

FOREIGN DIRECT INVESTMENT IN THE SOUTH CAUCASUS

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Foreign Direct Investment in Azerbaijan—the Quality of Quantity

By Gerald Hübner, Frankfurt am Main

Abstract

Azerbaijan is one of the largest recipients of Foreign Direct Investment (FDI) in the Eastern European/South Caucasus Region. Its success comes from its attractiveness as a resource-rich country. These investments were an important catalyst for the start of the country's impressive economic boom. But investments outside the oil sector remained very low. Hence, FDI could not produce its full potential: a broad transfer of international know-how, management and technology combined with sufficient funds for other sectors of the economy. The country underperforms in these areas and is only able to cover its losses with huge transfers from oil profits. The time is ripe for Azerbaijan to break new ground.

Introduction

Azerbaijan was one of the fastest growing economies in the world over the first decade of the 21st century. This growth was, and remains, linked to the fact that Azerbaijan has significant amounts of hydrocarbon reserves and the interest to exploit and sell these resources on the world markets. The country's leaders viewed the oil resources as a sheet anchor and buried treasure to be salvaged to ensure a prosperous future for their country.

As the Soviet Union focused its hydrocarbon exploitation activities in the decades before its collapse on the huge reserves in Siberia, it neglected extraction and infrastructure development in the Caspian Basin. In order for Azerbaijan to take advantage of its resources after gaining independence, it needed three things: sufficient capital, technology, and know-how to properly manage investments in this segment of the economy. But the country lacked all three in both the state and private domestic sectors. As a consequence, it had to attract international investors—a typical approach for a resource-abundant developing or transition country. And this is where foreign investments, and especially Foreign Direct Investments (FDI), came to play a sizeable role in Azerbaijan.

Before we look into the facts and figures and the FDI environment in Azerbaijan, we will briefly outline what FDI is and explain the underlying motives and determinants for FDI in general. We will also define the constraints on investment abroad and in Azerbaijan respectively. And finally, we will examine what role FDI can play in an economy like Azerbaijan's and investigate what the country can do to attract an economically diversified portfolio of foreign investments.

FDI—Definition, Motives and Determinants

All of the key international organisations, such as the International Monetary Fund (IMF), the Organisation for Economic Cooperation and Development (OECD),

and the United Nations Conference on Trade and Development (UNCTAD) define FDI as: the long-term financial participation by an investor from one country in an enterprise from another country, thereby having a significant degree of influence on the management of the enterprise (at least a 10% share of capital plus technology and know-how transfer indicating a “significant” degree of influence).

But why would a company take the high risk of directly investing in another country? It would do so if the investment advantages are considered to be higher than the anticipated risks and would outweigh costs. The literature employs the concept of “OLI” (first introduced by John Dunning in the late 1970s). According to this concept, an investor's decision to invest in a foreign country is determined by the existence of three different types of advantages or preconditions: Ownership, Localisation and Internalisation advantages. Ownership advantage refers to a product or production process that no domestic company already controls. Such ownership includes patents, technology, but also intangible assets, such as reputation, brand name, knowledge and management skills. Internalisation is derived from a company's interest in maintaining its knowledge assets internally. It prevents host country companies from copying (if they have the ability to do so) and entering into direct competition with the foreign investor. If the foreign investor lacks such an advantage, he would prefer to use licensing to serve demand in the foreign market. These two advantages are more or less location-independent. The third aspect is the set of location-specific advantages, which determine the attractiveness of a country.

There are three main location-specific determinants of a country's attractiveness for FDI:

- Market-seeking (or horizontal) investment: the investing company wants to tap a new sizeable market with growth potential, which makes investment more attractive than exporting to the market. These investments aim at penetrating the local market of the host country.

- Efficiency-seeking (or vertical) investment: this category of investments is production-cost minimizing. Companies seek to produce in lower cost locations to increase their (global) competitiveness. They look for cheaper labour resources and factory costs (taxes, trade barriers, transportation costs).
- Resource-seeking investments: Here, usually non-renewable natural resources attract investors. These investments are often also combined with “strategic asset-seeking investments”, where the investors are global players and—with the support of their home governments—seek to work up their international market position and get a strategic advantage. Resource-seeking investments (in conjunction with strategic asset-seeking) were the first that Azerbaijan attracted on a large scale.

According to the OECD, investments in the first two categories were the main drivers of the “first wave” of FDI in Central European countries in the 1990s and the “second wave” since the beginning of the new millennium in South East Europe. These countries do not possess large-scale natural resources which would have attracted a significant influx of FDI. They were attractive due to their market (demand for goods) and efficiency potential. They competed among themselves with smart economic development policies, which were also targeted at FDI. These countries combined large-scale privatisation with corporate taxation measures, incentive schemes, free trade zones and direct investment promotions. They opened up their financial markets for development and competition, demonstrated a relatively low level of corruption, and benefited from a highly skilled, low-cost labour force that could be employed in a variety of positions.

On average, the countries of the CIS lacked such an enabling environment. But since 2000 the region started to show a continuously growing local demand for goods, especially in the bigger countries (Russia, Ukraine, and prospering Kazakhstan). Even though the environment for FDI was, and is, much more challenging due to slower transition processes, high level of corruption, lower qualified labour forces and low levels of labour productivity (Figure 1), investors began to move eastwards and invest in the region beyond the natural resource sector. The “third wave” was just about to take off in the CIS region, when it was suddenly interrupted by the global financial crisis. After several years of an upward FDI trend, the net inflows declined by roughly 50% between 2008 and 2009 (Figure 2).

The Case of Azerbaijan: High FDI Inflows but Low Diversification

How does Azerbaijan compare against these criteria? Azerbaijan shows a different path of development than

the CIS average due to the attractiveness of its hydrocarbon reserves. First of all, since Azerbaijan gained independence, the country was able to attract significant inflows of foreign investment, 70% of which were FDI. This influx began in the second half of the 1990s (the first influx of foreign money to re-/build the Baku–Supsa pipeline for the so-called early oil from the Caspian to the Georgian port of Supsa) and peaked between 2005 and 2007. Between 1993 and 2010 total foreign investments amounted to 54.2 billion USD, out of which 37.6 billion USD was FDI. (Figure 4). Investments into fixed capital developed almost congruently. They made up half of total foreign investments (27.7 billion USD).

According to its capital account classification, Azerbaijan recorded positive FDI flows of 4 billion USD on a netted basis (gross inflows minus dividends and profits which were not reinvested into the local economy minus real FDI outflows, which are investments from domestic companies abroad). (Table 5) With a population of around 9 million, Azerbaijan accumulated net FDI per capita of 450 USD through year-end 2010. This is more than twice the CIS average and lies in the same range with Central Europe.

At first glance these figures and ratios look quite impressive. The high FDI inflow definitely contributed to the highest GDP growth rates in the world during 2005–2009. The huge influx of foreign capital also acted like a catalyst for the overall economic recovery and development of the country. But we need to be careful here. As was already mentioned, the huge investment appetite in Azerbaijan stemmed mainly from the global oil industry. Resource-seeking advantages were and still are the prime investment motive in Azerbaijan. As we can see in Figure 5, 88% of total FDI between 1993 and 2010 went to the oil-extracting industry. With British Petroleum having a lead in the biggest oil-extracting projects, UK is the lead FDI contributor, followed by the USA (Exxon, Amoco, Unocal), Turkey (Turkish Petroleum), Russia (Lukoil), Norway (Statoil) and Japan (Itochu).¹

Total non-oil FDI inflow stood at 4.4 billion USD since 1993 and showed a stronger increase only over the last four years (2.2 billion USD or 50% of total non-oil FDI). Non-oil FDI is also rather concentrated, both country-wise and sector-wise. The top three countries, Turkey, USA and UK, count for almost two thirds of all investments (Figure 6). This reflects to a significant extent their hydrocarbon-related up- and downstream investments in the country. The concentration would

¹ Unfortunately, there is no publicly available information on the exact distribution of total FDI by countries (of investors) for the last decade. Even Azpromo, the Azerbaijan Investment Promoting Agency was not able to provide such information on enquiry.

certainly also explain the 52% share of industry-related investments among non-oil FDI (Figure 7). Investments in additional non-oil segments cover areas with local market potential and with non-tradable goods, such as telecommunication services (mobile phone operators with overseas investments from Turkey and the USA), local food and beverage industry (e.g. Coca-Cola Turkey), tourism infrastructure (hotels with foreign ownership) or construction (with investments from Turkey, but also Germany).

The Economic Potential of FDI: Qualitative and Quantitative Aspects

In a diversified environment, FDI can contribute to broad know-how and technology transfer, inclusion into the global economy, and the development of the financial sector as one of the preconditions for further economic stimulation. It usually contributes to wealth and job creation. And it can have an impact on educational levels and an increase of skills among the working population through training and investments in research and development. Overall, there is a strong correlation between FDI and economic growth. That is what we also see in Azerbaijan, where the huge investments into the oil industry acted as a catalyst for other economic sectors, such as construction, transportation, and finance.

Government officials and the investment promoting agency proudly proclaim over and over again how quickly the economy developed, especially during the first decade of the 21st century, and the large amount of FDI they attracted. They refer to their investment-grade sovereign-rating and to the reduced formal poverty rate of below 10%, down from around 50% ten years ago. Of course, these are achievements, which are not negligible. For ordinary citizens this prosperity is today visible as twinkling sea fronts, well-appointed boulevards and the glamorous skyscrapers of the capital. But this type of quantity-related argumentation does not usually include a qualitative analysis. What they do not mention is the rather low FDI share in the non-oil sector. And here, investors do not choose Azerbaijan as a destination for efficiency-seeking investments, but predominantly as a place to sell goods (market-seeking investments).

It is arguable to what extent the resource-seeking and partly market-seeking investments help the overall development of the economy and the country. For instance, although the share of oil GDP is just below or around 50% and oil-related FDI accounts for as much as 88% of all FDI, the share of employees in the mining industry to the overall Azeri working population is just 1% (41,000 employees). That means that foreign FDI per "mining employee" was one million USD over the last two decades. In contrast, non-oil FDI in agriculture

was just 4.5 million USD (1% of non-oil FDI) in almost two decades of investments. But the sector employs 1.5 million people (40% of the working population). This is a per capita FDI of 3 USD in the agro-sector! Consequently, this sector shows the lowest value added to the economy (10 times less than the construction sector, tourism or transport and 500 times less than the mining industry). These figures provide a good picture of how national wealth is predominantly distributed.

For the time being, it would be highly doubtful to assume that Azerbaijan could survive at its current economic level without its reliance on the oil and gas industry. While no changes are needed immediately, the country cannot count on the fossil fuel sector in the mid- to long-term perspective.

Constraints and Opportunities for FDI in Azerbaijan

There are several reasons for the limited investment appetite outside of the almost independently functioning oil and gas sector. Azerbaijan is perceived as a tough autocratic system with widespread corruption, high informal market-entry barriers, sector monopolies combined with unfavourable monetary conditions.² Independent institutions, accountability, and the transparency needed to maintain an efficient market economy are by and large still in the early stages of development. Transparency and checks and balances of public sector accounts are notably lacking. The domestic market is rather small and regional trade barriers (for selling locally-produced goods) are high. Here, Azerbaijan takes one of the lowest positions according to the Doing Business Report of the World Bank. The banking sector is still underdeveloped, with very few international investors (Figure 8) and a significant share of state-owned assets. The appreciating currency is good for confidence among the population but highly unfavourable for efficiency-seeking investors as it makes production more expensive.³ Azerbaijan has so far failed to join the WTO, although it started accession negotiations in 1997. And, it is still considered a country with a higher geopolitical risk due to its unresolved conflict with Armenia over Nagorno-Karabakh.

On the positive side, Azerbaijan's government has embraced wide-ranging reforms to improve economic freedom. It signed bilateral trade treaties and introduced

2 Compare: Gerald Hübner, "As If Nothing Happened? How Azerbaijan's Economy Manages to Sail Through Stormy Weather," *Caucasus Analytical Digest*, No. 18 (The South Caucasus after the Global Economic Crisis), 05.07.2010, pp 8.

