COVID-19 Era and INVESTMENT PERSPECTIVES
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OVERVIEW OF THE PROJECT AND THE POLICY PAPER

In 2019 Konrad Adenauer Stiftung (KAS) and Economic Policy Research Center (EPRC) established a platform for economic policy discussions – KAS EPRC Economic Area. The platform is a long-term initiative aimed at creating research-based discussions on social and economic issues. KAS EPRC Economic Area aims to engage interested parties and experts to present argumentative positions on important issues of economic policy and share expert opinions.

The platform offers policy papers to the government and wider society, allowing stakeholders to assess initiated decisions and, sometimes, concrete results and impact of taken decisions.

On June 30, 2020, in the frames of the platform, the 4th round of discussions was organized on the topic - “Coronavirus Era and Investment Perspectives”. It was dedicated to the investment environment and associated opportunities and challenges in Georgia, as well as a new reality having emerged as a result of the novel coronavirus. The moderator of the discussion was Nino Evgenidze – Executive Director of Economic Policy Research Center. Panelists of the discussion were: Giorgi Cherkezishvili – Head of Secretariat of the Investors Council of Georgia, Giorgi Pertaia – President of the Georgian Chamber of Commerce and Industry and Lekso Aleksishvili – General Director of PMCG.
INTRODUCTION

In recent years, the Foreign Direct Investments (FDI) in Georgia have been characterized by unstable flows. In 2017 FDI reached its historic maximum, but in the following years it has been declining. A drastic fall was seen in 2018 and 2019, when the FDI inflow dropped by almost one third as compared to 2014. Thus, decrease in investments to Georgia has started long before Covid-19 pandemic. The year 2020 and with it, the pandemic have posed additional investment challenges to the entire world, including Georgia.

According to the international organizations, the damage caused to the world economy by the spread of Covid-19 will have a severe negative impact on foreign direct investments. For instance, the Organization for Economic Cooperation and Development (OECD) forecasts world FDI reduction of at least 30% in 2020. The decline in investments will be much higher in developing countries. After the drop in the first half of 2020, the pre-pandemic investment rate, even in the most optimistic scenario, will not be reached by 2021. The United Nations has a more pessimistic forecast of 30 to 40% FDI decrease. By sectors, FDIs are expected to decrease by 208% in energy and raw material production sectors, by 116% in aviation and 47% in automobile industry.

This downward trend increases the competition on the international investment market and the Georgian Government will have to take additional efforts in order to attract already limited foreign investment resources to the country.

WHAT FACTORS CREATE FAVORABLE ENVIRONMENT FOR INVESTMENT? – First and foremost, stable political situation, protection of private property, fair juridical system, favorable tax regulations, cheap and qualified labor force, predictable economic environment and economic openness of the country, natural resources, strategic geographic location, free trade regimes, low level of corruption and country specific attractive features. Clearly, in all these, the conjuncture on the global investment market is also among weighty factors.

INVESTMENT DYNAMICS IN GEORGIA

According to the data of the National Statistics Office of Georgia (Geostat), after 2008, that is the global crisis and the Russia-Georgia war, investment flows to Georgia increased over the period between 2010 and 2014; this was followed by a decrease in 2015 and 2016, and an increase again in 2017, reaching the record high indicator in the history of Georgia of USD 2 billion (investments have been recorded since 1997) mainly owing to investments from Azerbaijan for the construction of Shah Deniz main gas pipeline. In 2018 investments decreased again, falling even below the 2014 indicator. The coronavirus epoch has had an even more adverse effect on the investment indicator, showing 42% drop in investments in the first quarter of 2020 (Figure 1).

When analyzing the FDI dynamics, apart from nominal figures, a special importance is attached to an FDI share in the country’s gross domestic product (GDP). In this regard, the worst indicator in the past decade was seen in 2012-2013, when the FDI share in the GDP comprised 5.8%. Since 2014, the share of investments in the GDP has been increasing, reaching the highest indicators of 11.4% and 12% in 2016 and 2017, respectively. However, one should take into account that due to the devaluation of the national currency, the GDP shrank in USD terms in 2015 and 2016, thereby increasing the share of FDI against the GDP. In 2019, according to preliminary data, the FDI share comprised 7.1% of the GDP.

Official sources cite the following reasons of the drop in FDIs: transfer of several large enterprises owned by foreign investors into the ownership of a Georgian resident; also, decrease in liabilities of non-resident direct investors (loan
indebtedness was covered); However, apart from these reasons, the key reason causing the decrease in investments was the completion of the main gas pipeline construction project. The completion of Shah Deniz project resulted in almost halving the investments from Azerbaijan.

Since neither a new large investment project has been launched in the country, nor the economy grows at a rate that would stimulate additional investment inflows, the result is the decrease in investments.

