**Czech University of Life Sciences Prague**

**Faculty of Economics and Management**

**Department of economics**


**Diploma Thesis**

# Analysis of the impact of EU foreign direct investment (FDI) on economic growth in Georgia

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# CZECH UNIVERSITY OF LIFE SCIENCES PRAGUE

Faculty of Economics and Management

# DIPLOMA THESIS ASSIGNMENT

George Bugianishvili, BBA

Economics and Management
Economics and Management

Thesis title

**Analysis of the impact of EU foreign direct investment (FDI) on economic growth in Georgia**

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**Objectives of thesis**

The diploma thesis deals with the Analysis of the impact of EU foreign direct investment (FDI) on economic growth in Georgia.

The main purpose of the paper is to determine the FDI from European Union countries and assess its influence on the Georgian economy.

Moreover, to be able to achieve the main objective, the research also considers a set of sub-objectives which include a theoretical review of foreign direct investments from the EU countries and the study of its impact on the economic development of Georgia, its statistical analysis in Regional and Sectoral directions. The historical review of the political and economic environment has also been taken into consideration.

According to the results of the analysis, there were suggested some recommendations which need to be implemented by the government and which should help to increase the influence of foreign direct investment in Georgian economy as well as attracting new foreign investors.

**Methodology**

For the practical significance of the paper, Statistical research has been conducted on FDI flows to identify the impact on economic growth, since it is an important basis for a number of reforms.

More specifically, in the research process, there are used Dynamic (time series) analysis indicators, and general and specific statistical and comparative methods such as statistical grouping, ratio and mean method, and The absolute/relative regression methods.

The work uses official data based on examinations and conclusions conducted by both Georgian and foreign researchers, as well as local and international organizations such as National Statistics Office of Georgia, the World Bank, the International Monetary Fund and other organizations and the results of specific statistical surveys.

**The proposed extent of the thesis**

60 – 80

**Keywords**

Georgia, European Union, GDP, FDI, Transition economy, Economic Growth, Rose Revolution, Economic History, Sectoral structure.

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**Recommended information sources**


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Prague on 06. 04. 2020

**Declaration**

I declare that I have worked on my diploma thesis titled "Analysis of the impact of EU foreign direct investment (FDI) on economic growth in Georgia" by myself and I have used only the sources mentioned at the end of the thesis. As the author of the diploma thesis, I declare that the thesis does not break copyrights of any their person.

In Prague, on 6th of April _____

**Acknowledgement**

I would like to thank to my supervisor Ing. Karel Malec, PhD for his expert suggestions, insightful comments and encouragement during my work on this thesis. Furthermore, I am very thankful for my Georgian and International friends for giving me valuable assistance and thought-provoking motivation of staying resilient. And the last but not the least, I want to express my profound gratitude to my parents, sister and brother for providing me with unfailing support and continuous inspiration throughout my years of study. This accomplishment would not have been possible without them.

# Analysis of the impact of EU foreign direct investment (FDI) on economic growth in Georgia

**Abstract**

The diploma thesis deals with the Analysis of the impact of EU foreign direct investment (FDI) on economic growth in Georgia.

The main purpose of the paper is to determine the FDI from the European Union and assess its influence on the Georgian economy.

Moreover, to be able to achieve the main objective, the research also considers a set of sub-objectives which include a theoretical review of foreign direct investments from the EU countries and the study of its impact on the economic development of Georgia, its statistical analysis in regional and sectoral directions. The historical review of the political and economic environment has also been taken into consideration.

According to the results of the analysis, there were suggested some recommendations which need to be implemented by the government and which should help to increase the influence of foreign direct investment in Georgian economy as well as a stimulating economy to maintain sustainability.

**Keywords:** Georgia, European Union, GDP, FDI, Transition Economy, Economic Growth, Rose Revolution, Economic History, Sectoral Structure.

# Analýza dopadu přímých zahraničních investic EU (FDI) na hospodářský růst v Gruzii


**Abstrakt**

Diplomová práce se zabývá analýzou dopadu přímých zahraničních investic ze zemí EU (FDI) na ekonomický růst v Gruzii.

Hlavním účelem práce je určit přímé zahraniční investice ze zemí Evropské unie a posoudit jejich vliv na gruzínské hospodářství.

Pro dosažení hlavního cíle výzkum zvažuje soubor dalších dílčích cílů, které zahrnují teoretický přehled přímých zahraničních investic ze zemí EU a zkoumá jejich dopad na ekonomický rozvoj Gruzie, a dále statistickou analýzu přímých zahraničních investic v regionech a sektorech průmyslu.. Zohledněn byl také historický pohled na politické a ekonomické prostředí.

Podle výsledků analýzy byla stanovena některá doporučení, která by bylo vhodné implementovat vládou za pomocí implementace těchto doporučení by pak mělo být dosaženo zvýšení vlivu přímých zahraničních investic na gruzínskou ekonomiku, a zároveň bylo díky tomu dosaženo stimulace hospodářství s cílem jeho udržitelnosti.



**Klíčová slova:** Gruzie, Evropská unie, HDP, FDI, přechodné hospodářství, ekonomický růst, růžová revoluce, hospodářská historie, odvětvová struktura.

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# List of abbreviations

| | |
|---|---|
| EU | European Union |
| FDI | Foreign Direct Investment |
| GDP | Gross Domestic Product |
| CIS | Commonwealth of Independent States |
| RR | Rose Revolution |
| OECD | Organisation for Economic Co-operation and Development |
| DCFTA | Deep and Comprehensive Free Trade Area Agreement |
| PCA | Partnership and Cooperation Agreement |
| ENP | European Neighbourhood Policy |
| EIB | European Investment Bank |
| EIP | Foreign Investment Plan |
| TETN | Trans-European Transport Network |

# 1. Introduction

As international coordination of economic relations grows, cooperation between countries is increasing, followed by the exchange of technological, intellectual and financial resources. One of the most important forms of economic cooperation is foreign direct investment, whose inflow will have a positive impact on the country's economic and social development and thus, it is one of the most important areas of interest for the country. The importance of foreign direct investment is especially high in transition economy countries where the level of financial market formation does not allow for effective financing of private business.

EU Integration has been one of Georgia's major goals for years. Many steps have been taken in this regard since Georgia's independence. Georgia is actively pursuing economic and political reforms in response to EU recommendations. At the same time, the EU is making significant efforts for Georgia such as providing the tools for achieving solid economic growth, and assisting the government and civil sector in promoting democracy and the economical sustainability.

To support and achieve goals mentioned above, it is necessary to analyse the volume and structure of FDI from the EU; Its quantitative, geographical and qualitative studies will provide both government and investor type of economic decision-makers, with adequate support and effective economic policy tools for Georgian economy.

# 2. Objectives and Methodology

## 2.1 Objectives

The diploma thesis focuses on foreign direct investment from EU countries and their impact on economic growth rates in Georgia. The main purpose of the paper is to determine the FDI from European Union countries and assess its influence on the Georgian economy.

Moreover, to be able to achieve the main objective, the research also considers a set of sub-objectives which include an FDI statistical analysis in regional and sectoral directions, theoretical review of foreign direct investments from the EU countries and the study of its impact on the economic development of Georgia. The historical review of the political and economic environment has also been taken into consideration.

Finally, the paper will summarize results about the studied topic and provide relevant recommendations, suggestions, and proof addressing two research questions:

1. Whether or not the foreign direct investments are directly linked and the most important source of achieving economic and political stability in Georgia.
2. How essential is to attract FDI for such transition economy country as Georgia by establishing effective partnerships (European Union) with strategically important countries?

## 2.2 Methodology

The paper uses official data of the National Statistics Office of Georgia, World Bank, International Monetary Fund and other organizations and results of special statistical studies. The theoretical basis of the work is Georgian and foreign economist's textbooks, researches, evaluations, and materials published by various agencies, such as National Bank of Georgia, Ministry of Economy and Sustainable Development of Georgia, as well as EU Statistics Office (Eurostat), and other international organizations; Thereupon, data for the literature overview of the diploma thesis is collected from the available professional sources focused on the topic of foreign direct investment. As one of the main sources for diploma thesis are considered academic books, web pages and articles devoted to FDI analysis.

For the practical significance of the paper, statistical research has been conducted on FDI flows to identify the impact on economic growth, since it is an important basis for several reforms.

More specifically, the paper analyses situation in Georgia according to secondary data which was generated from the Georgian Statistical Office, World Bank and some other resources.

Additionally, general and specific statistical and comparative methods have been used such as dynamic (time series) analysis indicators and correlation regression.

Here are the following formulas used:

Statistical Average:

$$\acute{Y} = \frac{Y1 + Y2 + Y3 + \cdots Yn}{n} = \frac{\sum Y}{n} \quad (1)$$

Relative absolute change – It shows how each subsequent level of dynamics increases/decreases relative to the previous level:

$$\Delta = y_t - y_{t-1} \quad (2)$$

Basic absolute change shows how each subsequent level of dynamics increases/decreases relative to the first level:

$$\Delta = yt - y1 \quad (3)$$

Average absolute change. It is calculated by the following formula:

$$\dot{\Delta}=\frac{\sum\Delta}{n-1} \tag{4}$$

Absolute growth rate is calculated by the formula:

$$K=\frac{Yt}{Y1}*100 \tag{5}$$

Relative growth rate is calculated by the formula:

$$K=\frac{Yt}{Yt-1}*100 \tag{6}$$

Average annual growth rate:

$$\mathrm{K}=\sqrt[n-1]{\mathrm{k1}*\mathrm{k2}*\ldots*\mathrm{kn}\text{-}1} \tag{7}$$

The average annual growth rate for a relative growth rate:

$$K=\sqrt[n-1]{\frac{\mathrm{Y_n}}{\mathrm{Y_1}}} \tag{8}$$

For the Absolute growth increasing rate, there is the following formula:

$$T_{n-1}=\frac{\mathrm{Y_n}-\mathrm{Y_1}}{\mathrm{Y_1}}*100=K_n-100 \tag{9}$$

Formula of Relative growth increasing rate:

$$T_{n-1}=\frac{\mathrm{Y_n}-Y_{n-1}}{Y_{n-1}}*100=K_n-100 \tag{10}$$

Finally, the formula of Annual average increase/decrease rate:

$$T=K-100 \tag{11}$$

# 3. Literature Review

The Literature review of the diploma thesis will cover a deep theoretical description of the current state of knowledge in the field of foreign direct investment (FDI). It will define global indicators of FDI and illustrate the main arguments related to its impact on economic growth. The theoretical part will also make a basic overview of the European neighbourhood with brief economic history, and European Enlargement policy in Georgia.

## 3.1 Foreign Direct Investment and their Global Indicators

The word "Investment" has a Latin origin and in the modern sense, it means the long-term investment of capital in various sectors of the economy.

As reported by historical sources, the "Investiture" was referred to a hierarchically a high-ranking person for transferring land or any position to his vassals. Over time, the term "Investment" has come to mean different things and is widely used in various fields of activity (Etymonline, 2018).

There are different types of investments. For instance, investments are divided into local and foreign investments by place. Local investment involves the investment of capital by a resident, while foreign investment involves the investment by a non-resident of capital in another country.

Foreign investment is divided into the portfolio and direct investment. Portfolio investments mean having 10% of the host country in a given company and mainly includes to purchase the securities and is often associated with short-term investments and volatile capital flows (UNCTAD, 2018).

Foreign Direct Investment (FDI), according to the International Monetary Fund and the International Organization for Economic Co-operation and Development, expresses the long-term interests of one resident company in another. Long-term interests mean long-term business relationships between these companies, as the investor acquires 10% or more of the charter capital and is entitled to have a significant impact on the business of the receiving company. FDI includes:

- Companies investing equity in another country, equity of subsidiaries as well as shares in subsidiaries or associates;
- Profit reinvestment – A direct investor's share of the enterprise profits that are not distributed as a dividend and is not transferred to a direct investor account;

- Intra-corporate equity transfers – It is usually carried out, on the one hand, by the direct investor and on the other by subsidiaries or associates, as well as between affiliates.

Foreign direct investment is in turn classified into the following forms: Greenfield (so-called Greenfield Investment), Brownfield, Merger, and Absorption (M&A), horizontal and vertical investment. In detail:

Greenfield-type investment is a form of foreign direct investment in which investments are made to establish new companies or expand existing facilities in a non-resident country. Greenfield investments are made by large transnational companies that enter emerging markets and begin construction of enterprise and realization centres there. The positive effect of these types of investments is that long-term jobs are created in the recipient country and often promote quality and low-cost competition (Moosa, 2002).

Brownfield Investment involves the acquisition of a pre-existing facility to be used for other activities.

Mergers and acquisitions are two distinct types of foreign direct investment: Mergers involve the creation of a single business entity based on a combination of assets and liabilities of two or more companies. "Absorption" implies joining a relatively small company by a larger entity. In most cases, this type of transaction is forced (Roberts, 2016).

Horizontal investments are a form of foreign direct investment when investments abroad are made in the same field in which the company operates. Horizontal FDI is based on two main factors: economies of scale at the firm level and positive trade costs. The main purpose of such investments is to avoid transportation costs and gain easy access to foreign markets.

The theoretical model of the Vertical FDI is based on the difference in the volume of factors of production between countries. This type of investment occurs when transnational companies are in the process of production in several stages, with branches in various countries providing internal production processes. There are two forms of vertical foreign direct investment: The first is the kind of investment where a branch in another country produces raw materials and supplies and supplies the head office. In the second case of vertical foreign direct investment, transnational companies transfer branches to different countries to produce factors and ensure in the domestic production process (Kurtović, 2002).

Thus, each form of foreign direct investment plays an important role in the sustainable economic development of the recipient country. In the case of the right economic policy of the host country, the recipient increases the competitiveness of the country, promotes employment and reduces social inequality in the host country.

Foreign direct investment is associated not only with the inflow of financial capital but also as a tool for bringing knowledge, modern management practices, product design, quality characteristics, brand, international product marketing channels, etc. Consequently, it facilitates integration into the host nation's global production network, which in turn is the basis of a successful export strategy (Timothy, 2013).

There are important factors that contribute to the growth of investment flows in one country or another. The following can be considered as potential determinants of foreign direct investment:

Scope of the host country – as a rule, large economies have large markets and foreign investors always consider investing in another country depending on market size. The larger the country's economy, the lower the average firm's costs and the government can offer financial incentives to lead multinationals to invest. GDP is one of the major determinants of the size of the country's market. Accordingly, countries can attract more FDI if their markets are large enough. This argument is supported by Moore and Frey, who argue that large-scale economies as domestic also gives foreign firms the real opportunity to attract more sales and more profits, while also attracting more FDI (Moore, 1993; Frey, 1984).

Macroeconomic stability – the fact that the macroeconomic instability of the recipient country will generate uncertainty in the country's domestic market, which will have an adverse effect on investment projects. Bevan studied the relationship between FDI and various economic factors in transition economies and found a positive relationship between them (Bevan, 2000). According to this study, Garibaldi suggested that one of the most crucial factors affecting FDI was the low exchange rate risk of the recipient country (Garibaldi, 2001).

