



ECONOMICAL BLOCKS OF ESTABLISHING FAVORABLE INVESTMENT ENVIRONMENT

Resume

Effective economical policy of the country shall prevent multiple obstacles of establishing favorable investment environment and promote its actualization. As there are quite many negative phenomenon of the investment environment and due to their influence upon each other, the investment policy of the country shall be multifaceted and of complex internal structure. Each facet of the Policy is the block of activities, which are directed towards solution of private tasks of forming favorable investment climate.

Investment environment reflects status of economical conditions, giving rise to the profitability of investments, i.e. their level of attractiveness. The government creates additional stimuli to the improvement of investment environment. Activities of forming favorable investment environment are built based on the functional grounds. We separate four blocks:

1. Identification of potential financial resources of the investment process;
2. Creation of macro-economical environment, supporting transformation of the said investments into the real investment demand;
3. State stimulation of the subjects of investment process and thus creation of additional investment demand;
4. Creation of conditions for establishing subjects having investment abilities.

In this article is discussed the blocks of the process of establishing favorable investment environment in details.

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Let us discuss the blocks of the process of establishing favorable investment environment in details:

1. The first Block is analytical. Its task is to identify financial opportunities, the resources of investment process. Under the conditions of favorable investment climate, these potential resources may create investment demand.

Resources of investment process are separated into the internal and external resources. External resources, in their turn, may consist of the investment placed by foreign companies into the economy of the country and different financial assistance of other countries and funds, which are attracted by the government for realization of their purposeful investment programs. Though, for today, external resources of investments remain at the extremely low level, as, on the one hand, Georgian investment environment is not favorable to the foreign investments. On the other hand, state budget of the Country is in critical need of attracting resources for repayment of the state debt, financing social and other programs and, according to the practice, the country is in fact left without resources for financing state investment programs.

Waiting for the rapid improvement of situation is unreal, as the process of accumulation is being gradually widened; it cannot be separated from the growth of



incomes of the public. The level of incomes is limited with low effectiveness of production, which has not been able to be increased during recent years. Under such conditions, special importance is gained by activation of already accumulated saving for the interests of national industry.

Low level of accumulation prevents the opportunity for serious rise of investment process in the Country. Though, it is not disappeared, as part of industrial enterprises was able to adopt with the market conditions. Many of them could even find export signs of distributing their products. Import-consuming fields are getting on their feet as well.

Though investment demand is not established only at the expense of net income. It is known that support of real production is provided at the expense of depreciation charges. They allow renovation of production. These charges are becoming sources of financing new technique in the production, as devices purchased with them is much better in characteristic than the old one. Depreciation charges are considered to be the main resources of the country today, determining more than half of the investment demand. Though, they use this source of financing investment inappropriately; namely, for filling turnover sources, determining more than half of the investment demand.

2. Another block of forming favorable investment environment includes directions of economical policy for creation such favorable macro economical environment, which provides profitability of investments implemented in the field of production.

Such directions, in the first place, shall include efforts of the government to transfer savings into investments.

In order to make potential investment process real, financial stability is necessary. It considers reduction of the level of current inflation, preventing investment process and elimination of the reasons, which may give rise to the growth of inflation wave in the future. It includes growth of the deficit of budget, state debt and the deficit of tax balance. These are interconnected processes, which give rise to the balances decomposition of commodity and financial markets and falling of the rate of national currency, which will be following with the higher inflation in the future.

Inflation transfers the capital from production filed to the speculative business and it is the characteristic sign of negative investment environment of the country. That is why fighting current inflation shall be turned into the stabilizing, and thus – investment policy of the government. We shall maintain inflation to the degree not preventing investment flow in production. According to the global experience, its level shall not be more

than 40% a year.

Difficulty of fighting inflation is connected by many analysts to the budgetary crisis and state debt. Repayment of loans and interests accrued to them reduces potential of society and shortens its investment resources. Repayment of foreign debt by the state reduces exchange rate of national currency, making new spiral of inflation in the country. That is why, regulation of industrial relations related with the foreign debts of the country is closely related with the problem of establishing favorable investment climate.

Large domestic debt of the country does not condition outflow of resources from the country and it does not seem to affect investment process. However, it is evident that access profitability of state securities market left other markets without financial resources and thus prevented investments. When the state is unable to repay own debts, the state debenture market loses the privileges of making high incomes in particular way. That is why, after some time transfer of free financial resources from state debenture market to the real sector of economy shall be considered.

