GEORGIAN FOUNDATION FOR
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TRADE AND INVESTMENT RELATIONS BETWEEN GEORGIA AND CHINA

VAKHTANG CHARAIA

94

EXPERT OPINION

RONDELI FOUNDATION
საქართველოს სტრატეგიისა და საერთაშორისო ურთიერთობათა კვლევის ფონდი
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On the Investment Potential of China

The interest of investors in developing countries (for example, 2014 was the first and so far the only year when investments in developing countries exceeded investments in developed countries – USD 704 billion as opposed to USD 563 billion[1]) is often caused by certain advantages offered by the country, including a cheap labor force, a flexible labor code, low taxes, the government being on good terms with businesses, the ease of obtaining dominant status on the market and many others.

However, the above said should not be understood as though it is only investors who are willing to have these kinds of investment opportunities. No less interest is expressed by countries with developing economies which do not possess enough domestic resources to overcome the so-called "investment hunger." Furthermore, some developing countries, including Georgia, create a system of tax breaks in order to resolve this "hunger" problem as well as modeling the business environment on investors, creating free economic zones and so on.

According to the data from 2016, the amount of foreign direct investments (FDIs) worldwide reached USD 1,746 billion, of which about USD 1 trillion was invested in developed countries while USD 700 billion went to developing countries and countries in transition.[2]

The largest part of FDIs went to the USA (about USD 391 billion) with the UK being the runner up (USD 254 billion) and China holding the third position (USD 134 billion). As for the list of countries making the FDIs, the USA is still the leader here (USD 299 billion) with China holding the second place (USD 183 billion).[3]

According to the Investment Promotion Agency, China is considered to be the most promising home economy for the period from 2017 to 2019 as well as the top prospective host economy for 2017 to 2019 for multinational enterprises.[4] In other words, China is both one of the world's largest investor countries as well as being one of the most popular destinations for FDIs.

Georgia's Economy in Brief

Many important steps have been taken with the aim of attracting FDIs to Georgia. The most prominent include: permanent improvement of the legal basis, signing the Deep and Comprehensive Free Trade Area agreement (DCFTA)[5] and the Association Agreement with the EU and establishing free trade agreements with China, Turkey, Switzerland, Norway, Iceland, Liechtenstein and the member states of the Commonwealth of Independent States and the EU.[6]

Advances in the international ratings deserve to be mentioned separately. More specifically, Georgia holds the 16th place in the world in 2017 according to the World Bank's Doing Business study.[7] The country holds the 13th place according to the Heritage Foundation's Economic Freedom Index 2017.[8] Georgia was on the 5th place in the world in 2016 according to the Fraser Institute's Economic Freedom Index.[9] Georgia also holds the 6th place in the world among the safest countries in the Crime and Safety Index of 2016.[10] Georgia held the 44th place in 2016 according to the Corruption Perception Index, which is better result than many European countries have.[11]

No less important than these results is the fact that Georgia's statistical data has been improving for the past two decades. More specifically, from 1995 to 2016:

- The gross domestic product (GDP) per capita increased almost six-fold from just USD 600 to USD 3,852.5.[12]
- The banking sector's assets, one of the vital elements of the country's financial stability, increased 90 times.[13]
- Exports increased 12 times.[14]
- FDIs increased from about USD 3.7 million to USD 1.6 billion.[15]
- Average wage increased 66 times by 2015.[16]

Despite such success stories, there have been numerous difficult periods in the history of post-Soviet Georgia from the 1990s as the country went through civil war, hyperinflation, a full embargo from the Russian Federation as its main trade partner and followed by a military conflict in 2008 year.[17] At the same time, Georgia has several problems which it has failed to resolve so far.[18] These include: the small consumer market[19] (in the future, it should be resolved through free trade regimes with the EU, China and other important partners), low qualifications of the labor force, the existence of the occupied territories[20] with the consequent risks of new military operations and others.