Infrastructure – access to quality infrastructure plays an important role in attracting FDI, especially in the fields of telecommunications, transportation, and electricity. Kummer found a positive association between FDI and infrastructure attracted to the country (Kummer, 1994).

Labour Cost – cheap and skilled labour is one of the key indicators of FDI, as it has a positive impact on the productivity of FDI. Dunning (1993) emphasizes that investment results in lower labour costs and higher labour productivity. Loree (1995) also found that a positive association is with lower labour costs and direct labour costs.

Openness and Export Orientation – export promotion plays an important role in attracting foreign direct investment, as well as increasing production in a given country. Edwards (1990) concludes that the openness of a country's economy has a positive effect on FDI flows. Investors always want to invest in countries that participate in regional trade unions and trade agreements, such as EU member states.

The motive of a foreign investor when investing in another country can be:

- Natural resource orientation: Raw materials, primary commodities;
- Foreign market orientation: Market size and per capita income; Access to regional and third-country markets; Customer tastes in specific markets; Market structure;
- Effectiveness orientation: Cheap unskilled labour; Qualified workforce; Costs (from transport and communication host countries), Costs for intermediate products; Membership in regional integration groups;

Foreign direct investment in natural resources allow countries with poor resources to obtain raw materials in countries where natural resources are in excess. These types of investments were still actively used in the colonization process. Resource-oriented direct foreign Investment has a variety of impacts on the economy of the recipient countries. The effect is significantly positive when it comes to the use of inexhaustible resources, including cheap and motivated workforce investments (World Bank, 2017).

The main purpose of foreign direct investment in foreign markets is to avoid import barriers, discriminatory government policies and high transport costs. These types of investments are attracted by the scale and prospects of the recipient country's economy. Foreign direct investment in foreign markets has a positive effect on the economy of the host countries, which is reflected in the transfer of advanced technologies, especially in the service sector (Bris, 2013).

Effective FDI is mainly carried out between countries whose markets are closely integrated (e.g. EU countries). This type of investment benefits from offshore. It attracts the recipient nation's cheap labour and natural resources. Efficiency-oriented investment intro-

duces new manufacturing technology to the host country, thereby enhancing the host country's competitive advantage and experience in management. It ensures the competitiveness of the recipient country is increased.

### 3.1.1 Theoretical overview of the impact of foreign direct investment on economic growth

Certain theoretical models of economic growth emphasize the positive impact of FDI on the recipient countries economic growth rates, such as productivity growth, technological progress, and so on.

According to the neoclassical model of economic growth, foreign direct investment increases the accumulation of physical capital and promotes economic growth. Intuitively, a high accumulation of capital increases economic growth rates. Regardless, the accumulation of capital in the presence of permanent and positive rates of economic growth per inhabitant is only temporary, and technological progress plays a key role (Masoud, 2013).

FDI has a positive effect on economic growth and increases in the amount of investment and productivity in the receiving country. However, these types of investments can only affect economic growth in the short run, given the nature of the diminishing returns on physical capital that characterize it in the long run. According to the exogenous growth model, FDI only has a steady-state of operation and has no effect on the growth rate except when transitioning to a new steady-state (Caves, 1974).

As reported by Morley (2015) endogenous model of economic growth, FDI plays one of the main roles. Regarding to this model, products are created through the use of labour and capital in the production process, and thus, affect economic growth through labour and capital as follows: enhances capital, qualitatively improves labour force, can transfer new technologies, and thus has a complete factor potential for growth of nonviolence. Also, according to the endogenous model of growth, the rate of technological progress is a key indicator of the long-term growth rate of production. The endogenous growth model first appears in paper from Romer (1986). Helpman (1994) modified Romer’s endogenous growth model, arguing that technological innovation is a major catalyst for economic growth. Romer (1990) asserted that FDI has a positive effect on economic growth through human capital, which is also a key aspect of research and development. Regardless, the authors indicated that in-

creased competition in the domestic market would lead to an increase in technological innovation productivity in the production process, leading to long-term economic growth. In the endogenous model of economic growth, foreign direct investment is perceived as more productive than domestic investment (Lucas, 1988) as it increases the integration of new technologies into the economy of the recipient country. Foreign direct investment can play a crucial role in economic growth through capital accumulation and knowledge sharing. Barro and Romer (1993) emphasized the role of FDI in dispersion technologies and its relation to economic growth. Carkovic and Levine (2002) have confirmed that the main catalyst for long-term economic growth is technological progress.

As a result of the industrialization theory, FDI also has a positive effect on economic growth. According to the Canadian economist Hymer (1976), FDI brought in a combination of capital, management and advanced technologies for the recipient country. FDI provides the transfer of resources, including managerial skills, marketing, know-how. All of the above factors contribute to the economic growth of the recipient country.

**Outputs from FDI to Economic Growth**

There are several channels of the impact of FDI on economic growth, which can be focused on:

Personnel training – one of the most important of international companies for local staff retraining, which has a positive side effect. In many cases, foreign firms spend more on training programs than local companies. However, in this case, distance is one of the important factors, for example: If the foreign direct investment is mainly carried out in one region of the country, side effects will only occur in this part of the country (Gene & Helpman, 1994);

Competitiveness in the local market – If there is a difference in the quality of technology between local and foreign companies, local companies will slowly lose their share of the domestic market due to the uncompetitive quality of the products they produce and foreign companies will take the vacant place. In this way, FDI increases domestic competition. Alternatively, this effect is positive for the recipient country if the technological gap between domestic and foreign companies is not very high and competition forces both parties to lower the price and improve the quality;

Vertical Side Effects – Intermediate goods play a key role in the performance of local companies, as production growth in the country, is highly dependent on it. Intermediate goods purchased from foreign suppliers play an important role in total factor productivity as they can directly increase production. Foreign investor companies, intentionally or unintentionally, increase domestic productivity through opposite links, for example, technical assistance to increase product quality, ensuring new production capacities, etc. (Lipsey, 2002);

Foreign direct investment can increase the growth rate of the economy through external effects, such as technology transfer, management process, ideas, etc. External effects occur when multinationals are otherwise unable to influence the productivity of local companies. Modern approaches to management and dissemination of technologies have a positive impact on total factor productivity, which in turn increases overall output (Djankov & Hoekman, 2002).

**The positive or the negative impact of FDI on economic growth**

According to various sources in the paper, the link between economic growth and FDI is varied and diverse. In the case of Georgia, several researchers confirm the positive effect of FDI on economic growth rates. In the case of the rest of the world, several empirical studies confirm the positive and productive impact of FDI on economic growth (Johnson, 2006). For example, in 2002, the American economists examined and found a positive relationship between FDI and economic growth based on the effect of labour productivity (Cernat & Vranceanu, 2002). Using panel data (Gorg & Strobl, 2002), 139 countries were surveyed from 1980-2018, and the foundations of empirical research in terms of technology diffusion were found to be positive. They have proven that FDI increases technological innovation in the local economy, improves management practices, and so on. New ideas, management processes, and diffusion of technologies have a positive impact on the overall productivity, hence, increases overall output. Foreign investment through technology transfer can increase productivity, both domestically and by external factors (Rebelo, 1991). Blomstrom, Lipsey, & Zejan (1994) argued that FDI has a positive effect on economic growth in a given environment. According to their research, the investment growth rate is higher in richer countries, which means that there are some transitional income limits, above which the country is capable of using new technological innovations and make the maximum

amount of direct investments attracted (Blomstrom, 1986). However, there are other scholars who argue that the impact of FDI on economic growth is negative or negligible. For example, Harrison & Brian (1999) in the Venezuelan case of 1979-1989 failed to show a uniquely positive impact of foreign investment on local companies. Also, in the Moroccan example, Haddad and Harrison (1993) investigated the link between FDI and economic growth and found a non-correlated association. They concluded that the relationships between these indicators are indirect because factors contribute to other external effects.

Interestingly Strobl & Holger (2002) found that the relationship between FDI and economic growth is not sufficient, as multinational corporations focus on more productive sectors. They conclude that the productivity side effects depend on the location and characteristics of firms receiving these types of FDI. At the micro-level, Konings (2001), used data from Romanian and Bulgarian companies, concluded that there were negative side effects, although in the case of Poland the impact was not observed. López-Córdova (2003) noted that, according to data from the Mexican processing industry, FDI has a positive effect on total productivity.

Although foreign direct investment and the link between economic growths has been the subject of many scientific studies, with only a few papers using an industry-level approach, the main reason being the lack of relevant data. Bijsterbosch and Kolasa (2010) examined the relationship between FDI and economic growth at the level of manufacturing industries in central and eastern European countries and found a positive relationship between them.

Chowdhury (2005) mentioned that there is a bilateral relationship between FDI and economic growth in Thailand and Malaysia. In other words, foreign direct investment has a positive effect on economic growth and vice versa, meaning that higher yields can lead to higher motivation and more incentives for investors to invest more in foreign investment. If a government wants to attract foreign direct investment to foster economic growth, it should offer foreign investors better incentives than its competitors, such as flexible tax rates for specific sectors. But experience has shown that spending can outweigh the revenue earned. Thus, the main dilemma is considering how to analyze the cost benefits properly. At the same time, multinational corporations could have monopoly power over industrial supplies in specific sectors of FDI countries, while also gaining greater profits through local government tax breaks.

**An Empirical studies**

Many empirical studies have examined the relationship between FDI and economic growth rates. Consider some of them: Aitken & Harrison (1999) in the Venezuelan example examined how local companies benefit from FDI. The panel data approach is used in the study. The analysis is done at the company level. The regression analysis uses the following variables: FDI in different sectors, production growth, capital, and labour force. The authors selected approximately 4,000 units from 1976 to 1989. The study identified two types of impact of FDI on local companies. First - investment companies that employ less than 50 people have productive advantages; Second - the increase in foreign ownership negatively affects the productivity of fully-owned resident companies in the same sector. The regression analysis of the study uses the least-squares method (OLS) to indicate that the impact of foreign ownership on the economy is rather small. The weighted least-squares method shows that the positive effect for FDI companies slightly outweighs the negative effects on companies that remain locally owned. This side effect can be explained by the following: Multinational companies compete with local companies which reduces profitability. In other words, multinational companies have a negative impact on the survival of local companies. Finally, it should be noted that the overall effect of FDI is positive and only positive with regards to economic growth.

Keller & Yeaple (2003) calculated the benefits of the technique in the US manufacturing companies, with FDI, export and import figures in 1987 – 1996. Accordingly, total factor productivity as a function of FDI, export, import was determined.

The authors also used the least squares (OLS) and time fixed effects (FE) methods to estimate the regression analysis. The authors of the study conclude that the impact of foreign direct investment in US companies on economic growth is decisively economical, given that it increases productivity growth by about 11 %.

Information on the impact of foreign direct investment on economic growth by industry is provided by another important work by Castejón and Wörz (2006). The paper deals with industry-specific heterogeneity (eg: autonomous productivity, concentration levels, etc.), which discusses the countries of central and eastern Europe and the relation between FDI and economic growth in these countries. The authors studied eight industries and 35 countries according to the 1980 – 2018 data. The study identified two types of heterogeneity: at industry and country level. It has been found that the level of development

of the country is of the utmost importance for FDI to have a positive impact on economic growth. According to the paper, the benefits of these types of investments in OECD countries are high in the medium to high technology and medium skill-intensive industries, as FDI in these countries is significantly related to export-oriented industries. The authors also concluded that there is only a strong correlation between FDI and economic growth in the transport industry. The study argues that the impact of foreign investment on economic growth depends on the level of development in the recipient country, the structure of industrial sectors, the country's ability and the distribution of FDI. The study also argues that FDI can be considered as a contributing factor to economic growth if the economy of the recipient country is able to absorb investment. Thus, based on the present study, the impact remains ambiguous.

Borensztein, De Gregorio, and Lee (1998) focused on the impact of FDI on industries by the Chinese economy. Using panel data, the authors studied 19 industries across 30 provinces. Macro-level research shows that China does not benefit greatly from FDI. Regardless, the authors note that relatively developed provinces benefit from FDI flows, and these mainly apply to eastern and coastal provinces, as they have an "open door" policy for this type of investment.

Mayanja studied the relationship between FDI and technology transfer in 1979-1991. The study used panel data by 205 UK industries (Mayanja 2007). The author used the Kobe-Douglas production function. According to the model, factor productivity is a function of FDI, exports, and imports. From the empirical methodology, the study uses the least-squares estimation (OLS), fixed effects (FE), random effects (RE) and first-order difference (FOD) methods. The author highlights such important aspects as the timing of knowledge transfer, which has a direct role to play in the recipient country.

The transfer of knowledge of foreign investment to total productivity has two types of effects: instant and continuous. From the empirical results, the author concludes that in The UK there is a high correlation between FDI and economic growth rates when total productivity levels are increasing. Based on a review of the theoretical and empirical studies, it can’t be said whether there is only a positive correlation between FDI and economic growth or not.

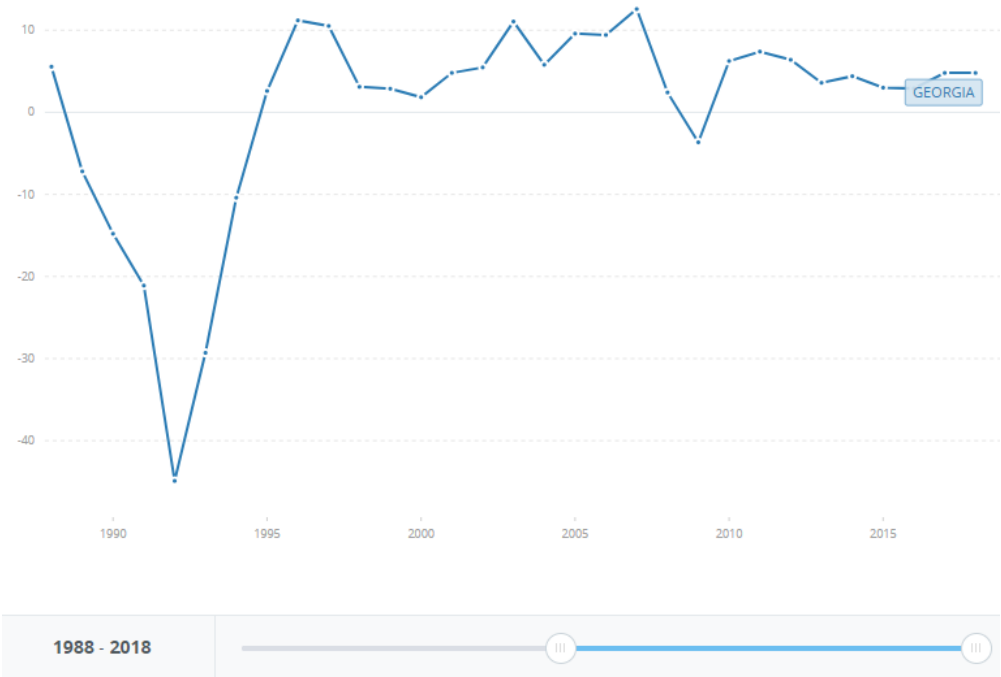
## 3.2 European Neighbourhood and Enlargement Policy in Georgia

### 3.2.1 Brief Economic History of Georgia (Statistical overview)

**1991 – 1994: Economic Shock**

According to the University of California Survey (J. Bradford DeLong, 1997) as a result of the defeat in World War II, Germany's income per capita ranged from $ 6,000 to $ 2,500 (about 60%). As reported by the IMF, the average annual per capita income in Georgia in 1991 was $ 5,550. That figure dropped to $ 2,466 (61%) in 1994. That is, in the early 1990s, the decline in income in Georgia was equal to that of Germany destroyed in World War II. Georgia's economic disaster of the 1990s was caused by many factors. It is difficult to pinpoint which factor was most devastating: civil war, war for territorial integrity, corruption, crime, ignorance of market economics, hyperinflation and energy crisis.