3 Compare: Gerald Hübner and Michael Jainzik, "Splendid isolation? Azerbaijan's economy between crisis resistance and debased performance," *Caucasus Analytical Digest*, No. 6 (The Caucasus in the Global Financial Crisis), 21.05.2009, pp 12–13.

investment stimulating legislation. It established an investment company to attract foreign investors—the Azerbaijan Investment Company—and promotes itself and investment opportunities worldwide through its foundation AZPROMO. The government finally started a one-stop-shop for investors to streamline business processes. It also cut corporate tax to a more favourable level of 20% (from 24% in 2005) and does not limit repatriation of profits. And the banking sector grew very strong, offering better interest rates and collateral requirements than its regional peers (Figure 9). And finally, foreign direct investments in the non-oil sectors grew significantly over the last four years (Figure 4 and Table 4).

The two most famous indices for assessing a country's business potential are the Doing Business Report of the World Bank and the Index of Economic Freedom of the Heritage Foundation and Dow Jones & Company. The Doing Business Report only focuses on the formal aspects of doing business in a country. Here, Azerbaijan was considered a top reformer in 2009 and jumped more than 60 positions up to the 33rd rank, but was overtaken by other reformers a year later. According to the 2011 Index of Economic Freedom, Azerbaijan ranks 92nd worldwide (which is above the CIS average, but significantly below its neighbours Georgia and Armenia).⁴ This index is more realistically founded since it relies on polls among businessmen. Here, Azerbaijan performs well on measures of fiscal freedom, labour freedom and business freedom; but poorly in property rights, freedom from corruption (TI list index 143 out of 180 countries) and monetary freedom (distortion of domestic prices).

Based on this analysis, direct recommendations include:

- Despite the considerable gains in regulatory reform and a growing economic diversification, substantial challenges remain, particularly in implementing deeper institutional and systemic reforms. To

facilitate economic diversification, the country could further promote oil-related upstream and downstream non-oil sectors (manufacturing and services). It would further need to increase both labour productivity and export performance via the import of technology, know-how and managerial expertise.

- Continued transformation and restructuring are needed to capitalize on Azerbaijan's well-educated labour force and tradition of entrepreneurship. Although the literacy rate is high in Azerbaijan, the level of skilled and technically advanced engineers and highly educated specialists in all fields is very low and needs significant investments and curriculum development. At the same time, the EBRD reported in its Transition Report 2010 that Azerbaijan is the country where companies spent less than in all other transition countries on Research & Development (R&D). Therefore, per-capita FDI should be coupled with policies designed to facilitate the transfer of knowledge and technology between firms. The government could also set incentive schemes for companies to invest more in its staff (education and vocational training) and in R&D.
- The government should further support and develop the still weak national banking system in order to create a more competitive environment. It should actively promote mergers and acquisitions among banks, especially with the participation of foreign investors. If such reforms are successful, access to finance for entrepreneurs at all levels (in general and especially in the form of better loan conditions) would improve.

Finally, the government needs urgently to tackle the pervasive culture of corruption. By doing so, many of the above mentioned deficits, such as the lack of monetary freedom as well as governance and transparency, would almost automatically improve. Here, the government took decisive steps since the beginning of 2011. It remains to be seen, whether the country will have the required patience and staying power to implement such reforms fully.

⁴ For comparison: Georgia: rank 29; Armenia: 36; Ukraine: 164; Moldova: 120; Russia: 143; Germany: 23.

About the Author

Gerald Hübner works at KfW Entwicklungsbank, the German Development Bank. He is project manager for private and financial sector development in Eastern Europe and the Caucasus. He is also co-author of the only German travel guide for Azerbaijan: "Aserbajdschan entdecken. Unterwegs im Land des Feuers." *This article expresses the opinion of the author and does not necessarily represent the position of KfW or Trescher-Verlag, the publishing company of the travel guide.*

(continued overleaf)

Further Reading

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STATISTICS

FDI-Related Data for Azerbaijan

Table 1: General Information 2000–2010 (all figures in mln USD unless stated otherwise)

	2000	2001	2002	2003	2004	2005
GDP in mln USD	5,272.90	5,707.70	6,235.3	7,276.2	8,680.4	13,238.7
Exchange Rate (AA) for 1 USD	0.89	0.93	0.97	0.98	0.98	0.95
Non-Oil GDP in %	64.8%	60.1%	60.9%	62.2%	61.5%	48.4%
GDP Growth Rate in constant prices	11.10%	9.9%	10.6%	11.2%	7.0%	26.4%
Population	8,081,000	8,141,400	8,202,500	8,265,700	8,347,300	8,436,400

	2006	2007	2008	2009	2010
GDP in mln USD	20,205.1	31,249.4	48,852.5	43,061.9	51,968.4
Exchange Rate (AA) for 1 USD	0.89	0.86	0.82	0.80	0.80
Non-Oil GDP in %	39.2%	35.6%	37.9%	45.4%	44.3%
GDP Growth Rate in constant prices	34.5%	25.0%	10.8%	9.3%	5.0%
Population	8,532,700	8,629,000	8,730,000	8,997,000	9,000,000

Sources: IMF, Statistical Committee of the Republic of Azerbaijan, Central Bank of Azerbaijan, Economist Intelligence Unit (EIU)

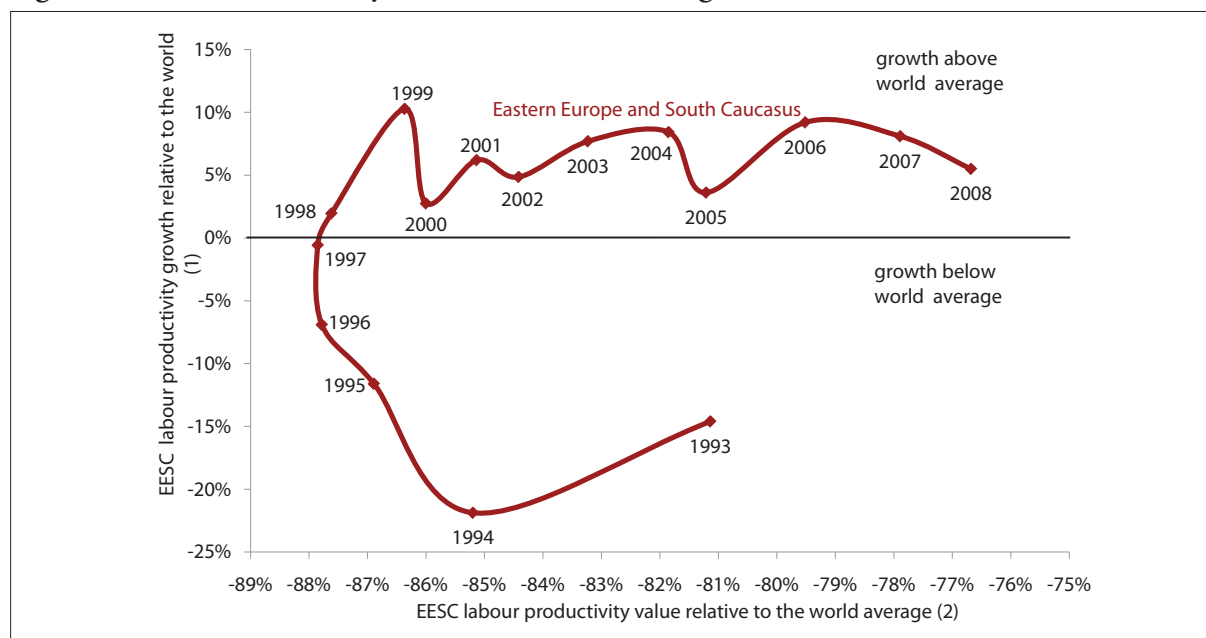
Table 2: Investments Directed to Economy 1993–2010 (all figures in mln USD unless stated otherwise)

	1993–1999	2000	2001	2002	2003	2004	2005
Total Investments	4,700.0	1,441.4	1,600.0	2,796.6	4,400.0	5,900.0	7,118.5
Total Investments, in % of GDP		27.3%	28.0%	44.9%	60.5%	68.0%	53.8%
of which Domestic Investments	30	514.4	500.0	561.7	955.4	1,347.2	2,225.3
of which to fixed capital	1,477.0	460.3	437.7	546.0	938.3	1,324.0	2,104.9
of which Foreign Investments	4,807.5	927.0	1,100.0	2,234.9	3,371.0	4,575.5	4,893.2
of which to fixed capital	2,336.6	507.5	733.1	1,560.9	2,848.0	3,598.8	3,665.0

	2006	2007	2008	2009	2010	1993–2010
Total Investments	8,300.4	12,066.1	16,222.0	13,033.5	17,354.8	94,933.3
Total Investments, in % of GDP	41.1%	38.6%	33.2%	30.3%	33.4%	
of which Domestic Investments	3,247.6	5,391.8	9,374.6	7,564.9	9,107.0	40,819.9
of which to fixed capital	2,901.4	4,626.7	7,702.2	6,079.9	7,309.3	35,907.7
of which Foreign Investments	5,502.8	6,674.3	6,847.4	5,468.6	8,247.8	54,200.0
of which to fixed capital	3,333.1	2,84.5	2,242.0	1,645.0	2,405.0	27,720.0

Sources: IMF, Statistical Committee of the Republic of Azerbaijan, UNCTAD, Central Bank of Azerbaijan

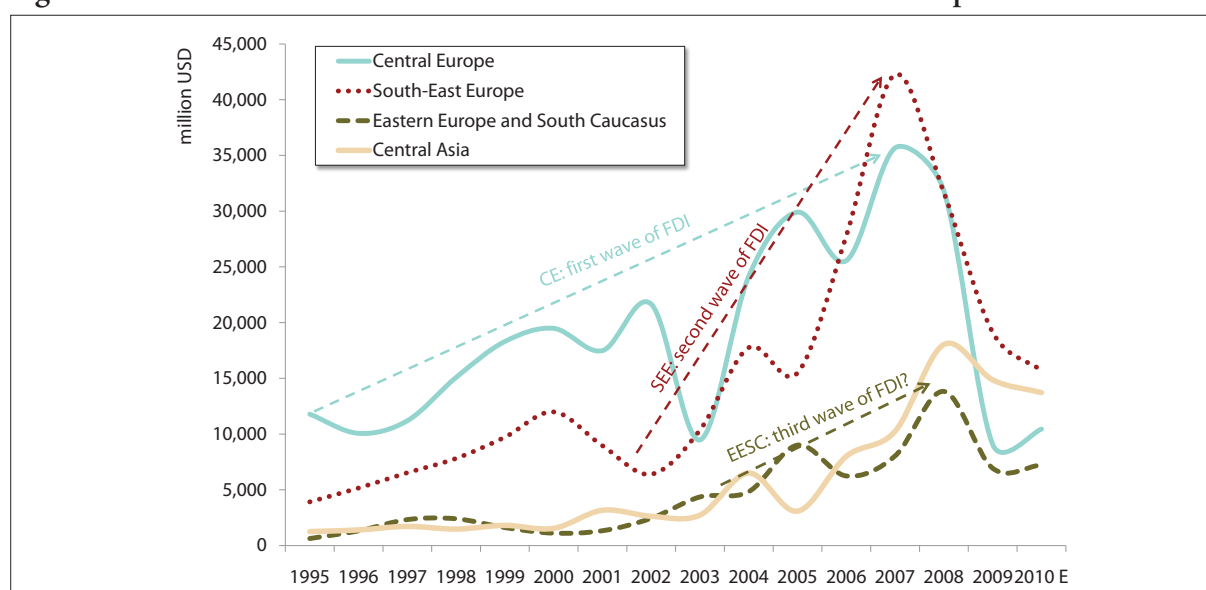
Figure 1: Labour Productivity Growth in the EESC Region



Note: GDP per employee is calculated as GDP in constant 2000 USD divided by employment over 15 years old; GDP per employee is not adjusted for cyclical fluctuations, number of work-hours and other factors that have an impact on GDP per employee but are non-related to productivity; labour productivity growth relative to the world is calculated as the difference between GDP per employee growth rate in the region and GDP per employee growth rate in the world.