This is further aggravated by issues relating to democracy, fair and independent judiciary and protection of investments. The investment environment of Georgia has been especially damaged of late on the international arena by the ambiguity around the Anaklia deep seaport construction project. Investment obligation on the construction of Anaklia seaport was assumed by the Anaklia Consortium whose key partner and owner of 42% of the shares was the US-based company, Conti Group. Anaklia seaport was a critically important project for Georgia’s economy, trade, security and deeper integration with Western partners, however, the fate of this project is now unknown.

According to the official statement of the government of Georgia, the construction of the seaport was suspended because of the investors’ failure to fulfill investment obligations within specified timeframes. However, one should recall a number of statements made by Georgia’s strategic partners about the suspension of the construction of Anaklia deep seaport. Among these statements, the strongest was made by US Secretary of State Mike Pompeo during a meeting.

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Figure 1
Source: Geostat
with the former Prime Minister of Georgia (Mamuka Bakhtadze): “I expressed the hope that Georgia will complete the implementation of the project of Anaklia deep seaport. Its implementation will strengthen Georgia’s ties with free economies and will not allow Georgia to be under the economic influence of Russia or China.”

The fact, though, is that despite repeated calls and strong statements of Western partners, the decision of the Georgian government on suspending the construction of the seaport has not changed. All the aforementioned, however, seriously damages the image of Georgia on the international arena, as of attractive and reliable country for investment and even more so, gives rise to strong suspicions and questions about Georgia’s willingness to pursue Western values and integrate into Euro-Atlantic community. These suspicions are also supported by active talks within the government circles that the Anaklia project is of a geopolitical nature rather than economically beneficial to Georgia.

Investments by sectors and countries

Sectoral analysis of investments made in Georgia makes it clear that most FDIs go to the financial sector (20.6% in 2019 and 57.4% in the first quarter of 2020) and this has been a sustained trend over the years, indicating that this sector is the most developed one in Georgia. The leader by regions is Tbilisi with its share of 63% in total investments.


Figure 2
Source: Geostat

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As regards key investors, the share of three largest investing countries in FDIs made up 48.7% in 2019 and has been distributed among the countries as follows: United Kingdom – 19.5%; Turkey – 18.7%, and Ireland – 10.5%. Percentage structure of countries by invested FDIs is shown in Figure #3.

**SHARE OF LARGEST INVESTING COUNTRIES, 2019***

![Figure 3](source: Geostat)

Furthermore, when analyzing main countries investing in Georgia, one should pay attention to offshore investments. The official statistics does not allow to accurately identify the amount of investments coming from offshore, especially considering the fact that only FDIs are recorded by countries whereas the information by countries is not available on other investments. According to official data, up to USD 5 billion FDIs flew into Georgia from offshore over the period between 2010 and 2018, which comprises 38% of total investments during that period. The largest amounts flew from the Netherlands, Ireland and the United Kingdom, making up USD 3 billion in total.

Investments from the Netherlands, Ireland and the United Kingdom are not only from offshore companies, but it is difficult to figure out the amount of non-offshore investments among them. The leader among offshore investments is Panama with USD 300 million, which is followed by Malta – USD 239 million, the Virgin Islands – USD 96 million, Belize – USD 64 million, etc. (Source: Transparency International Georgia).

Some consider that, the origin of money does not matter, what matters is that money flows into the country; however, this is a rather problematic approach because various corrupt deals and concrete people’s business interests may be behind offshore money coming into the country. This especially requires caution when largest investors of the country
include offshore companies – which represent the current investment reality of Georgia.

Considering that many questions are raised about offshore companies, it is important to better understand what is offshore, why it is used, what is the connection of Georgia to offshores and what kind of attitude is adopted by democratic countries to offshores.

In recent years, developed countries have hotly debated over possibilities of minimizing risks emanating from offshores. These countries are seeing a gradual establishment of a high standard of disclosing owners of offshore companies, which is a recommendation of the anti-corruption hub of the Organization for Economic Cooperation and Development (OECD). It is advisable for Georgia to take into account this recommendation too and to develop certain rules for offshore companies, especially when implementing investment projects of strategic importance.

CHALLENGES AND ADVANTAGES OF THE INVESTMENT ENVIRONMENT IN GEORGIA

As noted above, any country willing to attract investments must offer a potential investor a business and investment environment that is more favorable than in other countries. In this regard, Georgia is not an exception and authorities must be interested in creating open and liberal economic environment.

