THE MINISTRY OF EDUCATION OF THE REPUBLIC OF AZERBAIJAN

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MASTER DISSERTATION

ON THE TOPIC

Добавлено примечание ([WU1]): Dissertasiya adi böyük hərflərlə

“THE IMPACT OF GOVERNANCE QUALITY AND FINANCIAL STABILITY RISK OVER FDI FLOW: EVIDENCE FROM SOUTH CAUCASUS.”

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Elm andı

Mən, Abbasova Şəms Babaş qızı and içirəm ki, "The impact of governance quality and financial stability risk over FDI flow: evidence from South Caucasus." mövzusunda magistr dissertasiyasını elmi əxlaq normalarına və istinad qaydalarına tam riayət etməklə və istifadə etdiyim bütün mənbələri ədəbiyyat siyahısında əks etdirməklə yazmışam.

İDARƏETMƏ KEYFİYYƏTİNİN VƏ MALİYYƏ SABİTLİYİ RİSKİNİN BİRBAŞA XARİCİ İNVESTİSİYALAR AXINI ÜZƏRİNDƏKİ TƏSİRİ: CƏNUBİ QAFQAZ TİMSALINDA

XÜLASƏ

Tədqiqatın aktuallığı: Qloballaşmanın ən nəzərə çarpan nəticəsi Birbaşa Xarici İnvestisiyaların(BXİ) inkişaf etməkdə olan ölkələrdə müəyyən şərtlər daxilində kapital axınının artmasında oynadığı əsas rollardan biri olmasıdır.
Tədqiqatın məqsədi: Bu dissertasiya işi Cənubi Qafqazda idarəetmə keyfiyyətinin və maliyyə stabilliyi riskinin BXİ-ə olan təsirini müəyyənləşdirmək və mövcud olan məlumat bazası əsasında ekonometrik analizlər tətbiq edərək həmin amillərin təsirini statistik cəhətdən ölçmək məqsədi daşıyır.
İstifadə olunmuş tədqiqat metodları: İnstitusional keyfiyyəti təmsil edən məlumatlar Qanunun Aliliyi, Korrupsiyaya Nəzarət, Dövlətin Effektivliyi, Tənzimləmə Keyfiyyəti, Səs və Hesabatlılıq və Siyasi Sabitlik kimi dəyişənlər ortalama tapılaraq işlənməlidir. Maliyyə sabitliyinin risk faktorları Fitch reytinqlərindən götürülmüşdür və BXİ-lara necə təsir etdiyini təhlil etmək məqsədi daşıyır.
Tədqiqatın informasiya bazası: Lazımi məlumatlar Dünya Bankı və dissertasiyada qeyd olunmuş məqsədə nail olmaqdan ötrü müxtəlif məqalə və hesabatlardan bəhrələnmişdir.
Tədqiqatın məhdudiyyətləri: Tədqiqat zamanı bəzi məhdudiyyətlərlə qarşılaşıldı. Birincisi, bəzi məlumatların keyfiyyətini və düzgünlüyünü yoxlamaq, ikincisi isə tədqiqat üçün çox faydalı ola biləcək və bəzi sualları cavablandırmağa kömək edəcək məqalələrə çatmaqda problemlər yaşanmışdır.
Tədqiqatın elmi yeniliyi və praktiki nəticələri: Bu dissertasiya işi mövzusu tətbiq edilən statistik metodlarla Cənubi Qafqaz ölkələri üçün araşdıran ilk işlərdən biridir. Nəticə olaraq tədqiqat spesifik olaraq idarəetmə keyfiyyərinin və maliyyə stabilliyi riskinin dəyərləndirilməsi və BXİ-yə hansı əmsal və əhəmiyyətlilik ilə təsir etdiyini ortaya qoyur.
Nəticələrin istifadə oluna biləcəyi sahələr: Tədqiqatın nəticələri həm iqtisadi inkişafı BXİ-lər hesabına artırmaqla bağlı məşğul olan hökumət orqanları həm də Cənubi Qafqaza investisiya yatırmağa maraq göstərən potensial investorlar üçün əhəmiyyətli ola bilər.

Açar sözlər: Birbaşa Xarici İnvestisiya, iqtisadi inkişaf, maliyyə stabilliyi riski, idarəetmə keyfiyyəti

THE IMPACT OF GOVERNANCE QUALITY AND FINANCIAL STABILITY RISK OVER FDI FLOW: EVIDENCE FROM SOUTH CAUCASUS

SUMMARY

The actuality of the subject: FDI appears to have recently achieved the status of as a driver of economic growth for transition countries and most attractive source of capital inflow in developing countries under certain conditions.
Purpose and tasks of the research: This dissertation aims to determine the impact of management quality and financial stability risk on FDI in the South Caucasus and to measure the impact of these factors statistically by applying econometric analysis based on the available database.
Used research methods: Data representing Institutional Quality is to be processed by finding mean of 6 variables. The risk factors of a financial stability is taken from Fitch ratings.
The information base of the research: Required figures to be obtained through World Development Indicators of World Bank and based from various articles and reports to achieve this goal.
Restrictions of research: The first is to check the quality and accuracy of some of the data and the second is the lack of access to articles that can be very helpful to the research and help us answer some of the questions.
The novelty and practical results of investigation: The study specifically assesses the quality of management and the risk of financial stability and the coefficient and significance of the FDI.
Scientific-practical significance of results: The findings could be important for both government agencies involved in boosting economic growth through FDI, and for potential investors interested in investing in the region.

Keywords: FDI, economic growth, financial stability risk, institutional quality.

ABBREVIATIONS

AZPROMO	Azerbaijan Export and Investment Promotion Foundation
CBAR	Central of Azerbaijan Republic
EU	European Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
MNE	Multinational Enterprise
WGI	World Government Indicators
OECD	Organisation for Economic Co-operation and Development
UNDP	United Nations Development Programme
CIS	Commonwealth Independent States
UNCTAD	United Nations Conference on Trade and Development
VAT	Valued Added Taxes
USD	United States Dollars

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INTRODUCTION

Relevance of the research topic: For decades, FDI has been regarded as an essential component of a low-cost, well-organized market climate, as well as a significant driver of economic development. Nonetheless, the benefits of FDI are unlikely to accrue on their own and at the same rate across all nations, sectors of the economy, and populations.

The study aims to determine to what extent government incentives are sufficient to attract non-native investors, taking into account the position of government regulations in FDI. It includes government laws and rules, as well as how they are implemented.

Statement of the problem and learning level: Although there is not a similar research in the country, other countries have been studied extensively. Firstly, theoretical foundations have been built and proposed by books and academic journals which specify how financial stability forecasting should be conducted.

In addition, forecasting techniques have also been studied to a significant extent and these techniques have been applied both in practice and theory.

Finally, empirical researches have been done in regards to the effect of governance quality and financial stability risk its estimation.

Purposes and objectives of the research: Previously, many studies have been argued the impact of economic and financial risk on FDI. It can be concluded that decrease in political risk lead to an increase in inflows of FDI and encourage business. Some of the studies indicated that financial risk is not associated with FDI whereas level of political change has effect on FDI. Globally, Jordan economy showed strong association between financial and economic factors. Catherine and Rashid draw our attention towards economic and financial risk factors on FDI. Evidence presented in their study suggested that, financial risk have significant relationship with FDI while economic risk can be a contributing factor for FDI. In addition, most of the developing countries consider foreign direct investment as an important source of development. So this study can be helpful for those who want to find out the financial risk association with FDI in countries.

Object and subject of the research: There are several objectives of this dissertation as discussed below.

- Firstly, theoretical base for FDI and its determinants will be provided in the first chapter of the dissertation. This theoretical base will provide foundation for the further analysis in the dissertation.
- Secondly, the dissertation aims to evaluate the financial stability risk and governance quality of the selected countries. As FDI is a major factor in developing countries in order to reduce the deficiency of capital and technology significantly, it can be assumed that investigating this will enable the researcher to assess the financial stability of the businesses in the country to a considerable extent.

Research methods: The relevance of the research topic of this thesis is due to the great interest in this problem in modern science, as well as its lack of development. Sound econometric model could reveal specific areas to target and improve in order to boost FDI flow into the country.

The thesis aims to explore Institutional quality and financial factors affecting FDI in South Caucasus region building and applying comprehensive statistical model.

Research database: This dissertation fashioned on the basis of quantitative research of power of individual factors on Foreign Direct Investment. Annual FDI growth rate will be considered as a dependent variable, while Institutional Quality, Financial Risk Factors accounted as independent variables. Required figures to be obtained through World Development Indicators of World Bank, State Statistical Committee of Azerbaijan Republic and also Fitch ratings for the period. Data representing Institutional Quality is to be processed by finding mean of 6 variables such as Rule of Law, Control of Corruption, Government Effectiveness, Regulatory Quality, Voice and Accountability, and Political Stability. The risk factors of a financial stability are the sovereign risk, which, this paper is aim to analysis through their fluctuation, how FDI is significantly affected or not.