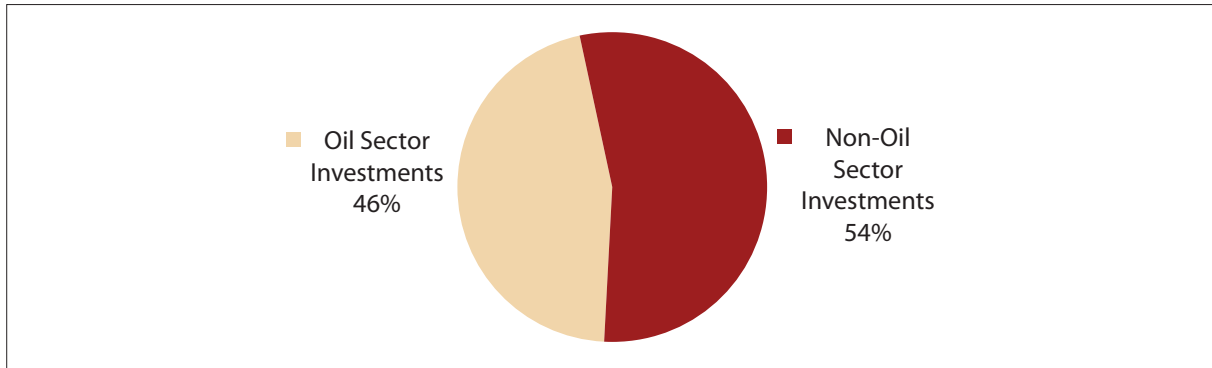
Source: Farra, Fadi: *Competitiveness and Private Sector Development: Eastern Europe and South Caucasus 2011. Competitiveness Outlook. Organisation for Economic Co-operation and Development (OECD), Paris 2011.*

Figure 2: The Three Waves of FDI Inflows in Central and South East Europe and the CIS



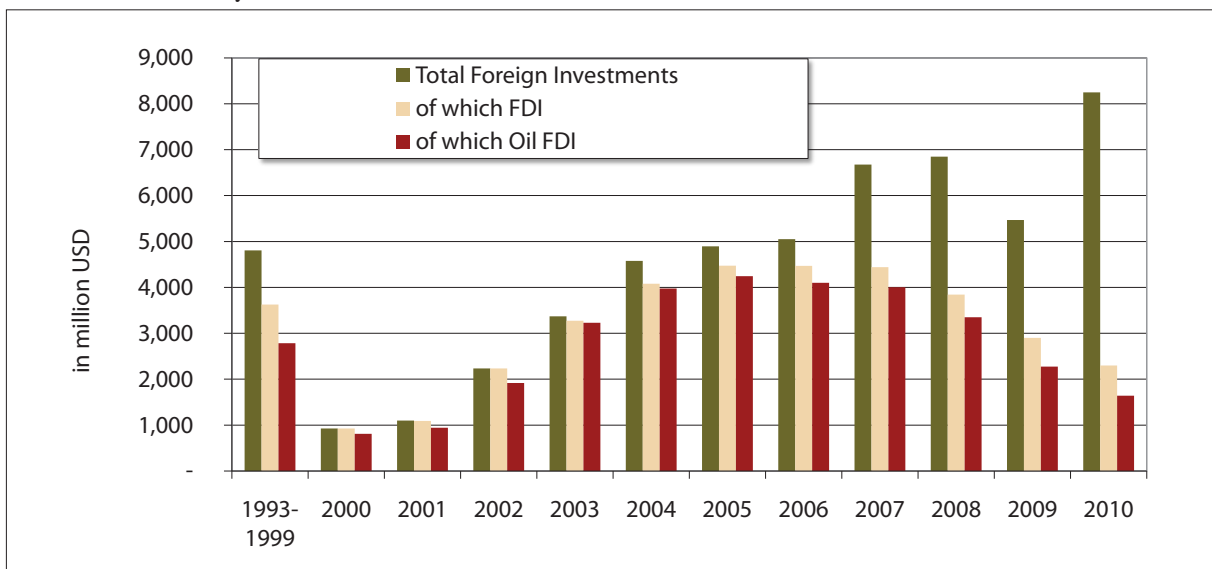
Note: Net FDI for 2010 are estimated. Central Asia region includes: Kazakhstan, Kyrgyzstan, Mongolia, Tajikistan, Turkmenistan, and Uzbekistan. South East Europe includes: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia, Montenegro, Romania, and Serbia. Central Europe includes: Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic, and Slovenia. Source: Farra, Fadi: *Competitiveness and Private Sector Development: Eastern Europe and South Caucasus 2011. Competitiveness Outlook. Organisation for Economic Co-operation and Development (OECD), Paris 2011.*

Figure 3: Oil-Sector and Non-Oil Sector Investments in Azerbaijan, 1993–2010



Sources: IMF, Statistical Committee of the Republic of Azerbaijan, UNCTAD

Figure 4: Development of Total Foreign Investments, FDI and Oil-sector FDI, Annually, 1993–2010



Sources: IMF, EBRD, Statistical Committee of the Republic of Azerbaijan, UNCTAD, Central Bank of Azerbaijan

Table 3: Total Foreign Investments 1993–2010 (all figures in mln USD unless stated otherwise)

	1993–1999	2000	2001	2002	2003	2004	2005
Total foreign investments	4,807.5	927.0	1,100.0	2,234.9	3,371.0	4,575.5	4,893.2
in % of total investments		64.3%	68.8%	79.9%	76.6%	77.6%	68.7%
of which in oil industry	3,000.0	546.1	941.8	1,693.0	2,972.4	4,088.1	3,800.9
of which in oil industry in %		58.9%	85.6%	75.8%	88.2%	89.3%	77.7%
of which financial credit							698.4
of which further investments (portfolio invest.)							163.4

	2006	2007	2008	2009	2010	1993–2010
Total foreign investments	5,052.8	6,674.3	6,847.4	5,468.6	8,247.8	54,200.0
in % of total investments	60.9%	55.3%	42.2%	42.0%	47.5%	57.1%
of which in oil industry	3,439.3	4,071.5	3,354.2	2,413.7	2,957.3	
of which in oil industry in %	68.1%	61.0%	49.0%	44.1%	35.9%	
of which financial credit	983.5	1,576.6	2,357.9	1,438.3	3,405.9	
of which further investments (portfolio invest.)	261.6	587.1	641.2	992.2	1,225.0	

Sources: IMF, EBRD, Statistical Committee of the Republic of Azerbaijan, UNCTAD, Central Bank of Azerbaijan, own calculation

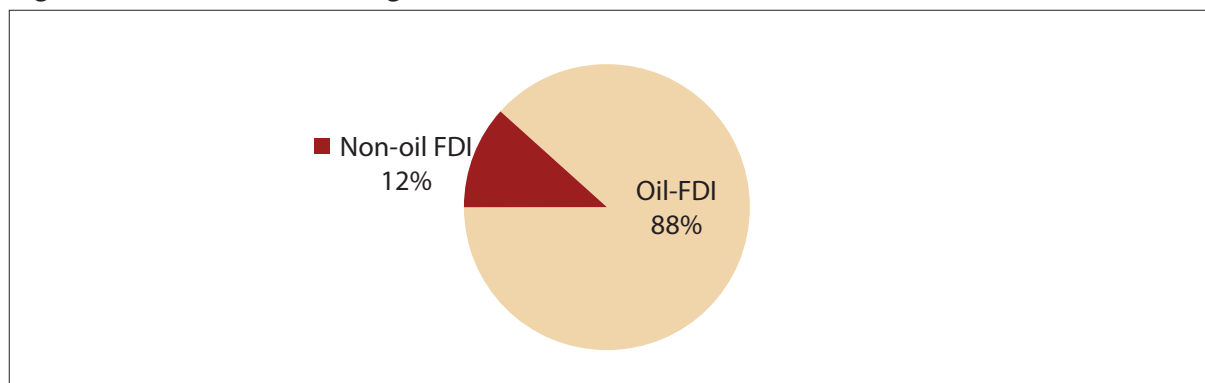
Table 4: Development of FDI in Capital Account, 1993–2010 (all figures in mln USD unless stated otherwise)

Capital Account Information	1993–1999	2000	2001	2002	2003	2004
FDI Inward Flows, net	3,627.5	129.2	226.5	1,392.4	2,816.2	3,515.0
FDI Outward Flows, net	0.0	0.0	0.0	-325.6	-464.5	-1,163.6
FDI net	3,627.5	129.2	226.5	1,066.8	2,351.7	2,351.4
FDI net, stock, accumulated	3,627.5	3,756.7	3,983.2	5,050.0	7,401.7	9,753.1
FDI net stock, accumulated in % of GDP		71.2%	69.8%	81.0%	101.7%	112.4%

Capital Account Information	2005	2006	2007	2008	2009	2010
FDI Inward Flows, net	1,680.2	-584.0	-4,749.0	14.0	473.0	1,017.0
FDI Outward Flows, net	-1,221.0	-705.0	-286.0	-556.0	-326.0	-512.0
FDI net	459.2	-1,289.0	-5,035.0	-542.0	147.0	505.0
FDI net, stock, accumulated	10,212.3	8,923.3	3,888.3	3,346.3	3,493.3	3,998.3
FDI net stock, accumulated in % of GDP	77.1%	44.2%	12.4%	6.8%	8.1%	7.7%

Sources: IMF, UNCTAD

Figure 5: Total FDI Inflows (gross) between 1993–2010



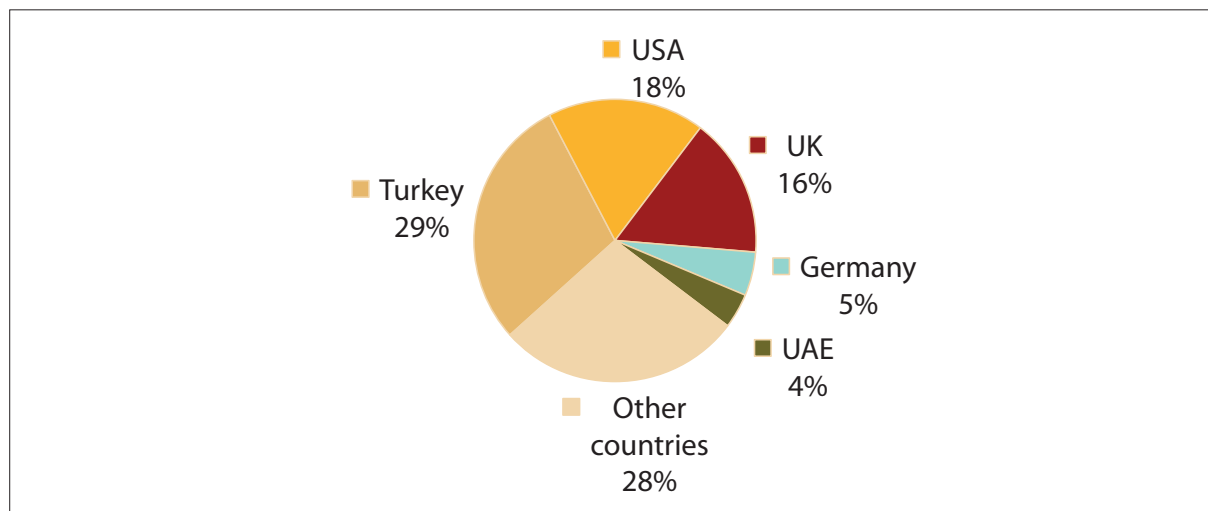
Sources: IMF, Statistical Committee of the Republic of Azerbaijan, UNCTAD

Table 5: Development of (Oil and Non-Oil) FDI Inflows between 1993–2010
(all figures in mln USD unless stated otherwise)

	1993–1999	2000	2001	2002	2003	2004	2005
Total FDI inflow	3,627.5	927.0	1,091.8	2,234.9	3,273.3	4,080.0	4,475.0
of which Oil FDI	2,785.3	809.0	941.8	1,916.0	3,227.9	3,975.8	4,244.5
of which Non-oil FDI	842.2	118.0	150.0	318.9	45.4	104.2	230.5
Non-oil FDI, in % of total FDI		12.7%	13.7%	14.3%	1.4%	2.6%	5.2%

	2006	2007	2008	2009	2010	1993–2010
Total FDI inflow	4,469.0	4,442.0	3,844.0	2,899.0	2,300.0	37,663.5
of which Oil FDI	4,100.6	4,002.9	3,349.9	2,274.6	1,640.4	33,268.7
of which Non-oil FDI	368.4	439.1	494.1	624.4	659.6	4,394.8
Non-oil FDI, in % of total FDI	8.2%	9.9%	12.9%	21.5%	28.7%	11.7%