In this regard, several respectable international organizations study investment activity of countries and based on indexes, publish the rankings of the countries. Worth mentioning among these ranking are indexes of ease of doing business (Doing Business) and economic freedom (Heritage Foundation). By these indexes Georgia ranks quite high: it is the seventh (among 190 countries) by ease of doing business in 2020 (moving down by one step, from 6th to 7th place, compared to 2019) and the 12th (among 180 countries) by the economic freedom, maintaining its place in a group of mostly free countries.

As seen from the above, Georgia is among the top 10 and the top 20 countries, respectively; however, these ratings do not reflect and accordingly, do not evaluate political stability and a number of associated threats in the countries. Nor do these rating reflect that a large part of the country is occupied, that the country fought war with Russia 12 years ago and since then virtually faces a constant threat of aggression. The factor of Russia and its occupation of the country’s territory is one of serious problems for the business environment in Georgia and accordingly, stimulating investors and a cause often cited by the Georgian government of lower investments. Therefore, membership of alliances such as, for example, NATO is important not only in political but also economic and investment terms. However, considering a post-war investment increase, which was observed after 2008, it becomes obvious that the factor of Russia does not always work and other factors, including a stable democratic development and reforms may be a good prerequisite for attracting investments.

Let’s then discuss problems related to democracy. According to the 2020 Democracy Index of The Economist magazine, Georgia is 89th among 278 countries and is considered to be a hybrid regime. By the Index evaluation criteria, Georgia has the lowest scores in the functioning of government and the political culture,5 which may be considered one of serious challenges in terms of attracting investments to the country.

Furthermore, although Georgia ranks 12th by the Index of Economic Freedom, it is 49th by the criterion of protection of property rights. Safely protected property is, however, one of crucial factors for any investor.

Georgia’s attractiveness as an investment destination is also undermined by the fact that the country is poor in natural resources. However, Georgia has a very favorable geopolitical location which may be an important and decisive factor.

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5 https://econ.st/3ft3Mxw
in attracting investments. But an obstacle here is the poorly developed transportation and logistical infrastructure. This is proved by international rankings whereby Georgia, according to IndexMundi, is the 133\textsuperscript{rd} by its logistical capacity with its 2.35 score which is lower than average (evaluated on a scale from 1 to 5 where 5 is the best).\footnote{https://bit.ly/3et8Ct4}

Yet another factor adversely affecting Georgia’s investment attractiveness is a shortage of qualified workforce.\footnote{https://bit.ly/3fryxmz} This is proved by the 2019 Global Competitiveness Index whereby Georgia is the 13\textsuperscript{th} among 141 countries by the secondary education level (completion of school), but 125\textsuperscript{th} by qualified workforce, vocational training, use and knowledge of computer technologies, availability of workforce. The gap between these two indicators is so wide that its immense negative effect on Georgia’s general education system is apparent.

Investment advantages of Georgia include a liberal foreign trade regime (especially, free trade agreements with the EU, CIS countries, Turkey, China and the Hong Kong Special Administrative Region) and the absence of control on the movement of foreign capital. In this regard, Georgia’s strategic geopolitical location is important and adds value to the investment potential of the country. There are obstacles here too, however; transportation and logistical infrastructure is underdeveloped while the construction of Anaklia deep seaport, an important project from the perspective of transportation/transit, has been suspended.

Georgia has a potential to become a main transportation and logistical hub of the Caucasus and Central Asia, which is one of main and necessary factors for the improvement of competitiveness of the country. The transportation and logistical potential is not fully utilized at present while these two factors are among decisive ones in attracting investments.

A fast development of logistical services and IT across the world in recent years caused revolutionary changes in production and distribution processes and led to the establishment of the global market. Increasing competition pushed logistical service providers to ensure high quality logistical services, which is unimaginable without a well-developed transportation infrastructure.

Countries that create favorable conditions and effective transportation and logistical infrastructure succeed in attracting companies that are integrated in the global economy. Considering these factors, it is especially important for Georgia to catch up with global trends as soon as possible and secure its own place on the world transportation and logistical map, thereby increasing investment attractiveness of the country.

Apart from the abovementioned factors and sectoral challenges, international donors and strategic partners of Georgia emphasize two main factors conducive to the improvement of investment environment in the country, especially in the epoch of coronavirus: legislative protection of investors and independent court system.

These are precisely those two factors that the head of USAID Georgia, Peter Wiebler, discussed in his interview to Analytica, noting that “First: investors must be confident that their investments are protected and there is a prospect after a certain period of time that their business will grow and they will get profit; and the second: investors must be confident that if any legal problem or dispute arises, there is a strong court system in the country, which respects property rights and supremacy of law.”

