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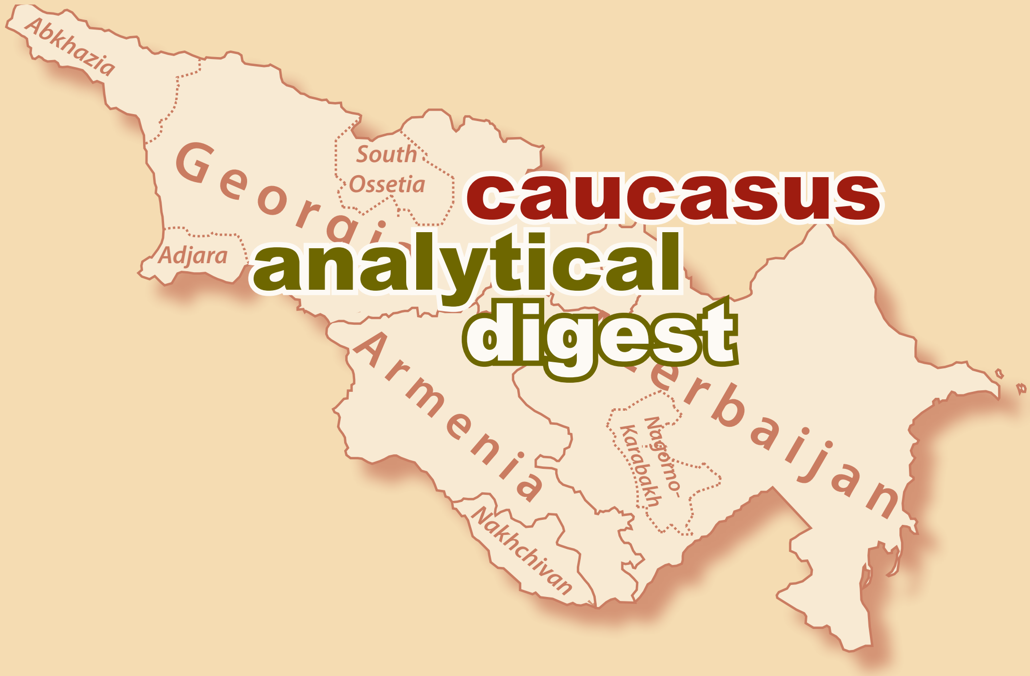

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FOREIGN DIRECT INVESTMENT

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Foreign Direct Investments in Armenia: Opening the Doors is Not Enough to Attract Investment

By Hasmik Hovhanesian and Heghine Manasyan, Yerevan

Abstract:
FDI continues to be an essential contributing factor to Armenia's economic development. The Government of Armenia, having recognized the importance of FDI in the economy, officially announced an "open-door policy" since its independence. While this policy was positively reflected in several global indicators assessed by international organizations, there had not been tangible outcomes related to foreign investments in the economy, a fact explained by several strong objective and subjective factors related to the current global economic situation. These trends will continue in the absence of proactive and aggressive FDI generation and export promotion policies in the country.

An Open Door Policy
The Government of Armenia officially announced its "open door" policy for FDI and foreign trade at the beginning of its independence in 1991. Thus, the government has continuously been working on improving the country's business climate, which has resulted in improved positions in different international ratings.

No limitations are placed on foreigners making investments in Armenia, with the exception of land ownership, though foreign-owned companies registered in Armenia have the right to buy and/or own land. Several free trade zones have been established as an additional tool for foreign investment promotion. In these residents are exempt from VAT and profit tax and benefit from a "one window" principle for government services. Recently, the government re-organized the FDI promotion agency—the Development Foundation of Armenia (former Armenian Development Agency)—to be better equipped technically and professionally to generate investments and promote exports. By law, foreign investments in Armenia cannot be nationalized or confiscated except to serve national interests and must be accompanied by full compensation at current market prices.

Membership in the Eurasian Economic Union has, however, brought several uncertainties to Armenia's business environment, leading to negative impacts on domestic and international economic indicators. The situation became even more severe due to Russia's current economic and political situation in the international arena. Armenia's economy is strongly dependent on transfer inflows, imports of energy resources, and exports of consumer products to Russia.

The major disadvantages of Armenia's business environment include corruption, lack of transparency and frequently changing regulatory system, although the government has introduced several reforms and improvements have been made.

After a quarter of a century of independence, it appears therefore that an "open door" policy to attract investment does only half of the job. This article will review some international indicators on the business environment of Armenia. It will then show the necessity of examining in detail what the barriers are to a more consistent and stable investment flow, explaining thereby why Armenia is still dependent on Russia.

International Indicators Measuring Armenia's Business Environment
The three South Caucasus countries have achieved various results on international indicators. (For a list of the ranking used, please see the Recommended Reading section at the end of this article.)

In 2015, Armenia's economic freedom score was 67.1 ranking the country in 52nd place out of 186 countries. Azerbaijan ranked 85th and Georgia ranked 22nd.

The Corruption Perception Index for Armenia in 2015 ranked it 95th among 168 countries. The rank of Azerbaijan was 119 and the rank of Georgia was 48. Corruption is an area that Armenia's government has to continue to improve.

Another measure of the business environment widely used in the international arena is the Doing Business Ranking, which measures business regulations across countries. For 2016 Armenia improved its position from 45th place to 35th out of 189 economies, although Armenia in 2015 became a member of the EEU, the members of which have worse positions.

Investors are looking into risks, too, especially political risks. Armenia and Azerbaijan have disputes related to the Nagorno-Karabakh region, which can easily escalate into a full-scale conflict as no experts see a resolution in the short-run. For example, the political risk assessment made by Delcredere|Ducroire, the Belgian public credit insurer, was pessimistic.

Even though the Global Innovation Index placed Armenia 61st out of 141 countries in 2015, it is the leading innovator for the high tech sector in the region. There is strong interest among foreign companies, currently dominated by the U.S. in Armenia's IT sector, as well as qualitatively high-level investments in this sector. There are several reasons for the competitiveness of this sector in Armenia:

- Armenia was considered to be a "Silicon Valley" during the Soviet era;
- There were developed schools with more than 50 years history for IT specialists;
- And the existence of over 7 million Diaspora all over the world with a major concentration in the USA and Russia.

None of these factors, however, can be attributed to private sector development policies. Rather these strengths are inherited from the Soviet era and from Armenia's history. As the rest of the article will show, Armenia's economic development still very much depends on external factors and especially Russia. Thus, Opening the door is insufficient to attract enough FDI to generate sustainable economic growth.

Armenia's Macro-Economic Indicators

Armenia has a population of 3 million. It does not have large reserves of any natural resources that would impact world market prices. Besides being landlocked, it is blockaded by Turkey and Azerbaijan, with only two access routes to the world market: through Georgia and through Iran.

Since its independence, Armenia has taken serious actions to transform its centrally planned economy into a market-oriented one. As a result, Armenia's economy started to register a double-digit growth rate with a tangible level of FDI. The positive trends in the economy lasted until the global economic crisis in 2008, followed by Russia's economic crisis. After the global crisis, the economy slowly started to recover registering a 2.6 percent growth rate. The economy continues to be strongly dependent on unfavorable external factors, with limited opportunities to implement expanding fiscal tools.

The Armenian economy in 2015 started with positive macroeconomic movements. The GDP growth rate for the first nine months of 2015 was 3.3 percent, which was mainly due to double-digit growth in the agricultural sector at 11.3 percent. For the same period, FDI in Armenia increased by 16.8 percent, followed by a 0.9 percent and 26.6 percent decrease in exports and imports, respectively. Although the economy was registering positive trends at the beginning of 2015, forecasting for the whole year remains pessimistic taking into consideration the situation in the world political arena and in the economy of Russia.

In 2014, GDP increased by 3.5 percent. All major sectors of the economy contributed to growth except the construction sector, which registered a 4.3 percent decrease. The agricultural sector registered a 7.2 percent increase followed by the service sector (7.8 percent), industry (2.7 percent), and trade (1.6 percent) increases.

Armenia joined the WTO in 2003. In 2015, Armenia became a full member of the EEU, thereby backtracking on signing a deep and comprehensive agreement with the EU. In mid-2015, Armenia and the EU announced their readiness to work toward closer economic relations within the context of the EEU.

Armenia's major trade partners continue to be Russia, the EU, the US, Canada, Iran, China, Georgia, and Turkey. Positive trends in Armenia's foreign trade come from increased diversification, while in the near past Armenian exports and imports were dependent on just a few countries.

Overall, the Armenian economy is greatly dependent on external factors due to the high level of remittances, a low level of domestic production compared to imports, and the absence of a solid economy. The economic downturn experienced by Russia means that the net inflow of remittances from this country will decrease (it constituted almost 80 percent of total remittances in 2014, while remittances accounted almost 13 percent of GDP in 2014), which will lead to weak private consumption constraining economic growth. The dramatic reduction in oil prices will inflame the situation even more as Russian consumption will also decrease, while this market constitutes almost 20.3 percent of all exports for Armenia. Russia's problems will have negative impacts on FDI inflow as well, because free access to the Russian market is considered one of the major incentives for making investments in Armenia, while decreased consumption there could mean non-profitability of the investments in Armenia.

Foreign Direct Investment Structure and the Business Environment of Armenia

The level of FDI is a direct reflection of any country's economy. Armenia is not excluded from this rule. Armenia conducts a relatively open-door policy for investment promotion. Currently, there are no restrictions on the volume and type of foreign ownership, access to financial sources, conversion or repatriation of capital and earnings including branch profits, dividends, interest, royalties, or management/technical service fees, wire transfers, and staff recruitment, including the number of foreign employees, according to the laws and regulations of Armenia.

The only limitation is related to land ownership, which means that a foreigner cannot buy and/or own land in Armenia as a physical entity. However, a legal entity registered in Armenia has the right to buy and/or own land. In addition, foreign companies have the same rights as domestic companies. There are also no sector-specific restrictions.

Foreign investments could not be nationalized, confiscated, or expropriated except in cases of natural or state emergency, although in all cases fair and market-oriented compensation would be implemented according to the legislation of Armenia.

Armenia's relatively stable economy is a key factor for FDI promotion, despite the facts of erratic economic growth, inflation and dependency on external factors. This situation can be explained by the strong willingness of Armenia's government to integrate into the world economy, officials' activities improving the business environment, as well as by strong relations with the IMF, which supports Armenia's economic policy.

In 2015, the government reformed the investment generation and exports promotion agency, offering foreign investors a one-stop shop for assistance. The newly reformed agency is called the Development Foundation of Armenia and provides consolidated services for (potential and acting) foreign investors and exporters.

The strongest advantage of the foreign investment environment is the quality/cost relation of the Armenian labor force. Most of the young labor force is trilingual and freely speaks Armenian, Russian, and English. Moreover, the labor force is mostly natural science oriented and the country has developed schools for IT specialists since the Soviet times, which explains why the software development sector constituted more than 3.5 percent of total FDI in Armenia for 2014.

Membership in the EEU is another incentive for foreign investors as "Made in Armenia" products have free access to Russian, Kazakh, Kyrgyz, and Belarusian markets. The Iranian market could also be considered an incentive for foreign investors, especially after the lifting of sanctions on Iran imposed by Western countries. Currently, Armenia's regional strategic partners are Russia and Iran, which is mainly explained by mutual political interests in the region. Armenia needs to create mutually beneficial conditions for the economies of Armenia and Russia and/or Iran to avoid the risk of diminished access to these markets.

Another positive factor that will influence the Armenian economy is the lifting of sanctions on Iran by the US and the EU. Armenian businessmen now have the green light to work in the Iranian market, as do Iranian investors interested in free access to the Russian consumption market.

After the global crisis, the level of FDI in Armenia in 2013 decreased to about a third of its previous level, to $370 million down from $944 million in 2008. The main country investing in Armenia in 2014 was Russia, which sought to control the electricity, gas, steam, and air conditioning supply sector of the economy. In 2013 and 2012, France took the lead in making investments in Armenia. The targeted sector for France was mainly telecommunications with the launch of Orange. Investments from Germany were mainly in the mineral products sector.

In 2015 Swiss investment went to the mining sector, while investments from Luxembourg and Russia went to electricity, gas, steam, and the air conditioning supply sector. Both France and the UK were interested in alcohol production. The UK has also shown interest in investing in Armenia's mining sector.

At the same time, several free trade zones (FTZ) have been established as an additional tool for foreign investment promotion, where residents are free from VAT, property tax, customs duty and profit tax followed by "one window" principle government services. FTZs are located in different cities throughout the country including the capital of Armenia.