Sources: Statistical Committee of the Republic of Azerbaijan, AZPROMO

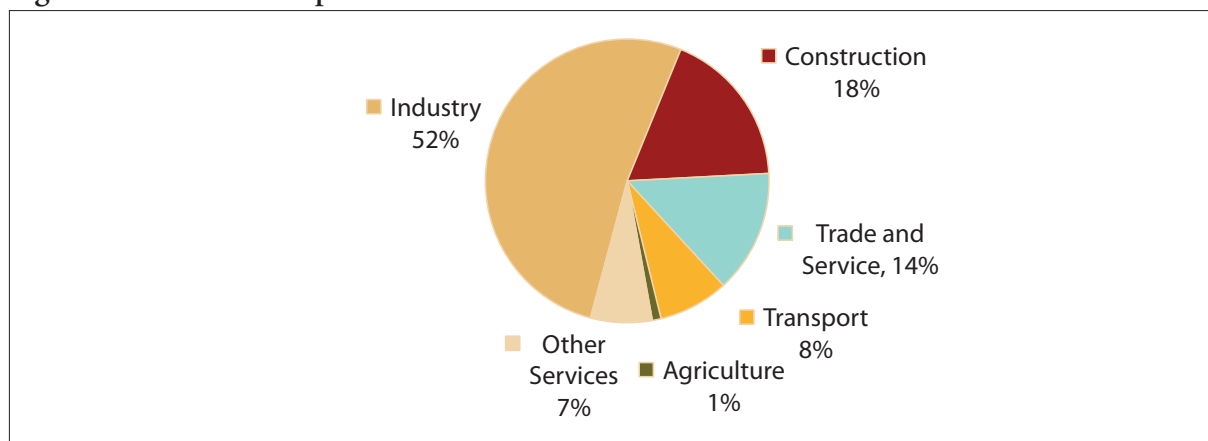
Figure 6: Non-Oil FDI per Country between 1993–2010: 4.4 billion USD

Sources: Statistical Committee of the Republic of Azerbaijan, AZPROMO

Table 6: Non-Oil FDI per Country
(annual FDI in mln USD 2005–2010, accumulated FDI in % 1993–2010)

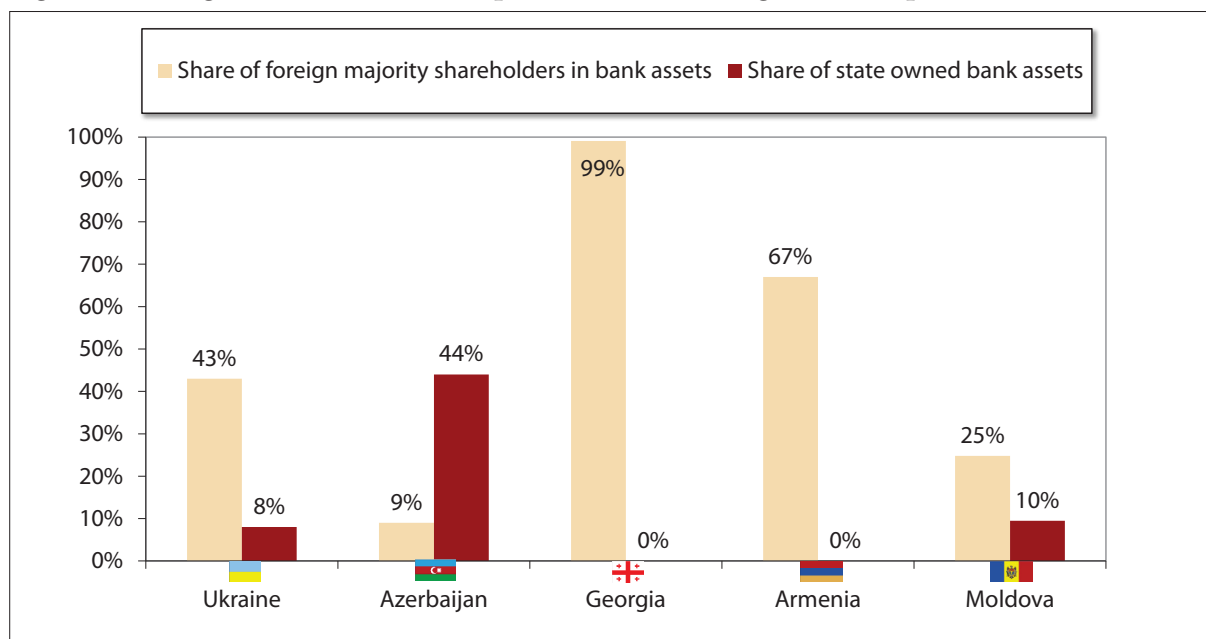
	2005	2006	2007	2008	2009	2010	1993–2010
Turkey	96.2	136.6	109.2	60.8	76.8	81.1	29%
USA	24.8	70.0	78.0	108.8	117.6	124.2	18%
UK	39.5	39.1	80.0	146.4	160.0	169.0	16%
Germany	21.5	17.4	22.9	48.2	38.8	41.0	5%
UAE	5.7	18.3	12.3	38.5	43.2	45.6	4%
Other countries							28%

Sources: IMF, Statistical Committee of the Republic of Azerbaijan, UNCTAD, Central Bank of Azerbaijan

Figure 7: Non-Oil FDI per Sector between 1993–2010: 4.4 billion USD

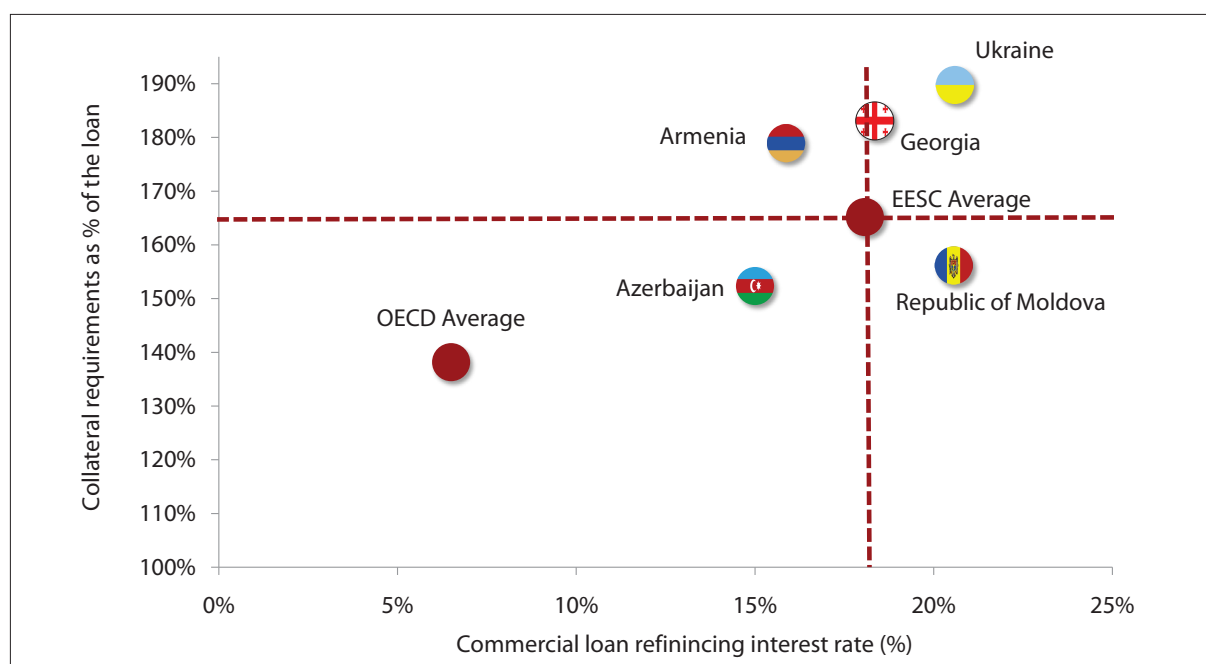
Sources: Statistical Committee of the Republic of Azerbaijan, AZPROMO

Figure 8: Foreign and State Ownership in Bank Assets, Regional Comparison



Source: EBRD; Central Banks of Armenia, Azerbaijan, Georgia, Moldova, Ukraine; own calculations

Figure 9: Comparison of Collateral Requirements for Bank Loans and Loan Interest Rates with Regional Peers and OECD Average



Source: Farra, Fadi: *Competitiveness and Private Sector Development: Eastern Europe and South Caucasus 2011*. *Competitiveness Outlook*. Organization for Economic Co-operation and Development (OECD), Paris 2011.

FDI Declines in Georgia

By Maia Edilashvili, Tbilisi

Abstract

Following an unprecedented surge in foreign direct investment in 2007, Georgia is suffering from a gradual decline in FDI inflows. Both local and international experts are unanimous in noting that the country is facing a tough challenge to either achieve a strong rebound of FDI or stimulate growth in high potential sectors of the economy in order to sustain the GDP growth rate and fully restore investor confidence.

Far Below Expectations

Despite extremely poor investment opportunities locally, the attraction of foreign direct investment has been one of the key priorities for the Mikheil Saakashvili government ever since it assumed power in 2003 and launched sweeping economic reforms. According to government estimates, Georgia's economy needs an annual injection of approximately \$2 billion in foreign capital to stay afloat. It achieved this goal in 2007. Driven to a large extent by privatization, FDI inflow more than doubled that year, reaching \$2.15 billion, which was 19.8% of GDP.

Credit for that skyrocketing foreign capital inflow should go to the government's efforts to streamline business regulations and reform the tax system, which left just six taxes instead of the initial 21, and only seven out of 15 customs procedures. Tax cuts have also played a role: VAT was reduced from 20% to 18%, profit tax from 20% to 15% and tax on dividends was lowered from 10% to 5%.

However, the global financial crisis coupled with the August war in 2008 and their aftermath have impeded growth. FDI nosedived to \$1.56 billion in 2008 and fell further to \$658 million in 2009. Despite such a dark picture, the government remained optimistic, with Prime Minister Nika Gilauri forecasting \$1.2 billion in foreign capital inflows in 2010. But again, the target was missed. According to the preliminary figure released by Geostat, Georgia's state statistics office, FDI plummeted by 16% year-on-year in 2010 to \$553 million. This is just 4.7% of GDP, not only well below the pre-crisis level but also at a record low level since 2004.

Georgia—A Model Reformer

Standing at a relatively low 5.9% in 2004, Georgia's GDP growth rate climbed to 12.3% in 2007. It is believed that without the government's success in creating a business-friendly climate and stamping out corruption this would have been impossible.

Investing Across Borders, the World Bank Group's initiative which measures the regulation of FDI, states that Georgia is one of the most open countries for foreign investors. The report argues that countries performing

well on its indicators tend to attract more FDI relative to the size of their economies and population. According to the report, in Georgia business start-up procedures take "less than a week" (4 days), while in Haiti and Angola they can take half a year; In Georgia it takes 50 days to lease land from the government, while accomplishing the same task requires 351 days in Bulgaria.

Georgia became the top reformer in the CIS region in 2006, according to the World Bank and International Finance Corporation (IFC) annual survey which ranks countries on regulations that influence the overall business environment. *Doing Business 2011: Making a Difference for Entrepreneurs* declared Georgia to be one of the world's top 10 *Doing Business* reformers over the past five years, meaning that the country "made the largest strides" to make its regulatory environment more business-friendly.

In addition, according to Transparency International's Corruption Perception Index (CPI), one of the most credible yardsticks measuring corruption in the public sector worldwide, Georgia ranks 68th out of 178 countries. On CPI 2010 Georgia's overall score totals 3.8 against 2.2 in 2002, with 10 points being the most 'clean' and 0 being 'highly corrupt.' In comparison, Armenia ranks 123rd and Azerbaijan is 134th. Georgia ranks ahead of Montenegro, Serbia, Albania and Bosnia & Herzegovina—all EU-membership candidates.

Keeping the Economy Going

A major driver of the growth, FDI has been critical in financing Georgia's current account deficit during the last decade.