**Chart 1**: GDP per capita growth (annual %) – Georgia (1988 – 2018)




Source: (World Bank, 2020)

**1995 – 1997: Signs of Awakening**

Since 1995, the economic situation in Georgia has begun to improve, with GDP growing at 2.6 %. The increase in 1996 – 1997 was 10.6 %, driven by the relatively stable

political situation, the end of the war and the monetary reform implemented in September 1995, when the coupon was replaced by a Lari. In 1995, the rate of hyperinflation decreased to 57 %, and in 1997 it was already 7.2 %. The exchange rate of the GEL was stable against the dollar and slightly varied within 1.3. In 1996 – 1997 Georgia's exports increased by 57 % (Forbes, 2018).

In 1997, foreign direct investment of 243 million USD came in, when in 1996 investment was only 4 million USD.

**1998 – 2000: Asia's Financial Crisis**

At the end of the twentieth century, the Asian financial crisis began to affect the world, which particularly affected Asian countries, including Russia. As Georgia's economic dependence on Russia was high during this period, the crisis also had a significant impact on Georgia (Kandelaki, 2006).

In 1998 – 2000, Georgia's economic growth rate dropped to 2.5 %. The GEL depreciated significantly, causing the price of one dollar to exceed 2 GEL. The annual inflation rate has risen to 11 %.

**2001 – 2003: Acceleration Growth**

It was very clearly visible (by massive demonstrations) that there was a demand for cardinal change. People wanted serious reforms in the country which converted to the Rose Revolution (RR). The new political party promised people improvement on the quality of their lives and to eliminate mass corruption (Kandelaki, 2006).

Rose revolution as a project became very successful when it is assessed retrospectively. It made Georgia improved – the economic growth during the period of the next nine years was one of the best in its whole history. The country became an absolute champion in terms of business environment reforms, improved economic figures, quality of freedom of speech and media increased. Therefore, Georgia became very attractive for potential investors and despite the continuous pressure from the Russian Federation and even the war of August in 2008, the country avoided the consequences of the global economic crisis (Kandelaki, 2006).

After the Asian financial crisis, Georgia's economic growth rate gradually increased and by 2003 the economy grew by 11.2 %. The growth that occurred during 2003 was mainly

driven by the increase in trade and agriculture. The development of the Baku-Ceyhan pipeline also had a significant positive impact (Namchavadze, 2018).

In 2003, budget revenues exceeded GEL 1 billion and government debt reached GEL 5.4 billion (63 % of GDP).

Although there was a positive economic trend during 2003, it had not been sufficient enough to stop the Rose Revolution, as the Revolution's main motto was to fight against corruption. According to the World Bank, in 2002, Georgia was the world's largest shadow economy.

Overall, the economic policy of free trade and democratization of the regulative procedures brought huge success to the Georgian economy. The massive reduction of corruption to average European figures, better degree of freedom of business environment and improvement of quality of public services placed Georgia on a pedestal amongst developing countries.

Worthnotingly, the story of the stagnation and the rising from the ash of Georgia became and will become a valuable lesson for future generations and future members of the political-economical world, as well as voters in Georgia and others who might face such kind of economical challenges (Jandieri, 2015).

**2004 – 2007: Rapid Growth**

The years of 2004 – 2007 are a period of significant reforms including reduced crime and corruption. The barriers of doing business have been significantly reduced. Types and rates of taxes have been reduced. All this was reflected in various international economic ratings. It was also accompanied by a period of the economic boom in the world (Namchavadze, 2018).

Georgia's economy grew by 5.8 % in 2004 and by 12.6 % in 2007. However, inflation was high – averaging 8.4 % annually. Budget revenues have increased fourfold and reached GEL 5 billion. Government debt reduced to GEL 4.3 billion (up to 26 % of GDP) (Forbes, 2018).

This high rate of foreign direct investment in Georgia – 2 billion USD in 2007 remains a record.

### 2008 – 2009: The Crisis

In the first half of 2008, the economy grew by 10 %, but by the end of 2008, the global financial crisis began. In August, during the Russia-Georgia war, Georgia's economic growth halted.

Since 2009, the international community has provided more than 4 billion USD in assistance and preferential loans to Georgia. At the same time, FDI inflows to Georgia in 2009 were 58 % and exports only 24 %, causing the country's economy to shrink by 3.7 %.

The budget deficit has increased and hence the national debt of the country. In two years, debt increased by GEL 3 billion (partly due to GEL depreciation), accounting for 41 % of GDP. The dollar depreciated to 1.8 unit (Forbes, 2018).

### 2010 – 2012: Escaping from The Crisis

Georgia's economy grew by an average of 6.6 % in 2010 – 2012. Foreign aid and credit played an important role in the growth. The budget deficit was high in 2010 – 2011, with the government spending increasing its deficit spending. As a result, government debt increased by another 2 billion GEL and exceeded 9 billion (although it declined to 35 % of GDP). In 2010, inflation was 11.2 %, and then declined in the following years.

Exports grew by an average of 29 % annually. Foreign direct investment averaged 950 million USD a year. The construction, trade, finance, hotel and restaurant industries were growing at the highest rates in the economy, yet the agricultural sector declined (Namchavadze, 2018).

### 2013: The Effect of Government Change

In 2013, the new government began to revise economic policies of the previous government and attempt to halt some infrastructure projects. At this point, it was unclear what the government was going to do to develop the economy. The economic growth rate dropped to 3.4 %. The balance of budget receipts and payments got "broken" and infrastructure spending had fallen sharply (from 1.5 to 1.1 billion).

In 2013, the agricultural sector grew the most by 11.3 %, as the government distributed crop vouchers to the people. The most significant decline was in the construction sector by 10 % (Forbes, 2018).

**2014 – Now: Moving Forward Slowly with Some Milestones**

The economy grew by an average of 3.4 % in 2014 – 2016. Georgia's exports fell by 27 %, largely due to the crisis in Russia and Azerbaijan. Remittances from abroad decreased by 22 %. In 2014 – 2016, the growth rate of tourism also decreased. Decreased foreign earnings led to a depreciation of the GEL, reaching 2.8 against the dollar. In the past 4 years, the inflation rate had averaged 3.7 %. Government debt to GDP rose to 44 %.

Foreign direct investment was the highest in 2014 – 1.8 billion USD. In the following years, an average of 1.6 billion USD was invested. The economy is expected to grow by 4 – 4.5 % in 2017, mainly driven by growth in exports, remittances, tourism and infrastructure construction (Forbes, 2018).

Annual conference held by UNCDAT had reviewed Foreign Direct Investment (FDI) business model and its perspectives to maximize outcomes by saving some resources, time and money (UNCDAT, 2018).

**Table 1**: Ease of doing a Business (2019)

| Rank | Country | EODB score | EODB score change |
|---|---|---|---|
| 1 | New Zealand | 86.6 | 0 |
| 2 | Singapore | 85.2 | 0.27 |
| 3 | Denmark | 84.6 | 0.59 |
| 4 | Hong Kong SAR, China | 84.2 | 0.04 |
| 5 | Korea, Rep | 84.1 | -0.01 |
| 6 | **Georgia** | 83.3 | 0.48 |
| 7 | Norway | 83.0 | 0.25 |
| 8 | United States | 82.8 | -0.01 |
| 9 | United Kingdom | 82.7 | 0.33 |
| 10 | North Macedonia | 81.6 | 0.32 |

Source: World Bank – Doing business, 2019

In 2019, Georgia took 6th place in the world in Ease of Doing A Business ranking. According to the (World Bank – Doing business 2019), Georgia is one of the most open countries in terms of attracting foreign investment and ranks the top 10 out of 190 countries. At the same time, it is worth noting that these indicators are related to alleviating regulations

and bureaucratic procedures, doing business (legal registration) significantly simplified (5.65 businesses are registered per 1,000 people). For the last 12 years, Georgia had been 4th in the list of top countries in terms of introducing innovations.

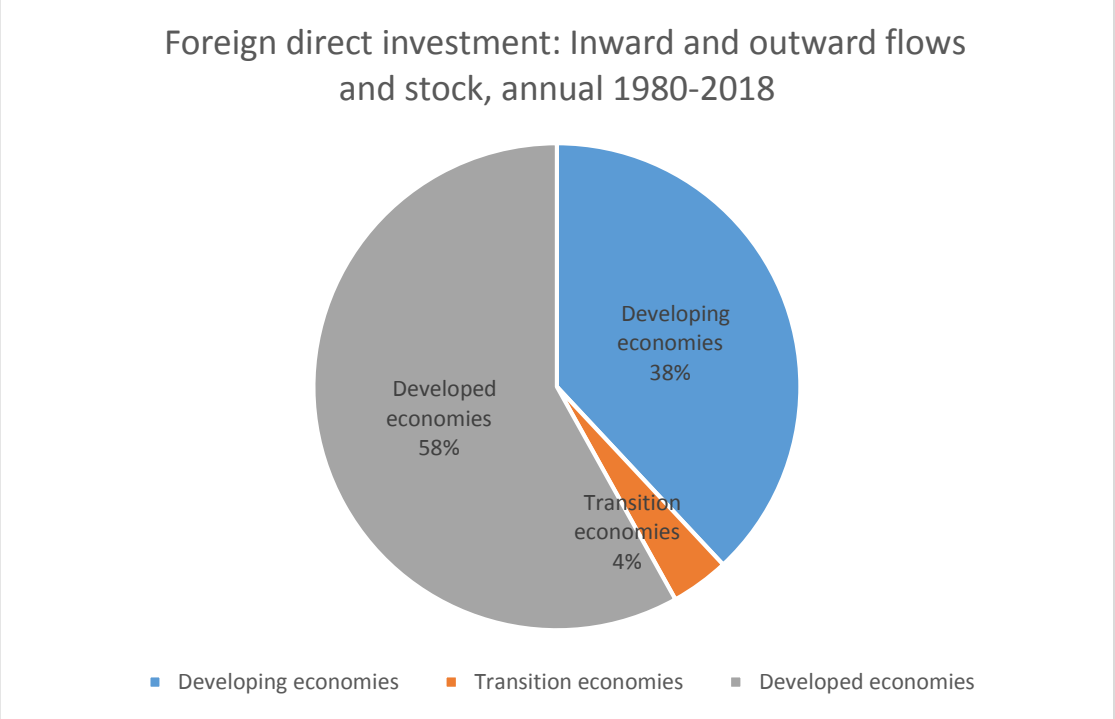
**Table 2**: Criteria of Ease of doing a Business (2019)

| Criteria | Ranking |
|---|---|
| Starting a business | 6 |
| Registering property procedures | 1 |
| Registering property times | 1 |
| Dealing with construction permits | 7 |
| Getting electricity | 2 |
| Protecting minority investors | 5 |
| Paying taxes | 20 |

Source: World Bank – Doing business, 2019

Table 2 shows the ranking of Georgia including the following criteria: starting a business, registering property procedures, registering property times, dealing with construction permits, getting electricity, protecting minority investors and paying taxes.

**Chart 2**: FDI inward and outward flows and stock (1980 – 2018)




Source: Eurostat, 2020

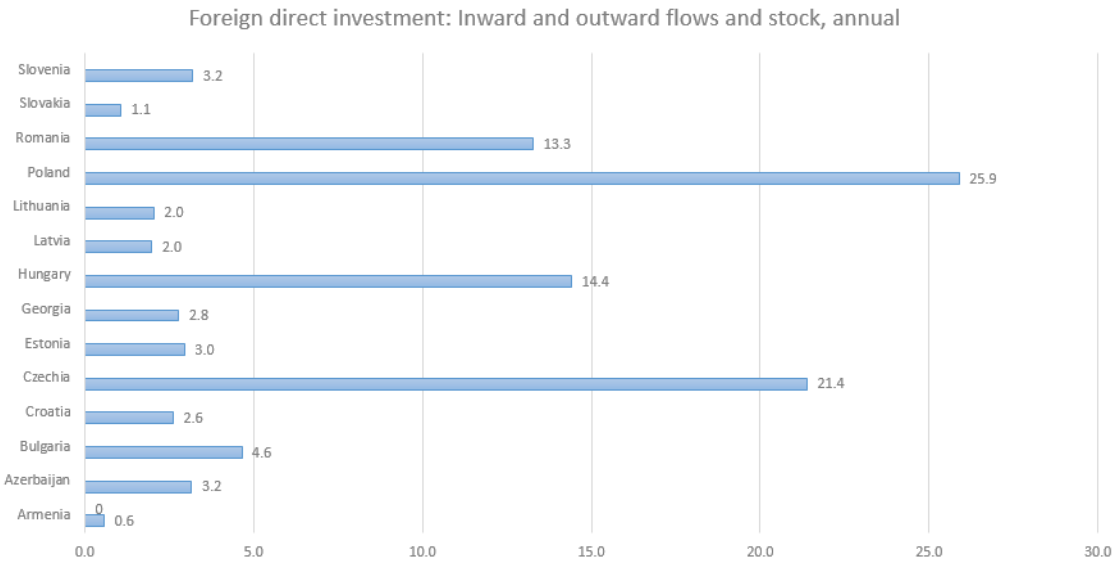
According to Chart 2, which covers the period from 1980 to the present, foreign direct investment in central and eastern Europe and the transcaucasian countries mainly originates from the 1990s. Among them, Poland is the only country where FDI flows were recorded until 1990. Since 1990, foreign investment flows have been observed for the first time since Poland in Bulgaria, Hungary and Romania. It can clearly be explained by the influence of the existing Soviet Union.

In consonance with the United Nations, FDI flows in 1980 – 2018 are mainly driven by growth. Among the developed countries, the highest share is in the developed economies (58 %) and the lowest in the transition countries (4 %).

Transcaucasian countries, including Georgia, belong to the group of countries in transition economies and thus to the category of recipients of the smallest investment flows worldwide. The thesis has randomly chosen 11 countries with more or less same geopolitical and economical background comparing to Post-soviet transition economic countries. Looking at the statistics of countries from 1980 to 2018, it can be said that FDI from the 11 countries was the highest in Poland, accounting for 1 % of the total, followed by the Czech Republic with 0.5 % (25 % within the countries) and Hungary with 0.48 % (14 %). As for the

Transcaucasian countries, Azerbaijan led with 0.1 % (3.2 % absolute), followed by Georgia with 0.07 % and Armenia with 0.05 % (Chart 3).