CHAPTER I. THEORETICAL ASPECTS OF FDI FLOW: THE ROLE OF GOVERNANCE QUALITY AND FINANCIAL STABILITY

1.1. The Concept of Foreign Direct Investment and major determinants

For decades FDI has been considered as an inevitable bunch of red-tape-free and well-organized business environment, and a considerably booster of economic growth. Nevertheless, advantages of FDI is not likely to build up on its own and at the same pace around the various states, fields of economy and communities. In-country regulation framework and the multinational investment structure play a crucial role in driving in oversea investors and enjoying all the positive externality of the FDI (Guasch, et al., 2007). Inward FDI receivers by and large face the most difficulties in the sense that those nations are in need of maintaining responsible, comprehensive and enforceable atmosphere within the economy that would encourage oversea investors to feel confident enough to invest in that particular economy.

The main role of foreign direct investment in welfare countries is a frequent study of factors that stimulate the attraction of FDI to the economies of countries in order to explain the location of FDI around the world.

The most investigations focus on economic determinants of FDI flows, while other types of factors are often neglected or reduced to simple mentioning. When research is conducted on non-economic factors, the lists of factors, approaches and outcomes are so different that the question of the relevance of the factors and the credibility of the results appears.

Sparks et al. in 2014 concludes that just 22.46 % of the variation of countries' FDI can be explained by economic factors. Even if there is a question about the relevance of the Country Liquidity Index used as a proxy for economic factors, the statement that economic determinants are not sufficient for the explanation of the location of FDI appears to be correct.

As a rule, FDI refers to asset introductions from abroad that bring resources into the manufacturing economy and are generally favored over different structures of oversea funding since they are not creating liability, does not cause instability. The returns of the investors is dependent on the quality of the penetration plan and its implication. FDI moreover encourages global exchange and spread of know-how, knowledges and innovation.

In many other empirical evidences it has been argued that inflow and outflow of FDI is a major factor in developing countries in order to eliminate the deficiency of capital and technology. In contrast, the challenges faced by developing countries are now creating business friendly environment.

Taking the view point of foreign investor, financial stability factor can affect investment decision as this defines sustainable or conducive environment to invest. On the other hand, financial stability risk affects FDI decision as foreign investors are encouraged by the economy that has low or acceptable financial risk. Economies with stronger currency show willingness to invest in the countries which containing weaker currency in order to get maximum.

The challenge to pull in FDI among nations has been intense, especially in late decades. Therefore, the problem of deciding the elements that guarantee the allure of businesses for Foreign Direct Investment is one of the crucial themes that is in the focus of simply logical research, just as viable investigations of global associations and national governments.

Theoretically, foreign debt can be consider in the form of additional resources, as well as financial, technological and managerial requirements. Foreign debt can be used to support the development process and to enhance more conducive environment as well as infrastructure to draw foreign investors. Therefore, increasing infrastructural growth can therefore attract foreign investors to invest and eventually increase foreign investment.

In addition, increase in exchange rate depreciates the currency value of host country which some encourage the foreign investors to invest because it benefits them in terms of profit relative to their own country. However, volatile exchange rate can increase the risk and uncertainty to invest for foreign investor which decreases the FDI inflow pattern (Kiyota and Urata, 2004).

Looking at the current account deficit, it shows the country import goods and services are seen to be more than its exports (Gosh and Ramakrishan, 2012). They argued that, countries that have current account deficit have more fast economic development and growth. But when countries have stronger economic growth, they are more likely to get attracted by foreign investor which allows foreign capital to increase.

Producing nations, developing economies and states experiencing significant change have come progressively to see FDI as a wellspring of GDP growth and renovation, revenue increase and work engagement. Nations have eased their FDI systems and sought after different tactics to pull in venture. They have focused to the question of how best to seek after local strategies to expand the advantages of alien capital in the local economy. The examinations of Foreign Direct Investment for Growth endeavors fundamentally to reveal insight into the issue, by concentrating on the general impact of FDI on macroeconomic development and other welfare-improving procedures, and on the channels through which these advantages produce results. The general advantages of FDI for productive nation economies are recorded in great details.

Given the proper national strategies and an essential degree of advancement, a prevalence of studies shows that FDI triggers innovation overflows, helps human capital arrangement, contributes to beneficial barter economy among nations, makes an increasingly focused business condition and upgrades enterprise improvement. These add to higher financial development, which is the most intense device for declining neediness in poor nations. Also, in addition to the clear monetary advantages, FDI may aid to improve natural and communal circumstances in the receiving nation by, for instance, moving "cleaner" innovations and prompting all the more communally mindful trade methods.

FDI in extraction industry possesses the ability to create unprecedented incomes that to be utilized to reinforce the host economy and reduce countrywide destitution. How significant role does FDI have to facilitate the move from meagre community to affluent nation? Customary models to ascertain the estimation of FDI to improvement depended upon ordinary investigation of similar preferred position: worldwide firms give cash-flow to put the host economy's abundant asset, under-developed labor force, enabling the nation to do what its normal enrichment permitted all the more effectively.

Yet, this conceptualization currently demonstrates to be extremely immobile. At the point when worldwide companies fabricate plants that are incorporated into their global network and market domination plans, they bring a bundle of the board, innovation, and quality control strategies that places the host nation at the front line of best practices of the planet. To improve their very own situation in worldwide markets, global companies redesign the capacities of these plants ceaselessly to keep them at the cutting edge in the multinational markets (Jude and Levieuge, 2017).

The question of how financial development contributes to economic growth has drawn attention of many researchers. For instance, it has been claimed that advanced financial system may soar economic growth in low or middle income countries. In contrast, T. Koivu believed that quantitative measure of financial sector (e. g. credit to private sector) does not accelerate sustainable GDP growth.

In the work of Hassan, Sanchez, and Yu, authors believe that well-functioning financial sector encourages economic development, yet healthy conditions within financial system lacks in some developing countries. In these countries fiscal policy and trade plays an effective role than finance. By means of Granger Causality Test, these scholars documented that domestic credit to private sector and trade is positively and significantly correlated with growth in European & Central Asian countries.

In 2002 T. Koivu make a statement that Interest Spread significantly discourages economy, whereas each additional credit allocated to private sector does not accelerate prosperity of states.

It has been asserted by Nabila Asghar and Zakir Hussain that poor structure of financial system and inefficiency provide room for limited benefits for economy in developing nations. Foreign Direct Investment and technological innovations assist constructing better financial system (Asghar and Hussain, 2014).

Study of Jülide Yildirim, Nadir Öcal, and Mahmut Erdogan in 2008 tracked footprints of credit and deposit amount rates on economy of Turkey in 2 consecutive half-decades of 1991-1995 and 1996-2001. The scholars announced that vast amount of deposits hindered economic escalation, due to less demand for supplied capital, by contrast credits to both businesses and individuals heartened it (Yildirim, et al., 2008).

There are many ways in which FDI benefits the host country:

1. Increased Employment and Economic Growth: The most obvious benefit of FDI is the development of jobs. It is also one of the most important reasons why a country, particularly one in development, seeks FDI. Increased FDI benefits both the manufacturing and service sectors. This, in turn, generates jobs and aids in the reduction of unemployment among the country's educated youth, as well as skilled and unskilled labor. Increased jobs leads to higher earnings, giving the public more purchasing power. This benefits the country's economy.
2. Human Resource Development: One of the less apparent benefits of FDI is this. As a result, it is often understated. The term "human capital" refers to the workforce's expertise and skills. The country's education and human capital quotient are boosted by skills acquired and improved through training and experience. Human capital is portable once it has been created. It can train human resources in other businesses, causing a chain reaction.
3. Development of Backward Areas: For a developing countries, this is one of the most important advantages of FDI. FDI allows a country's backward areas to be transformed into economic hubs. As a result, the area's social economy receives a boost.
4. Creation of a Competitive Market: Foreign direct investment (FDI) aims to build a competitive atmosphere and break domestic monopolies by making it easier for foreign companies to enter the domestic market. A healthy

competitive climate encourages businesses to improve their processes and product offerings on a regular basis, encouraging creativity. Consumers would now have access to a broader variety of goods at lower prices.

5. Stimulation of Economic Development: This is yet another significant benefit of FDI. Foreign direct investment (FDI) is a source of external capital and increased revenue for a government. At least some local labor, materials, and equipment are used when factories are built. When the factory is finished, it will hire some local workers and use locally sourced products and services. As a result, those who work in such factories have more money to spend. More jobs are created as a result of this.

Additionally, these factories would generate additional tax revenue for the government, which can be used to build and improve physical and financial infrastructure.

1.2. Measuring governance quality and financial stability risk

For Institutional variables of Governance, World Governance Indicators (WGI) are used. WGI is a research program of the World Bank that captures six main dimensions of governance, called Voice & Accountability, Political Stability and Lack of Violence, Government Effectiveness, Regulatory Quality, Rule of Law, and Control of Corruption. We have selected all the governance indicators for the purpose of the study. The variables are explained briefly:

1) Voice and Accountability: - This factor explores the degree to which citizens of a country will vote in the choice of their government, as well as freedom of expression for individuals and media and government accountability Of the six WGIs, this variable best captures the notion of most people about how pluralism is affected by a democratic institution that promotes voice and accountability. This factor should be negatively linked to trade and FDI as democratic institutions will give the country's people more power to resist the country's FDI inflows.

2.) Political Stability (PS): This parameter tests expectations of the possibility that by illegal or violent means the state will not be destabilized or overthrown. For FDI, due to the risk of expropriation, MNEs should tend to prefer a stable government to an unstable host government. Political stability does not need to be a crucial determinant for trade due to the lack of risk of plant and equipment expropriation.