During the 2007 boom year, the current account deficit in Georgia was \$2 billion, approximately 11.8% of GDP. In the wake of the crisis the lower demand in the external markets together with a dramatic drop in prices narrowed the current account deficit in 2009 to 11.7% of GDP and further to 10% of GDP in 2010.

The central bank of Georgia explained the improvement of the current account deficit by changes in the trade deficit. In 2009 the trade deficit narrowed by 32.5% to \$3.24 billion from \$4.56 billion in 2008, and increased only moderately—by 9%—in 2010 to \$3.52 billion.

However, the current account deficit of 10% is still viewed as large in comparison to other emerging market economies in the region. Warning that for Georgia a shortfall in FDI in 2011 would thwart GDP growth and widen the fiscal deficit, international analysts such as the International Monetary Fund recommended reducing the current account deficit to approximately 5–6% of GDP over the medium term.

Unlocking Growth Potential

The Georgian government's vision is that in the post-crisis environment, relying solely on a resurgence of FDI may no longer be enough to power growth and that a more proactive approach is required. The local economists agree that in order to boost productivity and attract private investment the authorities should concentrate on sectors with high growth potential, such as agriculture and energy, among others.

Critics have repeatedly slammed the Saakashvili government for allowing the share of agriculture in GDP to plunge to 8.4% in 2010 from 14.8% in 2005. While over 50% of the vegetable and fruit consumed annually in Georgia are imports from foreign countries, FDI in this sector remains low—at less than 2% in 2010. Responding to this criticism in his annual address to the parliament, President Saakashvili vowed to double agricultural productivity by 2015, pledging that an additional 150 million lari (\$90 million) would be channeled into the field.

The untapped potential of the energy sector looks equally impressive: while electricity exports in 2005 were approximately 122 thousand kW/h and were worth around \$3 million, they exceeded 1 billion kW/h with a total cost of over \$37 million in 2010. Last year Georgia exported 1,400 billion kW/h of electricity, which is 15% of total generation. The Ministry of Energy expects a dramatic increase, saying the country has the potential to export up to 5 billion kW/h electricity annually by 2016.

Foreign Capital: Key Players

In 2007 when Georgia's FDI inflow was at its height, the most attractive five sectors for foreign investors were transport and communications (20.7% of total FDI), industry (19.8%), energy (18%), hotels and restaurants (12%) and construction (8.5%). The Czech Republic, Netherlands, British Virgin Islands, Cyprus and Turkey were the top investors. That year Enego-Pro Georgia, the Czech company, became the biggest player on Georgia's power market after purchasing hydro power plants and distribution companies.

The preliminary statistics for 2010 show that foreign businessmen continue to invest heavily in transport and

communications—35% of total FDI. The industry sector also remained appealing with 16.4% of total FDI, while the finance sector's share jumped to 16.2% from 6.8% in 2007 and real estate's share climbed to 15.3% from just 1.5% three years ago.

The top investor in 2010 was the Netherlands with \$143.2 million of the total FDI. The United States came in second with \$108.4 million. Russia took the third position with \$51.3 million. International organizations were fourth with \$50.2 million and Azerbaijan held the fifth place with \$46.6 million. Over the past two years investors from the Netherlands were mostly engaged in the energy and financial sectors, while the United States was primarily interested in the transport and communications sector and industry. Russia was heavily investing in the transport and communications sector and the financial sector; the international organizations—mostly in the real estate and the financial sectors, Azerbaijan—in the real estate sector and transport and communications.

The United Arab Emirates, which was the biggest foreign investor in Georgia during the crisis—in 2008 and 2009—with \$306.5 million and \$169.8 million, respectively, fell to sixth place in 2010 with \$39.9 million. UAE's state-owned Ras Al Khaimah Investment Authority (RAKIA) has invested mostly in large real estate projects.

Turkey was the second largest foreign investor in 2009 with \$97.9 million. In 2010 its contribution to total FDI fell to \$37.5 million—the 7th position. The key destination for Turkish capital has been transport and communications and construction. Turkey has also demonstrated high interest in Georgia's hydropower sector. Currently, the total number of ongoing projects in the hydropower sector is 30 with estimated investment over \$3 billion. Out of these 30 projects, the Turkish investors are involved in the development of 16 and have expressed interest to engage in future projects as the Ministry of Energy keeps offering fresh proposals.

Stable Recovery Expected

In 2009 and 2010 the Georgian government focused on maintaining fiscal stability as well as attracting foreign investment inflows amid the drastically declining FDI globally.

After suffering a contraction of 3.8% in 2009, Georgia's economy grew by 6.4% in 2010, according to preliminary statistics. Fueled by a rebound of credit to the private sector and strong export demand, the growth in Georgia was one of the most impressive in the region (5% in oil and gas exporter Azerbaijan and 2.6% in oil and gas importer Armenia).

PM Gilauri has said that in 2011 the GDP growth “may range between 5% and 7%.” This optimism, accord-

ing to him, derives from Georgia's ability to demonstrate that despite political and international shocks the economic fundamentals have proved strong enough to recover shortly.

With the private sector recovering, the government decided to withdraw fiscal stimulus and cut spending. As a result, the fiscal deficit narrowed from 9.2% of GDP in 2009 to 6.6% in 2010. Taking all these positive signs into account, international analysts' forecasts are positive. According to the April IMF report, the policy response of the Georgian government to the crisis was successful in stabilizing the economy and regaining confidence. "The economy is recovering at a solid pace," the report notes and predicts that as a sign of sizable fiscal improvement, the 2011 budget deficit will decline to 3.9%. GDP growth is projected at 5.5%.

Key Task: Higher FDI in 2011

At present attracting FDI tops the Georgian government's agenda with the forecast for FDI in 2011 at approximately \$800 million. In the wake of the August war, the Georgian government's investment promotion campaigns—knowing that European investors tend to be wary of investing in conflict regions—mostly targeted the Asian countries, which are considered less cautious in this regard.

According to the Georgian National Investment Agency, which is responsible for developing the state policy for attracting FDI, Asian countries, in particular China and India, will remain the focus this year. Azerbaijan and Ukraine are also on the list, while priority sectors will be energy, tourism, infrastructure, agribusiness and textile.

Evaluating Georgia's opportunities to win back investors' confidence, the IMF considers that while the recovery of FDI has been slower in Georgia than initially anticipated, the overall position has continued to improve. By international standards, foreign investment inflows into Georgia are viewed as "quite respectable." In noting the progress, foreign analysts are cautiously optimistic. The IMF warns the Georgian government that the environment externally is likely to remain volatile. This means that the much expected rebound of FDI remains under a big question mark.

Conclusion

Prior to the twin crises, Georgia had witnessed a boom in foreign capital inflows. However, the shocks caused by the August war and global credit crunch dealt a big blow to investor confidence and entailed a continuing decline in FDI.

At present, the optimism of the Georgian authorities is centered on last year's stable fiscal position. This indicator, the government hopes, along with Georgia's internationally recognized business climate and the intensive investment promotion campaigns worldwide will help the country keep the trust of already established investors and attract fresh capital mostly from Asian countries.

In the medium term, as the risks linger, the key recommendation to the Georgian authorities from local and foreign experts is to provide better conditions for strong economic growth as well as to identify and promote the most promising business sectors.

About the Author

Maia Edilashvili is the editor of *Georgia Today*, an English-language weekly newspaper. She also regularly writes for *Investor.ge*, an English-language business magazine.

Foreign Investments in Armenia: Influence of the Crisis and Other Peculiarities

By Haroutiun Khachatryan, Yerevan

Abstract

The level of economic growth in the three South Caucasus countries correlates well with the amount of foreign direct investments in these countries. The Armenian government has been making efforts to diversify its economy, and in 2010, the inflow of investments, including foreign ones, increased to the food processing and tourism sectors, in addition to the traditionally-preferred mining, telecommunications and energy sectors.

Effectiveness of Foreign Investments in the Southern Caucasus

Despite the global economic crisis which hit Armenia in 2009, the amount of foreign direct investment flowing into the country has remained relatively stable in recent years. Figure 3 on p. 20 presents the level of foreign investment (FI) and foreign direct investment (FDI) as a percentage of GDP.¹ The GDP numbers differ from official sources because they are presented here in U.S. dollars. As the figure shows, the ratios of foreign investments/GDP and direct foreign investments/GDP have been fairly constant in Armenia in recent years—15–20% of GDP for FI and 8–9% of GDP for FDI. Although foreign investment inflows dropped during the crisis, they recovered in 2010. Foreign investments, and FDI in particular, play an important role in the country's economic life (though 2010 was an exception, as discussed below).

Figures 4 and 5 on p. 21 compare the size and efficiency of these investments in Azerbaijan and in Georgia with those of Armenia. For example, in Azerbaijan (Fig. 4) the ratio FI/GDP is close to the same value as in Armenia, 12%–20%, in 2007–2009². These data show that although the investments in Azerbaijan were much larger than in Armenia (US\$6–7 billion a year versus US\$1.5–2.0 billion in Armenia), these investments were not very effective (in terms of GDP stimu-

lation, at least in short perspective) compared to those in Armenia. Similar results can be seen for Georgia as well³ (Fig. 5) and they show that unlike Armenia and Azerbaijan, both FI and FDI in Georgia decreased both in 2009 and 2010. The numbers for 2010 are unexpected because Georgia's GDP grew in 2010 even as investment fell—in this case the correlation between the amount of foreign investment and economic growth did not hold constant. More important is the fact that many Western countries pledged to help Georgia after the August 2008 war, and much of that assistance was in fact provided. However, private investors were not enthusiastic about returning to Georgia. One reason for this decline was that in 2009 and 2010 the shock caused by the 2008 war continued to affect investors despite assurances provided by the Georgian government and its supporters. Another possible reason for the investment decline may be the fact that Russia had been a major source of investment for Georgia before 2008, and investors from that country were reluctant to go to Georgia in the immediate aftermath of the conflict.

Foreign Investments in Armenia

As for Armenia, FDI flows worth US\$700–800 million were typical in recent years and they were roughly half of total FI. The year 2009 was an exception and the Armenian government attracted significant quantities of loans from abroad (including US\$500 million as an intergovernmental loan from Russia) to counter the global financial and economic crisis. These loans partly replaced the shortage of FDI.

Figure 1 shows that during the crisis year of 2009, FI in Armenia decreased from US\$1.13 billion to US\$906 million dollars, but, GDP fell even more (in Armenian dram terms, it fell by 14%). However, the FDI/GDP ratio in that year was larger than in 2008. This was followed by an even deeper decrease in the amount of FDI (to US\$693 million in 2010) evidently caused by the

1 The usual definition of direct investment is: an investment which is sufficiently large to affect a company's subsequent decisions. In the methodology applied by the State Statistical Service of Armenia, an investor is named a direct investor if no less than 10% of the share capital of an Armenian company belongs to this investor. In some cases, the term "direct investment" is used as evidence that these funds were invested in the private sector, since there is no such criterion for investments in general. In particular, investment may include loans to public companies.

2 Source: Azerbaijan in Figures, available at <http://www.azstat.org/publications/azfigures/2010/en/020.shtml>, also data on Azerbaijan in 2010 available at: <http://www.azstat.org/macroeconomy/indexen.php>. Data for FDI in 2010 are not available and a tentative value is 12%. For Georgia, data are taken from: http://www.geostat.ge/index.php?action=page&p_id=119&lang=eng and http://www.geostat.ge/index.php?action=page&p_id=140&lang=eng

3 Data for Georgia and Azerbaijan are difficult to compare because the official data available on the sites of their respective statistical services are for FDI only for Georgia and total FI for Azerbaijan.

crisis. However, as one can see, earlier foreign investment played a role in restoring the economy after the “crisis” year of 2009.

Overall, Armenia has great difficulty attracting foreign investment. The country is not rich in natural resources, and therefore receives less attention from foreign investors than well endowed countries like Azerbaijan. In addition, like many other post-Soviet countries, Armenia has specific problems which make it less attractive to foreign investors. One major factor is the blockade of its communications imposed by Azerbaijan and supported by Turkey⁴. In fact, this factor makes investments in Armenia difficult because of the high transport tariffs for its cargoes. Accordingly, Armenia has to rely on Georgia for contact with the outside world because its fourth neighbor, Iran faces heavy Western sanctions of its own. These political issues make Armenia a bad partner compared not only to Azerbaijan (with its oil wealth) but also to Georgia.