Under present conditions, growth of foreign debt formed passive tax balance. Ineffective utilization of foreign debts gave rise to the temporary refusal on its repayment. This lowered existed demand of national currency and conditioned its devaluation, which was followed by inflation. The financial crisis confirmed the conclusion of economical theory regarding the fact that establishment of favorable investment climate shall be accompanied by the efforts of the government for balancing parts of incomes and outcomes of the tax balance of the country.

Under Georgian conditions, when the country is under economical crisis for a long period of time, the enterprises appeared themselves under difficult economical environment. The crisis gave rise to the deduction of demand and, respectively, incomes of enterprises. The enterprises were hard to withdraw their accounts, thus giving rise to the growth of nonpayment. Their growing will be definitely resulted in the collapse, as sending of production for debt without having hope for repayment of the debt, will be stopped at particular stage. Under such conditions, the issue of investment will not arise, as under such circumstances, the enterprises are unable to provide even simple reproduction. Based on this, the government is required to conduct activities for elimination of non-payment. This problem shall be solved by activation of bankruptcy mechanisms and regulation of the bill market. It is also indisputable that the problem of the default shall be softened by economical rise.

The activities, providing attraction of new capitals and supporting creation of competitive environment may play important role in establishment of favorable macro



economical environment for the investments. We speak about antimonopoly policy and the one limiting shadow sector of the economy. As monopolies, so – shadow sector limit opportunities of investment process, as they prevent inflow of capital into the national economy, creating barriers to the investments, which could be brought by new capital.

We have named directions of establishing favorable investment environment, such as transformation of saving into investment, reverse-action of current inflation and its elimination for this reason, such as: budgetary and tax balance deficit, defaults and other factors. They prevent normal functioning of market system (it also includes shadow economy and incompleteness of formation of legal field for industrial and investment processes). Change of industrial life with the said aspects shall create favorable macro economical conditions to the activation of investment process. Besides this, the government, in the form of central bank, shall monitor the level of interest rates of banks and support the trend of their deduction on permanent basis. Deduction of interest rates of the bank shall turn into the most important directions of activities, providing macro economical conditions of profitability of investments in the field of production.

3. In the third block of the activities, which are directed towards formation of favorable investment environment, we consider state motivation of the subjects of investment process and, relatively, formation of additional investment demand.

In the arsenal of active investment policy of the country, which influences upon the interests of potential investors, there are numbers of lines, regulating the process of capital-formation with every manufacturer. Such assistance of investors includes:

a) Raising the role of nontaxable part of depreciation charges (as created products). We mean rising of depreciation norm and wider usage of accelerated depreciation regime. Such activity works similar to the alleviation of the tax burden, though it is in closer relation with the reproduction of main capital;

b) Tax relieves given to the manufacturers may also act in the same direction, in the part, where their profit moves to the investments;

c) USA tax relieves are received by the enterprises investing in the professional training of their employees. They appeal such practice from 1970. This speaks of the complex nature of the investment policy of USA, as mastering new technologies is impossible without respective knowledge and skills. It seems that together with the growth of state incomes, development of the said experience will be necessary with us.

Complexity of tax relieves on profit – as the method of investment motivation in the country – is related

with the sustainable trend of hiding incomes by the manufacturer and, relatively, and the need of using tax relieves becomes unnecessary.

As investment relieves on taxation of profit and investment motivation by means of regulation of the depreciation regime is uniplanar levers, under Georgian conditions, it is more actual to pay attention to the mood of hope and thus strengthen demands of effectiveness of the investment resources.

Implementation of financial assistance may be provided within the bounds of the state resources, which are quite limited. This makes us determine this issue more clearly – who shall be supported in the first place with the extremely limited funds. Confidentially, purposeful preference activities shall be implemented for the investors with the private investments, as the priority of more effective investments.

Every strong manufacturer shall be stimulated from the state resources. This principle of supporting private investors shall be implemented for fulfillment of highly effective investment projects on the bases of the held competitions.

Herewith, allocation of strong manufacturers among private investors is the direction of economical policy of the country, which is characterized with the care on formation of new and competitive industrial structure.

Direct assistance of manufacturers may be expressed not only by using state cash resources, but also with the fact that the government undertakes investment risks in the share of private investors, using lease operations for foreign and local capital expenditures.

Governmental grants shall act in the same direction in terms of realization of highly effective investment projects passing the tender. The system of warranties for private investors is new direction of stimulation of development of innovations in our national industry.