3.) Government Effectiveness (GE): Each factor tests the quality of public services, the public service (and its degree of independence), the mechanism and execution of policy development, and the government's commitment to policy implementation. For FDI and exchange, foreign companies would be required to choose an effective government of the host country.

4.) Regulatory Quality (RQ): This variable measures the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development. Of the six indicators, this one should be very important for enhancing both FDI and trade.

5.) Rule of Law (RL): This variable measures the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, the police, and the courts. This should be important for both FDI and trade.

6.) Control of Corruption (CC): This variable measures the extent to which public power is not exercised for private gain, including both petty and grand forms of corruption, as well as "capture" of the state by elites and private interests. This could be important both for FDI and trade.

A number of potential risk factors for FDI have been examined in the IB literature, including those arising from political, social, geographical, technological, regulatory and/or firm specific spheres. However, the financial sector has been less taken into account and as a result, the risks to FDI emanating from both, recent financial crises (e.g., sovereign debt crisis) and any policy responses to them, have been underexplored.

In order to analyse financial stability risk over FDI flow in region we take Fitch ratings in order to evaluate countries' sovereign risk.

Fitch Ratings is a global credit rating agency with offices in New York and

London. Investors use the company's ratings to determine which investments are unlikely to default and, as a result, can have a good return. Fitch focuses its ratings on factors such as a company's leverage and how vulnerable it is to systemic changes such as interest rates.
The Fitch rating system is as follows:

Investment grade

AAA: Incredibly high-quality businesses (established, with consistent cash flows)
AA: still of good quality, with a low chance of default.
A: low chance of default; marginally more susceptible to market and economic factors
BBB: a low risk of default; market or economic factors can have a negative impact on the group.

Non-investment grade

BB: increased risk of default; more vulnerable to adverse changes in market or economic conditions; still financially flexible
B: deteriorating financial situation; high-risk investment
CCC: a real possibility of default
CC: There's a good chance you'll default.
C: The default or default-like process has started
RD: the issuer has defaulted on a payment
D: Defaulted

Fitch assigns sovereign credit ratings to countries based on their ability to fulfill their debt obligations. Investors may obtain sovereign credit ratings to help them understand the level of risk associated with investing in a specific country. Fitch and other credit rating agencies will be invited to assess their economic and political conditions, as well as their financial circumstances, in order to establish a representative rating. It's critical to get the best sovereign credit rating possible, particularly for developing countries, because it helps with accessing financing on international bond markets.

1.3. Review of existing studies

In 2006 Ajisafeet al. analyze the relationship between foreign private investment and foreign debt in Nigeria by using vector autoregressive model. They have considered time series data over the period from 1970-2003. Study results show that foreign debt and foreign private investment have a strong correlation, while the results of causality indicate a two-way connection between them.

Foreign debt can be argued to be beneficial to the economy as it attracts foreign investment, but it can deter foreign investment by using foreign debt. One research by Furceri & Borelli examines the effect of volatility of exchange rate on FDI inflow in EMU neighborhood countries. They have used panel data over the period from 1995 to 2004 and used Hausman test. Their research has indicated that impact of volatility of exchange rate on FDI inflow is significant and positive at low level of openness, whereas negative impact at high level of openness in EMU neighborhood countries is observed. The study concluded that FDI inflow in emerging and transition economies is viewed more valuable due to limited domestic resources. Furthermore, FDI inflow is also characterized by higher stability in exchange rate.

Indeed, the finance literature has tended to use sovereign yields as a proxy for political risk. Even though this may be not unproblematic, in that other risks may be included in valuation analysis leading to potential double counting, it still recognizes the relationship between structural features and politics. However, two problems emerge, one at the applied, and one at the conceptual level. Firstly, recent years have seen a trend for national governments to disengage themselves from monetary policy and regulation of financial sector, placing an increasingly strong emphasis on central bank independence. According to Bodea and Hicks any governments have agreed to place such policies at arm’s length. In other words, an entire policy area has become placed beyond politics, even though this can be challenged by emerging political actors and figures. In turn, this will make external lobbying of politicians less effective; firms have to accept policy as a given, rather than something that can be amended through political activities. Again, this has an impact on debt; central bank independence means governments unable to solve problems simply by printing more money, and, in turn, this means that the former will have a more predictable, if at times, unpalatable, set of consequences. In addition, if banks are asked to hold more regulatory capital, this will likely have a detrimental impact on the amount lent to firms.

Khrawish and Saim conducted a study to examine the economic and financial risk at the macro level of FDI in Jordan to better understand the financial risk mechanism for FDI. Their estimations were based on multiple regression models over the sample period from 1997 to 2007. Economic model results show that real GDP growth, GDP per capita, balance of budgets, balance of current accounts and inflation rate have significant positive impact on FDI.

On the other hand, financial model results indicate that stability of the exchange rate, foreign debt operations, foreign debt and current account have a significant positive effect at Jordon's FDI. Nevertheless, the foreign investment inflow in Jordon has been affected by instability of economy.

In 2011 Anilet al. draws our attention to the factors that contributed to the outflow of foreign direct investment in Turkish firms over the period 1989-2005. The results show that personnel quality, training programs quality, foreign market experience, brand image and trade mark, and company’s international experience are the factors that have insignificant negative effect on FDI outflow. Furthermore, managerial and technological know-how and ability of developing different products are the factors having significant negative impact on FDI outflow of Turkish firms. As a consequence, approach for internationalization is linked with resources, knowledge sharing and cost reduction purpose to operate in the low competitive markets.

Good governance’ institutions are said to promote investment climate in a country. Literature suggests that Good governance and institutions are needed to secure three essential prerequisites of market economies: security of property rights, enforcement of contracts, and to facilitate collective action. Therefore, institutions are required in a country in order to make market operate efficiently. This leads to an interesting question whether governance institutions indeed lead to improved economic outcomes. Since this paper deals with the attractiveness of a country to FDI and institutional factors, empirical studies dealing with various institutional factors and different regions of the world on similar lines are examined in this section.

The empirical study by Saidi, Ochi and Ghadri analyzes the impact of governance indicators and macroeconomic variables on the attractiveness of foreign direct investment in 20 developed and developing countries from 1998 to 2011 using fixed effects panel regressions. In their results they find out only two indicators namely, political stability and regulatory quality which have a major effect on FDI inflows.

Another research by Alemu studies the institutional impact on FDI of Asian countries only. He examines effects of host country institutional efficiency as captured by six elements of 'good governance' on 15 Asian countries' FDI inflow. Their results shows that government effectiveness, political stability, and absence of violence, rule of law, and the absence of corruption are robust factors determining FDI inflows of a country. For the purpose of this analysis, he uses fixed effects, random effects and winstein panel estimation methodology for praise for the purpose of this study.

Daude and Stein studied the role of institutional quality as a determinant of the position of FDI for OECD nations, using bilateral FDI stocks from OECD countries around the world. They find that better institutions have overall a positive and significant impact on FDI. In particular, the unpredictability of policies, excessive regulatory burden, deficient enforcement of property rights, and lack of commitment on the part of the government plays a major role in deterring FDI flows.

Given this background, we specify the data, variables, and methodology for our study in understanding the impact of governance institutions and financial stability in attracting FDI in a country.

CHAPTER II. DYNAMICS OF FDI FLOW VS. GOVERNANCE QUALITY AND FINANCIAL STABILITY RISK IN SOUTH CAUCASUS REGION

2.1. Analyisis of FDI flow vs. other indicators: Azerbaijan

Oil-rich Azerbaijan's hydrocarbon industry has consistently remained attractive to the outside stockholders. In the meantime, of 17 year-period starting from beginning of 21st century, just 15% or merely 11 billion US dollars have been invested in non-resource intensive economic areas (State Statistical Committe of Azerbaijan Republic, 2018).

In addition, outside speculators had deficient enthusiasm for the non-oil/gas part of the country, particularly the production business during that period. Slight appetite of overseas capital owners for Azerbaijan's non-petrol-related enterprises is incontrovertibly provocative, since funds were directed vigorously in the oil and gas regions. In order to achieving considerable expansion of Foreign Direct Investment streams towards other underdeveloped industry sectors, steps should be taken should be performed to distinguish and dispose of the variables that force outside capitalists.

The adequacy and competence of the Government's decisions on advancing venture movement are also among the concerns which should to be rethought.

Via the annual World Investment Survey, the UNDP anchors that worldwide FDI streams began their slide in 2018, dropping by 13 percent to $1.3 trillion (United Nations Conference on Trade and Development, 2019).

The decay – the third back to back year's fall in FDI – was mainly due to enormous scale repatriations of accumulated remote income by United States transnational companies in the initial 6 months of 2018, after tax policy reforms presented in that nation toward the end of 2017. In the first 6 months of 2018, the levy-driven fall (which ended 40 percent lower than a similar period in 2017) was in the subsequent half by expanded exchange movement.

A World Bank study revolutionizes the previous work on the work that includes the thoughts and ideas of more than 700 people who are worldwide on the leadership of many multinational companies. Research lists different factors that influence the level of foreign capital invested, including:

1) Involatile and stable political system (more than half of depositors rank this as a very crucial aspect and 37 percent as a vital aspect);

2) Law and regulations (43 percent on average);

3) Huge internal purchasing power (by average 40 percent); and

4) Overall business stamina and advantageous foreign currency conversion (a third and slightly less than 45 percent correspondingly).