Currently, the major sectors targeted for attracting FDI by the Government of Armenia include:

- Wine (with Tierras de Armenia and Pernod Ricard as major foreign investors);
- Pharmaceuticals (with Darmantest Laboratories and Fruitsmax as major foreign investors);
- Tourism and hotel construction (with Marriott, Golden Tulip, Best Western, and Hilton hotels as major foreign investors)
- And the IT sector (with Microsoft, Sun, and Synopsys as major foreign investors).

Renewable energy, food processing, R&D, jewelry, and clothing sectors are also considered targeted sectors for FDI promotion in Armenia. The sectors' development strategies were prepared with the main stress on FDI generation and exports promotion. At the same time, several international exhibitions were organized in Armenia with the strong assistance of the government, including co-financing for the participation of domestic producers representing the targeted sectors in international exhibitions outside of Armenia.

With strong advantages for FDI promotion, there are also several disadvantages in Armenia's business climate. The major disadvantages of the business environment of Armenia are a lack of transparency in the regulatory system and a relatively high level of corruption, although the Government of Armenia has introduced several reforms and tangible improvements. Monopoly is another issue, but it is more or less related to the strategic and natural resource oriented sectors of the economy. The government has taken limited measures in this area, such as establishing the anti-monopoly State Committee on the Protection of Economic Competitiveness in 2001.

Despite the current international political and economic climate, Armenia can guarantee a stable and strong capital inflow into its economy by implementing proactive foreign investment generation activities. Armenia can act as "a window" to the markets of Russia and Iran, suggesting mutually beneficial conditions for all three countries. Otherwise, the Armenian economy will continue to be dependent on the external environment with little or negative growths in all sphere of the economy.

In conclusion, having an open door policy is an important, but obviously not sufficient condition for effective FDI inflow into the economy of the country. Armenia is the best example of it. The Government of Armenia had to continue to improve the business environment, stressing transparency of the regulatory system, fighting against corruption, and stressing diversification of investments by sector and by region with a proactive investments generation and exports promotion policy and actions. This kind of policy will have tangible positive impacts on the economy by increasing employment, income levels and independence from external factors.

Conclusion

Armenia is characterized as being a small country in all economic characteristics, starting from area of land and population and ending with the existing volume of natural resources. Armenia is also a landlocked country that is blockaded by Azerbaijan and Turkey. Moreover, the Armenian economy is strongly dependent on the external environment, especially the Russian economy, making Armenia vulnerable to changes within Russia's economic, political, and social areas.

Despite these negative aspects, Armenia has a good pool of qualified labor, which is the major reason for the inflow of FDI into the country. There are two strong factors for foreign investors as well: 1) EEU membership, allowing foreign businessmen to export "Made in Armenia" products without any obstacles into the Russian market, and 2) the lifting of sanctions on Iran—another market for "Made in Armenia" products—which will permit Iranian investments in the Armenian economy to freely reach the Russian market.

In addition, the attitudes of international organizations could be summarized as being medium positive yet more inclined to higher levels.

Thus, to use all these opportunities, the Government of Armenia should be proactive in investment generation and export promotion, stressing improvements in legal transparency and a decrease in corruption levels in all arenas of the country. Proactivity also requires continued, interlinked and interrelated actions by all bodies of the government related to the actions of country-image building in the targeted market of investments generation and exports promotion.

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The opinions expressed in this article are the authors' own and do not necessarily reflect the view of the institutions with which they are affiliated.

Recommended Reading

- <www.eaeunion.org>
- <www.armstat.am>
- <www.comtrade.un.org>
- <www.delcredereducroire.be>
- <www.doingbuinsess.org>
- <www.fitchratings.com>
- <www.globalinnovationindex.org>
- <www.heritage.org>
- <www.imf.org>
- <www.mineconomy.am>
- <www.moodys.com>
- <www.transparency.org>
- <www.transparency.org>
- <www.worldbank.org>
- <www.wto.org>

FDI in Azerbaijan: A Structural Analysis of the Business Environment

By Hannes Meissner and Johannes Leitner, Vienna

Abstract:
Although Azerbaijan could be an attractive destination for international business endeavors, there are massive barriers in practice. The national economy of Azerbaijan is divided among several clientelistic networks, capturing state institutions in order to back their own business activities and keep out competitors. Opportunities are limited to areas in which international firms channel technology into the country that cannot be provided locally. However, even in such cases, Western enterprises still have to comply with the particularities, rules and norms of the local clientelistic system in order to be successful.

Great Potential

At first sight, Azerbaijan could be an attractive destination for doing business. The country is rich in natural resources. Oil and gas extraction produce high incomes—money that is available for investments and thus could boost business. Although the country currently suffers from low oil prices and a decline in oil production, it is economically still in a different position than its resource-poor post-Soviet counterparts. At the same time, Azerbaijan has proved to be a reliable business partner in the energy sector since the signing of the "Contract of the Century" in 1994. The country has, moreover, taken decisive reform steps, like the establishment of the State Oil Fund of Azerbaijan Republic (SOFAZ) in December 2000 and the implementation of the Extractive Industries Transparency Initiative (EITI) since 2003. In 2007/08, Azerbaijan even led the world as the top reformer in the World Bank's Ease of Doing Business Index. Is Azerbaijan thus a reliable destination for Western business in general?

This contribution demonstrates that the picture is more complex. In fact, the aforementioned reform measures have been isolated steps, well-orchestrated by the otherwise corrupt and authoritarian elite. At the same time, Western investments remain rare outside the oil sector. As a locally well-connected Austrian businessman told the authors: "You often meet foreigners with high expectations, coming to explore business opportunities. They want to take part in the country's `gold rush´. But this is an illusion. They always get disappointed very quickly." The following sections highlight the reasons behind these issues. First, we take a look beneath the surface of formal institutions, revealing that the national economy of Azerbaijan is divided among several clientelistic networks, capturing state institutions to realize their particularistic business interests. Next we analyze the impact of this constellation on Western businesses, providing a basis for our conclusions.

Informality: The Merger of Politics and Business

In OECD countries, formal institutions dominate. They work in a legal-rational manner and are characterized by predictability and impersonality. There is a differentiation between the private and the public sphere and thus a—more or less—clear boundary between politics and business. However, in many countries worldwide, formal and informal institutions collide and mix in hybrid ways. In this context, private actors seize public institutions to realize their particularistic interests of accumulating ever more power and private wealth. For this purpose, they systematically abuse, side-step, ignore, or even tailor formal institutions to fit their interests. Azerbaijan is a typical example.

The informal power system of Azerbaijan has often been characterized as a pyramid structure, of which the different levels are bonded by patron-client relationships. While the system unites different—to a certain degree rivalling—clientelistic networks, the president of the country is the central and final arbiter. As a leaked U.S. cable emphasizes, this system dominates the business sphere: Certain sectors of the national economy are controlled by a handful of well-connected families who, at the same time, control certain geographic areas. Conflicts are kept low by a central agreement to divide the spoils and not to interfere in each others' sphere. As the cable further highlights, the families also collude, using government mechanisms, to keep out foreign competitors, and official entities, such as the State Border Services, State Customs and tax authorities, create barriers that only the best connected can clear. The results are enormous opportunity and wealth for a small handful of players.

In order to describe this system of elite networks, the term "clan" is often used. There are traditionally three clans that are said to have influence: The Nakhchivan clan, the Yeraz clan and the Kurdish clan. However, it is important to note that these groups are not linked to traditional roots, but rather emerged around high-ranked members of the local Soviet nomenklatura. At the same time, since the turn of the millennium, clan loyalties have increasingly lost out to commitments of mutual business interests. Patriarch Heydar Aliyev's death in 2003 and the transfer of power to his son Ilham accelerated this development. In regards to the contemporary elite structure, the literature speaks of the "old guard", the "oligarchs" and the ruling "family". In times of economic crisis, a centralization of the informal system has recently taken place, since the president has strengthened his role.

Within this overall constellation, the closest power circle around Ilham Aliyev is said to consist of seven groups, and even these groups are identified with key individuals. Two of them are first and foremost political actors, whereas two others are active in the business sphere and the final three unite political and economic power. Ramiz Mehdiev, chief of the presidential administration and Ramil Usubov, minister of the interior, have major political influence. Concerning cadre policy and suppression, they are described as "the guys behind the doors". They are part of the "old guard" and Mehdiev is said to belong to the Nakhchivan network. These individuals obviously run their own businesses as well, although on a small scale. The other five players are all associated with big holdings. The exact structure of these holdings remains unclear, but the ruling family is said to have decisive influence in all of them, owning 70 to 80 percent of the shares. Kamaladdin Heydarov, minister of emergency situations, is connected to the GILAN Holding. Ziya Mammadov, minister of transportation, is related to ZQAN Holding. The national aviation company Jalal and the Silkway Holding are associated with Jahangir Askerov and his wife Zarifa Hamsayeva. The PASHA Holding is connected to the family of Mehriban Pashayeva, the First Lady.

Kamaladdin Heydarov is the most powerful oligarch in the country. As a member of the Nakhhchivan network, his father was a close ally of Heydar Aliyev. Kamaladdin Heydarov gathered massive wealth as chairman of the State Customs Committee, as significant illicit payments were paid up the food chain. The Heydarov family is active in food processing, agriculture, construction business, real estate, chemicals, textiles, tourism, banking, and insurance. Ziya Mammadov is said to be the second biggest oligarch, active in passenger transport and cargo shipments, the construction business, insurance and banking. The Pashayev family, geographically rooted in Baku and the Absheron peninsula, are less rich than the others, but due to their political status, the single most powerful family in Azerbaijan. PASHA Holding is a conglomerate including Pasha Bank, Pasha Insurance, Pasha Construction, and Pasha Travel. The family furthermore owns a local TV station and a mobile phone provider. They are also active in the cosmetics industry.

Implications for International Enterprises

The major problem for Western enterprises in this market is the quasi-monopolistic character of most of the important industries. The economic influence of the inner power circle combined with their political influence hardly leaves room for competitors who act against the ruling elite's interests. Nevertheless, there are opportunities for foreign businesses in areas that require high technology, which local companies are not capable of delivering. Foreign firms might get project financing for such efforts, a point that is increasingly crucial.

With the international slump in oil prices and the consequent depreciation of the country's Manat currency, the Azeri regime has been forced to address the diminishing resource inflow and must therefore seek additional foreign funding for its prestigious projects. Another endeavor that severely stressed the regime's budget, with an officially stated expenditure of $1.2bn was the "European Games" that took place in summer 2015. However, these figures raise serious skepticism as the real costs are probably much higher considering that the price tag for the new Olympic Stadium alone was $600 million. The country's declining macroeconomic performance has also been reflected in fluctuating GDP-growth rates (year-on-year) over the previous years with a low in 2011 of 0.11%, 2.2% in 2012, and a high in 2013 of 5.8% which was followed again by a decline to 2.8% in 2014. The sustainable drop in oil prices revealed—once again—the vulnerabilities of Azerbaijan's economic model, i.e. the high dependence on oil revenues, the low diversification of the economy and the problematic business environment[1]. In response to the latest macroeconomic developments of the country, the EBRD identified three key priority areas to reshape the economy: (i) Accelerating diversification of the economy, (ii) strengthening regulations for, and governance of, the financial sector, and (iii) a conservative budget for 2016 that reflects the country's declining economic performance.[2]

Azerbaijan is eager to present itself internationally as a reliable partner offering a wide range of business opportunities. The European Games were just one recent example for this strategy as Sports Minister Azad Rahimov put it in a 2015 BBC interview, "After the European Games in Baku, people across the world will know that Azerbaijan is in Europe"[3]. In contrast, the reality for international firms initiating business activities in the country looks quite different and leaves frustrated those projects that do not take advantage of a "krysha", i.e. a protector who guides the project through the informal networks which are crucial for successful operations. These informal decision-making platforms exist parallel to the formal institutions such as ministries, supervisory bodies and licensing offices, and are responsible for granting necessary permissions, licenses and clearance from tax authorities. The most difficult question for a foreign investor probably is

1 BEEPS V Survey. <http://ebrd-beeps.com/countries/azerbaijan/>

2 EBRD Transition Report 2015–16. <http://2015.tr-ebrd.com/en/countries/#>

3 BBC Report on the European Games in Azerbaijan 2015 <http://www.bbc.com/news/world-europe-32977924>

to determine the quality of the protector/broker. Is the contact person trustful and well established in the inner circle? When Western enterprises want to implement substantial business projects, they need direct personal access to high level power circles. However, given the economic crisis and the centralization of the informal power system, the freedom of an individual oligarch for taking a business decision on his own has recently decreased. Given this situation, an Austrian enterprise informed the authors that new projects are currently on hold.