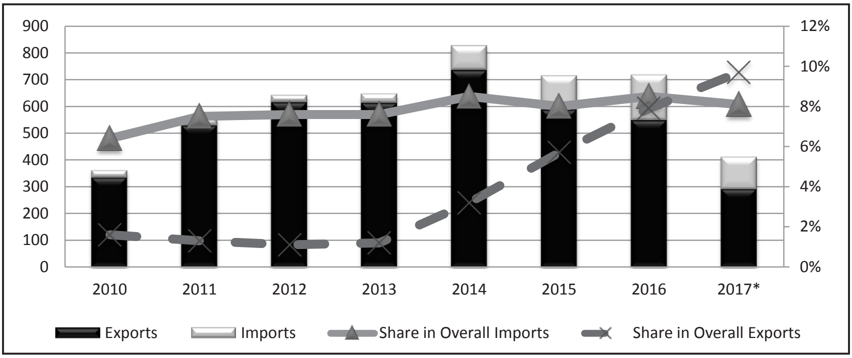
Development of Trade Relations

It is noteworthy that the trade turnover between China and Georgia has been increasing almost every year which is especially important for Georgia as the indicators of the export of Georgian goods to China is increasing (main export production is wine and other alcoholic beverages). The share of China in Georgian exports already reaches almost 10%. Georgian exports to China had increased 4.5 times by 2016 as compared to 2010 while imports had increased 1.6 times in the same period (see Chart 1) which indicates a new stage in Georgian-Chinese trade relations as well as providing a basis for developing Georgia's economy with a view to attracting new international companies.[21]

Chart 1

Trade between China and Georgia

(left column USD million, right column percentage)



*First two quarters of 2017

Source: National Statistics Office of Georgia (Geostat), www.geostat.ge/index.php?action=page&p_id=134&lang=eng.

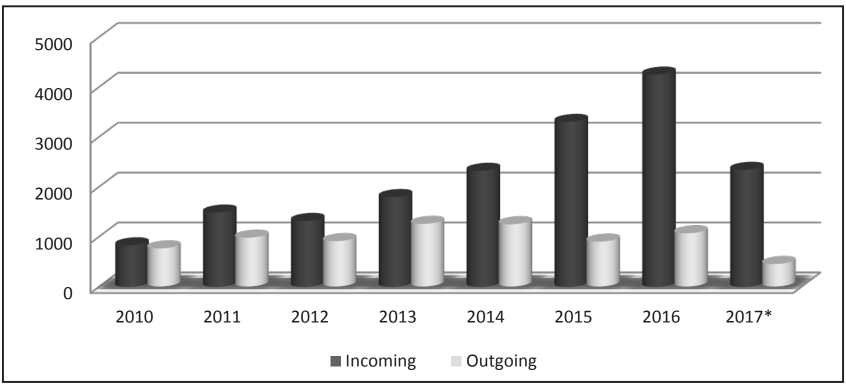
It is quite clear that the free trade agreement with China will stimulate the export potential of Georgian companies. At least Georgian wine companies will have new opportunities, as previously they had to pay 40% duty tax in order to enter the Chinese market, thereby making Georgian wine uncompetitive. China has become one of the most important consumers of Georgian wine from 2015. More specifically, about 7.4% of the wine exported from Georgia to the rest of world went to China (2,672,154 bottles) making it the fourth largest export market for Georgian wine.[22] Even more impressive was 2016 when the exports of Georgian wine reached 50 million bottles and wine exports to China saw an increase of 98% (5,299,149 bottles) making it the third largest export market for Georgian wine after Russia (over 22 million bottles) and Ukraine (over 5.8 million bottles).[23] As for the data from the first quarter of 2017, China occupies the second place after Russia (growth amounted to 383% as compared to the same period of 2016[24]), with the Chinese market potential to overtake the Russian market. According to the free trade agreement which was enacted on May 13, 2017 (negotiations started in September 2015), about 94% (except some minor exceptions) of Georgian goods and services exported to the 1.4 billion-strong Chinese market will not be subject to customs fees and enjoy a 0% tariff.[25] This agreement is a part of the new global policy of the Chinese government which is entitled to the One Belt, One Road (OBOR) initiative. China plans to sign free trade agreements with 65 countries participating in this initiative. It has already signed such agreements with 12 of these countries.[26]

Money Transfers and Tourism

Despite the fact that the Georgian-Chinese partnership in terms of money transfers is not especially important or large, it should be pointed out that it is characterized by quite active dynamics and the incoming transfers increased by more than five times in the past seven years (see Chart 2).