**Chart 3:** FDI inward and outward flows 11 countries (1980 – 2018)




Source: Eurostat, 2019

For the better demonstration, the thesis consists of an illustration of the statistics from countries from central and eastern Europe. Why the countries of the central and eastern Europe region were chosen (with the Soviet experience as part of them), and not, in particular, the four countries are known as the "Asian Tiger": South Korea, Taiwan, Hong Kong and Singapore? This is precisely because of their fast-paced growing economy. Foreign direct investment was mainly determined by the current reality of Georgia. The experience of the countries of central and eastern Europe are more interesting in terms of the impact of certain parallels, and also given the wide range of opportunities that the developed economy follows during the process of integration into the European family.

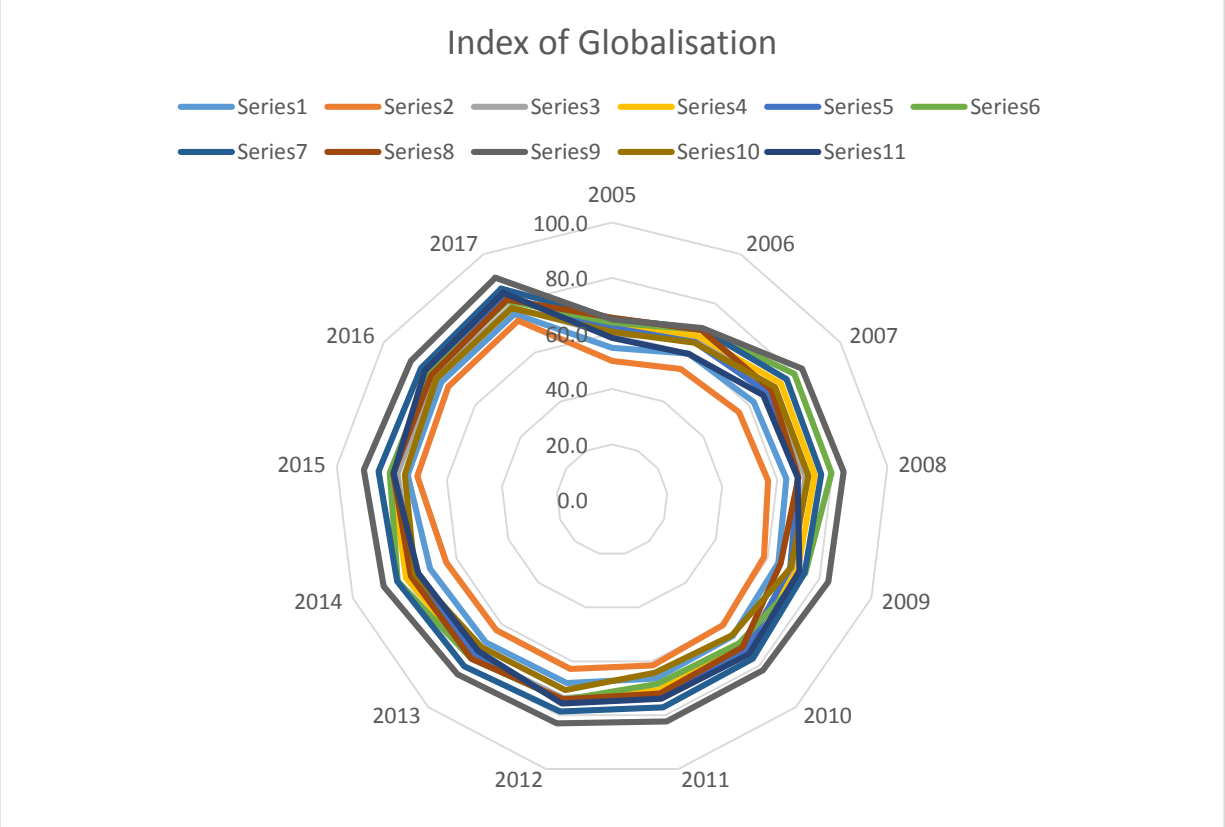
Due to the globalization of modern conditions, it is easy to find new opportunity of internationalizing, wherever possible, to have a chance to grow the country's economy. The process of globalization has contributed to the acceleration of the integration processes and to be able to make economic cooperation closer. The fast improvement of new technologies we have, more open are the borders and the processes among the strongest economies help transition economy courtiers to improve as well. An example of those types of country is

Georgia. Every year The Swiss institute publishes reports about the progress of each country in terms of economic growth and ease doing of business in the region. (Swiss Institute, 2018) The Swiss Institute of Economics reports on two areas of economic globalization: actual economic flows and economic constraints.

The actual economic flows index is based on information on trade, FDI and portfolio investment. World Bank data (2018), and IMF financial statistics on portfolio investment (2014 – IMF's International Financial Statistics) are used for trade information in 2018. Trading means the sum of the country's exports and imports, and the sum of the country's stock assets and liabilities (from normalized GDP) in portfolio investments.

The index of economic restrictions is calculated by hidden import taxes, ineffective and unfair tariff rates, taxes that limit international trade, and capital controls. Under those circumstances, a country that is struggling with high rates of income is less global. (2018 KOF Index of Globalization, method 2016.)

**Chart 4**: Index of Globalisation of Georgia (2005 – 2018)




Source: Eurostat, 2019

According to this index, economic globalization in Georgia has been growing steadily over the last 15 years. Georgia is considered to be economically globalized and has one of the highest rates among many European countries. Georgia's investment attractiveness is also confirmed by reports published by many international institutions. For example, on (World Bank, 2019) there is a quote: "*Deep reforms in economic management and governance have earned Georgia a reputation of star reformer*." To bolster the private sector, the country has introduced rules and regulations that make it easier to do business, and the country's international ratings on governance and the investment climate have soared.

Geostat office published the following trend for economic measurements:

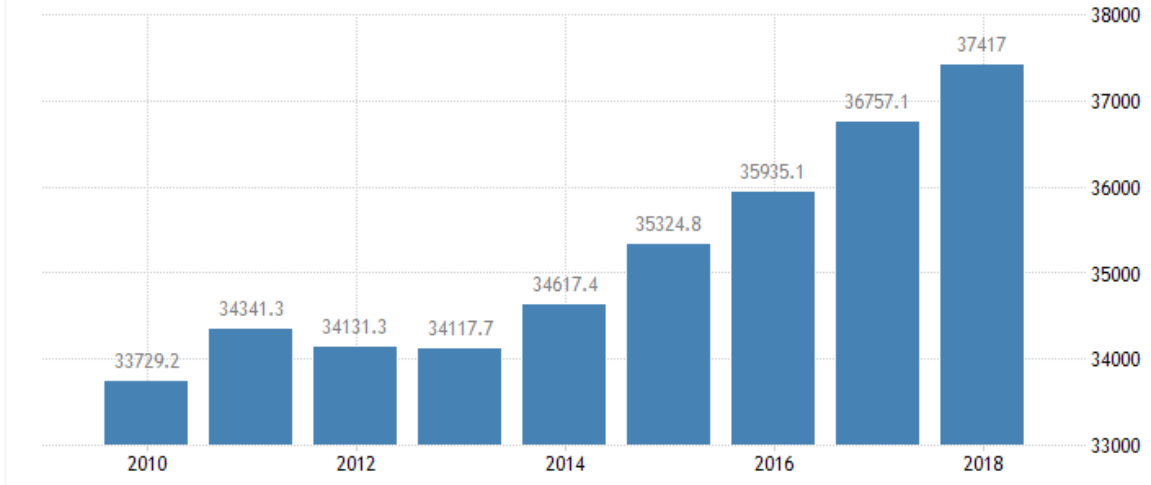
**Image 1:** Top 5 economic measurements in Georgia, 2019


Source: (Geostat, 2019)

### 3.2.2 European Enlargement Policy in Georgia

European Union (EU) consists of 27 European member states, it covers 4 324 782 km², population of 445,250,514 people which accounts for 5.75 % of the world's population (Worldometer 2020). GDP of 3.2 % and Unemployment of 6.8 %. There is a single internal market in the EU, the legislation of the individual countries is regulated (EU Commission, 2018).

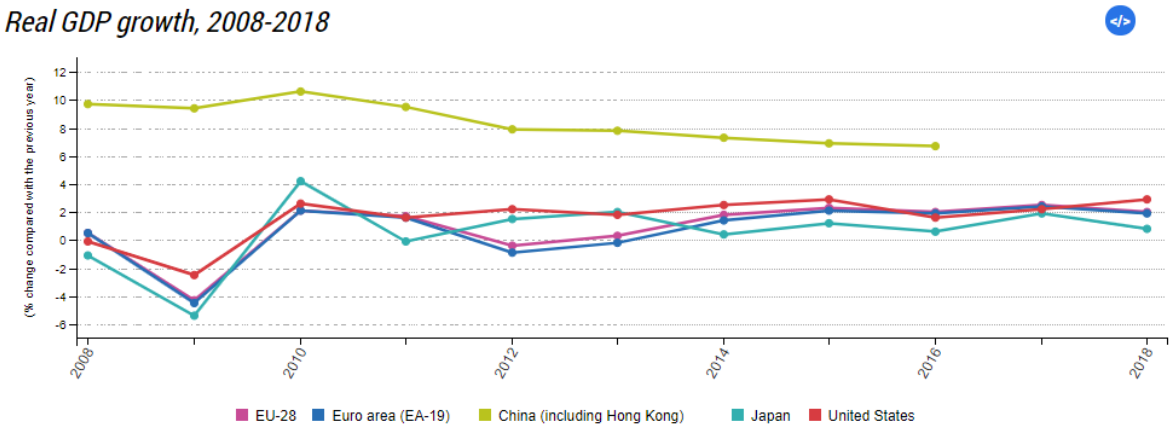
**Chart 5**: GDP per capita (2010 – 2018)




Source: Trading Economics, 2019

From Chart 5 and Chart 6, it is obvious how consistent the economy EU has been over the years. GDP per capita is gradually maintaining more welfare for the EU population whereas Real GDP growth is a measurement for economic output that is price-adjusted. It means "Inflation-corrected" GDP over time and, for the last years, real GDP growth is very stable. It has some fluctuations but overall the real growth is about 2 %.

**Chart 6:** Real GDP growth of EU (2008 – 2018)




Source: Own calculation based on data from Eurostat, 2020

The main policy objective of the EU is to ensure the free movement of people, goods, services and capital in a single, internal market; Publication of jurisprudential, legislation and domestic affairs; Maintain common policies in trade, agriculture, fisheries and regional development. In 1999, it was decided to introduce the single currency (Eurozone), which came into force in 2002; The Eurozone currently unites 19 countries in which the European

Union operates. The European Union originates from the European Coal and Steel Union and the European Economic Community, which created six states in 1951 and 1958. The unions have grown territorially as a result of the adoption of new member states, and the power has been supplemented by various policies. In 1993, as a result of the Maastricht Treaty, the European Union was created, which also introduced the European Citizenship Institute. The last major amendment to the EU constitutional framework – the Lisbon Treaty – came into force in 2009. On 23 June 2016, the United Kingdom supported the referendum on leaving the European Union. The EU member states are Belgium, Germany, Italy, Luxembourg, Netherlands, France, Denmark, Ireland, Greece, Spain, Portugal, Austria, Finland, Sweden, Estonia, Cyprus, Latvia, Lithuania, Malta, Poland, Slovakia, Slovenia, Slovenia, Slovenia, Slovenia, Slovenia Hungary, Czech Republic, Bulgaria, Romania and Croatia (Cini, & Pérez-Solórzano Borragán, 2016).

EU Candidate Countries: Georgia, Ukraine, Turkey, Iceland, Serbia, Montenegro and Albania. Any European state can become a member of The European Union which recognizes pluralistic democracy, the rule of law, safeguards the constitutional rights of its citizens, has a well-functioning and competitive market economy, shares the EU's political and economic goals.

After the collapse of the Soviet Union and the restoration of independence, cooperation between Georgia and the European Union began in 1992, and today Georgia is an associated member of the European Union.

The EU is a political and economic union of 27 states. Stable economic relations with the EU are very essential for Georgia. Meeting European standards will open the way to the largest markets for goods and services produced in Georgia. Free movement of Georgian products will help increase Georgia's export potential. It will become a more attractive country for investors, both in terms of political and economic stability, leading to increased investment flows in the country and the creation of new jobs (Joint statement of the Parties to the Joint Civil Society Forum, 2016).

Bilateral relations have become more intense since 2003, when Georgia began actively pursuing political and economic reforms. An entirely new phase in these relations begins on June 27, 2014, when the Association Agreement was signed. Georgia is actively

pursuing the process of EU integration and state development. Negotiations on the Association Agreement officially began in July 2010 and ended in July 2013 (EU-Georgia Association Agreement, 2014).

The agreement was initialled on November 29, 2013, within the framework of the Eastern Partnership Vilnius Summit. It was signed on June 27, 2014, in Brussels. The prospect of signing this agreement was opened by the initiative of the Eastern Partnership and replaced by the Cooperation Agreement signed in 1996 (Deep and Comprehensive Free Trade Area – DCFTA). It provides important concrete mechanisms for rapprochement with the EU. The agreement covers such a high level of convergence with the EU and its legislation that its effective implementation makes the country's Europeanization process irreversible. The Association Agreement aims at the political association with the EU and gradual economic integration. The agreement recognizes Georgia's European aspirations and European choices, noting that common values based on the EU – democracy, protection of human rights and fundamental freedoms along with the rules of law are also the cornerstone of political association and economic integration. The agreement covers a variety of issues. These include trade and trade-related issues: envisaging the establishment of deep and comprehensive free trade between Georgia and the EU (DCFTA, 2016).

The EU policy shows that the enlargement policy is geographical-regional. Expanding interest is shaped by existing practices in the new region, not the country. For instance, Turkey candidate status in 1999 was quite captivating. It had been expecting this status since 1987 (the day of application), but the EU decided only when the ambition to integrate the Western Balkans emerged and Turkey became part of this regional (South-Eastern Europe) context. Also, Malta and Cyprus appeared to be actual, which made their applications in 1990. Their membership was decided relatively easily due to a purely geographical (partly historical) factor. These two states were the closest geographical neighbours to the EU and at the same time historically very closely related to the member states. The enlargement process of the European Union is taking place in the context of enhanced regional cooperation, which aims at long-term stability and development. Infrastructure links are a necessary condition for EU integration.

The EU institutions towards Georgia, Moldova and Ukraine act in the same logic as the enlargement candidate countries. First, it should be noted that the objectives of the planned transformation, as well as the degree of their overall outcome, are not very different

from the standards set by the candidate country. Also, the amount of funding sources is almost equal. The EIB has the same mandate in the newly associated countries as in the western Balkan states. Free trade regime, forms of political cooperation, participation in programs and agencies are practically the same as in the enlargement region.