Provision of entering new technologies into the production, may be provided by the government through assistance of the leasing operations. In such case, it is possible to accept new devices and Know-How by avoiding credit and transferring these expenditure to the self-cost. This, in its turn, allows opportunity for reduction of taxes, as self-cost is not taxable. Herewith, leasing is not only direct distribution of resources, but also the stimuli for using new technologies.

Extending leasing relations confirms effectiveness of activities of stimulation of the resources used by the government on investments, i.e. profitability of stimulation of growth of effectiveness of capital-investment. This is one of the factors making investments attractive.

It shall be taken into account that using the block of stimulation of investments shall not be only lever of



economical policy of investment. It may assist accumulation of resources in the enterprises, but in case of unfavorable investment climate, these resources may not enrich capital expenditures. That is why, stimulation of the entrepreneurs shall be provided not before formation of the investment climate, but as the part of forming the said climate.

We have already noted the necessity of conforming stimulating investment policy to the structural transformation. This conformity considers strong entrepreneurial assistance, which has the ability of adaptation with the changeable demand, being able to offer jobs and cooperation to other subjects of the market. Strong manufacturers are able to create healthy zone of increasing demands and profitability. Its extension shall influence positively upon economical development. This conclusion, made earlier by the institutionalists of the 70s of last century, gradually becomes evident to our community. Utilization of this demand requires small but important specification. Assistance of manufacturers, even if they are strong, shall be implemented in the size their products are demanded and perspective for. In such case, the assistance will strengthen advantageous influence of strong manufacturer upon positive fluctuations, taking place in the economy. Failure to follow this condition, will give rise to the volume of products, which are not demanded, and it will give rise to the growth of incomes without covering with mass of the goods, i.e. it fuels inflation processes.

Real sector of the economy is famous to be in stagnation and it is unable to express internal demand on the products of the first subdivision. That is why, state support shall be used by the enterprises, products of which may be required with real solvent demands. Today, this is production of consumer market and the products, which are oriented towards export production.

Understanding necessity of assistance of production in the fields having rapid turnover of capital, and providing accumulation of commodities of consumer market, speaks for the changing of stereotype of economical understanding, which were firmly related with the development of the field of the first division during Soviet period.

Supporting consumer market is of non-inflation nature. It is directed towards manufacturing of goods of real demand and it supports growth of profitability in the society, as well as the process of saving, which is in the future needed for the investment. The author of German Economic Miracle Ludwig Erhard established post war investment climate of Germany by stimulating consumer market. Today, supporting the fields manufacturing products for consumer market is considered to be the promising direction of the investment policy of

the country.

Reduction of national currency rate makes the import expensive, limiting its volume and getting rid of the part of competitors of local manufacturers of goods. This creates favorable situation at the consumer sector for extension of production, which may be continued for long period of time. Under such conditions, assistance of consumer sector of economy may have long-term and desired influence upon formation of investment climate.

Governmental assistance of the entrepreneurs operating in the consumer sector of the economy:

- improves non-inflation development of economy at the expense of increasing foods of public consuming;
- provides growth of the sector having small term of redemption, which makes accumulation of financial resources needed for investment easier;
- provides growth of GDP at the expense of increasing net export and national production.

4. Except the said three blocks of investment policy, providing establishment of macro economical conditions of the investment process, today fourth block is also of special actuality to Georgia. It includes activities for creation of conditions needed for formation of subjects having ability of investment.

This direction of investment policy exists in every county of market economy, as the government assisting economical growth tries to form line of effective manufacturers. Such manufactures, in the first place, are formed by the market and move them to the avant-garde positions, by means of natural selection of competition fight. Though, evolution of market subjects is a long-term process. Modern states of market economy try to accelerate this process and actively assist investment process. Example to this is privatization of the public property, which is aimed at formation of the subjects of market having ability for development of own enterprises. Under Georgian conditions, purpose of privatization was assistance of formation of these market structures, to allow them be adapted with the market environment independently. They considered that such adaptation would give rise to the demand on the investment activities. Though, such theoretical ideas was not confirmed by the industrial practice at that time, as changing industrial status of enterprise could not rapidly change internal processes of new structure. Besides this, as we have said above, mentalities of the administration and collective of privatized enterprises, did not become marketable at once. It was evidently opposing new demands of adaptation, thus slowing down opportunities of investment process.

Notwithstanding this, data reflecting outcomes of privatization process speak of higher efficiency of the privatized industrial enterprises. There is the trend: "deep-



ly privatized enterprises”, where the share of assets owned by government is fewer, it is more effective than “average privatized enterprises”, and both these groups are more effective than the enterprises, which were left under governmental ownership. This means that the privatized enterprises, together with accumulation of financial resources, will be able to be included in the investment process earlier than the public enterprises.