Chart 2

Money Transfers from China to Georgia and Vice Versa

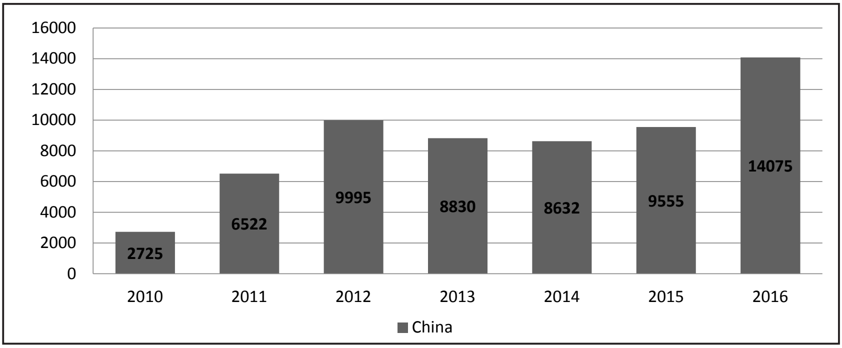


Source: National Bank of Georgia, www.nbg.gov.ge/index.php?m=304.

The tourism sector is also looking quite dynamic and attractive. The number of Chinese tourists has increased almost five times from 2010 to 2016 (see Chart 3). If we take into account the interest of the Chinese in travelling and sightseeing around historical monuments, also adding to this the direct air connection with China and the recent growth of the number of Chinese cultural elements in Georgia (Chinese food restaurants, Chinese speaking guides, Chinese investments in tourism industry and others), we should expect even greater numbers of Chinese tourists to visit Georgia.

Chart 3

Number of Chinese Tourists by Year



Source: Georgian National Tourism Administration, www.gnta.ge/statistics/.

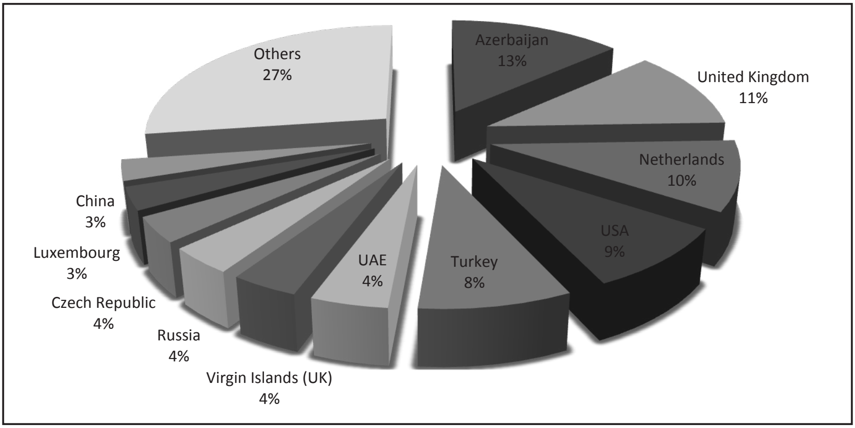
Foreign Direct Investments

For Georgia, as for other countries, FDIs are of vital importance.[27]

According to the statistical data, FDIs in Georgia in the period starting from 1996 to the first quarter of 2017 amounted to USD 16.9 billion of which 41% came from EU member states. That said, Chinese investments have been gaining ground for the last couple of years (see Chart 4). More specifically, the amount of Chinese FDIs reached almost USD half-a-billion (USD 489 million) in the period from 2002 to 2017 of which 91% (USD 444 million) was invested in the past five years. Taking into account that China has been trying to strengthen its economic position in the world since 2013, China is indeed becoming a solid partner for Georgia, especially in terms of the OBOR initiative (with the project budget of USD 40 billion).

Chart 4

FDIs in Georgia by Country
(USD million, from 1996 to Q1 2017)

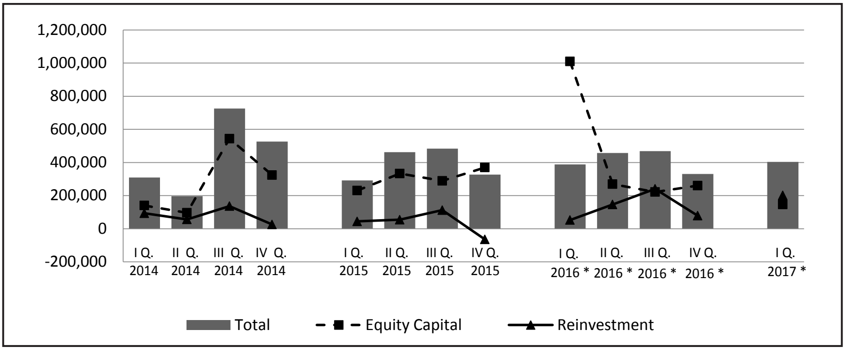


Source: National Statistics Office of Georgia,
www.geostat.ge/index.php?action=page&p_id=2231&lang=eng.