During the 27 - year relationship between Georgia and the European Union, several important agreements were concluded that have facilitated our economic integration across Europe. Here are some of them:

- On April 22, 1996, the Partnership and Cooperation Agreement (PCA) was signed between the European Union and Georgia to establish bilateral economic and political relations.
- On October 22, 2008, the European Union and the World Bank, providing $ 4.5 billion in assistance to Georgia in 2008 – 2010, organized a donor conference in Brussels.
- On June 27, 2014, In Brussels, the Association Agreement between the European Union and Georgia was signed. All products of origin were certain and conditions (food safety and product safety standards) were met;
- On March 21, 2018, the European Union presented its Foreign Investment Plan (EIP) in Tbilisi. Under this plan, in 2017 – 2020, the EU mobilized investment from the public and private sectors for more than 70 economies worldwide, including Georgia and other Eastern Partnership countries.
- On 15 January 2019, the European Commission unveiled an Investment Plan for the Trans-European Transport Network (TETN) aimed at strengthening interconnectedness in the Eastern Partnership countries and encouraging economic growth. Investments in infrastructure projects identified under the investment plan in Georgia and the rest of the Eastern Partnership in total 13 billion euros (Infocenter, 2019).

**(Partnership and Cooperation Agreement – PCA)**

In 1992, the European Union recognized Georgia as an independent state and began cooperating with it. Initially, this cooperation was conducted at a low intensity and was mainly limited to humanitarian and technical assistance to Georgia.

In 1996 the Partnership and Cooperation agreement was signed for a period of 10 years and agreed that they will be able to work together in multiple areas where parties are

committed to working together to achieve political, economic and social goals. Although the Agreement does not specify the criteria for the intermediate or ultimate objective of cooperation (for example, the criteria for joining the EU), it can benefit from EU standards and be able to apply it consistently (Eumonitor, 2007).

**European Neighbourhood Policy (ENP)**

On 18 November 2002, the Council of Ministers of Foreign Affairs of the European Union and the Copenhagen Council of the European Union expressed their willingness to deepen EU relations with Georgia, Ukraine, Moldova, Belarus and the southern Mediterranean. It also welcomed the proposals made by the Secretary-General of the European Commission and the Council of the European Union, EU High Representative for the Common Foreign and Security Policy in this regard. The Neighbourhood Policy was intended to support the process of political, economic and cultural rapprochement between the EU and its neighbouring countries.

The European Neighbourhood Policy on Georgia has been circulating since June 2004 and aimed to achieve progress in areas such as:

- Creation of new tools for investment promotion and protection;
- Harmonization of standards and rules;
- Creating the bases for free movement of human resources and legal migration
- The EU's more active involvement in Conflict Resolution and Crisis Management;
- Addressing greater efforts to deepen cooperation in the field of human rights and culture;

European Neighbourhood Policy has made a significant contribution to deepening cooperation between Georgia and the European Union and has facilitated the process of economic reform and the establishment of state institutions in the country (ENP, 2017).

**Visa Liberalisation**

On the 29th of May 2012, Georgia maintained Visa Liberalisation. Visa-free travel allows Georgian citizens to have only short-term visits without a visa if they have a biometric passport. A short visit means 90 days for any 180 days. After a 90-day stay in the EU/Schengen countries, a Georgian citizen must leave the territory of that country. The next entry into the EU/Schengen area is possible after the expiry of the next 90 days (180 days in

total). Short-term visits are available for a variety of purposes: tourism, visiting family members/relatives, business meetings, short-term training and exchange programs/training, courses, participation in cultural or scientific events, treatments and more. The duration of any such visit shall not exceed 90 days. Visa-free travel will not apply to long-term visits to the Schengen area for education, work or other purposes. Citizens of Georgia should apply to the consulate of the respective country accredited in Georgia if they wish to stay for a long period.

**Free Trade – DCFTA**

The preparatory process for the DCFTA began in 2009. The commission's trade mission visited to Tbilisi on October 13 – 14, 2008 laid the groundwork for the preparatory process to start negotiations on the Free Trade Agreement.

In a following visit in March 2009, the Georgian government was presented with the EU Commission's Recommendations Regarding Georgia's Preparedness for the DCFTA Negotiations.

The Deep and Comprehensive Free Trade Area Agreement (DCFTA) with the European Union is an essential part of the Association Agreement (Title IV – Trade and Trade-related Matters), as it covers the mechanism of economic integration with the EU and opens the EU internal market for Georgia. Unlike other free trade agreements signed by Georgia, DCFTA is committed to liberalizing both trade in goods and services. Also, the DCFTA covers a wide range of trade-related issues (food safety, competition policy, intellectual property protection, financial services, etc.) and provides for the gradual approximation of Georgian trade legislation to EU law.

DCFTA allows Georgia to gradually achieve three of the four agreements of the EU internal market: free movement of goods, services and capital. Fourth agreement – the free movement of people is facilitated by the process of visa liberalization. As for recommendations, the EU Commission identified four priority fields: technical barriers to trade, sanitary measures (e.g. food safety), intellectual property rights, and competition (Infocenter, 2018).

# 4. Practical Part

The practical part consists of the dynamics and sectoral structure of Foreign direct investments. Statistical and comparative analysis tools and indicators have been used for the proper research in order to determine the impact of EU foreign direct investment (FDI) on economic growth in Georgia.

## 4.1 Dynamics of FDI from EU Countries

Georgia's economic relations with the European Union have a great importance. If the standards are met, Georgian products will make their way to the European market. This is directly linked to economic stability in Georgia, which in turn is driven by the growth of the country's investment potential shown and proved in the research below.

To create a general idea of investments in Georgia, let's consider the rate of investment both in dynamics and in different contexts to calculate different average values, as well as absolute growth, growth, average annual growth and growth rates based on the available data.

The statistical analysis is based on data from 28 EU member states. Despite the variations in the number of EU Member States caused by EU enlargement policies in 2004 (Estonia, Cyprus, Latvia, Lithuania, Malta, Poland, Slovakia, Slovenia, Hungary, Czech Republic), 2007 (Bulgaria and Romania) and 2013 (Croatia), at different times to ensure data comparability, it is necessary to have a constant number of countries (EU, 2008).

**Table 3**: FDI in Georgia (1996 – 2018)

| Year | Total FDI (1000 USD) | Q I | Q II | Q III | Q IV |
|---|---|---|---|---|---|
| 1996 | 3.8 | ... | ... | ... | ... |
| 1997 | 242.6 | 38.8 | 48.50 | 97 | 58.2 |
| 1998 | 265.3 | 19.1 | 97.80 | 45 | 103.4 |
| 1999 | 82.2 | 19.4 | 22.30 | 20 | 20.6 |
| 2000 | 131.2 | 32.7 | 30.00 | 28.9 | 39.5 |
| 2001 | 109.8 | 20 | 30.80 | 29.8 | 29.2 |
| 2002 | 160.2 | 24.4 | 44.60 | 36.4 | 54.8 |
| 2003 | 334.6 | 56.3 | 80.40 | 83.4 | 114.4 |
| 2004 | 492.3 | 118.2 | 117.20 | 133 | 123.9 |
| 2005 | 452.8 | 88.6 | 104.80 | 79.6 | 179.7 |
| 2006 | 1171.2 | 145.2 | 318.00 | 332.4 | 375.5 |
| 2007 | 1764.7 | 330.8 | 375.30 | 470.6 | 588 |
| 2008 | 1575.2 | 540.1 | 607.70 | 136.1 | 291.3 |
| 2009 | 666.8 | 114.5 | 178.30 | 179.1 | 194.9 |
| 2010 | 865.6 | 176.1 | 211.50 | 236.8 | 241.2 |
| 2011 | 1134 | 222.6 | 273.10 | 309.1 | 329.2 |
| 2012 | 1048.2 | 312.4 | 248.00 | 220.5 | 267.3 |
| 2013 | 1039.2 | 291.8 | 224.10 | 271.6 | 251.6 |
| 2014 | 1837 | 331.9 | 217.60 | 749.5 | 538 |
| 2015 | 1729.1 | 343.4 | 493.20 | 531.1 | 361.3 |
| 2016 | 1650.3 | 392.2 | 452.10 | 506.5 | 299.5 |
| 2017 | 1962.6 | 411.7 | 394.00 | 627.9 | 529 |
| 2018 | 1265.2 | 323.5 | 403.6 | 367 | 171 |

Source: National Statistics Office of Georgia (Statistical survey on external activities), 2019

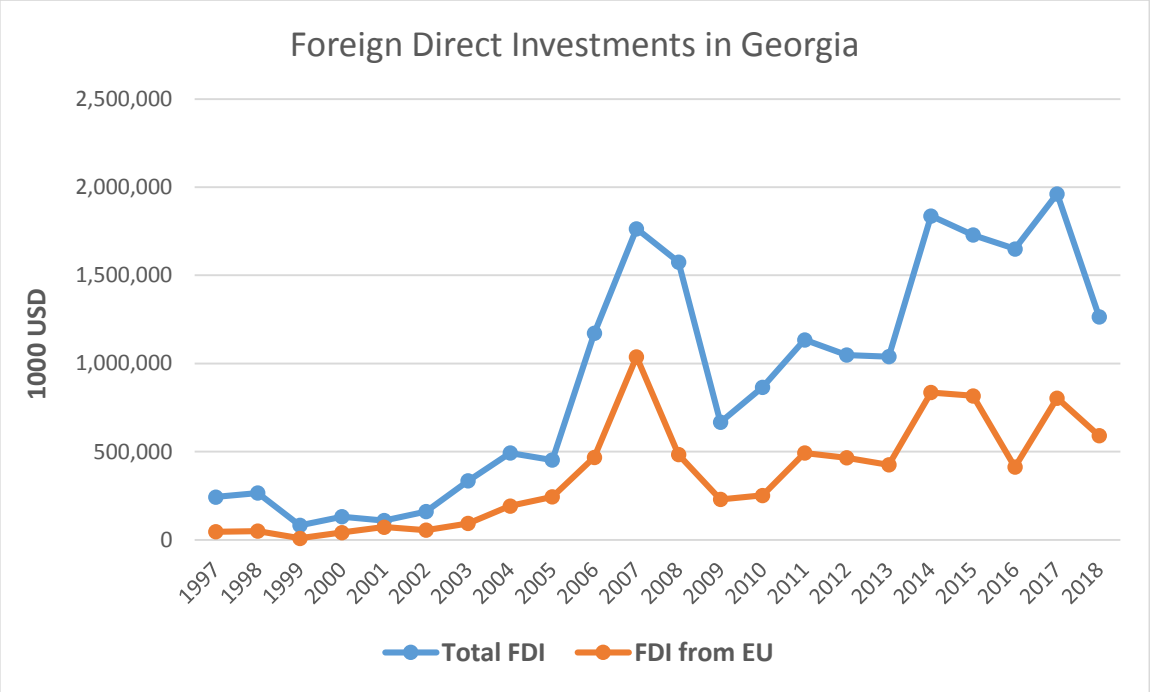
If Table 3 shows quarter-based FDI flows from the European Union to Georgia, Table 4 shows what was the share of foreign direct investment from the EU in total FDI flow. It is notable that in 2007, Georgia gained the biggest attraction from EU (almost 60 %) because the government which lead the country after the Rose Revolution achieved its peak in diplomatic affairs; they established proficient communication and attracted the attention country and business-wise.

**Table 4**: EU FDI share in Georgia (1996 – 2018)

| Year | Total FDI (1000 USD) | EU countries | Total Share in FDI |
|---|---|---|---|
| 1997 | 242,586 | 45,794 | 18.90% |
| 1998 | 265,332 | 49,540 | 18.70% |
| 1999 | 82,207 | 8,561 | 10.40% |
| 2000 | 131,232 | 41,551 | 31.70% |
| 2001 | 109,840 | 71,930 | 65.50% |
| 2002 | 160,212 | 55,189 | 34.40% |
| 2003 | 334,568 | 92,906 | 27.80% |
| 2004 | 492,329 | 192,326 | 39.10% |
| 2005 | 452,752 | 243,846 | 53.90% |
| 2006 | 1,171,180 | 468,313 | 40.00% |
| 2007 | 1,764,721 | 1,038,201 | 58.80% |
| 2008 | 1,575,243 | 483,739 | 30.70% |
| 2009 | 666,775 | 228,988 | 34.30% |
| 2010 | 865,638 | 251,870 | 29.10% |
| 2011 | 1,133,971 | 492,378 | 43.40% |
| 2012 | 1,048,227 | 465,597 | 44.40% |
| 2013 | 1,039,174 | 425,100 | 40.90% |
| 2014 | 1,836,980 | 835,965 | 45.50% |
| 2015 | 1,729,088 | 816,315 | 47.20% |
| 2016 | 1,650,328 | 412,629 | 25.00% |
| 2017 | 1,962,613 | 804,316 | 41.00% |
| 2018 | 1,265,236 | 590,111 | 46.60% |

Source: National Statistics Office of Georgia, 2019

**Chart 7**: Graphical explanation of EU FDI share in total FDI in Georgia (1996 – 2018)




Source: Own processed data provided by the National Statistics Office of Georgia, 2019

In both, EU countries and the EU as a unit, FDI was characterized by an upward trend, though this trend cannot be called a stable. If its magnitude was too small in 1996 – 2004 and could not reach half a billion, things would be changed radically in 2005 – 2008. During this period, the maximum rate was recorded in 2007; The total foreign direct investment amounted to 1,764,721 million USD. The total amount of FDI reached 1,038,201 million USD, which is 58.8 % of total FDI. However, the 2008 Russia-Georgian war and the global financial crisis had a negative impact on the economy as a whole as well as the investment environment causing FDI to decline sharply. The second wave of growth begins in 2013 and reaches its historic peak in 2017 by 1,962,613 USD total with the EU share of 804,316 thousand USD.

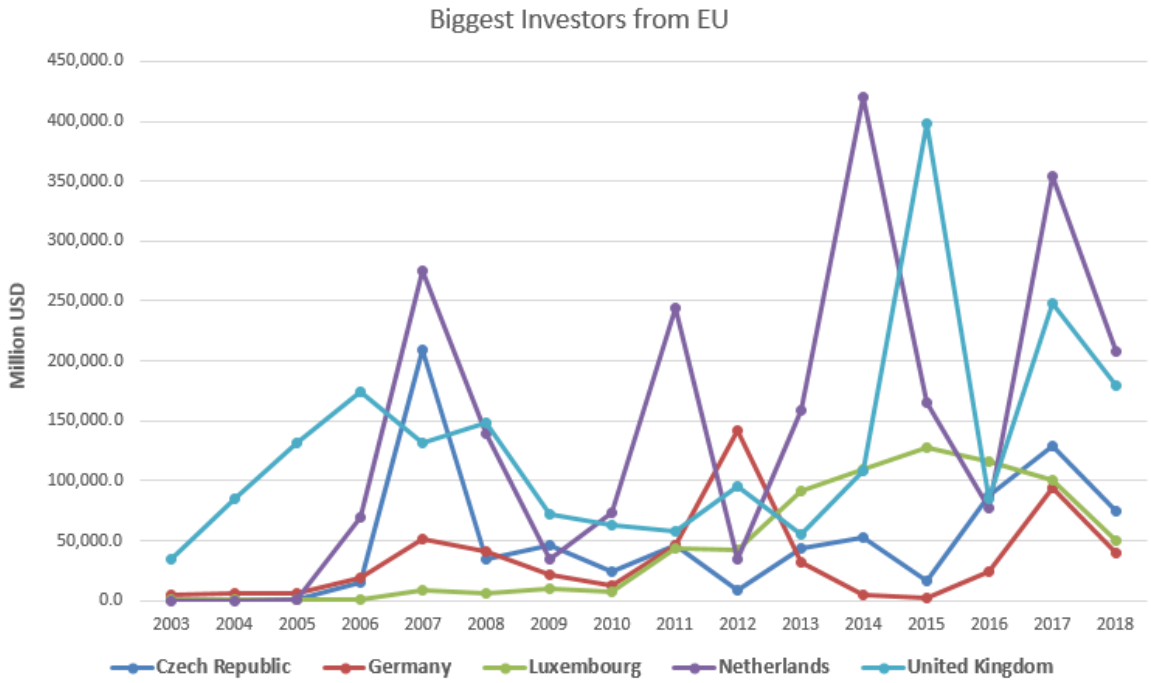
In 1997 – 2018 Georgia totalled 19.9 billion USD FDI. Total direct investment from 28 EU countries amounted to 8.1 billion USD which is 40.6 % of total foreign direct investment. During the same period, CIS countries invested 3.9 billion USD direct investments, which is 20 % of total foreign direct investments.