The following factors include: labor force intelligence and preparedness; strong and concrete groundwork to help companies and individuals; negligible taxation; cheap employee potential; real state accessibility; and nationwide capital raising. In this analysis, in the execution of legal proceedings, shareholders often depend on certainty and competence. By the way, the following aspects are proportionate to depositors as crucially essential or imperative: verifiability and expectation of respect for governmental organizations, venture capital insurance, starting business and doing business ratings, levy free trade, development of capital inflows and multidimensional commercial contracts between countries are further below.

Some sub-global institutions conduct research on FDI movements in collaboration with transnational development establishments. More precisely, Azerbaijan's results in such communications within Eurasia and the CIS attract more attention. As an example, the study "Monitoring of Mutual Investments in CIS Countries 2017" by the Eurasian Development Bank outlines a problem that Azerbaijan's cumulative straight capital outflow in the Commonwealth of Independent States and Georgia amounted to $2.4 billion until the middle of the 2nd decade of the 21st century. While, as an addressee of Foreign Direct Investment from the Commonwealth of Independent States and Georgia, the achievements of our country as a fund attractor are moderately shy: just US$ 1 billion (90% of which originated from the Russian Federation) (European Development Bank, 2018).

According to data provided by the UNCTAD World Investment Report, FDI to Azerbaijan fell significantly by US$ 1.46 billion to a low of US$ 1.4 billion (2017:

US$ 2.86). The current trend agrees with the movement of the CIS and South-East European countries at FDI stages. The implementation of FDI into the country focuses primarily on resource-based sectors (i.e. oil and gas). Nonetheless, one of the administration's top (if not the first) economic priorities is to diversify the nation's revenues and increase the share of FDI in areas such as holiday business, information and communication technology, transport, and agriculture.

According to the reporter (UNCTAD), Azerbaijan's total cumulative amount of foreign direct investment is approximately US$31 billion, representing 68% of the nation's Gross Domestic Product in 2018. The Russian Federation, among other things, retains its leadership as an investor in terms of the net US dollars invested in Azerbaijan. This act can be explained by the fact that Azerbaijan not only has one main geographical location in the region (i.e. access to the Middle East and Iran, as well as the interception of the trade route from China to the European market) and that the country also has adequate oil and gas reserves in the Caspian Sea.

The Government of the Republic of Azerbaijan has shown a position that highlights the vitality of the current investment atmosphere that is developing. Therefore, it may not be fair to consider that the country's current 25th rank among 180 different states in the World Bank's Doing Business report is a mere coincidence. 66 per cent of states within the EU's investigation explicit they might invest in Azerbaijan Republic once more; moreover, 89 per cent of these firms expect that their investments will remain stable or grow (Azernews, 2018).

The government has set up a one-time shop to issue corporate authorizations and licenses (United Nations Conference on Trade and Development, 2019).

The construction of the Southern Gas Corridor that could carry Azerbaijani gas through Georgia, Turkey and Europe has been prioritized by the EU (Azernews, 2018). Italy is in discussions to take a position on the reprocessing of waste tires in order to obtain and export alternative energy.

President Aliyev has jointly signed a decree establishing a trade zone area next to the Alyat port of call, establishing a sixty-five metric linear unit south of the capital of Azerbaijan. Under the recently amended Customs Tariff Act, entrepreneurs incorporating long-term fixed assets for priority sectors are exempt from taxes for a period of up to seven years.

The government's aim was to empower the venture (as an example: the involvement of the Investment Promotion Certificate paper together with the toll, as well as the complete exclusion from customs obligations in the provision of mechanical hardware for industrial areas with the greatest need) to set up techno-parks (full exception from customs obligations and duties, VAT including, when bringing in innovative gear by resident persons from modern and mechanical parks for the purpose of development and innovative work outpouring for a long time from the date of receipt of the equipment). To help national incomes and to protect local traders, just as to encourage non-oil shipments.

At the AZPROMO platform, data on investment impulses, trade and investment conditions were distributed in 3 languages. The website highlights the fact that Azerbaijan currently has double tax agreements with just over 50 countries and mutual funds across the globe. In essence, the virtual look of AZPROMO has been extended over the last few years. However, data on the cooperation site may be more limited than data from similar websites of other countries or global organisations.

The UNCTAD (United Nations Conference on Trade and Development) prepares and publishes an annual World Investment Report that focuses on growth dynamics, government policy interventions, and developments in foreign direct investment (FDI) around the world. Global foreign direct investment (FDI) flows dropped by 23% from $1.87 trillion in 2016 to $1.43 trillion in 2017, according to the World Investment Report 2018 on Investment and New Industrial Policies. In 2017, 65 countries and economies adopted at least 126 investment policy measures (compared to 58 countries and economies adopting 124 investment policy measures in 2016), with 84 percent of them being beneficial to investors. According to the study, they lowered entry barriers in a range of industries, including transportation, electricity, and manufacturing.

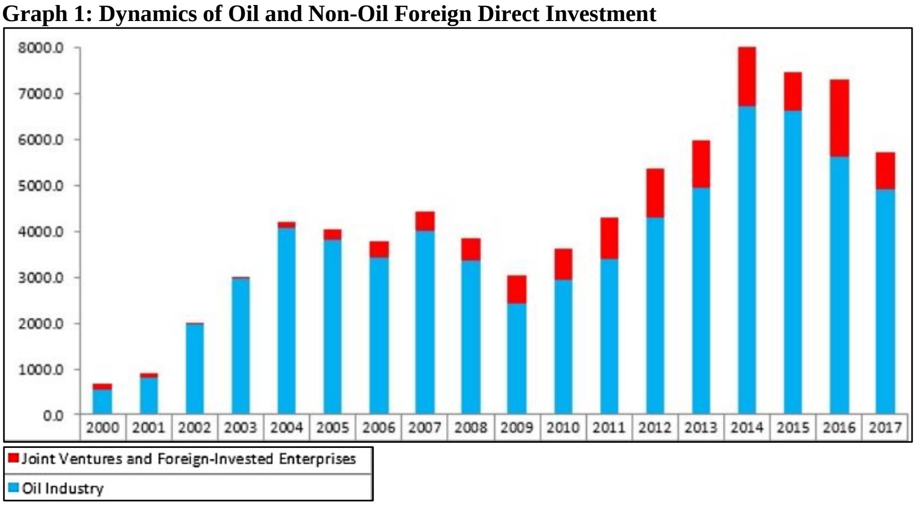
The “Global Investment Competitiveness Report 2017-2018: Foreign

Investor Perspectives and Policy Implications," published by the World Bank Group, is based on a groundbreaking survey of 754 executives from multinational companies investing in developing countries. The efficacy of fiscal incentives in attracting FDI is evaluated in this study.

According to the State Statistical Committee, Azerbaijan received $125.5 billion in FDI between 1995 and 2017, including $120.6 billion (96.1%) from 2000 to 2017. (SSC). Between 2000 and 2017, the government of Azerbaijan and state-owned and private companies obtained loans from a number of international finance and credit institutions totaling $29.2 billion (24.2%) of all foreign investments. Direct investments accounted for $64.5 billion (64.5 percent), incentive payments under oil deals accounted for $217.7 million (0.2 percent), and other investments accounted for $13.4 billion (11.1 percent) (mainly portfolio investments).

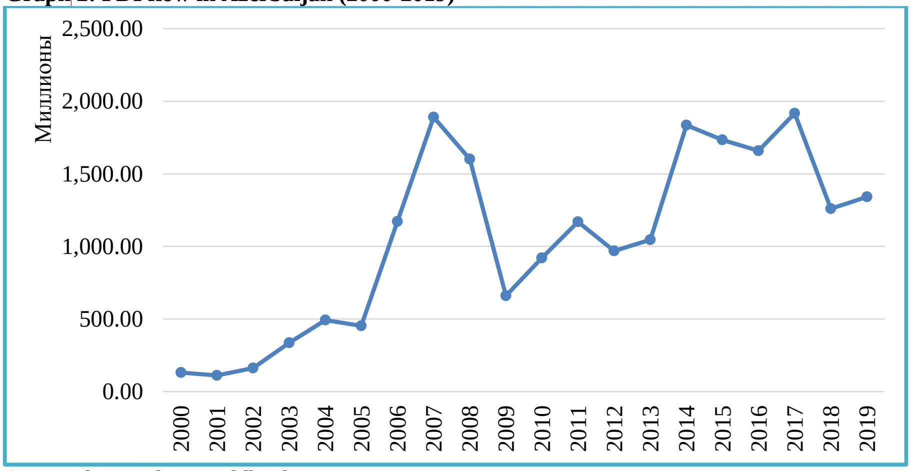
The oil sector has always had a higher stock of FDI than the non-oil sector (see Graph 1).

Graph 1: Dynamics of Oil and Non-Oil Foreign Direct Investment



Source: https://bakuresearchinstitute.org/

Graph 2: FDI flow in Azerbaijan (2000-2019)



Source: https://data.worldbank.org

Добавлено примечание ([WU2]): Yazı qaydalarına uyğun bütün Graphleri table-lari duzeldin

In the second quarter of 2019, foreign direct investment in Azerbaijan increased by USD 915 million. From 2006 to 2019, foreign direct investment in Azerbaijan averaged USD 1285.44 million, reaching an all-time high of USD 2231 million in the fourth quarter of 2014 and a record low of USD 586 million in the third quarter of 2009. FDI continues to decrease flow from January 2017 to January 2018. The lowest amount in 2019 was USD 809 million over the period 2016-2019.