Stability of the Informal Power System

The stability of the informal power system is another crucial factor for evaluating both future business opportunities and the safety of investments already made. Although the inner circle of Azerbaijan's ruling elite is a black box which can hardly be analyzed from within, conflicts are currently kept low. However, the coalition can only survive as long as there are enough resources to be distributed among its members to meet their demands. Exactly this pie might be under increasing pressure from diminishing oil revenues which reduce the pieces of the pie to be allocated among the members. To raise the regime's legitimacy before the November 2015 elections, the president demanded from one of his close clients, Jahangir Ashkarov of Azerbaijan's AZAL airline, to adjust ticket prices to international market levels. Also, for symbolic reasons, the fight against corruption was again high on the official political agenda to positively stimulate the electorate who suffers from reduced public spending and the devaluated Manat.

The coalition which characterizes the ruling elite is certainly not a coalition of equal partners. Instead, it can best be described and analyzed as a patronage regime with Ilham Aliyev on the top as illustrated in the second section of this analysis. The patron-client relationship typically works through the exchange of security and wealth provided by the patron for absolute loyalty and reliability provided by the client. The quality of the contact is substantially determined by one's position in this patron-client system. The further the client is distanced from the center, i.e. the patron, the weaker his/her power to influence decisions for their business. Additionally, the quality of a client is largely indicated by the duration of the friendship, political loyalty and absence of scandals. On the other hand, factors that might endanger the quality of such patron-client relationships are political ambitions of the client, which might question the absolute power of the patron, or a public scandal, which would weaken the patron's legitimacy, potentially leading him to dismiss the client. It might also happen that the client serves as a scapegoat for the patron if something goes wrong. If a client falls from favor with the patron, the client's business partners are immediately out of the game as well. But also, if the client needs to decide between loyalty to his business partners or his patron, he/she will typically decide for the patron.

Property rights, legal disputes, and other matters can hardly be fought through formal institutions in Azerbaijan. Decisions always depend on personal linkages and relationships. All parties involved need to be willing to comply with the rules of the informal system; otherwise one can quickly fall from disgrace and is forced to leave the country immediately. This happened to an Austrian company that refused to stick to the informal rules and guarantee kickback payments. In a matter of days, they had to close their offices, secure their files and charter a plane back to Vienna.

Conclusion

Behind Azerbaijan's facades, reality shows a regime that is based on a patron-client relationship among the ruling elites, which captures the state for their private gains. The collusion of public power and business interests for private gains, which are represented through omnipresent holding companies that control and protect their markets with backing from official authorities. Such a closed system leaves only a little room for international business interests, who want to participate in the prospering economic scene. However, while opportunities are ample, success stories are only written by those firms that channel technology into the country which cannot be provided locally. However, in order to be successful in this case, Western enterprises still have to comply with the particularities, rules and norms of the local clientelistic system.

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Johannes Leitner is head of the Competence Centre for Black Sea Region Studies at the University of Applied Sciences BFI Vienna (UAS BFI Vienna).

Recommended Reading:
- Leaked US Cable: <https://wikileaks.org/plusd/cables/10BAKU54_a.html>
- Farid Guliyev (2012): Political Elites, in: *Challenges of the Caspian Resource Boom. Domestic Elites and Policy-Making*, Andreas Heinrich and Heiko Pleines, eds., Houndmills: Palgrave Macmillan, pp. 117–130.

Foreign Direct Investment Trends and Policies in Georgia

By Irina Guruli, Tbilisi

Abstract:
Foreign direct investment (FDI) is a volatile yet essential source of foreign currency inflow in Georgia and accounts for the bulk of total investments undertaken in the country. Nevertheless, achieving stable investment inflows remains a challenge. Moreover, the impact of FDI on economic growth and employment figures has not reached its full potential, due mainly to insufficient institution building and the failure to create a predictable and stable business environment in the country.

Understanding Georgia's Foreign Direct Investment Trends

A liberal business environment, simplified tax and administrative legislation, preferential trade regimes, a strategic geographic location and equal opportunities for domestic as well as foreign investors has transformed Georgia into an attractive place for investments. Business and investment policy can be divided before and after 2012. In the mid-2000s the government policy was directed towards radical reforms aimed at creating a favorable business and investment environment and fostering foreign investment inflows. Notwithstanding these efforts, the government policy was characterized by a number of factors that shed negative light on the investment climate of Georgia. After the election of a new government in 2012, the major priorities emphasized fostering domestic entrepreneurial activities and small and medium enterprise (SME) growth. However, legislative changes introduced by the new government questioned the liberal path that Georgia has taken and affected investors' interest in the country.

Attracting foreign direct investments has been a priority of Georgia's government for more than a decade now. The rigorous reforms resulted in substantially improved rankings in various ratings published by international organizations, the World Bank among them. Georgia was named a top reformer and the country's advance in the ranking was the most progress in a single year achieved by any country since the launch of the Doing Business Reports (World Bank, 2006). In parallel with the pronounced economic growth, the government under Saakashvili's administration was characterized by a number of factors that shed negative light on the investment climate of Georgia. The most problematic issues were protection of property rights, business seizure, favoritism issues, the rule of law, and the impartiality of the justice system.

Over the course of the past ten years, FDI inflows to Georgia amounted to roughly 4 billion USD, which translates into 755 million per year on average. GDP growth over the course of 2003–2012 on average amounted to 6.7 percent. FDI inflow trends have been characterized by high uncertainty and volatility. Net inflows of FDI peaked in 2007 at 1.8 billion USD, with real GDP growth of 12.6 percent. This tendency slumped due to the 2008 war and global economic crisis, and saw a slow and bumpy recovery. FDI was down to 0.7 billion USD in 2009. In 2014 FDI inflow increased dramatically, reaching 1.3 billion USD, a maximum since 2008 and representing around 10 percent of GDP.

FDI distribution among sectors varies greatly and not all sectors have benefited from foreign investments. Since 2007, the largest FDI recipient was the transport and communication sector, with investments amounting to almost 2 billion USD. Communications saw the least volatility over the years. The second most important FDI recipient was the energy sector; however, it was characterized by unpredictability. The real estate sector has received slightly above one billion USD with a certain slump in 2013. The manufacturing sector has been characterized by a pronounced trend with slight volatility. The least promising sector in regards to attracting investments is health and social care. During the first three quarters of 2015, the sectoral breakdown of investments looks as follows: 45 percent transport and communications, 15 percent financial sector, 13 percent construction, 7 percent manufacturing, 4 percent real estate and energy each, 3 percent mining.

In 2014, 46 percent of total investments came from EU countries, while 30 percent from the Commonwealth of Independent States (CIS). Over the past decade, the Netherlands has been the largest EU investor, with over 1.3 billion USD invested. The Dutch investments are prominent in the sectors of manufacturing, mining, transport and communication, as well as construction. The largest non-EU investor is Azerbaijan with more than 1.6 billion USD invested, mainly in transport and communication (BP Group) and energy sector (Socar Energy Georgia a subsidiary of Azerbaijani State Oil Company in Georgia).

Projections for 2016 are not very promising. The preliminary data for the first three quarters of 2015 do not give reason for optimism; statistics show a 17 percent decline in the total FDI inflows as compared to the same period last year. The outlook for developing countries suggests that regional conflict, coupled with falling oil prices and international sanctions reduced foreign investors' confidence in the strength of local economies.

FDI, Employment and Economic Growth

FDI accounts for the bulk of total investments in Georgia, as domestic savings are inadequate to meet local financing needs. Therefore, FDI is believed to be an important source of output growth and employment.

However, there is no clear correlation between the FDI inflow and economic growth in Georgia. Georgian FDI is heavily reliant on one-off, large-scale investments. It is hard to identify a consistent source of FDI and a stable investment recipient sector. The contribution of different countries and sectors vary greatly from year to year. These large-scale investments leave the statistics vulnerable to fluctuations due to the impact of the loss of a single large investor, while at the same time, suggesting that it is the smaller, more consistent investments that Georgia has failed to attract in the recent years.

When it comes to juxtaposing employment and FDI figures across different sectors, positive tendencies in FDI inflows do have positive effects on employment statistics, however these effects are not strong and not always consistent. In short, FDI in Georgia does not influence employment at its greatest potential likely due to the inconsistency and instability of FDI sources, as well as the time lag that might be deteriorating the actual effects.

Future growth prospects depend on Georgia's ability to leverage the Deep and Comprehensive Free Trade Area and Association Agreement with the EU, which will improve market access and encourage FDI. Although the EU–Georgia Association Agreement provides limited investment-related provisions, the Agreement will help establish and restore foreign investors' confidence in the country. Net FDI is likely to amount to 6.3 percent of GDP on average, while the national savings rate is expected to increase to 20.5 percent of GDP by 2017.

Business and Investment Climate in Georgia

In the mid-2000s, the Georgian government took comprehensive steps for improving Georgia's business and investment climate. As a result, Georgia's position has improved in a number of international ratings, and interest from the side of foreign investors has also increased. After the military conflict with Russia in 2008, a set of new reforms was introduced to diversify the economy and once again improve the country's image for attracting foreign investments. However, apart from the overall improvement and marked economic growth, there were a number of factors that distorted the business and investment climate in Georgia. Among these factors were: issues related with protection of property rights, appropriation of businesses and favoritism from the side of the government. In 2012, the main declared aim of the government was to free businesses from possible governmental pressure.

If the government under Saakashvili's administration was determined to attract large volumes of foreign investments and brand Georgia as a country with an investor-friendly business climate, the newly elected government placed more emphasis on spurring domestic growth. Since 2012, the government's major priorities emphasized fostering domestic entrepreneurial activities and SME growth. Major attention was paid to the agricultural sector, as well as domestic production by providing soft loans, infrastructure renovation, and capacity-building activities.

Compared with the region's advanced reformers, Georgia has had a mixed record of entrepreneurship. Despite the relatively conducive business environment, the pool of talent as well as the share of SMEs per 1,000 people is relatively low in the regional context. At the same time, Georgian entrepreneurs are less likely to engage in innovation activities[1]. Georgia ranks 73rd out of 141 countries. The Global Innovation Index (GII) report acknowledges Georgia as an innovation achiever among other countries in the same income-group. Over the course of the past few years, rankings have improved in line with institutional changes; however, there is a need for further strengthening the education and research systems and improving firms' capabilities[2]. According to the GII report, the major challenges of the Georgian private sector are low levels of capitalization, lack of training, sparse patenting activity, and few knowledge-intensive industries, all of which severely hampers innovation capacity. Investments in innovation capabilities are needed, a challenge for a country with limited resources.

To support and foster the development of micro, small, and medium-sized enterprises, two new agencies—the Entrepreneurship Development Agency and the Innovation and Technology Agency—were established under the Ministry of Economy and Sustainable Development in 2014. These agencies seek to promote entrepreneurship by improving access to finance, entrepreneurial learning, consultancy services, export promotion and innovation, and adaptation to Deep and Comprehensive Free Trade Area requirements. Moreover, for stimulating domestic production, the Produce in Georgia Program was also launched in 2014. It aims to enhance business competitiveness by providing access to commercial finance, consultancy, and new technologies.

1 World Bank Reports (2015). *The Jobs Challenge in the South Caucasus—Georgia*. <http://www.worldbank.org/en/news/feature/2015/01/12/the-jobs-challenge-in-the-south-caucasus---georgia>

2 The Global Innovation Index (2015). <https://www.globalinnovationindex.org/content/page/GII-Home>

Apart from the declared goals, the newly elected government started to pass a wide range of legislative changes that resulted in a rather unpredictable and unstable business environment. A number of legislative changes were understood as a shift from the previously declared liberal path of government. To name just a few that adversely affected Georgia's investment climate: restricting the previous migration law by imposing visa regimes and restrictions for a number of countries, prohibiting land purchase by foreign nationals, and prolonging the ambiguous process of drafting amendments to the labor code.

Conclusion

FDI is an important source of private capital in Georgia. However, it is a rather unstable source characterized by volatility, since the country failed to attract more consistent investments in recent years. Investments are mostly one time and relatively large. These large-scale investments leave the statistics vulnerable to fluctuations due to the impact of the loss of a single large investor. Underlying causes for this situation lie in the inability to interlink FDI with subsequent institution-building capacities which would help create a predictable and stable environment for investors.

A clear-cut, well-coordinated policy and participatory decision-making are crucial factors in overcoming major gaps that hamper domestic private sector development and the attraction of foreign investment. Of course, regional political instability and ongoing economic crisis makes it particularity hard to restore and retain investors' confidence, however a well thought out domestic policy could partially mitigate the negative externalities.