The share of foreign direct investment from the EU countries during the period 1997 – 2018 peaked in 2001, accounting for 65.5 % of total foreign direct investment. Alternatively, in nominal terms, 2007 remains a record year in terms of direct investment from EU

countries. Despite the higher total FDI in 2017, the share of EU countries accounted for 41 % (58.8 % in 2007 – 1,038,201 million USD). This fact speaks volumes about the geographical composition and structure of FDI during this period. The share of foreign direct investment from EU countries decreased, but the share of foreign direct investment from CIS countries decreased from 9.1 % to 27.1 %, which led to an increase in the overall figure.

According to the aggregate data for this period, the largest investor countries among the EU countries are: United Kingdom - 2,069 million USD (25.5 %), Netherlands - 2,255 million USD (27.8 %), Czech Republic - 789,286 million USD (9.7 %), Luxembourg - 712,655 million USD (8.9 %) and Germany - 548,982.8 million USD (6.8 %).

**Table 8**: Top 5 investors of European Union (2003 – 2018)




Source: Own processing based on data from Geostat. 2019

According to data from 2018, total direct investment from EU countries amounted to 590,111 million USD, which is 35 % less than the previous year. Among them, the volume of direct investments from the United Kingdom amounted to 178,835.8 million USD. The volume of direct investments from the Netherlands amounted to 208,385.0 million USD, which is 18 % less than the same period of the previous year. For Luxembourg, it was 53 million USD, 53 % less than the same period last year. And direct investment from the Czech Republic amounted to 74,999 million USD, which is almost 40 % decrease from the same period last year.

**Table 5**: Top 5 investors of European Union (2003 – 2018)

| Year | Czech Republic | Germany | Luxembourg | Netherlands | United Kingdom |
|---|---|---|---|---|---|
| 2003 | 250 | 4,624 | 250 | 144 | 34,843 |
| 2004 | 277 | 5,514 | 277 | 36 | 85,100 |
| 2005 | 1,280 | 6,218 | 553 | 632 | 131,546 |
| 2006 | 15,032 | 19,473 | 261 | 69,406 | 174,535 |
| 2007 | 209,229 | 51,898 | 8,480 | 274,707 | 132,178 |
| 2008 | 34,858 | 40,591 | 5,731 | 138,707 | 148,180 |
| 2009 | 45,679 | 21,345 | 9,497 | 34,325 | 72,439 |
| 2010 | 24,214 | 12,848 | 7,060 | 73,009 | 62,336 |
| 2011 | 46,598 | 46,571 | 43,284 | 244,536 | 57,217 |
| 2012 | 8,031 | 142,406 | 42,032 | 34,210 | 95,537 |
| 2013 | 43,578 | 31,927 | 91,736 | 159,181 | 55,171 |
| 2014 | 51,962 | 4,187 | 109,633 | 420,491 | 108,851 |
| 2015 | 16,673 | 2,609 | 127,265 | 164,899 | 398,813 |
| 2016 | 87,529 | 24,177 | 115,746 | 77,338 | 85,211 |
| 2017 | 129,097 | 94,655 | 100,715 | 354,524 | 247,480 |
| 2018 | 75,000 | 39,940 | 50,136 | 208,385 | 178,836 |
| **Total** | **789,286** | **548,983** | **712,655** | **2,254,529** | **2,068,272** |

Source: Own processing based on data from Geostat. 2020

Some of the main causes of the downturn include the transfer of several enterprises to the ownership of Georgian residents and the reduction of liabilities to non-resident direct investors (debt repayments).

**Financial Sector**

It is interesting to discuss the largest investor countries in the sectorial context. In 2018, 87 % of direct investment (204 million USD) from the United Kingdom is estimated to come from the financial sector. The rest of the sectors do not exceed 13 %. The investment portfolio diversification level is very low, and most of the largest EU investor countries come from the financial sector, not the real economy fields, where consumer products are to be created, where products to be produced to satisfy local consumers needs. In addition, it should be noted that the volume of FDI in the financial sector from the UK decreased by 48 million (21 %) in 2018 compared to the same indicator from the previous year. 49 % of total FDI from the Netherlands (168 million dollars) comes from the economic sector of the

processing industry, with a nominal value of 82 million. The mining sector is followed by the economic sector (USD 52 million) with 31 %, followed by the financial sector (USD 31 million) with 18.4 %. Direct investment from the Czech Republic (USD 72 million) comes almost entirely from the energy sector of USD 71 million, which is 98 %. As for direct investments from Luxembourg (USD 48 million) in 2018, the leading sector is processing industry by share of 75 % with the nominal value of 36 million USD.

The main components of FDI are equity, reinvestment and debt. The National Bureau of Statistics of Georgia has been publishing FDI data in this regard since 2016, and the dynamic ratios of the respective indicator are available from 2013.

The volume of direct investments withdrawn from the European Union during 2013-2018 totalled 3,884,436 million. Amount of 2,275 million USD direct investment was invested in equity, 1,701 million USD in reinvestment and negative debt of 198 million USD in debt, which means that liabilities to non-resident direct investors decreased during this period – taken from the previous period. Loan rights and status for trade credits the payment and/or non-resident direct investment enterprise on the issue of loans and non-resident investors to trade credits.

**Table 6**: Foreign Direct Investments in Georgia by Components (2013 – 2018)

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|
| Total | **1,039.20** | **1,837.00** | **1,729.10** | **1,650.30** | **1,962.60** | **1,265.20** |
| | 0 | 0 | 0 | 0 | 0 | 0 |
| Equity | 535.8 | 1,150.70 | 1,283.90 | 1,805.70 | 1,091.30 | 803.4 |
| Reinvestment of earnings^ | 276.8 | 322.9 | 158 | 311 | 616.6 | 437.2 |
| Debt instru-ments^^ | 226.6 | 363.4 | 287.2 | 466.4 | 254.7 | 24.6 |

^ Reinvestment of earnings – the difference between profit/loss and dividends

^^ Debt instruments- includes trade credits and loans.

Source: National Statistics Office of Georgia and National Bank of Georgia, 2019

As for data for 2018, the proportion of direct investment from EU countries by components, 71.7 % comes from reinvestment, 22 % from equity and 6.2 % from debt.

As it is shown in the dynamics, the share of reinvestment in total FDI is significantly increasing.

In 2017, January 1, income tax Estonian model was announced with a long-term positive impact on business, particularly in huge businesses, which are long-term goals are focused and as modelled on reinvested capital are not taxed accordingly, investors have more incentive not to share the profits and rather to reinvest their funds. The analysis shows that the volume of reinvestment in 2017 amounted to 616.6 million US dollars whereas in 2016 there was 311 mln. USD, hence there is a 90.5 % improvement.

**Regional Context**

It is also interesting to consider direct investment from the EU in the regional context. Data has been available since the year 2013. The total amount of direct investments withdrawn from the European Union during 2013 – 2018 amounted to 3,884,436 mln USD. Out of it, 2 614 million USD comes from capital city Tbilisi, which is 67.2 %. Adjara region is in the second place – 318.4 million USD (8.4 %), followed by Samtskhe-Javakheti region with 310.2 million USD (8.2 %). The data on the financial sector (commercial banks, microfinance organizations and insurance companies) are all located in Tbilisi, nonetheless, the analysis reveals that the largest portion of EU direct investment falls in the capital. Total flows of regions reach 31 % in 2013 – 2018 which clearly indicates a lack diversification of investments.

As of 2018, 81.2 % of FDI in Georgia (1,033,291 mln.) was made in Tbilisi, then Kvemo Kartli region is second with 87,028 million USD (13.1 %), and 3$^{rd}$ place is for Adjara region with 75,551 million USD amount of investments.

Overall, there is no surprise to see the capital of Georgia, having 4/5 of investments if we consider the fact that most of the people (almost third) live in Tbilisi, having most of the offices to be located and all the governmental institutions to be centralized in Tbilisi.

**Table 7**: FDI in Georgia by regions (2013 – 2018)

| Regions | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|
| Total | 1,039,174 | 1,836,980 | 1,729,088 | 1,650,328 | 1,962,613 | 1,265,236 |
| Tbilisi | 750,270 | 1,343,188 | 1,383,265 | 1,415,376 | 1,514,710 | 1,033,291 |
| Adjara | 83,138 | 169,076 | 207,849 | 108,434 | 209,642 | 75,551 |
| Kakheti | 11,029 | 15,796 | 17,542 | 3,422 | 12,114 | 9,785 |
| Samtskhe-Javakheti | 51,770 | 74,291 | 31,275 | 30,813 | 38,856 | 44,796 |
| Kvemo Kartli | 17,658 | 55,672 | 21,181 | 29,130 | 64,702 | 87,028 |
| Samegrelo-Zemo Svaneti and Guria | 66,302 | 93,431 | 50,730 | 34,701 | 55,912 | 10,531 |
| Imereti, Ra-cha-Lechkhumi and Kvemo Svaneti | 59,124 | 27,951 | 25,702 | 25,408 | 59,853 | 26,763 |
| Shida Kartli and Mtskheta-Mtianeti | 115 | 57,576 | 8,456 | 3,044 | 6,824 | 18,123 |

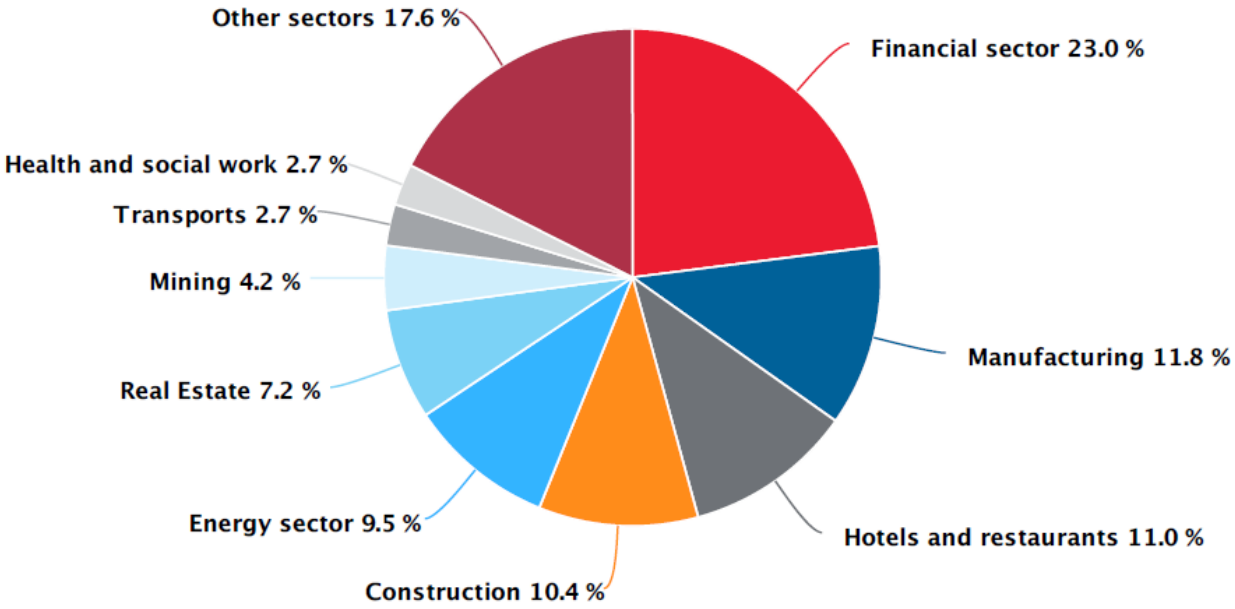
Source: Own processing based on data from Geostat, 2020

## 4.2 Sectoral structure of FDI from EU countries

FDI dynamic information by economy sectors has been available since 2007, based on data processing by types of core business activities. Alternatively, information on sectors and countries of the economy has been commercially available since 2009.

From 2009 – 2018, there was 5,189 million USD direct investment made from EU countries. Looking at their sectors, the largest direct investment was in the financial sector – 23 %, in the energy sector – 9.5 % and in the manufacturing industry – 11.8 %.

**Chart 9**: FDI by major economics sectors (2018)



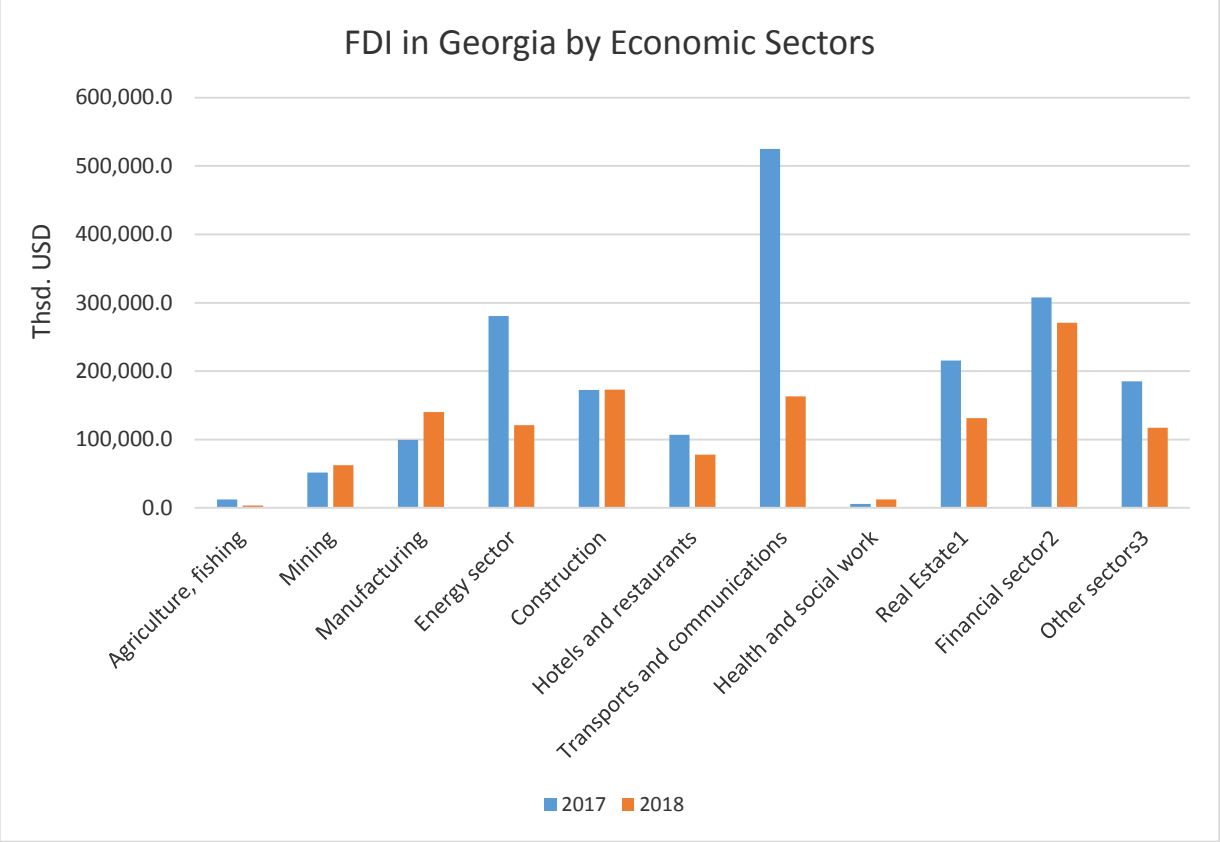

Source: Own processing based on data from Geostat. 2019

The total amount of direct investments in the financial sector from the EU countries amounted to 1,053 mln. USD reached its peak in 2017, when 86.3 % of total foreign direct investment in the financial sector came from EU countries, amounting to 261.3 million USD. The largest investor country in the financial sector in 2009 – 2018 in the United Kingdom with a net investment of 801 million USD. The Netherlands is second with 197 million USD.