Current foreign investments in Armenia focus on the mining industry, energy and telecommunications. Also the construction sphere has been growing rapidly in Armenia, but it was mainly fed by local rather than foreign investments. However, after the decline of 2009, the government has enhanced its efforts to diversify the economy, which, means, in particular, attracting more foreign investments in other spheres, too.

The Armenian government tries to make the investment climate favorable for both foreign and local investors. Since the early 2000s Armenia eliminated existing privileges for foreign investors and now treats foreign and local investors similarly. Eliminating such preferences for outsiders makes sense because the country has a large and unused potential for domestic investments. According to government estimates, Armenia has great development potential in tourism, medicine, the food industry and machinery. Accordingly in 2010, the food industry, tourism and science-intensive production became leading foreign investment magnets. The government also believes that Armenia’s IT sector has good perspectives for development; in the past, it attracted significant foreign investments (in particular, Synopsys, a prominent American chip maker, has a large software branch in Armenia). Nevertheless, in

recent years, this sector has not been a leader in attracting foreign investments.

The government has also used incentives to import innovation technologies. For example, it established tax privileges for investors who introduce technologies which are new for Armenia. Prime Minister Tigran Sargsyan (in office since April 2008) has also demonstrated readiness to create free economic zones in Armenia for the first time since the country gained independence 20 years ago. This government is also the first in independent Armenia to provide financial assistance to perspective Armenian companies as it did during the crisis of 2009. It continues to make the business climate in Armenia more attractive in 2011.

Russia, France and the Netherlands became the largest investors in Armenia’s economy in 2010 by investing US\$270.3 million, US\$146.8 million and US\$64.3 million, respectively. Their shares in the total foreign investment in Armenia were 38.5%, 20.9% and 9.2% in 2010. In 2010 Russia remained the largest investor in Armenia due to investments in energy, mining, transport, telecommunications and other spheres.

Investments and the Armenian Diaspora

Armenia’s large diaspora distinguishes it from many other countries and many Armenians abroad are successful business people. In practice, many people prefer to invest in Armenia simply because they are ethnic Armenians. There are no statistical data about the influence of ethnic origin on investment decisions, but it is known that the investments of diaspora Armenians are usually not large. They cannot compare with, say, the investments of Russia’s Gazprom in Armenia. There are exceptions, however. For example, in 2008, Argentina was the second-ranked investor in Armenia after Russia (and it was the fourth in 2010). This high status was due to the efforts of a single person, Eduardo Eurnekian, an Argentine businessman of Armenian origin. Eurnekian is the main shareholder in a consortium operating dozens of airports in Argentina and elsewhere. Under a 2001 agreement between the Armenian government and Eurnekian’s Corporacion America, it will modernize and manage operations at Zvartnots International Airport in Yerevan, Armenia’s main entry port by air. The deal was then worth US\$50 million, but the investor has since invested much more in Zvartnots. Besides the airport, Eurnekian has also invested in agriculture and banking.

This example shows the great potential of the Armenian diaspora for the economy of Armenia. However, it is not typical since the majority of the Armenians abroad work with medium-size businesses. The leaders of the country have made different efforts to use this resource

⁴ During a conference of the of the Asian Development bank on the investment problems of Armenia held on March 21, 2011, Prime Minister Tigran Sargsyan said: “The objective factor [which is not beneficial for the economy] is our geopolitical situation and those political risks facing the region in general.” <http://www.gov.am/en/news/item/5594/>. Regnum news agency goes further to quote him as saying (in Russian only): “The monopoly of Georgia on the Armenian transit is a constraining factor.” <http://www.regnum.ru/news/fd-abroad/armenia/721.03.2011>.

more effectively, starting with the so-called All-Armenian business meetings held in the early 1990s. The creation of a Ministry of Diaspora in 2008, under the presidency of Serzh Sargsyan, was another step in this direction. In April 2011, this Ministry made an attempt to create a worldwide network of Armenian business people. How effective this attempt will be remains to be seen. Currently, the diaspora's contribution to the economy of Armenia is not large but it is increasing.

Conclusion

Foreign direct investment is an important factor driving the economic growth of the South Caucasus countries. The blockade resulting from unsettled conflicts remains a major factor hindering investments in Armenia. Nevertheless, the current government is taking unprecedented measures to raise the attractiveness of the country for investors, both domestic and foreign.

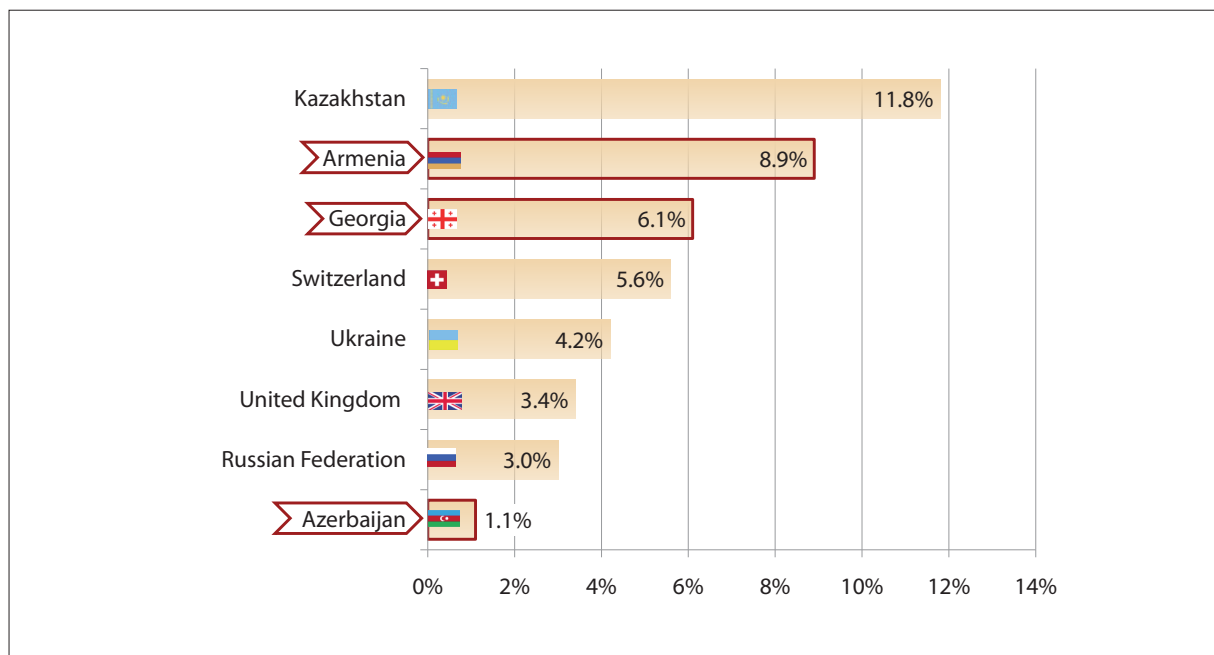
About the Author:

Haroutiun Khachatryan is an analyst and journalist based in Yerevan, Armenia. He is also the Editor-in-chief of The Noyan Tapan Highlights weekly.

STATISTICS

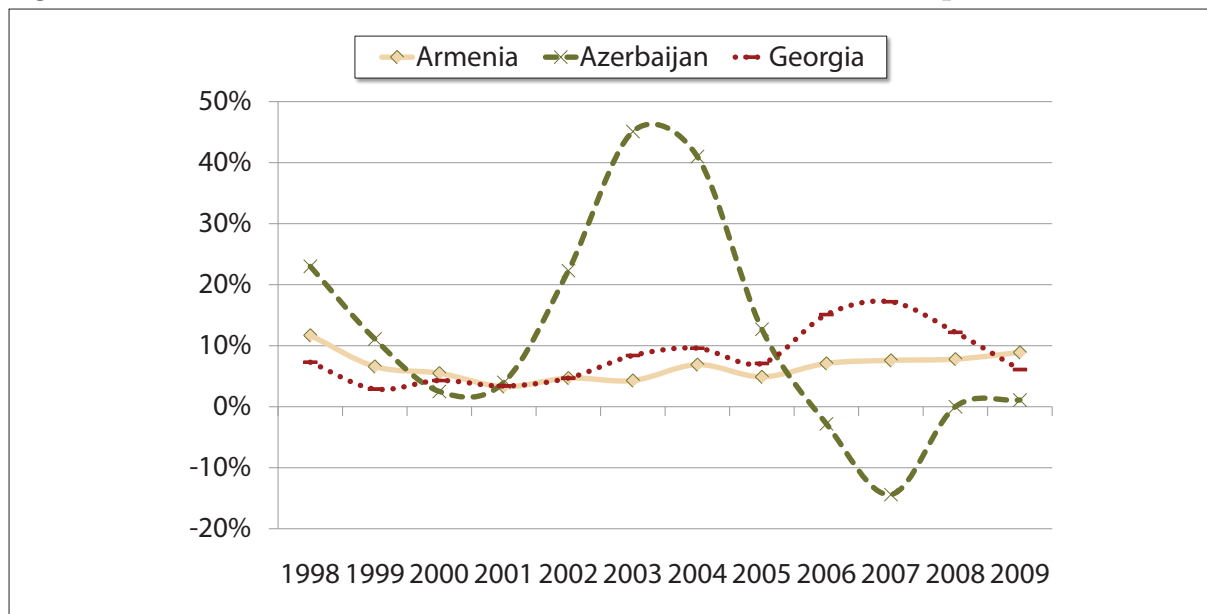
FDI and GDP

Figure 1: FDI in International Comparison (net inflows as percent of GDP, 2009)



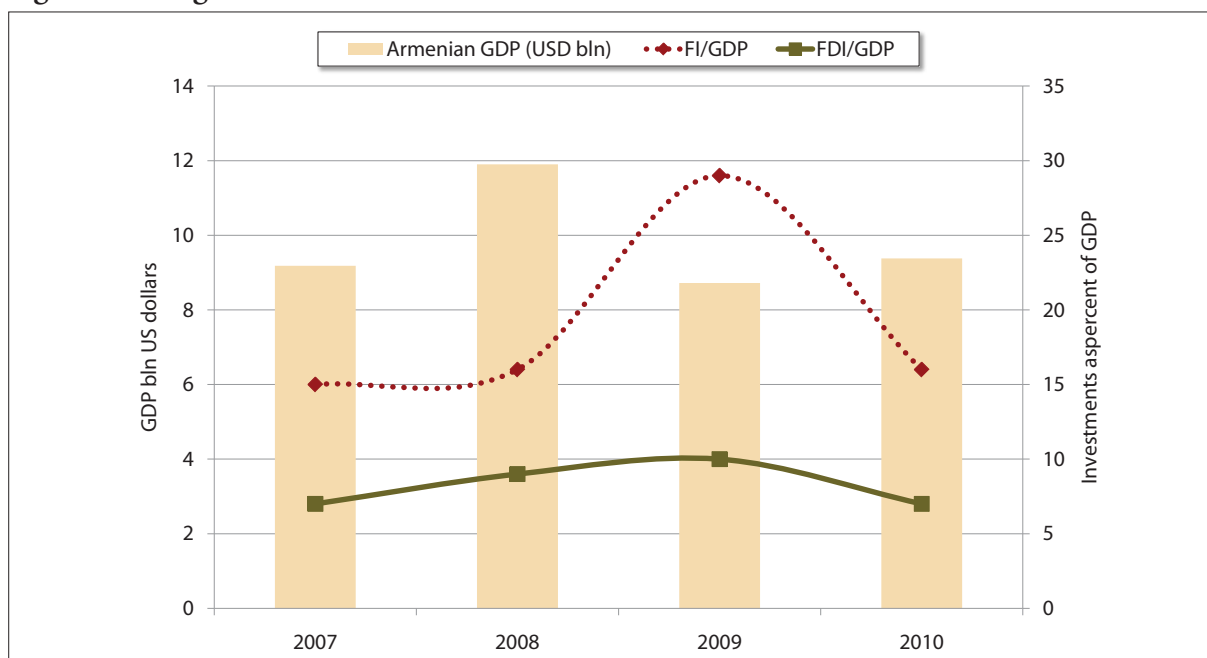
Source: World Bank, World Development Indicators & Global Development Finance, <http://databank.worldbank.org/>