Elections and referendums in Azerbaijan have been regularly criticized by international organizations monitoring elections in Azerbaijan, including the OSCE Office for Democratic Institutions and Human Rights, saying that they have not been free or fair.

In addition to the economic issues, there are significant problems related to the country's governance, as well as the general business climate. Although the country's partially free market is generally open to trade and investment, lax property rights safeguards, large companies controlled by the ruling family and officials' families, and pervasive corruption have led to monopolization and obstruction of growth in the non-oil sector.

The independence of the judiciary and the freedom of the press are highly necessary in order to ensure the effectiveness of anti-corruption policies. In 2017, the European Research Centre for Anti-Corruption and State-Building (ERCAS) Index of Public Integrity ranked Azerbaijan 65th out of 109 countries in terms of judicial independence (we can consider Georgia, which ranked 45th in a regional comparison), while the country was at the very bottom of the list of 109 countries in terms of press freedom.

Voice and accountability index (-2.5 weak; 2.5 strong), 2000 - 2019: The average value for Azerbaijan during that period was a minimum of -1.56 points in 2016 and a maximum of -0.9062 points in 2000.

Political stability index (-2.5 weak; 2.5 strong), 2000 - 2019: The average value for Azerbaijan during that period was a minimum of -1.1932 points in 2002 and a maximum of -0.2385 points in 2010.

Government effectiveness index (-2.5 weak; 2.5 strong), 2000 - 2019: The average value for Azerbaijan during that period was a minimum of -1.006 points in 2000 and a maximum of -0.1 points in 2018.

Regulatory quality index (-2.5 weak; 2.5 strong), 2000 - 2019: The average value for Azerbaijan during that period was a minimum of -0.9319 points in 2000 and a maximum of -0.23 points in 2019.

Rule of law index (-2.5 weak; 2.5 strong), 2000 - 2019: The average value for Azerbaijan during that period was a minimum of -1.149 points in 2000 and a maximum of -0.52 points in 2016.

Control of corruption (-2.5 weak; 2.5 strong), 2000 - 2019: The average value for Azerbaijan during that period was a minimum of -1.30 points in 2000 and a maximum of -0.83 points in 2018.

Summary of all the governance quality indicators with avarage points during the period of 2000-2019 are below:

Table 1: Governance quality indicators of Azerbaijan (2000-2019)

Year	Voice and Accountability	Political Stability and Absence of Violence/Terrorism	Government Effectiveness	Regulatory Quality	Rule of Law	Control of Corruption
2000	-0.9062	-0.8302	-1.006	-0.9319	-1.14998	-1.3006
2001	-0.9438	-1.0117	-0.9675	-0.8194	-1.02932	-1.2399
2002	-0.9813	-1.1932	-0.929	-0.707	-0.90866	-1.1793
2003	-1.0447	-0.9487	-0.7669	-0.5656	-0.83652	-1.0071
2004	-1.0567	-1.0611	-0.7424	-0.5902	-0.87477	-1.163
2005	-1.1242	-1.1275	-0.7294	-0.5777	-0.79175	-1.0449
2006	-1.2792	-1.0942	-0.6535	-0.5232	-0.88504	-1.0898
2007	-1.2334	-0.6256	-0.7892	-0.459	-0.87931	-1.1229
2008	-1.3251	-0.3335	-0.7735	-0.3549	-0.83245	-1.1485
2009	-1.2598	-0.2759	-0.6581	-0.3081	-0.87999	-1.1885
2010	-1.3046	-0.2385	-0.8069	-0.3724	-0.89305	-1.2438
2011	-1.3018	-0.5321	-0.7651	-0.372	-0.89371	-1.1789
2012	-1.2995	-0.7158	-0.7826	-0.4556	-0.83451	-1.1269
2013	-1.4028	-0.4129	-0.475	-0.4083	-0.72386	-0.9668
2014	-1.4792	-0.5599	-0.3638	-0.2771	-0.67224	-1.0187
2015	-1.5524	-0.7296	-0.2574	-0.2547	-0.67369	-0.93
2016	-1.56	-0.8	-0.17	-0.28	-0.52	-0.84
2017	-1.56	-0.75	-0.17	-0.25	-0.56	-0.89
2018	-1.5	-0.7	-0.1	-0.3	-0.6	-0.83
2019	-1.49	-0.68	-0.14	-0.23	-0.58	-0.87

Source: https://info.worldbank.org/governance/wgi/

The Agency estimates that the results are negative. The problem ranking on the senior unsecured foreign currency bond of Azerbaijan was also downgraded from 'BBB-' to 'BB+'. The Country Ceiling was changed from 'BBB-' to 'BB+'.

In 2016, Fitch expects real GDP to contract by 3.3%, even as the average 'BBB' nation would rise by 2.6%. As the long-term trend of declining output in Azerbaijan's oil fields is intensified by a fire on a main platform in SOCAR's Guneshli sector, oil production will drop slightly. As the government cuts back on spending, bank lending comes to a halt, and consumer trust and purchasing power decline, Fitch expects non-oil activity to contract by 4%. Most of the fall in spending, however, can be absorbed by reducing imports.

Fitch Ratings-London-04 August 2017: At 'BB+' with Negative Outlooks, Fitch Ratings has reported Azerbaijan's Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDR).

The 'BB+' ratings of Azerbaijan balance a solid external balance sheet with low government debt, resulting from accumulated surpluses in periods of high oil revenue, heavy hydrocarbon dependency, an underdeveloped and volatile policy system, low governance indicators and a poor banking sector.

Fitch Ratings-Moscow-28 February 2018: Fitch Ratings has revised the Negative Stable Outlook of the Mortgage and Credit Guarantee Fund of the Republic of Azerbaijan (MCGF) while affirming the 'BB+' Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) of the fund.

According to a report by the Fitch Ratings International Rating Agency, published on the agency's website, Trend reported on October 4, Azerbaijan has therefore retained its leadership position in 2019 and displayed steady growth rates with a BB + rating.

For the third quarter of 2019, Fitch Ratings' economic report was based on an assessment of 22 Eastern European and post-Soviet countries.

Table 2: Financial stability index of Azerbaijan 2000-2019 period

Long term Rating			
Foreign currency		**Local currency**	
Date	**Rating(Outlook)**	**Date**	**Rating**
10-04-20	BB+	10-04-20	BB+
17-01-20	BB+	17-01-20	BB+
19-07-19	BB+	19-07-19	BB+
25-01-19	BB+	25-01-19	BB+
27-07-18	BB+ (Stable)	27-07-18	BB+
02-02-18	BB+ (Stable)	02-02-18	BB+
04-08-17	BB+ (Negative)	04-08-17	BB+
24-02-17	BB+ (Negative)	24-02-17	BB+
26-08-16	BB+ (Negative)	26-08-16	BB+
22-07-16	BB+ (Negative)	22-07-16	BB+

26-02-16	BB+ (Negative)	26-02-16	BB+
28-08-15	BBB-	28-08-15	BBB-
13-03-15	BBB-	13-03-15	BBB-
26-09-14	BBB- (Stable)	26-09-14	BBB-
28-03-14	BBB- (Stable)	28-03-14	BBB-
11-03-14	BBB- (Stable)	11-03-14	BBB-
17-10-13	BBB- (Stable)	17-10-13	BBB-
26-04-13	BBB- (Stable)	26-04-13	BBB-
11-05-12	BBB- (Stable)	11-05-12	BBB-
17-05-11	BBB- (Positive)	17-05-11	BBB-
20-05-10	BBB- (Stable)	20-05-10	BBB-
05-02-07	BB+ (Stable)	05-02-07	BB+
22-11-04	BB (Stable)	22-11-04	BB
25-07-02	BB- (Positive)	25-07-02	BB-
20-07-01	BB- (Stable)	20-07-01	BB-
21-09-00	B+ (Positive)	21-09-00	BB-
03-07-00	B+	03-07-00	BB-

Source: https://countryeconomy.com/ratings/azerbaijan

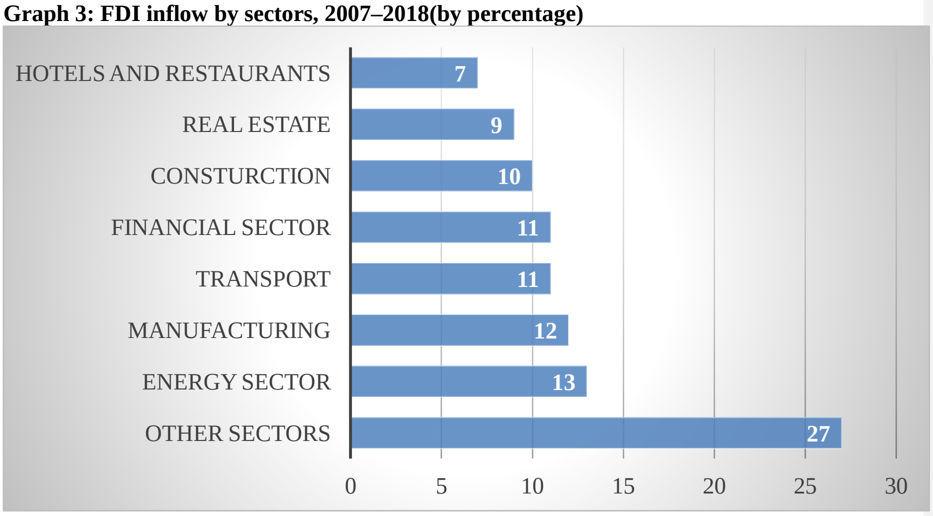
2.2. Analyisis of FDI flow vs. other indicators: Georgia

It is important to stress that the EU is the largest investor in Georgia, accounting for more than 40% of the total investment made over the last decade. At the same time, Azerbaijan is the leading country in making investments for the same period; it is mainly interested in infrastructure projects aimed at diversifying its transport of hydrocarbon resources through Georgia.