The volume of direct investments from the EU countries in the energy sector in 2009-2018 amounted to 903 million USD, the maximum rate in 2014 – 186 million USD, which is 97.8 % of the total foreign direct investments in the energy sector. The largest investor countries are the Czech Republic: 510 million USD, Netherlands with 304 million USD and Luxembourg 127 million USD.

During the same period, EU direct investment in the processing industry amounted to 771 million EUR. The maximum rate recorded in 2018 and it was 150 million USD. The largest investor countries are the Netherlands with 374 million USD and Luxembourg 315 million USD.

**Chart 10**: FDI in Georgia by Economic sectors comparison (2017 – 2018)

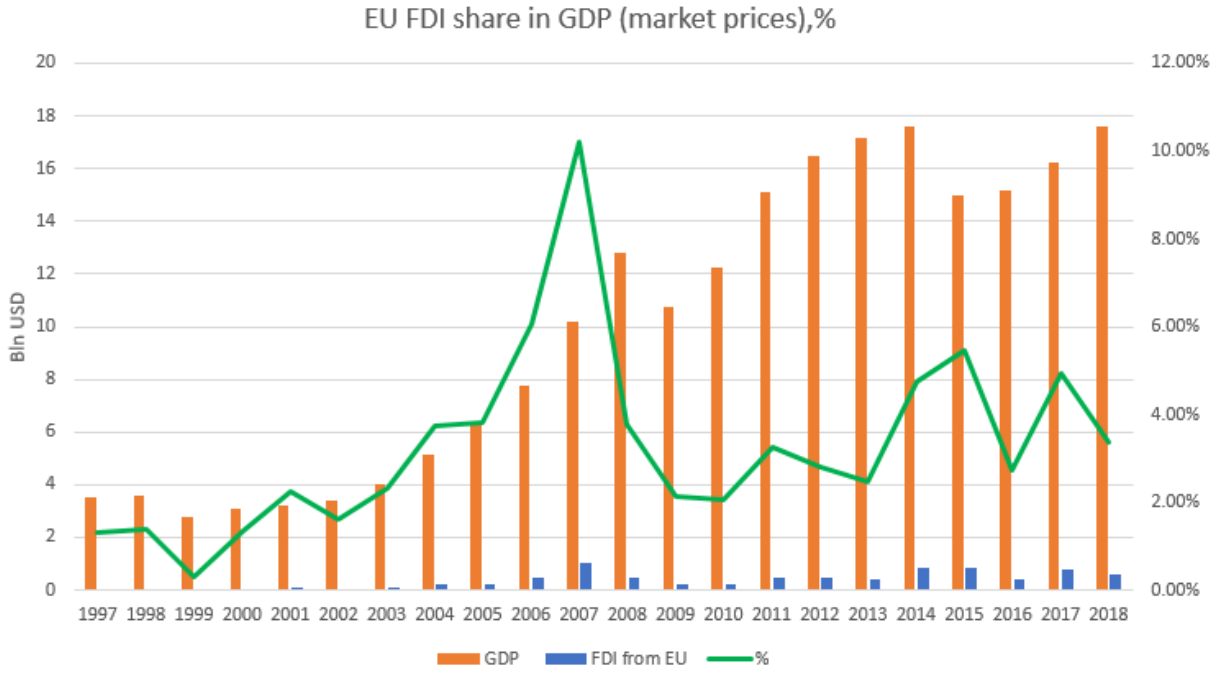



Source: Own processing based on data from Geostat, 2018

According to the sectors of the economy in 2018, the volume of investments from EU countries tops the financial sector with 270.7 million. The Energy sector occupies the second place with 173 mln. USD which is almost the same level as it was in 2017 - 172.5 ml. compared to the previous year. The Transports and communications sector is on the third stage with USD 163 million, which is 70 % lower than the previous year.

Gradually after discussing the trends of total and shares of FDI from European Union countries as well as the GDP, the ratio of EU direct investment to GDP is also worth mentioning.

**Chart 11**: FDI share Georgia from EU comparing to GDP (1997 – 2018)




Source: Own processing based on data from Geostat, 2019

As the chart shows, the EU FDI to GDP ratio is also fluctuating. This figure reached a maximum of 6 % in 2007, while the share of total foreign direct investment reached a maximum of 10.7 % in the same period. However, in 2009 – 2018, the trend had a fluctuating nature.

The analysis shows that FDI does not play a huge role in the establishment of Georgia's GDP as much as government investments do. The country still contributes the most to GDP growth, and there is essentially no other alternative. Therefore, it is legitimate to argue that the state should not reduce infrastructure and social spending, as these costs are the main drivers of the economy.

Speaking of investment factors, one of the factors was discussed was cheap labour. Large corporations in developing countries often use them to manufacture their products. An important reason for this is that the cost of production is less than the cost of transportation. Ideal conditions have been created for Georgia in this respect, especially after the conclusion of the Association Agreement, which includes the Deep and Comprehensive Free Trade Area (DCFTA). As a result of this agreement, Georgia has become attractive not only for cheap labour, but also for the creation of new distribution channels. Today, one of the largest markets in the world – the EU market is available for quality products made in Georgia.

Given this factor, it will be interesting to consider direct investment from the European Union and foreign trade in goods, especially exports to the EU.

**Table 8**: Correlation between FDI from EU to Georgia and GDP growth (1997 – 2018)

| Year | FDI from EU Billion USD | GDP Billion USD |
|---|---|---|
| 1997 | 0.05 | 3.51 |
| 1998 | 0.05 | 3.61 |
| 1999 | 0.01 | 2.80 |
| 2000 | 0.04 | 3.06 |
| 2001 | 0.07 | 3.22 |
| 2002 | 0.06 | 3.40 |
| 2003 | 0.09 | 3.99 |
| 2004 | 0.19 | 5.13 |
| 2005 | 0.24 | 6.41 |
| 2006 | 0.47 | 7.75 |
| 2007 | 1.04 | 10.17 |
| 2008 | 0.48 | 12.80 |
| 2009 | 0.23 | 10.77 |
| 2010 | 0.25 | 12.24 |
| 2011 | 0.49 | 15.11 |
| 2012 | 0.47 | 16.49 |
| 2013 | 0.43 | 17.19 |
| 2014 | 0.84 | 17.63 |
| 2015 | 0.82 | 14.95 |
| 2016 | 0.41 | 15.14 |
| 2017 | 0.80 | 16.24 |
| 2018 | 0.59 | 17.60 |

| Correlation | | |
|---|---|---|
| | USD Billion | GDP USD Billion |
| USD Billion | 1 | |
| GDP USD Billion | **76%** | 1 |

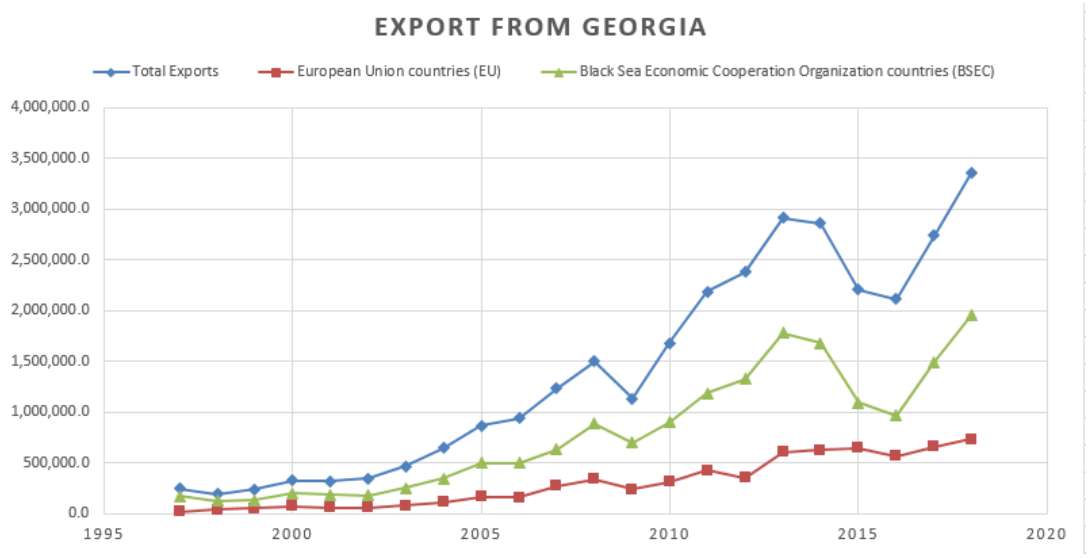
Source: Own processing based on data from Geostat, 2020

Correlation analysis shows more than average positive dependency between FDI and GDP growth (76 %). It means that GDP can benefit from foreign direct investment nevertheless, there are other factors that influence GDP growth. That's why it's crucial for

the country to have a well-developed infrastructure and basis for GDP growth including regulations, political stability, etc.

Taking into consideration the circumstances above, there is a high probability that the correlation trend between these two variables will increase, therefore society and economy will maintain most beneficial consequences out of it.

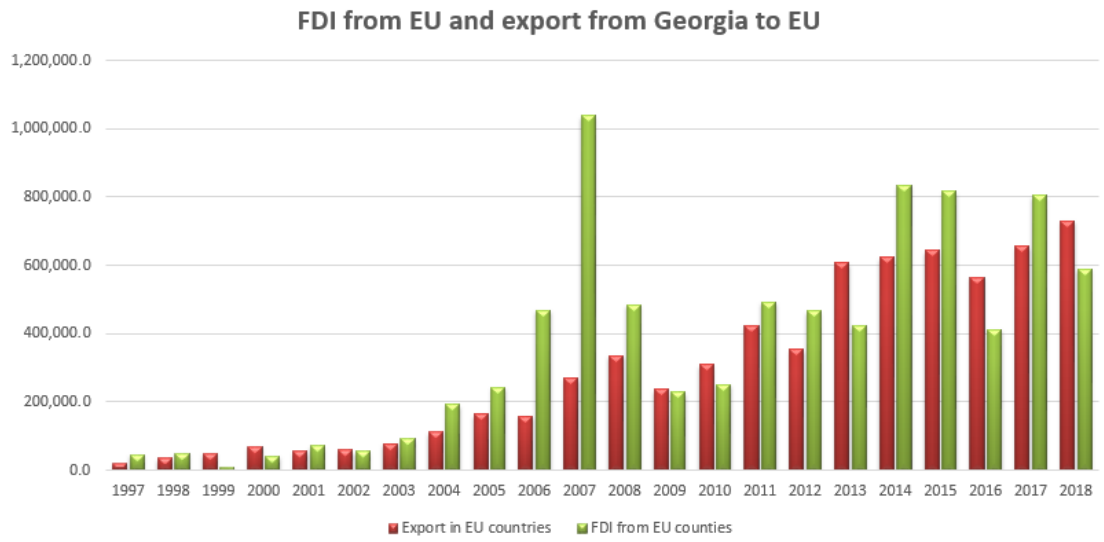
**Chart 12**: Export from Georgia (1995 – 2018)




Source: Own processing based on data from Geostat, 2019

Besides, there is an opportunity to see the trend of export from Georgia and its share to export values in European Union countries.

**Chart 13**: Export in EU compared to FDI from EU countries (1996 – 2018)




Source: Own processing based on data from Geostat, 2020

In many cases, both indicators have an upward trend, but there are exceptions. Exports to EU countries are growing at a more stable pace, while the rate of direct investment from the EU is more fluctuating.

During 2004 – 2007, as a result of high economic activity, exports from Georgia to the EU were increasing, but the rate of growth was much higher than the amount of direct investment from EU countries to Georgia. From 2008 to the end of 2010, both levels decline, but the rate of direct investment declines more actively. The decline was due to two reasons:

1) The global financial crisis of 2007 – 2008, which may be considered the worst crisis in world economic history since the Great Depression of 1929 – 1933.

2) The August 2008 Russian-Georgian war, which significantly slowed down Georgia's economic development. Particularly affected was Georgia's foreign economic relations, meaning Georgia's image as a stable partner had been tarnished. For most foreign investors, investing in a conflict-ridden country has become risky.

Since 2010, both indicators have been resuming growth, with growth rates increasing in 2014, which can be linked to the launch of the Deep and Comprehensive Free Trade Area Component. Georgia is perceived as a more stable and reliable economic partner by EU member states. This also shows the link between foreign direct investment and exports, and the analysis shows that Georgia's export opportunities are attractive to European investors.

While the notion of residency and citizenship differs from, another indicator of how to improve economic relations with the EU is by increasing the number of organizations registered by partner countries on a specific date. Similar information is processed by the Business Registry Division of the Business Statistics Department of the National Statistics Office of Georgia. As of June 2019, 755,023 organizations are registered in Georgia. Of those, 48,766 are foreign companies, and EU citizens are 5,383, which is 11 %. This figure is much lower than the FDI figures for 2018, from EU direct investment (46.2 %).

Also following data from different countries has been taken in to account:

**Table 9**: Registered business in Georgia from EU (2019)

| Registered business entities from EU | | |
|---|---|---|
| **Country** | **Organizations** | **%** |
| **EU counties** | 5383 | 100% |
| Germany | 811 | 15% |
| United Kingdom | 807 | 15% |
| Netherlands | 461 | 9% |
| Italy | 325 | 6% |
| France | 305 | 6% |
| Poland | 293 | 5% |
| Latvia | 268 | 5% |
| Cyprus | 258 | 5% |
| Greece | 232 | 4% |
| Lithuania (Lietuva) | 225 | 4% |
| Spain | 216 | 4% |
| Austria | 167 | 3% |
| Czech Republic | 129 | 2% |
| Bulgaria | 113 | 2% |
| Estonia | 104 | 2% |
| Others | 669 | 12% |

Source: Own processing based on data from Geostat, 2020

Germany (15 %) and the United Kingdom (15 %) are the countries with the largest share of registered organizations, followed by the Netherlands (9 %). As we can see, the United Kingdom and the Netherlands are also in the top three in terms of direct investment. The difference with FDI is Germany's discovery of a leading position.