Figure 2: FDI in the South Caucasian Countries 1998–2009 (net inflows as percent of GDP, 2009)



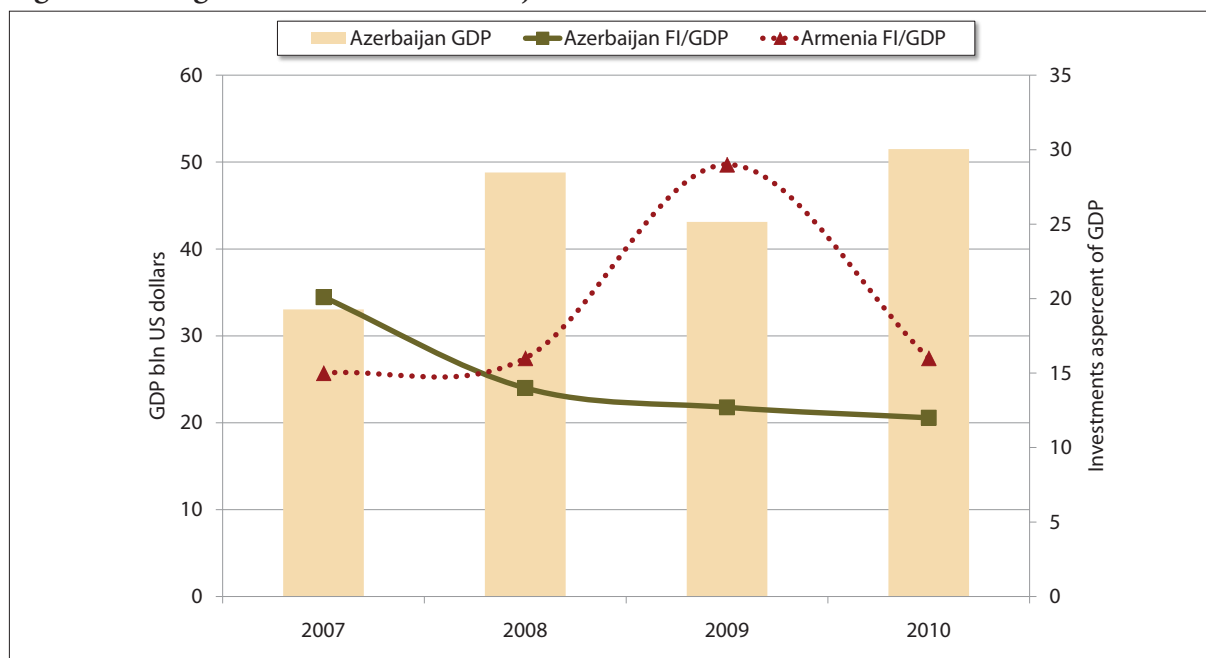
Source: World Bank, World Development Indicators & Global Development Finance, <http://databank.worldbank.org/>

Figure 3: Foreign Investments in Armenia 2007–2010



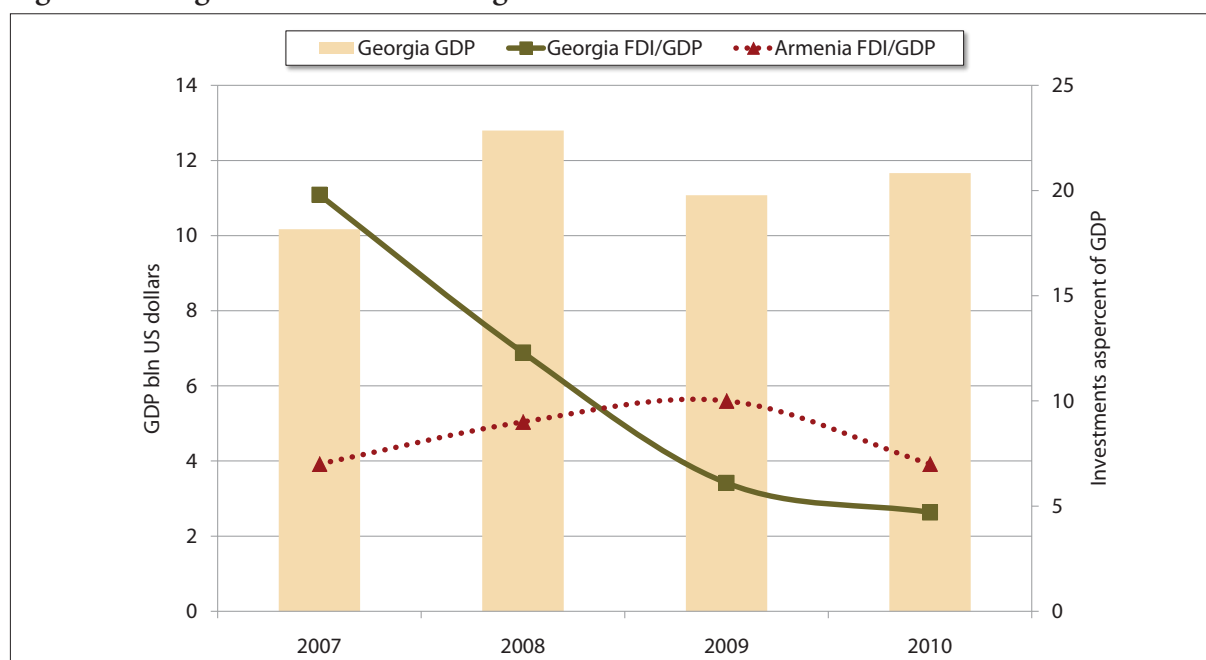
Source: National Statistical Service of Armenia, www.armstat.am

Figure 4: Foreign Investments in Azerbaijan 2007–2010



Sources: National Statistical Service of Armenia, www.armstat.am; Azerbaijan in Figures, available at <http://www.azstat.org/publications/azfigures/2010/en/020.shtml>; data on Azerbaijan in 2010 available at: <http://www.azstat.org/macroeconomy/indexen.php>. Data for FDI in 2010 are not available and a tentative value is 12%.

Figure 5: Foreign Investments in Georgia 2007–2010



Sources: National Statistical Service of Armenia, www.armstat.am; http://www.geostat.ge/index.php?action=page&p_id=119&lang=eng and http://www.geostat.ge/index.php?action=page&p_id=140&lang=eng.

RANKINGS

Investment Climate in the South Caucasus

Ease of Doing Business

Prepared by: Worldbank

Established: 2003

Frequency: Annual

The data refer to the respective previous year.

Covered countries: at present 183

URL: <http://www.doingbusiness.org/economyrankings/>

Brief description:

The ease of doing business index ranks economies from 1 to 175. The index is calculated as the ranking on the simple average of country percentile rankings on each of the 10 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 8,000 local experts, including lawyers, business consultants, accountants, government officials and other professionals routinely administering or advising on legal and regulatory requirements.

Table 1: Ease of Doing Business. Ranking 2010

	USA	Georgia	Germany	Armenia	Azerbaijan	China	Russia	Ukraine
<i>Overall rank</i>	5	12	22	48	54	79	123	145
Starting a Business	9	8	88	22	15	151	108	118
Dealing with Construction Permits	27	7	18	78	160	181	182	179
Registering Property	12	2	67	5	10	38	51	164
Getting Credit	6	15	15	46	46	65	89	32
Protecting Investors	5	20	93	93	20	93	93	109
Paying Taxes	62	61	88	159	103	114	105	181
Trading Across Borders	20	35	14	82	177	50	162	139
Enforcing Contracts	8	41	6	63	27	15	18	43
Closing a Business	14	105	35	54	88	68	103	150

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.

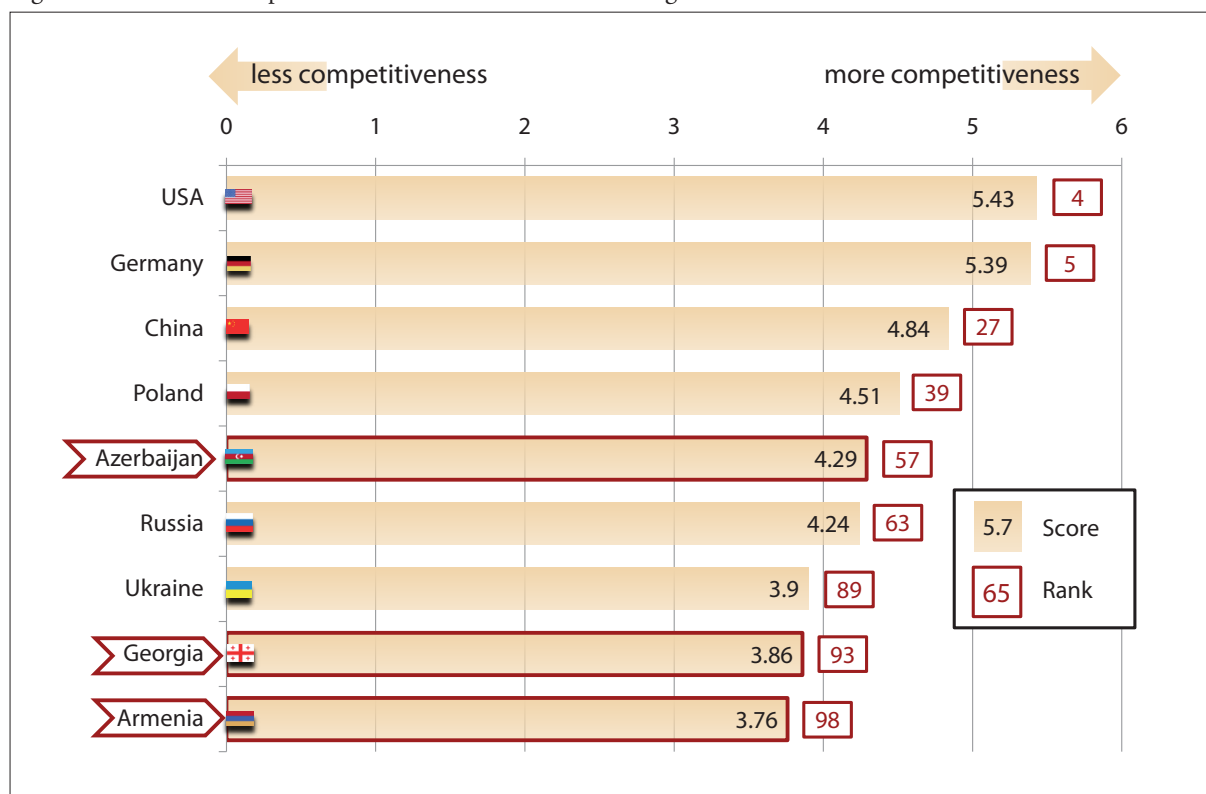
Covered countries: at present 133

URL: <http://www.weforum.org/en/initiatives/gcp/Global%20Competitiveness%20Report/index.htm>

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 nine 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, market size, flexibility and efficiency of labor market, sophistication and openness of financial markets), technological readiness, 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 13.000 business leaders are polled in the 133 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 1: Global Competitiveness Index: Scores and Ranking 2010–2011



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 183

URL: <http://www.heritage.org/Index/Ranking.aspx>

Brief description:

The 2007 methodology has been revised to provide an even clearer picture of economic freedom. The index measures 10 specific factors, and averages them equally into a total score. Each one of the 10 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, Freedom from Government, Monetary, Investment and Financial Freedom, Property rights, Freedom from Corruption, Labor Freedom.