There is also a new emerging player—China, with already a significant amount of investment (almost US$700 million in the last decade), huge potential and opportunities in almost all sectors of Georgia's economy, particularly under its One Belt, One Road Global Initiative and free trade regimes already signed between China–Georgia and EU–Georgia.

Based on the different countries' interests in Georgia, which could vary from very primitive to high-tech industries, from local resource acquisition to geostrategic positioning, other sectors receiving FDI in Georgia are highly diversified, including energy, transport, finance, real estate and other sectors (see Graph. 3) It is also important to point out that the share of high-tech industries is relatively small, despite the fact that Georgia has the largest solar panel plant in Europe and is one of the few countries in which electric cars are to be produced by 2020 and there are some other relatively small innovative companies.

Graph 3: FDI inflow by sectors, 2007–2018(by percentage)



Source: National Statistics Office of Georgia, n.d.

The last but not least important issue and challenge is that the majority (81 per cent) of FDIs in Georgia are directed to their capital city—Tbilisi. Two of Georgia's largest regions represent a total of 90% of all FDIs in Georgia. Unfortunately, this has had its own impact on the uneven development of the country, seen through the regional prism, causing investment hunger in the regions and driving the rural population to the capital city.

Georgia is one of the post-Soviet countries in which FDIs have played a key role in the transformation of the host economy over the last 20 years (Gürsoy & Kurşun, 2008; Chochia & Popjanevski, 2016). However, there are still a lot of questions for which the answers are not on the horizon. The questions are very simple but need to be answered, what are the motivations of the MNEs and their impact on the Georgian economy? How much is this facilitating the development and modernisation of the various sectors of the economy? And the level of integration between the MNEs and the different sectors of the Georgian economy. In this article, the authors are trying to address these specific issues.

Based on the theoretical framework proposed by John H. Dunning, FDI motivations are categorized as resource-based, market-based, efficiency-seeking, and strategic asset-seeking motivations. They each have a particular effect on the host economy, each of which is marked by a different degree of economic growth and economic integration into global markets.

In the service sector, countries with unfavorable characteristics are hardly attracting market-oriented FDIs in which the GDP per capita parameter defines location attractiveness. However, if we consider the distribution in the case of Georgia, it is clear that, in terms of FDI attractiveness, the service sector is one of the dominant industries, and so are the financial and energy sectors, trade and tourism, transport and communications; all of which, owing to the privatization process, have taken place in Georgia in the respective sectors over the past decades. However, in terms of economic growth and exports, market-oriented investments in the Georgian service sector are less efficient; they are characterized as having minimal capabilities.

Resource-seeking FDIs primarily attract large volumes of capital inflows, encourage technical development and technology transfer, and provide steady currency inflows to the economy as well. Investments of this type are most frequently concentrated in enclave formations, with poor links to local commodity markets and labor markets. One of the negative side effects may also be the local elite's corruption promotion at the macro stage (Brouthers, 2008). The "infection" of "The Dutch Decease" may be caused by resource-seeking FDIs, although such FDIs are good for promoting international trade.

The main problem in the case of FDI analysis is that most of the researches are based only on the overall amount of the investments and do not seem to be involved in the heterogeneity of different economies. Based on the questions raised, the research was focused on MNE motivations and their effect on different industries, taking into a consideration the specifications of the host economy.

To this end, the government has introduced a range of significant institutional reforms, including a simplified and streamlined tax system, a transparent and open governance framework, a stronger legal system, strengthened property rights, sound prudential regulation and banking system oversight. Georgia boosted its ratings to the top ten in the Doing Business survey. Other cross-country surveys indicate that economic freedom (#13 out of 180 countries), openness to trade (#41 out of 160 countries), and the fight against corruption (#44 out of 176 countries) have made remarkable progress.

Gross FDI inflows peaked at approximately 18% of GDP in 2007 and have remained relatively strong (ranging from 6-10% of GDP) since then, despite many external and domestic shocks. It is necessary to understand whether these FDI inflows contribute to growth and meet policymakers' expectations for FDIs to meet insufficient capital inflows, promote export growth, reduce unemployment and increase economic development, increase key macroeconomic parameters (GDP and GDP per capita) and increase the international economic competitiveness of the country.

The purpose of this chapter is to analyze the variables that describe the structure and composition of FDI in the country and its effect on the Georgian economy. It reviews the composition of FDI in the country and sector and recognizes drivers and constraints associated with inflows of FDI. Possible solutions and suggestions are proposed based on the results of this study.

- In the large transport projects in Georgia, there is a major concentration of FDI. Further research would be important in order to understand why this sector has become especially attractive and how it can maximize its positive effect on the domestic economy;
- Despite a favorable market climate and a relatively resilient macroeconomic environment, skills mismatch, insufficient infrastructure and restricted access to finance restrict local as well as foreign firms;
- While theoretically, FDI has a positive impact on employment, the empirical relationship between employment and FDI seems at best tenuous in the case of Georgia; at the same time, there is a strong positive association between employment in different sectors and investment in fixed assets in almost all

sectors. In order to understand how various investment projects have been related to direct jobs impacts and if there have been any spillovers or secondary effects, a more thorough review is necessary;

- FDI has largely funded the current account gap in recent years; however, if company efficiency is not increased over time and does not produce exports, it can generate significant outflows or repatriation of income in the medium to long term;
- Improve FDI statistics to allow policy makers to better recognize FDI inflows related to mergers/acquisitions and investments in Greenfield, as well as their direct and indirect effect on production and jobs in various sectors and at the macro level;
- Develop the legal structure, recognize existing FDI deterrents that are still present in the economy and introduce public policies to promote investment in a variety of sectors (such as agriculture, mining, light manufacturing, etc.) and attract responsible investors.
- Ensure that the level of education, the provision of infrastructure services, local technical capacities and the growth of domestic financial markets are captured by the full benefits of FDI;
- Maintain a level playing field and a tax structure that is stable, certain, clear and transparent.

In neoclassical growth models, FDI supports capital stock accumulation, which ultimately leads to economic growth. These models are based on the premise that domestic capital efficiency is the same as international capital efficiency. Consequently, the inflow of FDI has no spillover impact on the host economy by technology transfer, but only through an increase in output inputs.

In order to enhance their technical capabilities, FDI is usually carried out by multinational companies that spend a significant amount of money in R&D. Indeed, Yu et al. in 2011 say that one of the most important technical dissemination platforms is FDI. As a result, in the host country, FDI not only increases the quantity of capital products, but also enhances the efficiency and variety of production technologies. Furthermore, the transition of advanced technology contributes to "technological diffusion"-the involvement of international technologically advanced companies makes it easier for domestic manufacturers to implement new technologies and increase the effectiveness of their business operations.

In 2015, about 70% of Georgia's total FDI could be related to six large-scale ventures that were dominated by investments in infrastructure. BP was the largest single investor group, taking a significant part of FDI to Georgia with its interests in the region. BP was Georgia's largest FDI source for four consecutive years (2013-2016), according to Geostat statistics, with more than $2 billion invested in the South Caucasus Pipeline Expansion (SCPX) project alone in the country during 2014-2017. Another example of the value of major foreign investors is the Hualing Group, which, since 2007, has brought more than $500 million to Georgia, much of which was invested between 2013 and 2015.

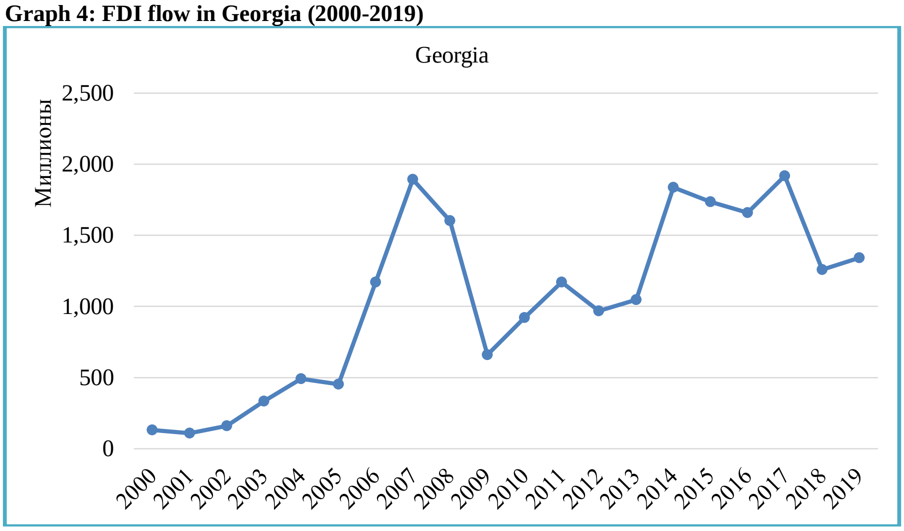
The size of the economy, the stable economic and political climate, the favorable investment environment and competitive domestic markets provide a strong starting point for foreign investors to consider investing heavily in a developing country. The key determinants of the country's attractiveness to foreign investors are therefore the growth of human resources, the quality of infrastructure, access to finance, the stable tax system, the legal framework and government policy, macroeconomic stability and economic conditions of the main partner countries.