The EU–Georgia Association Agreement likely will help stimulate strong foreign investors' confidence in the country. The Agreement is believed to have a positive impact on the level of competitiveness of Georgian firms, as well as increasing interest in Georgia among foreign companies. The agreement also envisages the harmonization of Georgian legislation with that of the EU, further facilitating trade.

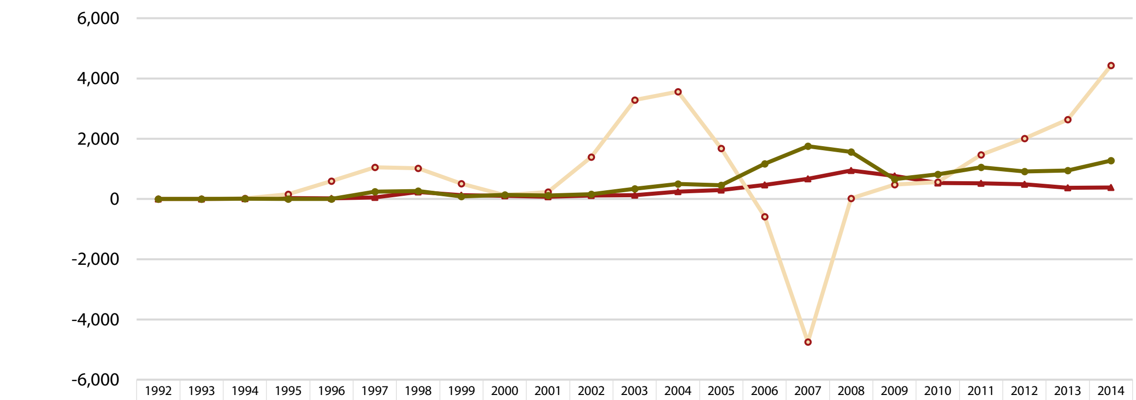
About the Author

Irina Guruli is a Program Manager at the Economic Policy Research Center (EPRC) in Tbilisi, Georgia. She is a PhD student and a visiting lecturer at Ilia State University in Tbilisi.

STATISTICS

FDI in the Countries of the South Caucasus

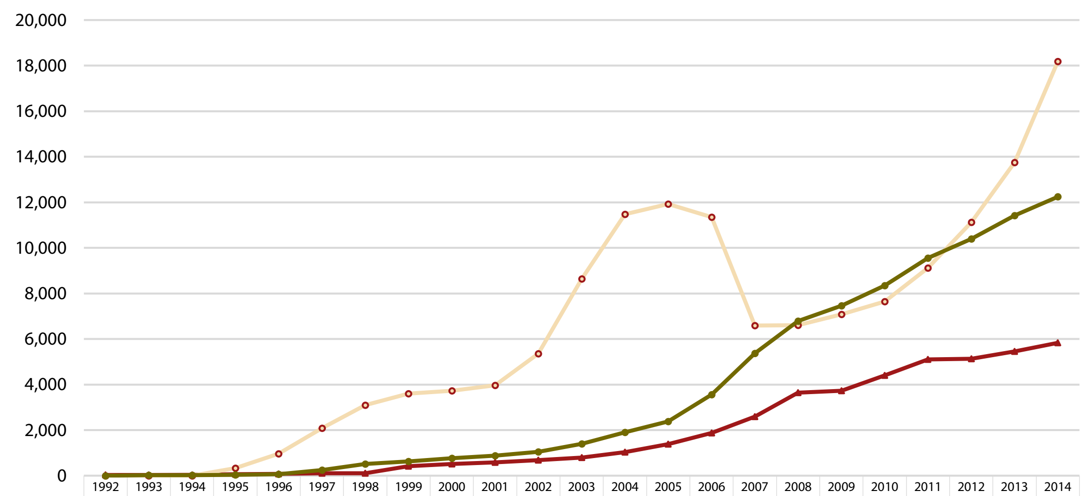
Figure 1: Net FDI Inflows 1992–2014 (in Current USD in Millions)



	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Armenia	2	1	8	25	18	52	232	122	104	70	111	123	247	292	467	668	944	760	529	515	489	370	383
Azerbaijan	0	0	22	155	591	1,051	1,023	510	130	227	1,392	3,285	3,556	1,680	-584	-4,749	14	473	563	1,465	2,005	2,632	4,430
Georgia	0	0	8	0	0	243	265	82	131	110	160	335	492	453	1,170	1,750	1,564	659	814	1,048	911	949	1,279

Source: UNCTAD Data Center, <http://unctadstat.unctad.org/wds/ReportFolders/reportFolders.aspx?sCS_ChosenLang=en>

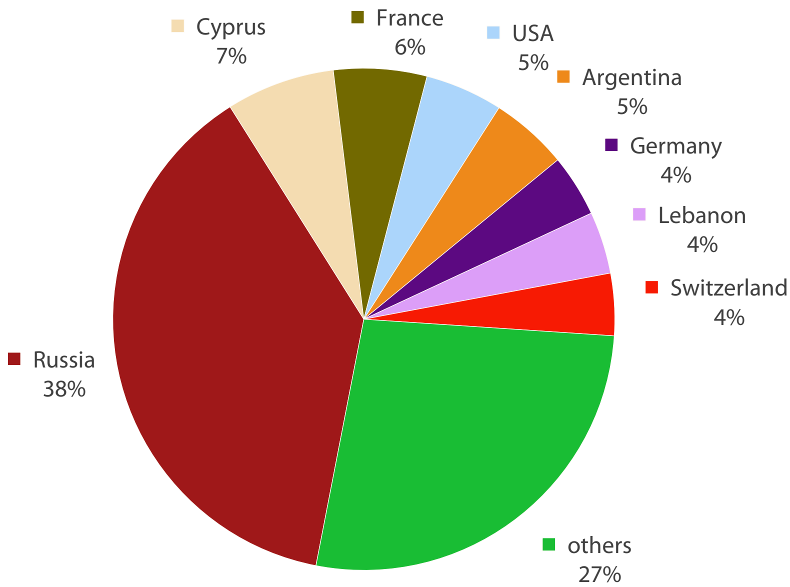
Figure 2: Net FDI Stock 1992–2014 (in Current USD in Millions)



	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Armenia	31	31	41	66	84	103	103	421	513	580	684	795	1,039	1,383	1,880	2,586	3,643	3,734	4,405	5,103	5,134	5,448	5,831
Azerbaijan	0	0	0	330	957	2,089	3,095	3,605	3,735	3,962	5,354	8,639	11,482	11,930	11,347	6,598	6,612	7,085	7,648	9,113	11,118	13,750	18,180
Georgia	0	18	26	32	68	246	512	631	762	879	1,049	1,395	1,908	2,374	3,559	5,372	6,786	7,466	8,350	9,550	10,389	11,418	12,241

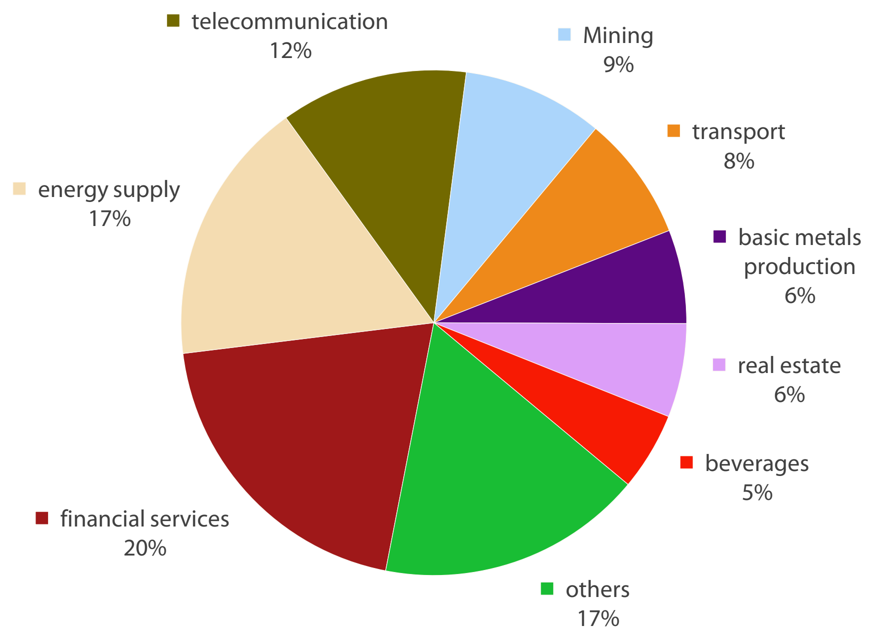
Source: UNCTAD Data Center, <http://unctadstat.unctad.org/wds/ReportFolders/reportFolders.aspx?sCS_ChosenLang=en>

Figure 3: Armenia: Net FDI Stock by Country of Origin (as of 2014)



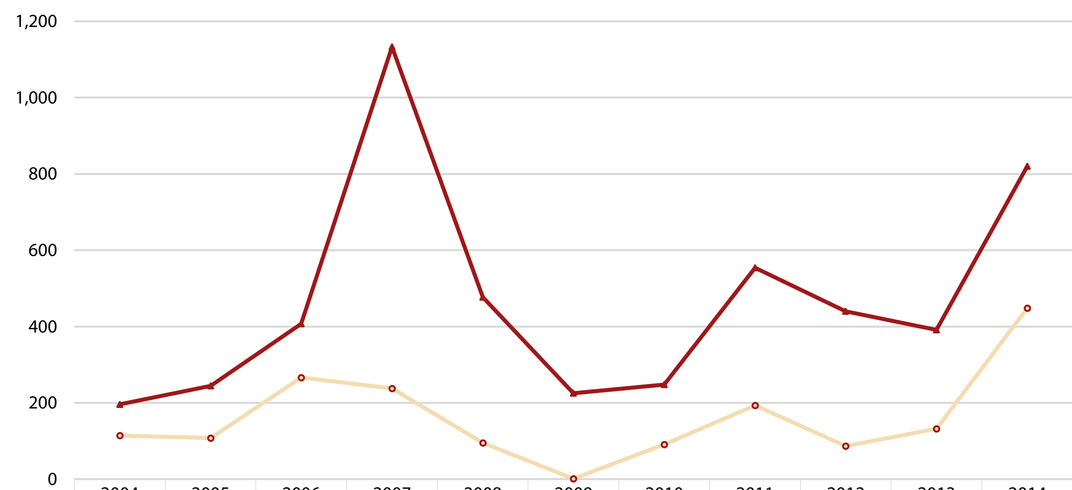
Source: Statistical yearbook of Armenia 2015, pp. 516–521, <http://www.armstat.am/en/?nid=45&year=2015>

Figure 4: Armenia: Net FDI Stock by Branch of Economy (as of 2014)



Source: Statistical yearbook of Armenia 2015, pp. 532–539, <http://www.armstat.am/en/?nid=45&year=2015>

Figure 5: Georgia: Net FDI Inflow by Country of Origin: EU vs. CIS (Million USD)

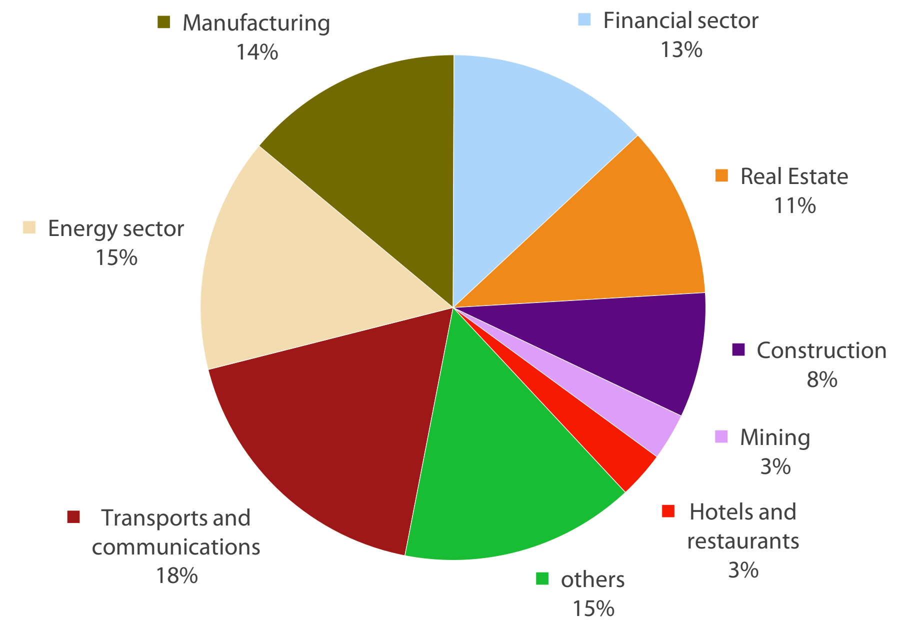


	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
EU	196	244	407	1133	477	225	248	554	440	391	820
CIS	114	108	266	238	95	1	91	193	87	132	448

Note: CIS refers to all countries on the territory of the former Soviet Union except the Baltic States, which are counted as EU

Sources: own calculation by Irine Guruli, based on data from National Statistics Office of Georgia (Statistical survey on external economic activities), National Bank of Georgia, Ministry of Economy and Sustainable Development of Georgia, Ministry of Finance and Economy of Adjarian A/R.