If we inspect FDIs to Georgia by component, it becomes clear that the investments are mainly focused in assets. However, quite solid reinvestment trends were observed in 2016 and the first quarter of 2017 as well. The latter might be connected with the so-called Estonian Model of the profit tax adopted by the Government of Georgia which provides for the non-taxation of profits in case of their reinvestment. Particularly, the share of reinvested money in 2016 reached 32% of the overall investments (USD 518 million) while this figure increased to 50% or USD 201 million in the first quarter of 2017 (see Chart 5).

Chart 5

FDIs in Georgia by Components



*Preliminary Data

Source: National Statistics Office of Georgia, www.geostat.ge/index.php?action=page&p_id=2231&lang=eng.

Sectors which attract the most FDIs in Georgia are considered to be: energy, transport, real estate and construction, and processing industries. It is interesting that the structure of the Chinese investments in Georgia is consistent with this list of attractive investment destinations (see Table 1). A negative investment indicator means that the investor sold the previous investment to someone else.

Several large projects can be distinguished from the list of Chinese investment in Georgia connected with the construction sector such as, for example, the Tbilisi Sea Olympic Complex, an especially large investment, prepared for the 2015 Youth Olympic Festival with USD 200 million in investment from the Hualing Group. The Hualing Group has invested in sectors such as construction, hotels, medical care, wood processing, cement production, free trade zones, airplane transfers and the banking sector.[28]

Table 1

Direct Investments from China to Georgia

(USD thousand)

Year	2011	2012	2013	2014	2015	2016*	2017 I Quarter*	Total
Overall	9,643	36,126	89,874	217,944	66,948	27,379	6,575	454,489
Construction	8,752	6,809	55,472	202,921	56,815	-3,176	-6,316	321,279
Finance Sector	-	28,919	36,041	7,210	4,973	8,408	1,960	87,512
Real Estate	-	64	-72	4,193	27,719	19,351	10,357	61,612
Mining Industries	627	1,476	-132	-89	-425	408	-1	1,865
Energy	-1,322	18	-1,795	2,457	-1,619	548	109	-1,604
Processing Industries	1,534	-1,145	-133	607	-20,539	953	182	-18,541
Other Sectors	52	-15	493	645	23	886	282	2,367

*Preliminary Data

Source: National Statistics Office of Georgia, www.geostat.ge/index.php?action=page&p_id=2231&lang=eng.

It should be pointed out that the structure of Chinese investments, as well as investments in general, is far from what would be desirable for the long-term development of the Georgian economy. More specifically, about three-quarters of Chinese investments are distributed among the real estate and construction sectors with investments in the high-tech and educationally loaded sectors virtually nonexistent. Despite the significant influx of Chinese investments in Georgia over the past couple of years, their regional distribution is negligible. Namely, 88% of Chinese FDIs was focused on Tbilisi in the period from 2013 to the first quarter of 2017 while the remaining 12% went to the regions (see Table 2).

Table 2

Direct Investments from China by Georgian Regions

(USD thousand)

Region	2013	2014	2015	2016*	2017 I Quarter*	Total
Overall	89,874	217,944	66,949	27,380	6,575	408,721
Tbilisi	67,430	211,056	61,976	14,900	6,173	361,534
Imereti, Racha-Lechkhumi and Kvemo Svaneti	24,323	4,579	5,496	9,494	-3	43,889
Kvemo Kartli	-	-	1,526	979	223	2,728
Others	-1,879	2,309	-2,049	2,007	182	570