In terms of investor motivation, research has established four forms of foreign direct investment: natural-resource-seeking FDI, market-seeking FDI, efficiency-seeking FDI and strategic-asset-seeking FDI. Each kind of FDI needs a different kind of care from national policymakers. Georgia has the ability to draw efficiency-seeking FDIs and take advantage of its favorable geographical position to harness the transit sector's investment potential. Investments in this sector (such as large BP investments) need political stability; in addition, competitively priced inputs and labor and rapid technological growth are required for efficiency-seeking FDI.

Georgia ranked ninth among 190 nations and highest in the Europe and Central Asia region, according to Doing Business 2018. The result has been achieved through the introduction of 47 reforms over the past 15 years, the highest number among the countries in the ECA region. Moreover, by systemic changes in cross-border trade and insolvency resolution, the Georgian legal system can be further strengthened. It should be noted that, according to the World Economic Forum's Global Competitiveness Index (2017-2018), the legal system in Georgia is behind best international practice in terms of (1) efficiency in conflict resolution and efficiency in challenging regulations; (2) the prevalence of favoritism in government officials' decisions and (3) gaps in the independence of the judiciary, which have diminished the attractiveness of the Georgian legal system for foreign investors.

The stable macroeconomic environment is widely recognized as further reducing FDI risk, enabling better planning, ensuring robust domestic demand, and a good export platform. As stated before, the fall in world market commodity prices, the global appreciation of the dollar and the weakening of regional demand in the period 2014-2016 placed pressure on Georgia's macroeconomic stability. Taken together, these factors led mainly to slow economic growth in 2015, raising additional barriers to attracting foreign investment. During 2017, the macro environment was largely supportive of FDI, with substantial efforts to reduce inflation, sustain a floating, stable, completely convertible and transparent exchange rate regime. Furthermore, fiscal policy and the external sector have supported development, but they reflect some of the significant risks (increased borrowers' debt burden for both the private and government sectors; contingent liabilities) that the government is consciously addressing. Overall, the macro environment does not seem to have served as a barrier to FDI, while uncertainty undoubtedly plays a role in regional conditions and prospects.

Graph 4: FDI flow in Georgia (2000-2019)



Source: https://data.worldbank.org

Foreign direct investment in Georgia grew by $187 million in the second quarter of 2019. Between 2005 and 2019, Georgia's foreign direct investment reached $316.87 million, reaching an all-time high of $740.50 million in the third quarter of 2014 and a record low of $79.60 million in the third quarter of 2005.

Voice and accountability index (-2.5 weak; 2.5 strong), 2000 - 2019: The average value for Georgia during that period was a minimum of -0.505 points in 2000 and a maximum of 0.2952 points in 2016.

Political stability index (-2.5 weak; 2.5 strong), 2000 - 2019: The average value for Georgia during that period was a minimum of -1.2987 points in 2003 and a maximum of -0.31 points in 2016.

Government effectiveness index (-2.5 weak; 2.5 strong), 2000 - 2019: The average value for Georgia during that period was a minimum of -0.796 points in 20002 and a maximum of 0.83 points in 2019.

Regulatory quality index (-2.5 weak; 2.5 strong), 2000 - 2019: The average value for Georgia during that period was a minimum of -0.7803 points in 2002 and a maximum of 1.126 points in 2018.

Rule of law index (-2.5 weak; 2.5 strong), 2000 - 2019: The average value for

Georgia during that period was a minimum of -1.056 points in 2002 and a maximum of 0.38 points in 2016.

Control of corruption (-2.5 weak; 2.5 strong), 2000 - 2019: The average value for Georgia during that period was a minimum of -1.234 points in 2002 and a maximum of 0.74 points in 2017.

Summary of all the governance quality indicators with avarage points during the period of 2000-2019 are below:

Table 3: Governance quality of Georgia during 2000-2019

Year	Voice and Account ability	Political Stability and Absence of Violence/Terrorism	Government Effectiveness	Regulatory Quality	Rule of Law	Control of Corruption
2000	-0.284	-0.8133	-0.6484	-0.3892	-0.933	-1.008
2001	-0.3944	-1.0025	-0.7222	-0.58476	-0.9947	-1.1211
2002	-0.505	-1.1918	-0.796	-0.7803	-1.056	-1.234
2003	-0.178	-1.2987	-0.3995	-0.625	-0.898	-0.696
2004	-0.078	-0.8652	-0.5374	-0.4554	-0.658	-0.469
2005	-0.09	-0.7542	-0.434	-0.602	-0.709	-0.215
2006	-0.093	-0.9645	-0.2445	-0.1407	-0.464	0.0444
2007	-0.23	-0.6448	0.1106	0.29357	-0.347	-0.135
2008	-0.257	-0.9201	0.2967	0.48402	-0.267	-0.108
2009	-0.189	-0.9666	0.2873	0.50081	-0.205	-0.124
2010	-0.161	-0.7183	0.3093	0.59384	-0.21	0.008
2011	-0.173	-0.657	0.5537	0.66425	-0.124	0.1184
2012	0.0216	-0.6805	0.6058	0.69368	-0.015	0.4013
2013	0.1388	-0.4414	0.5852	0.75661	-0.006	0.4692
2014	0.2847	-0.3215	0.4892	0.93399	0.1909	0.7859
2015	0.2746	-0.4661	0.4045	0.92246	0.2715	0.6796
2016	0.2952	-0.3133	0.5182	1.00866	0.3837	0.6854
2017	0.2643	-0.3708	0.582	1.05312	0.3289	0.7445
2018	0.248	-0.4326	0.6146	1.12584	0.3276	0.7081
2019	0.196	-0.4459	0.8299	1.12207	0.31	0.6685

Source: https://info.worldbank.org/governance/wgi/

Fitch Ratings confirmed Georgia’s long-term foreign and local currency Issuer Default Ratings (IDRs) at 'BB-' with Stable Outlooks. The issue ratings on Georgia's senior unsecured foreign- and local-currency bonds were also confrmed that at 'BB-'. At 'BB', the Country Ceiling was affirmed.

Fitch Ratings clarified that the ratings balanced Georgia's large current account deficit, high external debt level, low external liquidity and low per capita income levels with high concessional debt ratios, economic stability, favorable governance indicators and the stand-by policy anchor of the International Monetary Fund (IMF).

Georgia's Issuer Default Ratings (IDR) have been evaluated at 'BB-' by global rating agency Fitch Ratings. Fitch says the outlook is positive.

The ratings of Georgia are backed by indices of governance and market climate that are above the current medians of peers in the 'BB' group and a track record of macroeconomic resilience to regional shocks.

According to Fitch, external financing remains a primary rating vulnerability for Georgia, with net external debt at 61.9 percent of GDP at the end of 2018, higher than the current median 'BB'.

Fitch Ratings-London-24 August 2018: The Georgia Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDR) have been confirmed by Fitch Ratings at 'BB-'. Positive is the Outlook.

The ratings of Georgia are accompanied by indices of governance and market climate that are above the current medians of peers from the group 'BB' and a track record of macroeconomic stability against regional shocks. The IMF Extended Fund Facility (EFF) program also anchors trust in the economic policy of the authorities. The external finances of Georgia remain considerably poorer than most peers in the 'BB' group.

Fitch Ratings - Frankfurt am Main - 14 Aug 2020: The Georgia Long-Term Foreign-Currency Issuer Default Rating (IDR) was confirmed by Fitch Ratings at 'BB'.

Georgia's scores are accompanied by good systemic metrics compared to 'BB' group peers, such as governance and market climate. Georgia's resilience to previous shocks has been underpinned by a stable and reliable policy structure. These credit strengths are balanced by a high proportion of government debt denominated in foreign currencies, poor external liquidity and higher standards for external financing relative to peers.