Figure 6: Georgia: Net FDI Inflow by Branch of Economy, Accumlated for 2010–14



Sources: own calculation by Irine Guruli, based on data from National Statistics Office of Georgia (Statistical survey on external economic activities), National Bank of Georgia, Ministry of Economy and Sustainable Development of Georgia, Ministry of Finance and Economy of Adjarian A/R.

DOCUMENTATION

Economy-Related Country Rankings

Part 1: Economic System

Index of Economic Freedom

Prepared by: The Heritage Foundation and Wall Street Journal (USA)
Established: 1995
Frequency: Annual
The data refer to the previous respective year.
Covered countries: at present 186
URL: <http://www.heritage.org/Index/Ranking.aspx>

Brief description:

The methodology was revised in 2007 to provide an even clearer picture of economic freedom. The index measures ten specific factors, and averages them equally into a total score. Each one of the ten freedoms is graded using a scale from 0 to 100, where 100 represents the maximum freedom. A score of 100 signifies an economic environment or set of policies that is most conducive to economic freedom. The ten component freedoms are: Business, Trade and Fiscal Freedom, Government Spending, Monetary, Investment and Financial Freedom, Property Rights, Freedom from Corruption, Labor Freedom.

Figure 1: Index of Economic Freedom: Score and Ranking 2016

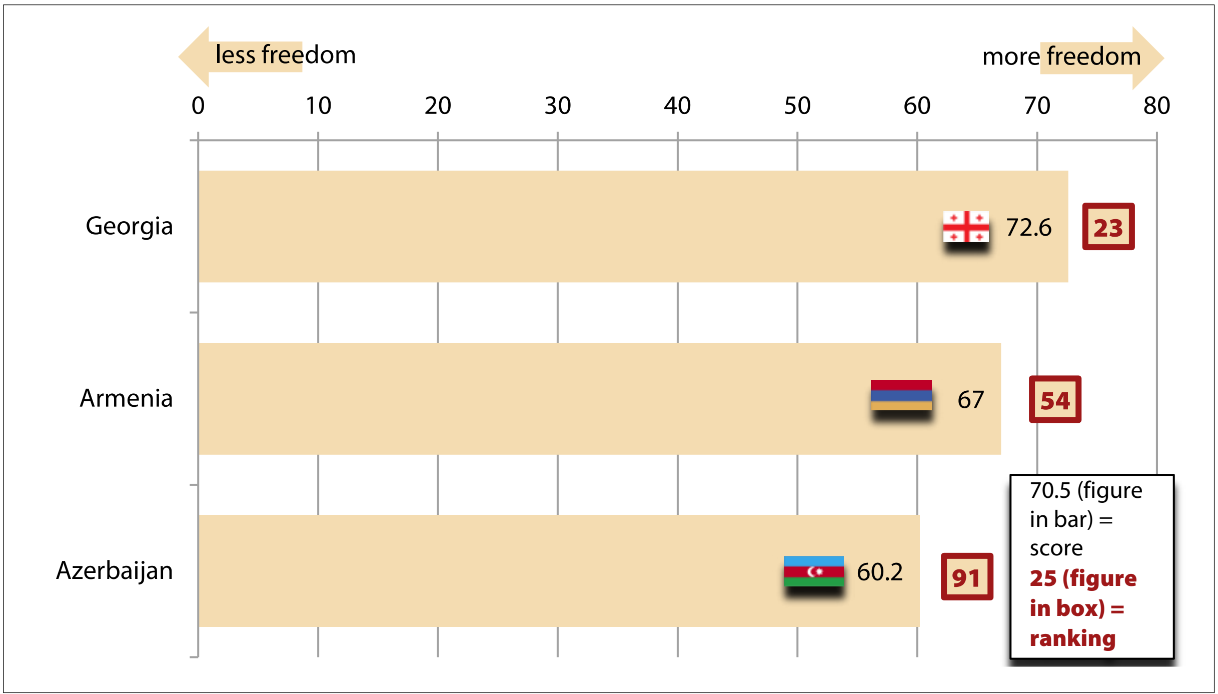


Table 1: Index of Economic Freedom: Component Scores 2016

	Azerbaijan	Armenia	Georgia
Ranking	***91***	***54***	***23***
Rule of Law			
Property Rights	20.0	20.0	40.0
Freedom from Corruption	29.0	37.0	52.0
Regulatory Efficiency			
Business Freedom	70.3	77.5	88.5
Labor Freedom	75.2	62.2	75.7
Monetary Freedom	77.0	72.8	80.5
Limited Government			
Government Spending	56.7	80.7	75.3
Fiscal Freedom	88.0	83.8	87.6
Open Markets			
Trade Freedom	75.8	85.6	88.6
Investment Freedom	60.0	80.0	80.0
Financial Freedom	50.0	70.0	60.0
Overall Score	***60.2***	***67.0***	***72.6***

Figure 2: Index of Economic Freedom: 1996–2016

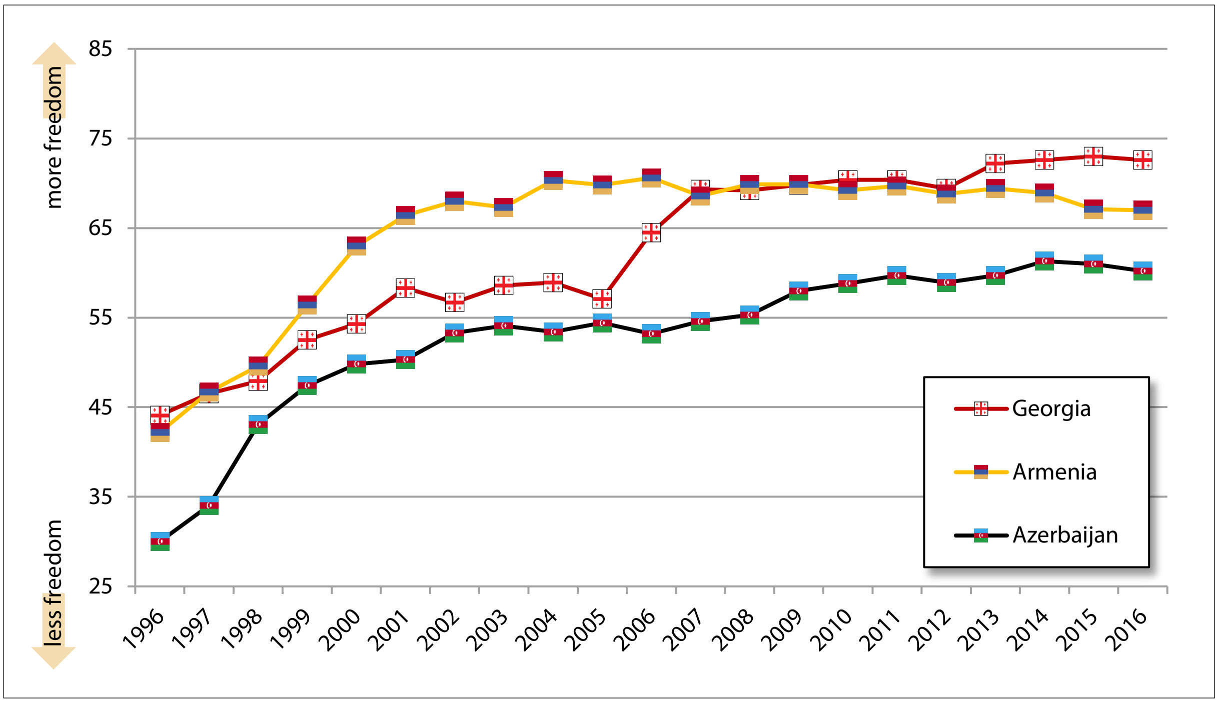


Table 2: Index of Economic Freedom: 1996–2016

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Georgia	44.1	46.5	47.9	52.5	54.3	58.3	56.7	58.6	58.9	57.1	64.5	69.3	69.2	69.8	70.4	70.4	69.4	72.2	72.6	73.0	72.6
Armenia	42.2	46.7	49.6	56.4	63.0	66.4	68.0	67.3	70.3	69.8	70.6	68.6	69.9	69.9	69.2	69.7	68.8	69.4	68.9	67.1	67.0
Azerbaijan	30.0	34.0	43.1	47.4	49.8	50.3	53.3	54.1	53.4	54.4	53.2	54.6	55.3	58.0	58.8	59.7	58.9	59.7	61.3	61.0	60.2

Global Competitiveness Index (GCI)

Prepared by: World Economic Forum
Established: 2005 (2001 – 2004: Growth Competitive Index)
Frequency: Annual
The data refer to the first year given in the title.
Covered countries: at present 144
URL: <https://www.weforum.org/reports>

Brief description:

The GCI assesses the competitiveness of nations and provides a holistic overview of factors that are critical to driving productivity and competitiveness. These factors are grouped into twelve pillars with 90 indicators: institutions (property rights, ethics and corruption, undue influence, government inefficiency, security, accountability), infrastructure (infrastructure quality, transport, energy, telecommunications), macroeconomy, health and primary education, higher education and training, market efficiency (competition, distortions), flexibility and efficiency of labor market, sophistication and openness of financial markets, technological readiness, market size, business sophistication, innovation.

The rankings are drawn from a combination of publicly available hard data and the results of the Executive Opinion Survey, a comprehensive annual survey conducted by the World Economic Forum, together with its network of Partner Institutions. By now over 15,000 business leaders are polled in the 144 economies worldwide which are included in the index. The survey questionnaire is designed to capture a broad range of factors affecting an economy's business climate that are critical determinants of sustained economic growth.

Figure 3: Global Competitiveness Index: Scores and Ranks 2015–2016

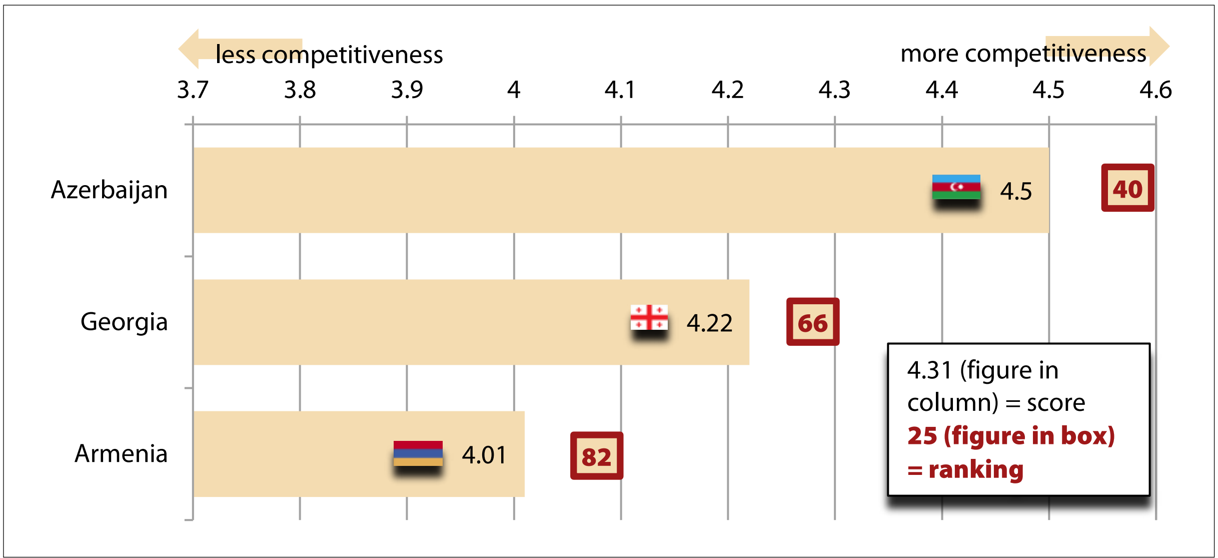


Table 3: Global Competitiveness Index: Component Scores 2015–2016

	Armenia	Azerbaijan	Georgia
1. Subindex: basic requirements	*4.4*	*4.9*	*4.8*
Institutions	3.8	3.9	4.4
Infrastructure	3.7	4.1	4.2
Macroeconomic environment	4.7	6.4	5.0
Health and primary education	5.4	5.2	5.8
2. Subindex: efficiency enhancers	*3.8*	*4.0*	*4.0*
Higher education and training	4.3	3.9	4.0
Goods market efficiency	4.5	4.3	4.5
Labor market efficiency	4.3	4.6	4.6
Financial market development	3.5	3.3	3.9
Technological readiness	3.7	4.3	3.8
Market size	2.8	3.9	3.0
3. Subindex: Innovation	*3.3*	*3.6*	*3.1*
Business sophistication	3.7	3.9	3.5
Innovation	3.0	3.3	2.7
Scores	*4.01*	*4.50*	*4.22*