### 4.2.1 Statistical overview of structural Foreign direct investments from EU to Georgia

To characterize FDI from EU countries and assess statistical trends, we use the data from the National Statistics Office from 1997 to 2018 measuring with Dynamic (time series) analysis indicators (Iosebashvili, 2010).

According to equation 1 (pp.3), the average level of FDI in Georgia is 368,871 thousand USD.

**The Absolute Change** is the difference between the next and previous levels. If one of the levels is taken as the previous level, then there is a Basic absolute change, and if each level is subtracted from its adjacent previous level, also we have a Relative absolute change.

Relative absolute change (equation 2, pp 3.) shows how each subsequent level of dynamics increases/decreases relative to the previous level, while Basic absolute change (equation 3, pp 3.) shows how each subsequent level of dynamics increases/decreases relative to the first level. Based on the definitions above, the calculation of the absolute change for EU direct investment is way easier:

**Table 10**: Absolute Change and Relative Change (1997 – 2018)

| Year | FDI from EU counties | Absolute change | Relative change |
|---|---|---|---|
| 1997 | 45,794 | | |
| 1998 | 49,540 | 3,747 | 3,747 |
| 1999 | 8,561 | (40,979) | (37,232) |
| 2000 | 41,551 | 32,989 | (4,243) |
| 2001 | 71,930 | 30,379 | 26,136 |
| 2002 | 55,189 | (16,741) | 9,395 |
| 2003 | 92,906 | 37,717 | 47,112 |
| 2004 | 192,326 | 99,420 | 146,532 |
| 2005 | 243,846 | 51,520 | 198,052 |
| 2006 | 468,313 | 224,467 | 422,519 |
| 2007 | 1,038,201 | 569,888 | 992,407 |
| 2008 | 483,739 | (554,462) | 437,945 |
| 2009 | 228,988 | (254,751) | 183,194 |
| 2010 | 251,870 | 22,882 | 206,076 |
| 2011 | 492,378 | 240,508 | 446,584 |
| 2012 | 465,597 | (26,781) | 419,803 |
| 2013 | 425,100 | (40,497) | 379,306 |
| 2014 | 835,965 | 410,865 | 790,171 |
| 2015 | 816,315 | (19,650) | 770,521 |
| 2016 | 412,629 | (403,686) | 366,835 |
| 2017 | 804,316 | 391,687 | 758,522 |
| 2018 | 590,111 | (214,204) | 544,317 |

Source: Own processing based on data from Geostat, 2020

The results show that the highest absolute increase in the relative average is in 2007 (558 million USD). Compared to 2006, there was a very large "jump" caused by the rapid

growth of the economy, with the highest (negative) decline occurring in 2008 (-548 million USD).

The rate has also been volatile in recent years. In 2017, it was quite high at 366 million USD growth has been recorded, but data for 2018 show that direct investment from EU countries has decreased by 197 million USD compared to the previous year.

Based on equation 4, (pp 3.) **Average Absolute Change** shows how much the analytical variable increased (decreased) on average over a given period. In our case, the average absolute increase is 24,927 i.e. From 1997 – 2018, FDI from EU countries increased by an average of 24,927 thousand USD. If I compare these figures with the analogous figure of FDI from the CIS countries (12,933 thousand USD) it can be said that it is high, but if compared to the analogous figure for total foreign direct investment (55,849 thousand USD) it gets obvious that it is not very high then Average Absolute Increase. The main reason for this difference is Turkey, which is not a member of any of the above-mentioned unions (is a candidate for EU membership) and at the same time one of the largest investors in Georgia.

Very important is the **Growth Rate**, which shows how many times the level of a dynamic row increases compared to any previous level. Similarly to absolute change, growth rates can be calculated in two ways, basic and relative. If the previous level is considered to be one of the invariants, then there is an Absolute growth rate. On the contrary, if it changes and comparison occurs with nearest levels, finally we get Relative growth rate (Gelashvili, 2018).

**Table 11**: Absolute Growth Rate and Relative Growth Rate **K** (1997 – 2018)

| year | K % (absolute change) | K % (relative change) |
|---|---|---|
| 1997 | - | - |
| 1998 | 108.2 | 108.2 |
| 1999 | 17.3 | 18.7 |
| 2000 | 485.3 | 90.7 |
| 2001 | 173.1 | 157.1 |
| 2002 | 76.7 | 120.5 |
| 2003 | 168.3 | 202.9 |
| 2004 | 207.0 | 420.0 |
| 2005 | 126.8 | 532.5 |
| 2006 | 192.1 | 1022.7 |
| 2007 | 221.7 | 2267.1 |
| 2008 | 46.6 | 1056.3 |
| 2009 | 47.3 | 500.0 |
| 2010 | 110.0 | 550.0 |
| 2011 | 195.5 | 1075.2 |
| 2012 | 94.6 | 1016.7 |
| 2013 | 91.3 | 928.3 |
| 2014 | 196.7 | 1825.5 |
| 2015 | 97.6 | 1782.6 |
| 2016 | 50.5 | 901.1 |
| 2017 | 194.9 | 1756.4 |
| 2018 | 73.4 | 1288.6 |

Source: Own processing based on data from Geostat, 2020

Absolute growth rate (equation 5, 3 pp.) was 485.3 % in 2000 and 17.3% in 1999. This is due to the fact that at the initial stage of independence, as well as overall FDI, and in particular, FDI from the EU countries was at a very low rate, respectively, growth and decline were very much influenced by the increase/decrease rate.

In case of Relative growth rate, (equation 6, 3 pp.) the figure for 1999 was dropped and in the years that followed it was the extremum.

With the help of Growth rates, based on equations 7 and 6 (3 pp.) it is easy to calculate **The Average Annual Growth Rate for A Relative Growth Rate** with the result of:

$$K=124{,}40\ \%$$

Similarly, as the average absolute increase, compare this to the CIS and total FDI. The average annual growth rate for total foreign direct investment equals 130.1 %, while for

CIS it is 126.4 %. Obviously, both indicators are higher than the direct investment rate of EU countries.

The **Rate Of Increase** is obtained by the ratio of absolute increase to the previous corresponding level. Depending on which level is taken for comparison, there is an increasing rate of Absolute or Relative growth. Otherwise, it will be obtained in case of subtraction of the growth rate to 1 or 100 %.

Calculation of the growth rates for Absolute growth increasing rate and Relative growth increasing rate (equations 9, 10, pp.3):

**Table 12**: Absolute Change and Relative Change **T** (1997 – 2018)

| year | T% (absolute change) | T% (relative change) |
|---|---|---|
| 1997 | - | - |
| 1998 | 8.2 | 8.2 |
| 1999 | -82.7 | -81.3 |
| 2000 | 385.3 | -9.3 |
| 2001 | 73.1 | 57.1 |
| 2002 | -23.3 | 20.5 |
| 2003 | 68.3 | 102.9 |
| 2004 | 107.0 | 320.0 |
| 2005 | 26.8 | 432.5 |
| 2006 | 92.1 | 922.7 |
| 2007 | 121.7 | 2167.1 |
| 2008 | -53.4 | 956.3 |
| 2009 | -52.7 | 400.0 |
| 2010 | 10.0 | 450.0 |
| 2011 | 95.5 | 975.2 |
| 2012 | -5.4 | 916.7 |
| 2013 | -8.7 | 828.3 |
| 2014 | 96.7 | 1725.5 |
| 2015 | -2.4 | 1682.6 |
| 2016 | -49.5 | 801.1 |
| 2017 | 94.9 | 1656.4 |
| 2018 | -26.6 | 1188.6 |

Source: Own processing based on data from Geostat, 2020

**Average Annual Decrease/Increase Rate** (equation 11, pp 3.) shows a decrease/increase in average indicator over a given period and is calculated based on the average annual growth rate:

$$T = K - 1 = 1{,}24 - 1 = 0{,}24 = 24\ \%$$

After calculating the Average annual decrease/increase rate, we can precisely say that during the years 1997 – 2018, there were specific sections sharp growth and drastic declines caused by different internal and external reasons. The rate of foreign direct investment (FDI) from the European Union is changing at a fast rate. This difference may be explained by the changing nature of investment flows generally. On average, during this period, the turnover of foreign direct investments grew by 24 % annually which can be considered as a very positive trend.

# 5. Discussion

Globalization gives us lots of possibilities to compare various economic indicators with different angles.

According to literature review of the thesis, different authors used different methods and points of views to define what role foreign direct investment plays in economic society's life but over time, the main question stays the same: how economic growth is achieved and pace of life improves through attracting investments, more specifically, investing in sensitive economies such as developing or transition economy countries? Various sources in the paper, the link between economic growth and FDI is mixed.

Several empirical studies confirm the positive and productive impact of FDI on economic growth (Johnson, 2006) For example, Cernat, Vranceanu, and Blomstrom argued that FDI has a positive effect on economic growth in a given environment.

However, there were left-wingers believing that the impact of FDI on economic growth is negative or negligible. For example, in the Venezuelan example of 1979 – 1989 failed to show a uniquely positive impact of foreign investment on local companies (Harrison & Brian J, 1999). Also, in the Moroccan example, Heidi and Harrison (1993) investigated the link between FDI and economic growth and found a non-correlated dependence.

There is a very thought-provoking paper by Chowdhury & George (2005), arguing that there is a bilateral relationship between FDI and economic growth on the example of Thailand and Malaysia fluctuating on the changes over flexible tax rated and government expenditures.

Finally, through the listed channels it can be emphasized that, according to the main findings of the research, the relationship between FDI and economic growth is inconsistent. FDI has a positive effect on economic growth only if there are relevant preconditions. Foreign investment cannot be materialized unless the recipient country has such fundamental and adequate prerequisites as: private and public infrastructure, an adequate human capital environment and a legal framework; political, economic and territorial stability.

On the contrary, the analysis of the paper clearly shows that foreign direct investment does not play a huge role in the establishment of Georgia's GDP as much as government investments play a key role. The country still contributes the most to GDP growth, and there is essentially no other alternative. Consequently, it is legitimate to argue that the government should not reduce infrastructure and social spending, as these costs are the main engine of

the economy. It is very essential to improve the qualifications of the workforce. One of the positive factors of investing in Georgia is cheap labour, but conversely, it means low qualifications and low productivity, which in itself may not be attractive to investors. The qualification of the workforce will promote the interest of foreign investors in the fields of innovative and modern technologies. It definitely applies to the theory of Rebelo in 1991 proving that FDI increases technological innovation in the local economy, improves management practices, and so on. New ideas, management processes, and diffusion of technologies have a positive impact on the overall productivity, which in turn increases overall output. Foreign investment through technology transfer can increase productivity, both domestically and by external factors. It is worth to mention Bris paper saying that the main purpose of foreign direct investment in foreign markets is to avoid import barriers, discriminatory government policies and high transport costs. (Bris, 2013)

Overall, in the long run, the analysis might have different direction but new insights with new suggestions and different analysis tools will always be subject to criticism and constant improvement. Moreover, any shortcomings in this research may provide a starting point for other deeper studies with in-depth analysis.

# 6. Conclusion

Foreign direct investment can bring many benefits to the country. Positive effects include its impact on the economic growth, economic productivity growth and the cost-effective use of resources. Foreign investment in the country increases the volume of capital, which in-return promotes output growth. It also promotes the integration of Georgia's economy into the global economy by facilitating the growth of foreign trade.

Foreign direct investment increases employment and is important for the development of human capital. Due to high productivity, this type of employment often results in higher wages and better working conditions.

Due to the underdeveloped financial market in Georgia, the scarcity of local business financing sources is a significant driver of economic development. Against this background, the importance of foreign direct investment is increasing.

As can be seen, the foreign economic relations between Georgia and the EU are constantly deepening. This includes direct investments, as in the statistical analysis we have seen that in the period from 1997 – 2018, the direct investments from the EU countries were growing on average by 24 % annually, which is quite high. According to the World Bank's Doing Business 2019 report, Georgia ranks sixth among 190 countries in doing business.

Georgia has improved its position by seven places compared to the previous rankings, which will certainly help launch economic activity in Georgia – including for non-residents. The signing of the Association Agreement between the European Union and Georgia, which has led to the expansion of distribution channels and one of the largest markets in the world for Georgian-made products, has increased interest in the Georgian economy.

A review of EU direct investments by countries and sectors of the economy has shown that the figure is not sufficiently diversified. The share of several major partner countries is large, which relates to both the state of the FDI and the overall economy of several countries and investment sentiment.

Direct investment from EU countries by sectors of the economy is also less diversified. Sector analysis revealed that the share of the financial sector is large, which does not belong to the real sector of the economy, and it can also be noted that the role of the financial sector is particularly large in the sectoral structure of the largest investor countries, such as the FDI in the United Kingdom and the Netherlands.

All things considered, reinvestment share in EU direct investments by components is sharply increased (71 %), which is the result of tax code changes, in particular, by running the Estonian model. On the other hand, while other economic indicators decreased, it might become the cause of restraining the decline in foreign direct investment. Reducing the share of equity capital from 36 % to 22 % in the structure of direct investment from EU countries is a disadvantageous trend because long-term investments are made in equity.

Regardless of the correlation regression showed that dependency between FDI and GDP growth is quite positive (76 %), There are remaining several factors that have an impact on the economic growth of Georgia. One of the most important of these is the existence of political stability internally and externally, and a sustainable economic environment.

As part of economic policy, it's important to improve the qualifications of the workforce. One of the positive factors of investing in Georgia is cheap labour, but on the other hand, it means low qualifications and low productivity, which in itself may not be attractive for investors. The qualification of the workforce will promote the interest of foreign investors in the fields of innovative and modern technologies.

As shown, other than foreign direct investment, economic stability is highly related with economic growth. On the contrary, it's hard to maintain economic welfare without taking the political environment into account. Political tensions and territorial disputes such as the August war against Russia, 2008, which caused the collapse of the Georgian economy for at least 2 years can result in fatal consequences for the country's sustainable development.

In order to attract foreign direct investment, it is necessary to establish effective partnerships with strategically important countries. This will also achieve economic stability in the country, as long-term investments, involving long-term participation in the capital of long-term plans and having no a sense of instability. Therefore, Georgia should be engaged in European partnerships to maintain political security and economic consistency.

Ultimately, studying trends and statistical analysis of foreign direct investment in Georgia is becoming more and more important. Its importance is growing not only in terms of investment in the country and for evaluating its attractiveness, prospective investment sectors and for defining strategic partners, but also for optimal economics and to develop an investment policy. The political decisions and the logical continuation of the implementation

of the relevant measures would increase foreign Investments in the country, which will create more jobs, will increase local production, henceforth more product will be exported. As a result, it will cause economic growth, which will naturally impact the well-being of the population and contributes in raising of the awareness about Georgia globally.

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