Another lever of governmental assistance of the capital organization having the ability of investment is differentiation of policy against small and large businesses. Large business in the countries with the developed market economy are supported in cases if it is oriented towards production of strategic products or such science-consuming production, which provides best conditions for growth, as well as success of the country at the global market. Massive assistance of large business, usually, is not accepted, as they consider the market to be able to improve positions of those, who are able to use effective management together with the financial resources. Moreover, after the Second World War, state regulation of economy was directed towards strengthening of control of the process of economical power concentration, i.e. restriction of monopolistic production.

In the countries of developed economy, relation with the large business is different in particular way. This is provided lack of financial resources in the country and the fact that here lack of manufacturers is felt more distinctly, than their access amount. Due to this, the government is interested in allowing the enterprises holding resources to be widened, modernized, and to provide growth of distribution and widening investment process. Assistance of large business and, particularly, financial and industrial groups became reason for the miracle that took place in the South Korea. These groups are actively supported by the government in Russia. Their use many benefits, including management of the public shares in the part, where the government acted as the financial-industrial group. Multiple benefits and warranties granted to the said groups by the government, in fact, gave rise to their working with state resources and are not seeking for the independent resources for rising effectiveness of production. Today, the Groups are at the stage of regrouping, which is aimed at the provision of sustainability under new market conditions.

In the state regulation of investment process of the countries with the developed market economy, new direction is identified during last years; it is assistance of middle and small business. Reason to this is that small and middle business can strengthen competitive positions of domestic market by increasing number of sellers and regulating functioning of labor market with additional employment. In the western countries, small business is actively involved into the innovative activities, playing the

role of guide in the scientific-technical domain.

They assist small entrepreneurs with special governmental programs in the Western Countries. As a rule, it is expressed in tax holiday (at startup period), direct allowances and preferential credits. On these general moments of assisting small business in each country, the issues are accumulated, solution of which is considered to be the most actual. For example, in France assistance of such structures are related with the problems of rising qualification of the managing staff of the company. In Japan – the problems of rising qualification of managing staff of small companies. Small business in Japan receives benefits only in case if it works in the “points of economical growth”. As economy of Japan is being developed dynamically and it is changing industrial structure, priority directions of business is being changed as well. Due to this, priorities of directions of development of small business are not determined for more than the period of one year.

Governmental support of small business is provided in Georgia as well, though, this doesn't give rise to the rapid transfer of the resources of enterprises to the investment process of real sector of economy. Small business does not occupy leading positions in the field of scientific-technical progress. In this regard, small enterprises of Georgia are not similar to the Western ones. Small business in the field of production is concentrated at such fields of capital-consuming, as trading, food industry, hotel industry and etc.

Under our conditions, assistance of small companies of entrepreneurs cannot give investment effect within short period of time. This effect may be identified in long-term perspective, as development of small entrepreneurship gradually gives rise to the growth of accumulation of capital and savings of population. It is undeniable that possible growth of financial resources in the country shall be considered to be the precondition to the investment process.

Another market subject, playing the role of investor, is foreign capital imported into the economy of the country. Such investments are quite profitable for Georgia. Attraction of local investments at the expense of using bank credit gives lower effect, as it requires large expenses. Besides this, foreign investor brings new technological culture and that of management. This is another factor of attracting foreign investments.

Subject to the outcomes of 2012, economical perspective of Georgia and entire region conformed to the process of slow leaving of global financial crisis. In 2012, macroeconomic changes were positive and inflation was restricted in Georgia. However, at the same time, economical growth was slowed those times and investments were decreased due to post-election uncertainty.

In 2013, foreign investments of 914 million US Dollars were placed in Georgia. This was higher for



0.3% of the data of 2012. The largest investors were the Netherlands (180 million US Dollars) with almost fifth share of entire investments; second was represented with 145 millions, and the third – China – with 198 million US Dollars. In 2013, the largest direct investment was 198 million US Dollars, i.e. 22% of total volume – places into the energy sector. Second place is occupied by the financial sector with 170 million US Dollars and the third place – transport and communication (138 million US Dollars).

It shall be noted that supremacy of law and protection of private ownership were declared to be priorities in Georgia; the Country could maintain firm position in the international ratings and due to the geographical location and preferential system of relation with different countries, Georgia offered wide market to investors.

Total value of direct foreign investments in 2014 made 1272 million US Dollars, which was higher than the index of 2013 for 39 percents. The largest investor countries according to the implemented private foreign investments in Georgia were Netherlands, Azerbaijan and China. Their share of total private foreign investments made 65 percents.