Figure 4: Global Competitiveness Index: Scores 2006–2015/16

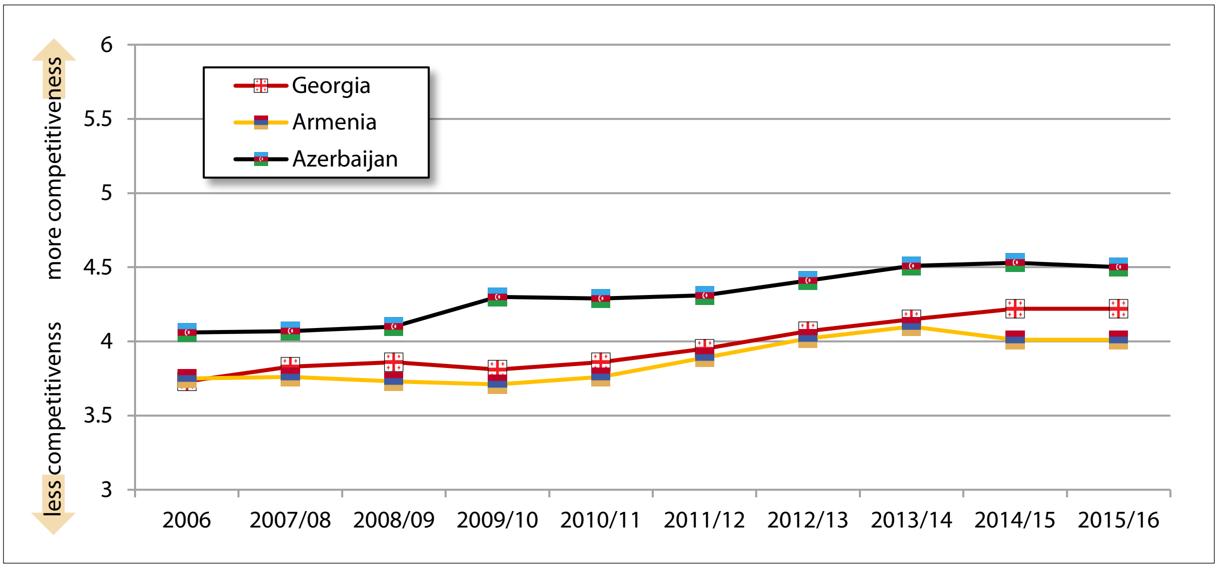


Table 4: Global Competitiveness Index: Scores 2006–2015/16

Country	2006	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2015/16
Azerbaijan	4.06	4.07	4.10	4.30	4.29	4.31	4.41	4.51	4.50
Georgia	3.73	3.83	3.86	3.81	3.86	3.95	4.07	4.15	4.22
Armenia	3.75	3.76	3.73	3.71	3.76	3.89	4.02	4.10	4.01

Part 2: Business Environment

Country Risk Assessments by Delcredere | Ducroire

Prepared by: Delcredere | Ducroire
Frequency: current updates
URL: <http://www.delcredereducroire.be/en/country-risks/#focusCountry=&focusContinent=&filter=undefined&min=0&max=7&tab=undefined>

Brief description:

For assessing the risk of export transactions and direct investments Delcredere | Ducroire, a public credit insurer, uses four plus three categories. These categories are rated from 1 to 7, with 1 expressing the lowest risk and 7 the highest. The category Commercial Risk, expressing the risk of default by a foreign private buyer, is rated from A to C. The category also includes macroeconomic and systemic factors impacting the payment capacity of debtors located in a country. Category A contains countries in which the systemic commercial risk is the lowest, while category C contains countries with the highest risk. To rank all categories and to assess risk, Delcredere | Ducroire uses various indiactors and expert opinions.

Table 5: Risk Assessments March 2016

	Armenia	Georgia	Azerbaijan
Export Transactions			
Political Risk			
Short Term	5	3	4
Medium/Long Term	6	6	5
Special Transactions	5	4	4
Commercial Risk	C	C	C
Direct Investments			
War Risk	5	5	4
Risk of Expropriation and Government Action	4	4	4
Transfer Risk	6	6	4

Ease of Doing Business

Prepared by: Worldbank
Established: 2003
Frequency: Annual
The data refer to the respective previous year.
Covered countries: at present 189
URL: <http://www.doingbusiness.org/economyrankings/>

Brief description:

The ease of doing business index ranks economies from 1 to 189. The index is calculated as the ranking on the simple average of country percentile rankings on each of the ten topics covered. The survey uses a simple business case to ensure comparability across countries and over time—with assumptions about the legal form of the business, its size, its location and the nature of its operations. Surveys are administered through more than 10,200 local experts. In 2014 the ranking was adjusted. Eight of ten Ease of doing Business' indicators were changed.

Figure 5: Ease of Doing Business. Overall Ranking 2016

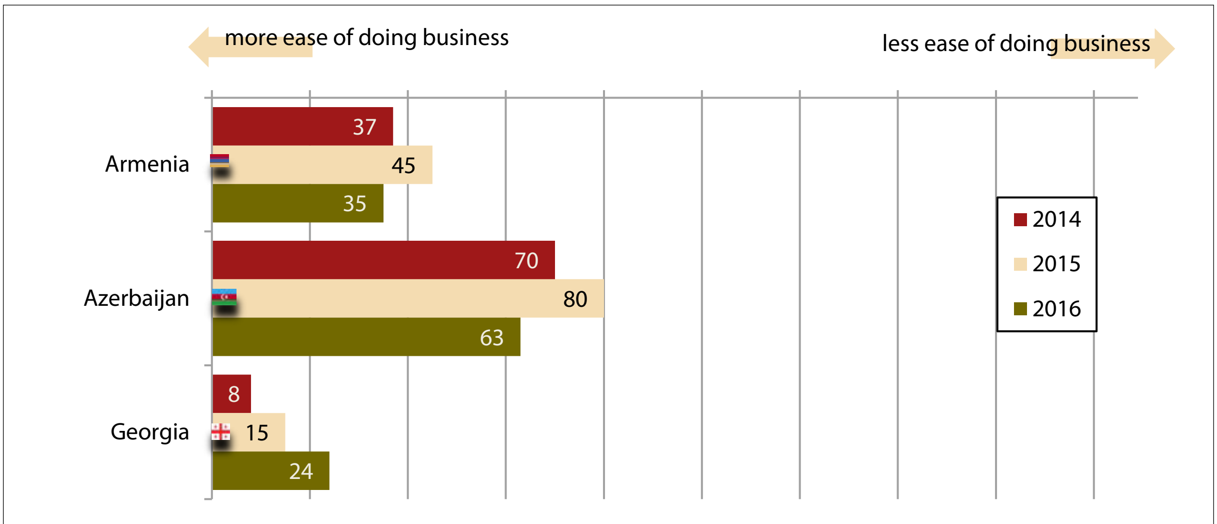


Table 6: Ease of Doing Business. Individual Topic Rankings 2016

	Armenia	Azerbaijan	Georgia
Overall rank	*35*	*63*	*24*
Starting a Business	7	5	6
Dealing with Construction Permits	114	62	11
Getting Electricity	110	99	62
Registering Property	22	14	3
Getting Credit	109	42	7
Protecting Investors	36	49	20
Paying Taxes	34	41	40
Trading Across Borders	94	29	78
Enforcing Contracts	40	28	13
Resolving Insolvency	84	71	101

Index of Economic Freedom—Business Freedom

Prepared by: The Heritage Foundation and Wall Street Journal (USA)
Established: 1995
Frequency: Annual
The data refer to the respective previous year.
Covered countries: at present 186
URL: <http://www.heritage.org/Index/Ranking.aspx>

Brief description:

Business freedom is the ability to create, operate, and close an enterprise quickly and easily. Burdensome, redundant regulatory rules are the most harmful barriers to business freedom. Business freedom is graded using a scale from 0 to 100, where 100 represents the maximum freedom.

Figure 6: Index of Economic Freedom: Business Freedom 2016

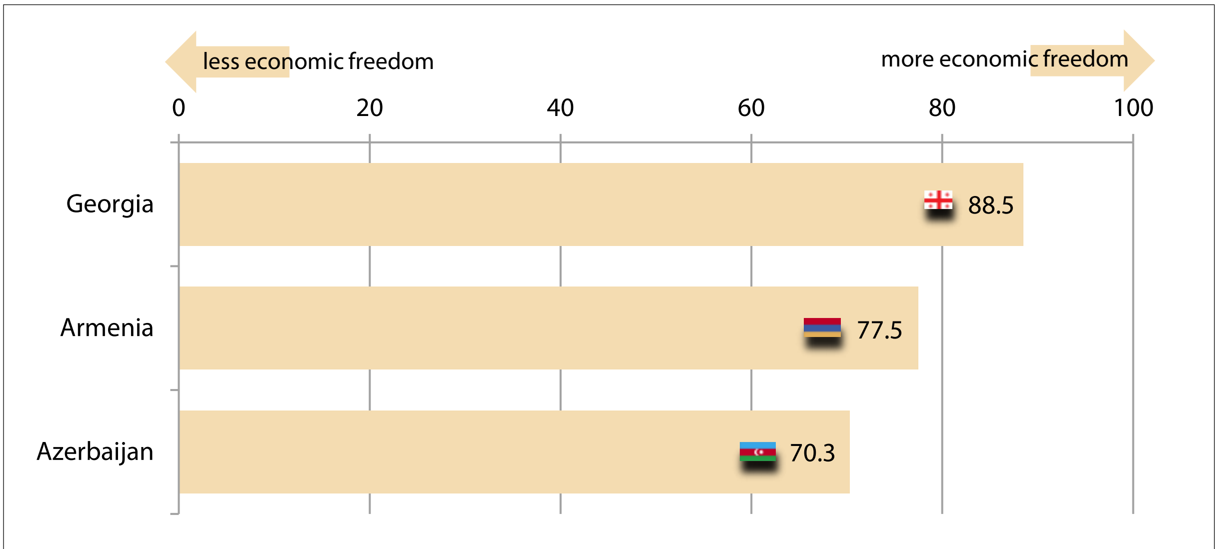


Table 7: Index of Economic Freedom: Business Freedom 1995–2016

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Georgia	55	55	55	55	55	55	55	55	55	55	73.9
Armenia	55	55	55	55	55	55	55	55	55	55	77.6
Azerbai-jan	40	55	55	55	55	55	55	55	55	55	56.7

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Georgia	80.8	85.0	86.6	87.9	87.3	86.9	90.6	87.8	88.6	88.5
Armenia	80.8	81.3	83.7	83.4	82.4	87.8	87.6	83.1	82.7	77.5
Azerbai-jan	58.0	62.6	74.6	74.6	72.9	68.6	69.2	73.5	74.5	70.3

Part 3: Corruption and Transparency

Corruption Perception Index

Prepared by: Transparency International
Established: 1995
Frequency: Annual
The data refer to previous 24 months
Covered countries: at present 168
URL: <http://www.transparency.org/policy_research/surveys_indices/cpi>

Brief description:
The Corruption Perceptions Index is a composite index that draws on multiple expert opinion surveys that poll perceptions of public sector corruption in 168 (in 2015) countries around the world. It scores countries on a scale from zero to ten, with zero indicating high levels of perceived corruption and ten indicating low levels of perceived corruption. Since December 2012 the score ranges from 0 (highly corrupted) to 100 (very clear).