Figure 2: Index of Economic Freedom: Score and Ranking 2011

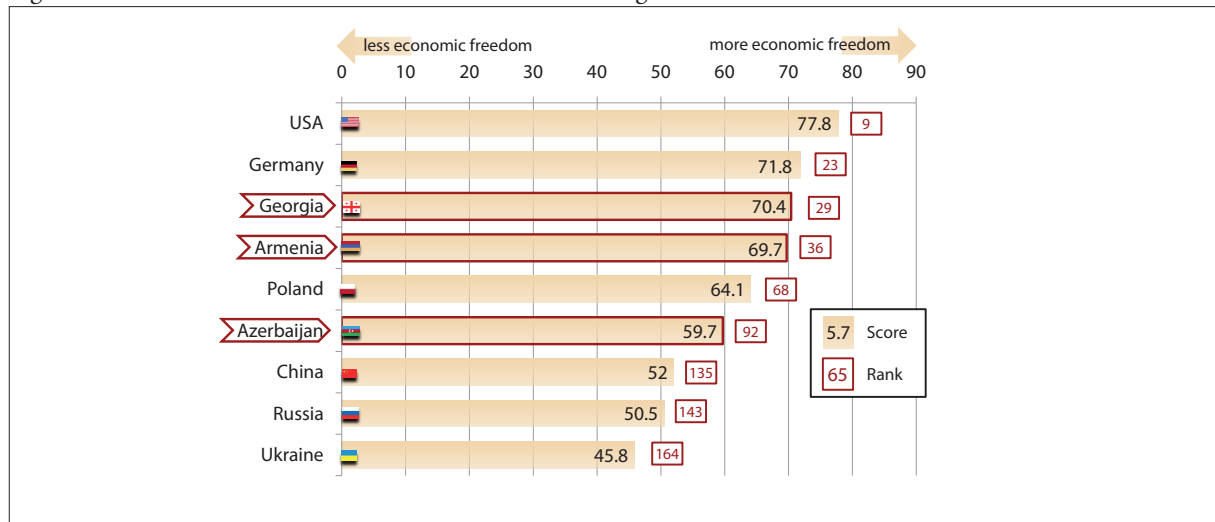
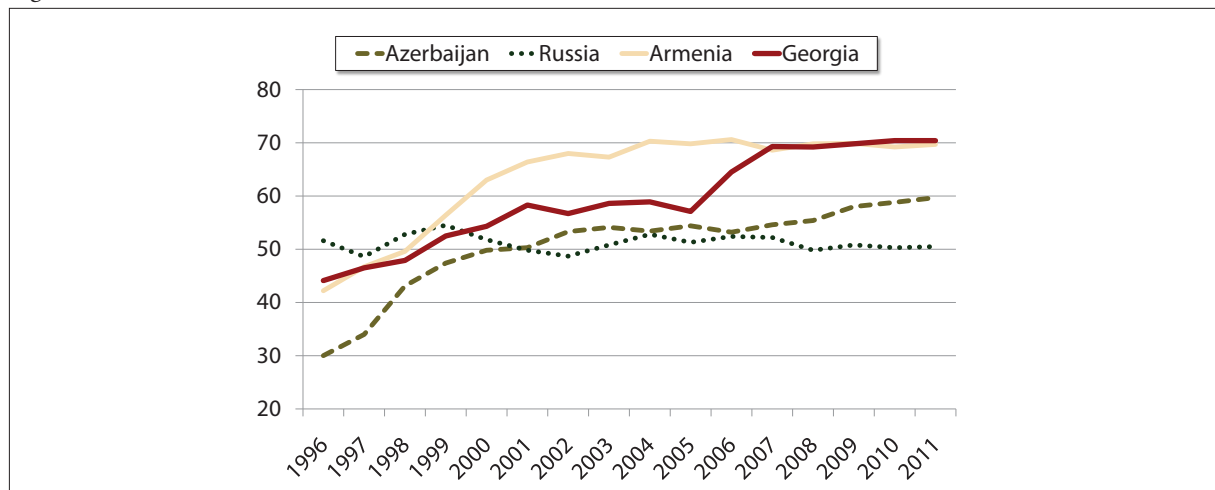


Figure 3: Index of Economic Freedom: 1995–2011



Corruption Perceptions Index

Prepared by: Transparency International

Established: 1995

Frequency: Annual

Covered countries: at present 180

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 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.

Figure 4: Corruption Perceptions Index 2010: Scores and Ranking

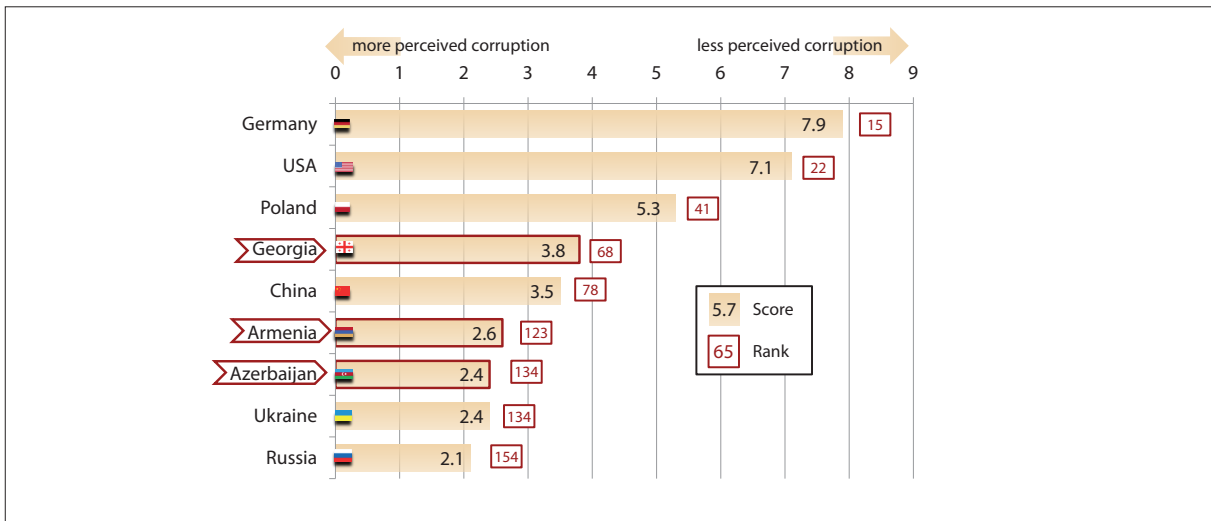
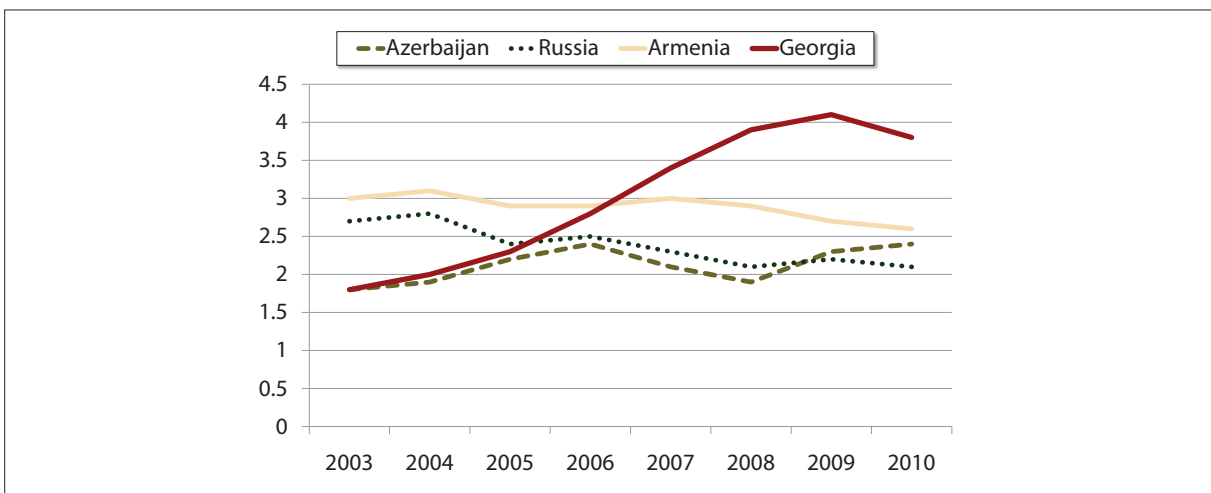


Figure 5: Corruption Perceptions Index 2003–2010



CHRONICLE

From 19 May to 6 June 2011

19 May 2011	The President of the European Parliament Jerzy Buzek calls for “renewed momentum” in Georgia’s reforms during a visit to Tbilisi as part of a trip to the three South Caucasus countries
20 May 2011	The Georgian Parliament endorses a resolution recognizing the massacre and deportations of Circassians in nineteenth century Tsarist Russia as “genocide”
20 May 2011	The Georgian Parliament adopts legislative amendments on easing visa rules for citizens of Albania, Bosnia and Herzegovina, Iraq, Montenegro and Serbia that allow them to stay in Georgia for a year without a visa
20 May 2011	Armenian Justice Minister Hrayr Tovmasian dismisses oppositions parties’ demands for holding early elections saying that the next parliamentary and presidential elections will be held in 2012 and 2013 respectively
22 May 2011	Georgian President Mikheil Saakashvili visits Hungary which currently holds the EU presidency
24 May 2011	Georgian Prime Minister Nika Gilauri says that according to preliminary figures Georgia’s economy has registered growth of 6% in the first quarter of 2011
25 May 2011	Azerbaijan joins the Non-Aligned Movement (NAM)
26 May 2011	The Georgian police use tear gas, water cannons and rubber bullets to disperse protesters rallying outside the Georgian Parliament
26 May 2011	The Armenian Parliament approves a general amnesty that should lead to the release of virtually all opposition members currently detained in prison
26 May 2011	One Georgian policeman and a protester die after being crushed by a car believed to be carrying opposition leaders leaving protest rallies outside the Georgian Parliament in Tbilisi
26 May 2011	Azerbaijani journalist and newspaper editor Eynulla Fatullayev is released after four years in prison
27 May 2011	The United States calls for a probe to investigate the incidents during the break up of a protest rally by the Georgian police in Tbilisi
29 May 2011	Leader of the breakaway region of Abkhazia Sergey Bagapsh dies in a Moscow hospital
30 May 2011	The husband of Georgian opposition leader Nino Burdjanadze, Badri Bitsadze, is charged with creating a group to organize attacks against policemen
31 May 2011	Turkish Prime Minister Recep Tayyip Erdogan and Georgian President Mikheil Saakashvili inaugurate a modernized border crossing point in Sarpi at the border between Turkey and Georgia
1 June 2011	Armenian Economy Minister Tigran Davtian says that the Armenian government stands by its earlier predictions that the country’s economic growth will nearly double in 2011 compared to 2010
1 June 2011	US Vice President Joe Biden and Georgian President Mikheil Saakashvili meet in Rome on the occasion of the 150 th anniversary of Italy’s unification to discuss security and democracy in Georgia as well as Russia’s WTO membership
1 June 2011	Georgian Foreign Minister Grigol Vashadze visits Cuba
1 June 2011	Residents in a village in Azerbaijan’s Naxcivan Autonomous Republic protest against unemployment and other social issues including electricity, gas and water shortages
2 June 2011	Russian Prime Minister Vladimir Putin meets with the Prime Minister of the breakaway region of Abkhazia Sergey Shamba and its Acting President Alexander Ankvab in Sukhumi on the sidelines of the funeral of Abkhaz leader Sergey Bagapsh
2 June 2011	The charges brought against the Azerbaijani Facebook activist and blogger Elnur Majidli of seeking to overthrow the Azerbaijani government are suspended
3 June 2011	Tigran Postanjian, the brother of Armenian opposition parliamentary deputy Zaruhi Postanjian, is released after three months in detention on corruption charges
3 June 2011	Outgoing U.S. Ambassador to Armenia Marie Yovanovitch praises the Armenian government for freeing opposition members and says that Washington welcomes the dialogue between the government and opposition forces hoping that it will lead to free and fair elections
6 June 2011	A visit to Armenia by Iranian President Mahmud Ahmadinejad scheduled for 6 June 2011 is postponed

ABOUT THE CAUCASUS ANALYTICAL DIGEST

Editors: Iris Kempe, Matthias Neumann, Robert Orttung, Jeronim Perović, Lili Di Pippo

The Caucasus Analytical Digest (CAD) is a monthly internet publication jointly produced by the Heinrich Böll Foundation in Tbilisi (www.boell.ge), the Research Centre for East European Studies at the University of Bremen (www.forschungsstelle.uni-bremen.de), the Resource Security Institute in Washington, DC (resourcesecurityinstitute.org/) and the Center for Security Studies (CSS) at ETH Zurich (www.css.ethz.ch) with support from 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 the Heinrich Boell Foundation.

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