The volume of foreign investments for 2015 kept increasing, as subject to the governmental plan, stimulation of export and attraction of foreign investments were considered, as well as assistance of development of entrepreneurs, and acceleration of important reforms. We would underline the energy sector, where there is the expectation for more than billion US Dollars and this expectation is supported with the real facts.

So-called foreign investment credits are extremely profitable, especially, when the credit and accrued interest are covered on the basis of distributing product, which are outcomes of the invested funds.

Attraction of foreign investments shall be provided wider in the fields, which satisfy socially important de-

mands, as well as in the technically retarded fields.

Mining industrial fields with the ability of export are required important capital investments. They may be attracted at the expense of foreign investments.

Investments placed into the main capital are the worthiest out of the entire foreign investments. However, their scales are relatively small with us. Distribution of private foreign investments in the section of economical sector according to the year 2014, is distributed in the following way:

Transport and communication	– 27%
Construction sector	– 23%
Manufacturing industry	– 13%
Energy	– 8%
Real estate	– 7%
Financial sector	– 6%
Mining industry	– 4%
Other segments	– 12%

Reason to this is insufficient capacity of investment market and high investment risks of production.

Devaluation of national currency strengthens distrust of foreign investors in Georgian market. Herewith, it complicates operation of joint enterprises, as share of local capital in such structures requires more material assets than in the last year, saying nothing about the fact that manufacturing of products accounted in US Dollars becomes much cheaper and of much lower profitable to the foreign investors. As for rising prices expressed in national currency, and their bringing to new rate of US Dollars, this is not always possible due to the restrictions of the demand. Herewith, investment environment becomes less favorable to the foreign and local capitals.

We have characterized directions of economical policy, which are related with assistance of formation of the market subjects having ability to make investment. These directions may be represented in the following Table:

Identification of potential financial resources of investment process			
1. Internal resources		2. External resources	
a) Investments of individuals	b) Investments of enterprises	a) Investments of foreign companies	b) Foreign financial assistance



Formation of macroeconomic environment supporting transformation of the demanded real investment resources:

a) Supporting mobilization of public saving and their transformation into the investments	b) Decreasing the level of inflation	c) Decreasing budgetary deficit and state debt	d) Decreasing deficit of taxation balance and preventing decreasing of the rate of national currency	e) Fighting non-payments	f) Formation of competitive environment and decreasing share of shadow sector of economy
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Using stimulation of activation of investment process:

a) Participation of government in the investment projects	b) Undertaking part of commercial risks of investments by the government	c) Transferring part of the tax burden from the field of production to the field of turnover	d) Supporting development of leasing operations	e) Creation of legislative field for the entrepreneurs and investment processes	f) Using effective depreciation policy	g) Decreasing level interest of banks
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Creation of the conditions for establishment of market subjects having ability for effective investments:

a) Privatization, as the method of creating subjects of investment	b) Development of financial-industrial groups	c) Attraction of foreign investments
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The blocks of the policy of establishing favorable investment environment, offered by us, reflect different aspects of the conditions, giving rise to the activation of the investment process.



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რეზიუმე

საინვესტიციო გარემო იმ ეკონომიკური პირობების მდგომარეობას ასახავს, რომელიც ინვესტიციების დაბანდების მომგებიანობის ანუ მიმზიდველობის დონეს განაპირობებს. სახელმწიფო დამატებით სტიმულებს უქმნის საინვესტიციო გარემოს გაუმჯობესებას. ხელსაყრელი საინვესტიციო გარემოს ფორმირების ღონისძიებებს ფუნქციური ნიშნით აგებენ. ჩვენ ოთხ ბლოკს გამოვყოფთ:

1. საინვესტიციო პროცესის პოტენციური ფინანსური რესურსების გამოვლენა;
 2. იმ მაკროეკონომიკური გარემოს შექმნა, რომელიც ხელს უწყობს ამ რესურსების ტრანსფორმირებას რეალურ საინვესტიციო მოთხოვნად;
 3. საინვესტიციო პროცესის სუბიექტების სახელმწიფოებრივი სტიმულირება და ამით დამატებითი საინვესტიციო მოთხოვნის შექმნა;
 4. ინვესტირების უნარის მქონე სუბიექტების ფორმირების პირობების შექმნა;
- ამ სტატიაში დაწვრილებითაა განხილული ხელსაყრელი საინვესტიციო გარემოს ჩამოყალიბების პროცესის ბლოკები.