Figure 7: Corruption Perception Index 2015: Scores and Ranking

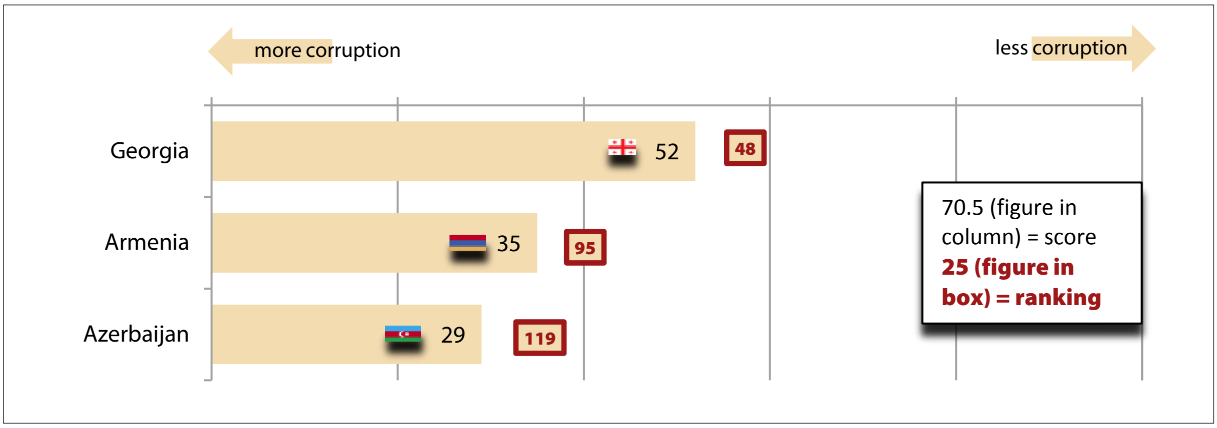
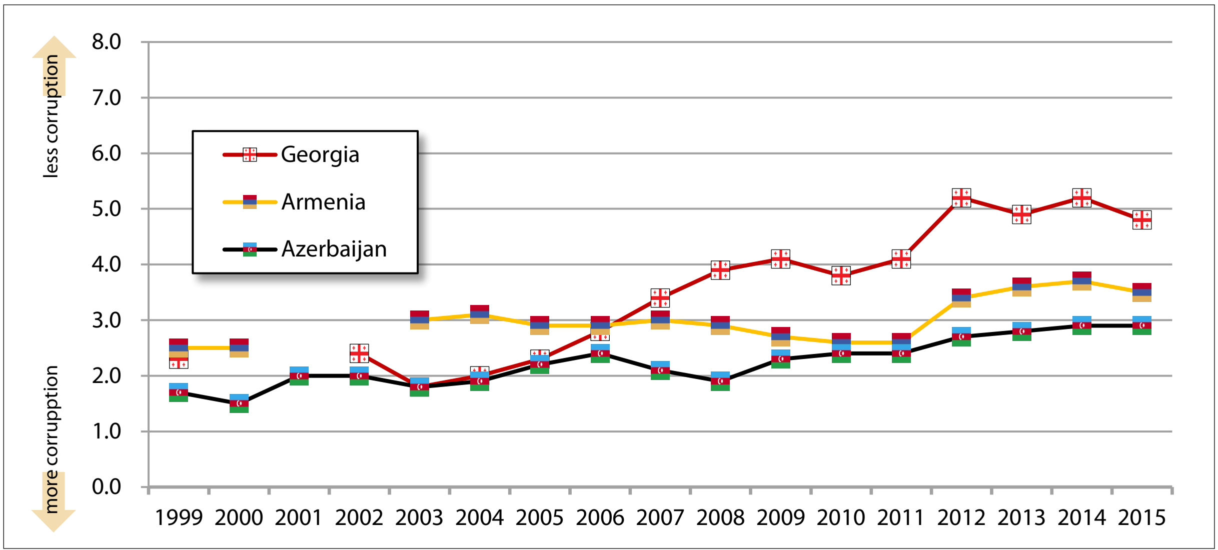


Figure 8: Corruption Perception Index 1998–2015:Scores



NB: scores 2012–2015 have been divided by ten

Table 8: Corruption Perception Index 1998–2015: Scores

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Georgia	2.3	*	*	2.4	1.8	2.0	2.3	2.8	3.4	3.9	4.1	3.8	4.1	52	49	52	48
Armenia	2.5	2.5	*	*	3.0	3.1	2.9	2.9	3.0	2.9	2.7	2.6	2.6	34	36	37	35
Azerbaijan	1.7	1.5	2.0	2.0	1.8	1.9	2.2	2.4	2.1	1.9	2.3	2.4	2.4	27	28	29	29

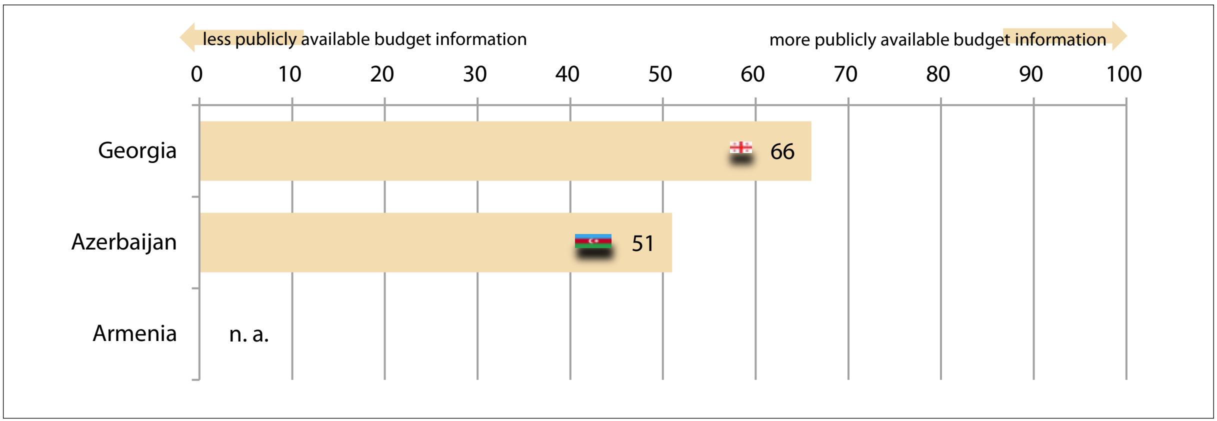
Open Budget Index

Prepared by: Center on Budget and Policy Priorities
Since: 2006
Frequency: every two years (planned)
The data refer to the respective previous year.
Covered countries: 102
URL: <http://internationalbudget.org/opening-budgets/open-budget-initiative/open-budget-survey/>

Brief description:

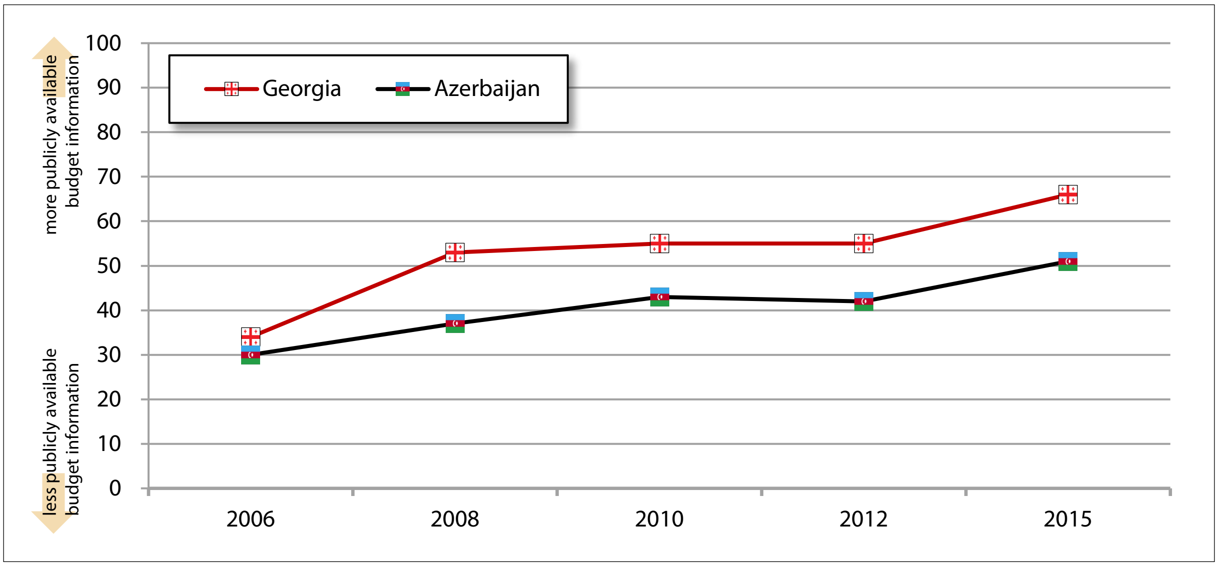
The Open Budget Index measures a country's budget transparency, the degree to which opportunities for public participation in the budget process are present, and the strength of the two formal oversight institutions, the legislature and the supreme audit institution. Assigning each country a score based on the average of the responses (in 2015) to 109 questions related to public availability of information on the Open Budget Questionnaire. This score reflects the quantity of publicly available budget information in the eight key budget documents. The scores ranging from 100 to 0 were calculated for the transparency standards. The index is a simple average of these percentages.

Figure 9: Open Budget Index 2015



Note: There are no values for Armenia.

Figure 10: Open Budget Index 2006–2015



Note: There are no values for Armenia.

Table 9: Open Budget Index 2006–2015

	2006	2008	2010	2012	2015
Georgia	34	53	55	55	66
Azerbaijan	30	37	43	42	51
Armenia	n. a.	n. a.	n. a.	n. a.	n. a.

Note: There are no values for Armenia.

Part 4: Socioeconomic Level of Development

Human Development Index

Prepared by: United Nations Development Program (UNDP)
Since: 1990 (back calculation of data for 1975 to 1990 for non-socialist countries)
Frequency: Annual
The data refer to the corresponding year of evaluation and are published two years later.
Covered countries: at present 188
URL: <http://hdr.undp.org/en/statistics/data/>

Brief description:

The Human Development Index (HDI) measures the average achievements in a country in three basic dimensions of human development: a long and healthy life (life expectancy), knowledge (adult literacy (2/3) and school enrolment (1/3) rate) and a decent standard of living (GDP per capita in purchasing power parity). Performance in each dimension is expressed as a value between 0 and 1. The HDI is then calculated as a simple average of the dimension indices.

Since 2012 the dimension knowledge is measured by mean of years of schooling for adults aged 25 years and expected years of schooling for children of school entering age (capped at 18 years).

Figure 11: Human Development Index: Scores and Rankings 2014

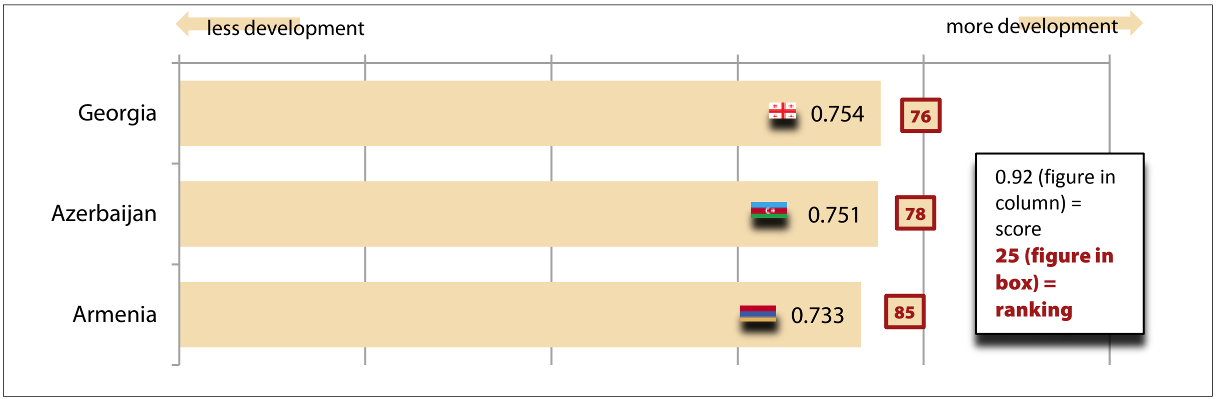


Figure 12: Human Development Index: 1990–2014

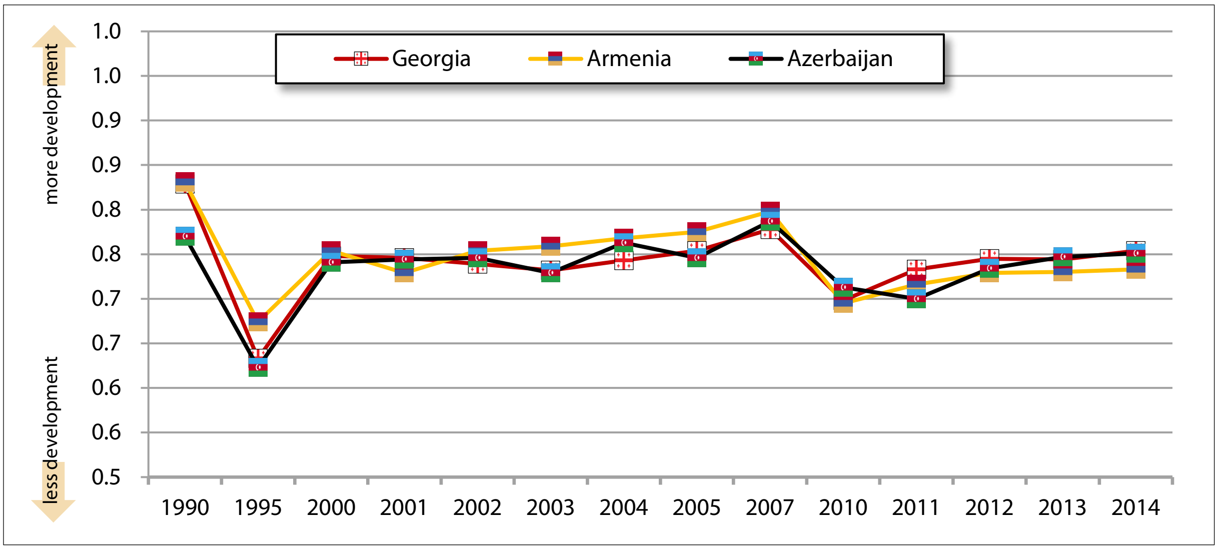


Table 10: Human Development Index: 1990–2014

	1990	1995	2000	2001	2002	2003	2004	2005	2007	2010	2011	2012	2013	2014
Georgia	0.829	0.633	0.748	0.746	0.739	0.732	0.743	0.754	0.778	0.698	0.733	0.745	0.744	0.754
Azerbai-jan	0.770	0.623	0.741	0.744	0.746	0.729	0.763	0.746	0.787	0.713	0.700	0.734	0.747	0.751
Armenia	0.831	0.674	0.754	0.729	0.754	0.759	0.768	0.775	0.798	0.695	0.716	0.729	0.730	0.733