These factors do not, of course, make up the full list, but they reflect main areas that are important for the improvement of investment environment of Georgia and necessary for a quick economic growth of the country. To this end, however, there is a need of larger investment inflows than in previous years as well as quick and instant response to challenges in order to offer more favorable investment climate to investors.
NEW CORONAVIRUS PANDEMIC AND INVESTMENT PROSPECTS

The year 2020 started with a new global challenge related to the outbreak of the novel coronavirus, which has affected every country. The scale of pandemic and the rapid spread of the infection from the beginning of the year led to changing the ordinary lifestyle, which caused unprecedented damage to the world economy. Although the exact economic damage resulting from the pandemic has not yet been calculated and the virus itself has not been defeated, there is no doubt that in 2020 the rate of economic growth in the world will significantly slow down. This will be especially painful for developing and less developed countries.

Closing borders by countries, suspending economic activities and disrupting or postponing important international or local events will definitely reduce the rate of economic growth. Georgia is not the exception in this regard - preliminary negative economic results caused by the pandemic have already been published.

Preliminary data of Geostat on investment flows in the first quarter of 2020 shows a sharp drop in FDIs to Georgia. In particular, investments in the first quarter of 2020 made up USD 165.4 million which is a 41.7% decrease compared to the first quarter of 2019. The report again cites the completion of the main gas pipeline construction project and the handover of several enterprises into the ownership of Georgian resident as the main cause of this decrease. Nowhere in the report is mentioned the economic stagnation resulting from the coronavirus pandemic.

The sharpest drop is seen in investments in the tourism sector; it shows a 76% decrease compared to the first quarter of the previous year. The same holds true for the transportation sector, which also shows 76% decrease. An insignificant increase (3%) is observed in investments in healthcare and social assistance sector, which seems logical at times of pandemic.

Two abovementioned sectors – tourism and transportation are among the sectors with the highest investment potential, though these sectors were most severely hit by a negative effect of pandemic.

In parallel to that, the factor of China will be necessarily reconsidered in the international arena and it is highly likely that it will lose its attractiveness as a place for the relocation of production capacities, because investors, when taking decisions, will look into not only cheap workforce and other economic indicators, but considering the new reality will also evaluate transparency and crisis management skills of a country.

FINDINGS AND RECOMMENDATIONS

Based on all the above said and in the light of assessment of the economic damages caused by the coronavirus pandemic, the following recommendations were made during the discussion held in the frames of the KAS EPRC Economic Area:

- Reforms addressed to improve economic and investment climate in Georgia should continue. In addition to the implications caused by the Covid-19, the factor of the 2020 parliamentary elections should also be taken into account. Generally, elections are crucial in terms of initiating new reforms or carrying on with already initiated ones. In this regards, special emphasis should be placed on developing and reforming the capital market in Georgia;

- The legislative framework should be improved, which includes the adoption of already drafted Law on Investment Funds and drafting of the Law on Insolvency, which apart from attracting investments will increase access for small and medium business to investment funds and financial resources;
Strong small and medium business play a crucial role in attracting investments. Georgia possesses a significant potential for the development and enhancement of this sector;

In order to attract investors in the services sectors, the country has to support technological developments, including the introduction of 5G, which will stimulate local and regional startups to set up innovative business projects in Georgia;

Fair and unbiased judicial system that rests on the principle of rule of law is necessary for the improvement of investment environment. This is named as one of crucial factors by strategic partners of Georgia too;

Georgia’s investment potential is especially attractive due to its strategic geopolitical location. In terms of full utilization of this advantage for a maximum benefit, it is important to have a proper transportation and logistical infrastructure. It is advisable to build logistical center in Georgia which will perform an important role not only in terms of attracting investments and enterprises, but also transportation/transit shipment too;

Although the improvement of education system brings results in a short run, without reforming and adjusting the system to modern labor market requirements it will be impossible to successfully position future investment prospects of Georgia. Therefore, the education system must constantly focus on ensuring a high qualification level of future generations.

The above listed factors do not, of course, make up an exhaustive list of those factors that have a significant impact on the improvement of investment climate; however, considering current situation and challenges in Georgia and the world, the recommendations provided above include main directions and decisive factors.

Furthermore, we should keep in mind that an intensive discussion is underway among expert circles about a possibility of transforming coronavirus challenges into additional opportunities.

It was precisely this opportunity that Professor Francis Fukuyama speaks about in his recent article published in American Interest: “The United States and other liberal democracies need to begin a gradual economic disengagement from China. The pandemic has demonstrated how both Europe and North America have become dangerously dependent on the manufacturing capabilities of a hostile power. There are today plenty of other places around the world where supply chains can be located. Squeezing every drop of efficiency out of them needs to give way to consideration of resilience, diversity of inputs, and regard for capabilities that are better kept under the control of countries that share democratic values.” In this regard, Georgia can successfully position itself on the international arena based on the results of fight against pandemic and crisis management.