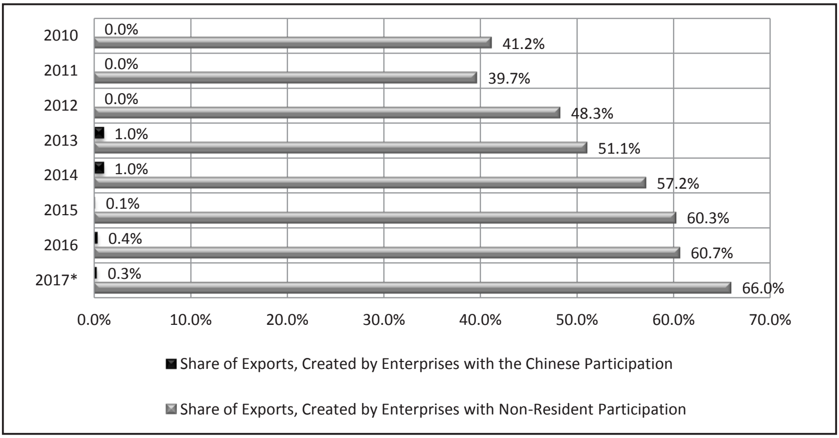
*Preliminary Data

Source: National Statistics Office of Georgia, www.geostat.ge/index.php?action=page&p_id=2231&lang=eng.

FDIs play an active role not only in favor of the local market and consumers but also in balancing the external trade. The share of companies created together with Georgian and foreign participation in the overall exports is growing year by year, exceeding 60% according to 2016 data (see Chart 6) which means that FDIs play an important role in the formation of Georgian exports. However, this happens mainly at the expense of low-technology fields.

Chart 6

Share of Exports in Total Exports, Created by Enterprises with Foreign Capital



*January to June 2017

Source: National Statistics Office of Georgia, www.geostat.ge/index.php?action=page&p_id=2231&lang=eng.

For now, Chinese investments are interested in covering the Georgian market which explains the negligible share of in total Georgian exports, created by enterprises with Chinese capital not even reaching 1% (see Chart 6). Due to the fact that the trade turnover between China and Georgia is growing, imports of Chinese production from China, rather than producing it here in Georgia, is popular so far. However, the free trade regime between Georgia and the EU should encourage the influx of the type of Chinese investments that will increase Georgia's exports to the EU's internal market.

Several important projects that are already planned by the Chinese in Georgia and whose operation can reach significant success must also be mentioned here. These include:

- The creation of the Georgia Development Bank with USD 1 billion in capital from 2018 by the CEFC China Energy Company Limited and Eurasian Invest LLC.[29] In strategic terms, this bank will serve as a new magnet for attracting Chinese investors to Georgia.
- Development of tea production in Georgia.[30]
- Creation of the Georgian-Chinese Fund for the Regeneration of Georgia which will be implemented with the support of the Georgia Partnership

Fund and Chinese CFC and fund Georgian startups with its USD 50 million budget (51% of the money will be Chinese contribution while 41% will be Georgian).[31]

- Creation of the Silk Road Common Market Zone which should facilitate the development of an innovative trade model.[32]

For all of the positive factors assisting Chinese-Georgian relations and which will probably also continue in the future, the existence of the constantly growing Chinese influence must also be taken into account. There is an opinion that the Chinese side does not shy away from using punitive mechanisms against partner countries, manifested in creating obstacles to trade.[33] By creating close economic ties with China and not anticipating the possible geopolitical vectors that China might pursue in the future, Georgia could well find itself on the receiving end of a heavy economic blow. This is why it is obligatory for Georgia to think about the geopolitical and geo-economic aspects of Russia-China, USA-China and EU-China relations. Hence, together with new opportunities, Georgia may have to face new challenges as well.

Conclusion

Increased Chinese investment potential has an important role to play in the success of the OBOR initiative.

Trade between Georgia and China has been extended significantly over the past several years with money transfers from China to Georgia increasing and Georgia becoming more attractive for Chinese tourists.

The level of Chinese investments in the Georgian economy is growing practically day-by-day and this trend will have an irreversible character in terms of the implementation of the Silk Road Economic Belt project.

Close economic ties with a country of formidable economic capabilities is definitely in the interest of Georgia in order to diversify export markets and attract foreign investments (with the consequent positive factors); however, we should not forget that a country fighting for world economic leadership has multiple influence mechanisms as well which might gradually create additional complications for Georgia which has been trying to establish closer economic, political and military ties with the West since its independence.

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