the investment portfolios of privatization and lease facilities that will help potential and potential investors in making rational investment decisions.

As it is known, one of the key factors in investment decision making by investors is the infrastructure required for investment and the level of its efficiency, and the readiness of the investment infrastructure is mainly determined by the relevant functioning of the engineering-communication networks. The main investment area is characterized by the so-called Brown-field type investments, unlike Green-field investments. Therefore, it is important for the state to use the state-private partnership (PPP) (Tanzi, 2011, p. 134) investment model (PPI) with respect to specific strategic projects and territories and upon submission of the strategically important investment project in specific areas, for economic activation of such territories, provide them with basic infrastructural elements with the condition of fulfilment of investment liabilities defined by the investor.

Finally, in our opinion the issue of implementation of the investment policy requires specific approach with regard to free economic and tourist zones as the "coefficient of efficiency" comes across some problems from the period of founding. The identification of the mentioned problems and the consequent measures should be taken first by the state. In addition, the potential for the Deep and Comprehensive Free Trade Area (DCFTA) with EU should be activated not only for promoting the attractiveness of European investment flows, who will be interested in realizing products produced in Georgia on the EU market (i.e. by speeding up the "diagonal cumulative" process) which is a complex and long-term process and will facilitate the activation of efficiency-seeking investments. In parallel to this, the state should create certain promotional financial and economic mechanisms in the direction of development and promotion of unique, progressive and resource saving technologies. It is also crucial to ensure speeding up the capital market infrastructure and development of appropriate instruments, as well as expanding the circle of partner

countries' bilateral agreements on protection and promotion of investments, which will make the investment environment more attractive and increase the investment activity of the country.

Conclusion

Due to all the above-mentioned directions, for ensuring the increase of the investment activity at a higher rate at the current stage of the transition economy of the country, the state must carry out the pro activation of investment policy and the growth of post-investment activity through close relations with privatization policy and intensive use of effective investment marketing tools.

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