The Global Innovation Index

Prepared by: Cornell University, INSEAD, the World Intellectual Property Organization (WIPO)
Established: 2007
Frequency: annual
The data refer to the previous respective year
Covered countries: at present 141
URL: <https://www.globalinnovationindex.org/content.aspx?page=data-analysis>

Brief description:

The Global Innovation Index (GII) relies on two sub-indices, the Innovation Input Sub-Index and the Innovation Output Sub-Index, each built around pillars.

Five input pillars capture elements of the national economy that enable innovative activities: (1) Institutions, (2) Human capital and research, (3) Infrastructure, (4) Market sophistication, and (5) Business sophistication. Two output pillars capture actual evidence of innovation outputs: (6) Knowledge and technology outputs and (7) Creative outputs.

Each pillar is divided into sub-pillars and each sub-pillar is composed of individual indicators (79 in total). Sub-pillar scores are calculated as the weighted average of individual indicators; pillar scores are calculated as the weighted average of sub-pillar scores. The Innovation Input Sub-Index is the simple average of the first five pillar scores. The Innovation Output Sub-Index is the simple average of the last two pillar scores. The overall GII is the simple average of the Input and Output Sub-Indices.

The framework is revised every year in a transparent exercise to improve the way innovation is measured. In 2015, a total of six indicators were modified. Scores and rankings from one year to the next are not directly comparable. Each ranking reflects the relative positioning of that particular country/economy.

Figure 13: Global Innovation Index Score 2015

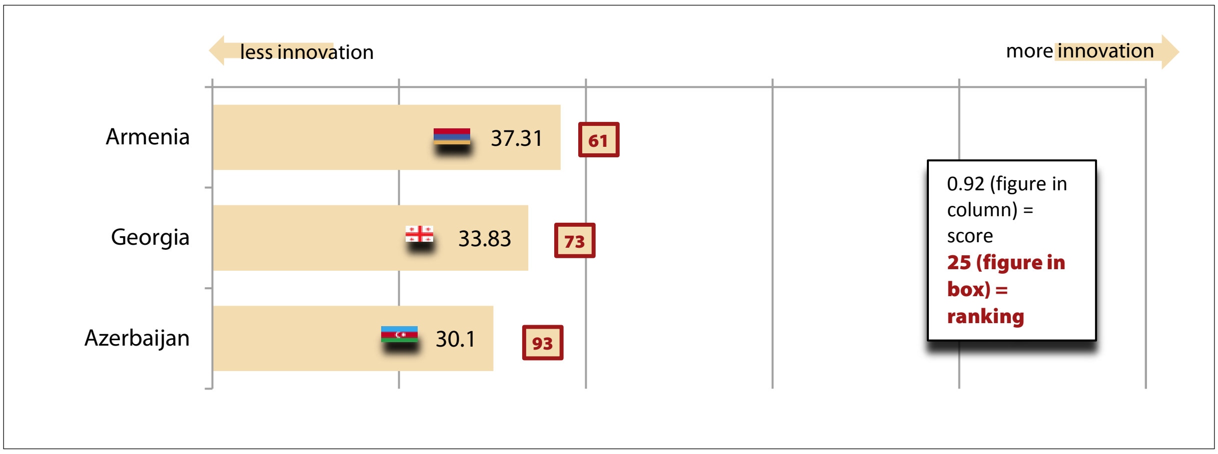


Table 11: Global Innovation Index Component Scores 2015

		Armenia	Azerbaijan	Georgia
Overall rank		*61*	*93*	*73*
Global Innovation Index		*37.3*	*30.1*	*33.8*
Innovation Input Sub-index		*41.8*	*37.6*	*41.8*
1	Institutions	67.0	56.2	68.2
1.1.	Political environment	54.5	41.5	54.2
1.2.	Regulatory environment	70.3	53.0	78.0
1.3.	Business environment	76.0	74.1	72.3
2	Human capital and research	19.0	21.9	23.6
2.1.	Education	26.4	31.2	38.4
2.2.	Tertiary education	27.9	22.1	30.5
2.3.	Research and development (R&D)	2.7	12.3	2.0
3	Infrastructure	37.3	37.1	36.5
3.1.	Information and communication technologies (ICT)	50.2	47.8	51.1
3.2.	General infrastructure	25.4	23.5	26.5
3.3.	Ecological sustainability	36.4	40.1	32.1
4	Market sophistication	54.7	52.0	52.8
4.1.	Credit	59.6	26.8	52.8
4.2.	Investment	26.1	59.2	26.4
4.3.	Trade and competition	78.3	70.1	79.3
5	Business sophistication	31.0	20.7	28.0
5.1.	Knowledge workers	39.9	23.8	27.1
5.2.	Innovation linkages	20.8	17.4	31.7
5.3.	Knowledge absorption	32.4	21.0	25.3
Innovation Output Sub-index		*32.8*	*22.6*	*25.8*
6	Knowledge and technology outputs	30.6	19.0	26.6
6.1.	Knowledge creation	25.4	2.8	20.2
6.2.	Knowledge impact	36.5	33.0	39.6
6.3.	Knowledge diffusion	29.8	21.2	20.1
7	Creative outputs	35.1	26.2	25.0
7.1.	Intangible assets	51.3	39.8	36.2
7.2.	Creative goods and services	23.7	20.1	22.1
7.3.	Creation of online content	14.1	5.1	5.5

Country rankings compiled by Anastasia Stoll

CHRONICLE

19 February – 19 March 2016

19 February 2016	Moscow grants Armenia a 200 million US dollars loan for the purchase of Russian arms
19 February 2016	Leader of Georgian opposition party Democratic Movement party, Nino Burjanadze, meets with Russian Deputy Foreign Minister Grigory Karasin in Moscow
22 February 2016	Officials from the Georgian Economy Ministry and the Chinese Ministry of Commerce held a first round of talks on a free trade agreement between the two countries in Tbilisi
23 February 2016	Azerbaijani President Ilham Aliyev meets with his Iranian counterpart Hassan Rohani in Tehran and sign cooperation documents on energy trade and transportation
25 February 2016	Georgia officially marks the Day of Soviet Occupation when the Red Army took over Tbilisi 95 years ago
25 February 2016	Georgian Deputy Energy Minister Mariam Valishvili, says that Georgia is importing electricity from Russia to supply to the breakaway region of Abkhazia at a "very preferential price" and as a short-term solution to prevent a power outrage
26 February 2016	Alexi Petriashvili, leader of opposition party Free Democrats (FD) and former Georgian state minister for European integration, is shot and wounded in Tbilisi
28 February 2016	Spanish Foreign Minister Jose Manuel Garcia-Margallo visits Tbilisi and reiterates Spain's "full support" to Georgia's territorial integrity
1 March 2016	Coal miners in the Georgian town of Tkibuli end a strike of two weeks following an agreement with a coal mining company on a gradual pay rise
3 March 2016	The European Commission approves the Trans Adriatic Pipeline (TAP) that will transport Azerbaijani natural gas to Italy via Greece
4 March 2016	Georgia's Energy Minister Kakha Kaladze says that a new deal with Azerbaijan to supply an additional 500 million cubic meters of gas removes the need for Georgia to receive additional gas through Russian energy company Gazprom
6 March 2016	Several thousand people form a human chain in Tbilisi in a protest organized by the opposition party United National Movement against talks between the Georgian government and Russian energy company Gazprom
7 March 2016	Turkey and Azerbaijan start joint military exercises in the Turkish city of Konya
9 March 2016	Georgian Energy Minister Kakha Kaladze tells Georgian lawmakers that Georgia has completely secured its gas supplies in a new deal with Azerbaijani state company SOCAR
11 March 2016	The Court of Appeals in Baku rules that human rights activists Leyla Yunus and her husband, Arif Yunus, are not allowed to leave Azerbaijan to seek medical treatment in Germany
11 March 2016	Georgia releases four South Ossetian prisoners in exchange for twelve prisoners handed over by the Abkhaz and South Ossetian breakaway regions in a rare tripartite deal
13 March 2016	Azerbaijan says that its border guards have shot five armed Bangladeshi and Azerbaijani citizens who were crossing illegally into Iran
15 March 2016	The Prosecutor's Office in Georgia says that five persons have been charged with the unlawful possession of videos of private lives in a case predating the recent release of sex tapes, purportedly showing Georgian politicians
17 March 2016	Azerbaijani President Ilham Aliyev signs an amnesty decree for 148 prisoners, including opposition activists and politicians, but not prominent investigative journalist Khadija Ismayilova
18 March 2016	The Georgian Parliament launches formal procedures for a proposed draft by the ruling Georgian Dream coalition aiming to define marriage as the union of a man and a woman in the Georgian constitution
19 March 2016	A rally is organized in the center of Tbilisi to protest against the infringement of privacy rights following the release of sex tapes, purportedly showing Georgian politicians

Compiled by Lili Di Puppo

For the full chronicle since 2009 see <www.laender-analysen.de/cad>

ABOUT THE CAUCASUS ANALYTICAL DIGEST

The Caucasus Analytical Digest (CAD) is a monthly internet publication jointly produced by the Caucasus Research Resource Centers (<http://www.crrccenters.org/>), the Research Centre for East European Studies at the University of Bremen (<www.forschungsstelle.uni-bremen.de>), the Institute for European, Russian and Eurasian Studies of the George Washington University (<www.gwu.edu/~ieresgwu>), the Resource Security Institute in Washington, DC (<resourcesecurityinstitute.org/>), the Center for Security Studies (CSS) at ETH Zurich (<www.css.ethz.ch>), and the German Association for East European Studies (DGO). The Caucasus Analytical Digest analyzes the political, economic, and social situation in the three South Caucasus states of Armenia, Azerbaijan and Georgia within the context of international and security dimensions of this region's development. CAD is supported by a grant from ASCN (<www.ascn.ch>).

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Resource Security Institute

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Caucasus Research Resource Centers

The Caucasus Research Resource Centers program (CRRC) is a network of research centers in Armenia, Azerbaijan and Georgia. We strengthen social science research and public policy analysis in the South Caucasus. A partnership between the Carnegie Corporation of New York, the Eurasia Partnership Foundation, and local universities, the CRRC network integrates research, training and scholarly collaboration in the region.

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ASCN <www.ascn.ch> is a programme aimed at promoting the social sciences and humanities in the South Caucasus (primarily Georgia and Armenia). Its different activities foster the emergence of a new generation of talented scholars. Promising junior researchers receive support through research projects, capacity-building trainings and scholarships. The programme emphasizes the advancement of individuals who, thanks to their ASCN experience, become better integrated in international academic networks. The ASCN programme is coordinated and operated by the Interfaculty Institute for Central and Eastern Europe (IICEE) at the University of Fribourg (Switzerland). It is initiated and supported by Gebert Rüf Stiftung <http://www.grstiftung.ch/en.html>.

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