Table 4: Financial stabilty of Georgia 2007-2019 period

Long term Rating			
Foreign currency		**Local currency**	
Date	**Rating(Outlook)**	**Date**	**Rating**
24-04-20	BB	24-04-20	BB
14-02-20	BB	14-02-20	BB
16-08-19	BB	16-08-19	BB
22-02-19	BB	22-02-19	BB
24-08-18	BB- (Positive)	24-08-18	BB-
16-03-18	BB- (Positive)	16-03-18	BB-
22-09-17	BB- (Stable)	22-09-17	BB-
24-03-17	BB- (Stable)	24-03-17	BB-
30-09-16	BB- (Stable)	30-09-16	BB-
22-07-16	BB- (Stable)	22-07-16	BB-
01-04-16	BB- (Stable)	01-04-16	BB-
02-10-15	BB- (Stable)	02-10-15	BB-
17-04-15	BB-	17-04-15	BB-
17-10-14	BB-	17-10-14	BB-
22-09-14	BB- (Stable)	22-09-14	BB-
29-08-14	BB- (Stable)	29-08-14	BB-
20-08-14	BB- (Stable)	20-08-14	BB-
04-08-14	BB- (Stable)	04-08-14	BB-
24-07-14	BB- (Stable)	24-07-14	BB-
19-06-14	BB- (Stable)	19-06-14	BB-
30-05-14	BB- (Stable)	30-05-14	BB-
22-05-14	BB- (Stable)	22-05-14	BB-
09-05-14	BB- (Stable)	09-05-14	BB-
11-04-14	BB- (Stable)	11-04-14	BB-
07-03-14	BB- (Stable)	07-03-14	BB-
26-02-14	BB- (Stable)	26-02-14	BB-
31-01-14	BB- (Stable)	31-01-14	BB-
23-01-14	BB- (Stable)	23-01-14	BB-
30-12-13	BB- (Stable)	30-12-13	BB-
27-12-13	BB- (Stable)	27-12-13	BB-
03-12-13	BB- (Stable)	03-12-13	BB-
20-11-13	BB- (Stable)	20-11-13	BB-
30-08-13	BB- (Stable)	30-08-13	BB-
25-03-13	BB- (Stable)	25-03-13	BB-

10-08-12	BB- (Stable)	10-08-12	BB-
15-06-12	BB- (Stable)	15-06-12	BB-
09-02-12	BB- (Stable)	09-02-12	BB-
18-01-12	BB- (Stable)	18-01-12	BB-
20-12-11	BB- (Stable)	20-12-11	BB-
08-10-11	B+	08-10-11	B+
28-09-11	B+	28-09-11	B+
03-03-11	B+ (Positive)	03-03-11	B+
26-08-09	B+ (Stable)	26-08-09	B+
07-04-09	B+ (Negative)	07-04-09	B+
08-08-08	B+ (Negative)	08-08-08	B+
18-07-07	BB- (Stable)	18-07-07	BB-

Source: https://countryeconomy.com/ratings/georgia

2.3. Analyisis of FDI flow vs. other indicators: Armenia

Like neighboring Azerbaijan and Georgia, Armenia has been given an opportunity to reinvent itself as a completely democratic state, along with its independence, and to gradually remove the negative effects of the dissolution of the Soviet Union. However, despite the many opportunities to establish new economic and political relations, the country remained in the Russian sphere of influence, clearly recognizing the Russian Federation as its main political ally and key economic partner.

In addition to analyzing statistical data explaining the existence of foreign direct investment (size, geographical and sectoral structure), important factors affecting FDI flows, the internal situation of the country under study, its current international status and the degree of economic dependence of the Russian Federation are addressed. The analysis is based on data released by the Republic of Armenia's Armenian Statistical Service (ARMSTAT) and the United Nations Conference on Trade and Development (UNCTD).

In 2018, FDI inflows to Armenia stood at USD 254 million, unchanged from the previous year, according to UNCTAD's World Investment Report 2020. The overall FDI inventory has been valued at USD 5.7 billion in 2019. The four main investors in Armenia are Russia, Greece, Cyprus and Germany, while substantial investments are also made by members of the Armenian diaspora (nearly 6 million people). Energy, telecommunications, metallurgy, hotel services and air transportation are major FDI industries.

Armenia has made considerable strides in liberalizing its economy. Armenia ranks first among CIS (Commonwealth of Independent States) countries in terms of FDI appeal, according to the World Bank. Such initiatives include free economic zones for high-tech industries that offer preferential treatment to businesses with regard to corporate income tax, VAT, property tax and customs duties.

The country does not place limits on international influence and private ownership and establishment rights, and the procedures for business registration are swift. Via the EU-Armenia Comprehensive and Strengthened Cooperation Agreement, FID is also promoted. Nevertheless, the country remains heavily dependent on the economic health of the Russian and EU FDI economies, has a limited domestic market, and corruption remains widespread. Armenia is ranked 47th out of 190 countries by the World Bank's 2020 Doing Business survey, losing six places compared to the previous year.

The country's attractiveness is related to its sustained economic growth in the past 10 years and to a series of reforms. There are also the following elements we may mention:

- Political stability
- Its geographical location enables the former Soviet republics to access
- Good integration into the world economic order: international and intercontinental (member of the Eurasian Economic Union)
- A professional and comparatively cheap labor force
- A developed economy with sectors that need foreign investment (such as telecommunications)
- Managed, low-level inflation
- A willingness to normalize relations with Turkey, indicating that the border might open up

The key impediments to the economic growth of Armenia are:

- A limited national market
- High cost of transport (all goods must transit through Georgia because of the embargo imposed by Turkey and Azerbaijan)
- Corruption, nepotism and intervention at the level of the State Authority
- A heavy focus on the economic situation in Germany and Russia
- High government debt slows down the required investment, particularly in infrastructure.
- Threat in connection with natural disasters (earthquakes)
- The poverty of the population is also a negative factor, especially in times of crisis, since it is possible to weaken the social environment and domestic consumption.
- A vulnerable banking sector which is highly exposed to volatile Central and Eastern European markets (including Russia)

The Armenian government is aware of the need to build a more favorable business climate and has made targeted efforts to promote foreign investment that is important for economic growth. The Poverty and Corruption Reduction Act, as well as other measures directly related to the business sector, have come into effect. We can call, in particular:

- For foreigners, fair rights
- No limits on foreign ownership
- Liberty to repatriate earnings
- Limited interference and deregulation from the state

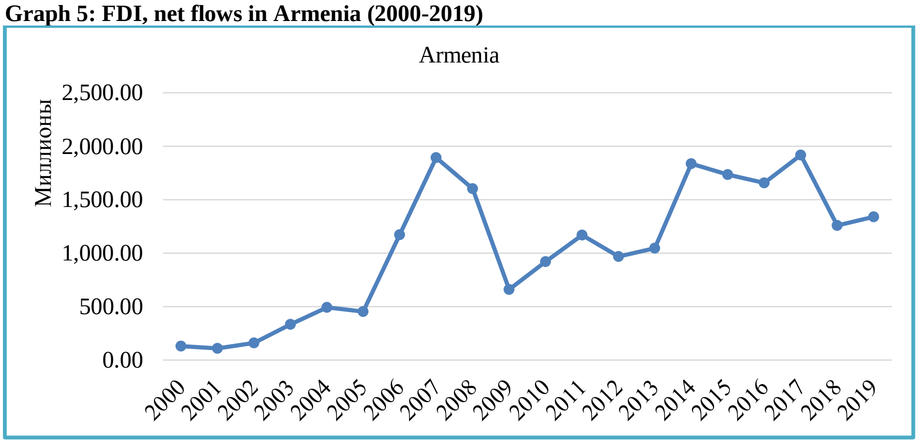
Over the last few years, the high-tech and ICT industries have drawn international investment. In order to hire trained human resources and experts in these fields, several foreign companies have founded offices in Armenia. Finally, in 2015, the Armenian Development Foundation was established by the government to attract foreign investment, promote tourism and grow exports, and has been operating under the new name of Business Armenia since 2018.

A foreign investor can acquire an interest in a domestic company (both public and private) through the purchase of shares or assets as part of a privatization program initiated by the government of Armenia. State-owned assets and businesses need to be privatized before they are purchased by a foreign investor. The country's privatization process is governed by the 'State Property Privatization Statute'.

Investments in Armenia may only be made by foreign investors through the establishment of entirely foreign-owned companies (including representations, affiliates and branches) or through the acquisition of established companies and shares, or through the establishment of joint ventures. The volume and type of foreign ownership, the number of foreign workers and access to financial sources are not restricted.

Moreover, a foreign investor is bound to be liable for any breach of the laws of the Republic of Armenia, as specified by the laws of the Republic of Armenia. A foreign investor's property, including working capital and property rights, can be used by that investor to guarantee some form of liability.

Graph 5: FDI, net flows in Armenia (2000-2019)



Source: https://data.worldbank.org

A separate chapter on anti-corruption policies is included in the 2014-2025 Armenia Growth Strategy (ADS). It offers a general history, lists past accomplishments in the areas of prevention and criminalization of corruption, and outlines, in general terms, and proposed future measures. The new Government Program states that addressing corruption effectively needs the proper application of controls and balances, the implementation of current legislative and institutional structures and the introduction of new initiatives.

The latter involves setting up a dedicated and autonomous anti-corruption body with functions of operational, intelligence, investigative and preliminary inquiry. Other measures involve improved vetting of high-level officials and wider processes for the declaration of properties, the removal of extra-budgetary funds, the penalization of inadequate procurement and excessive budgetary expenditure, and the implementation of greater transparency to beneficial owners of state-registered legal entities.

The Government prepared a concept paper on fighting corruption in the public administration system in April 2014 (Protocol Decision N 14) and the Anti-Corruption Policy and Action Plan 2015-2018 was adopted in September 2015 (Decision No 1141-N). The plan outlines the key means of combating corruption (including civil servants, the public administration system and civil society cooperation), the target sectors (education, collection of income, police and health care) and the approach to monitoring and assessment. Daily implementation reports were prepared by the GoA, but these did not include overall evaluations of success and challenges.

In December 2018, the government proposed a draft Anti-Corruption Strategy and Action Plan for 2019-2022, which had three key strategic directions: prevention of corruption, detection of corruption and education in the field of anti-corruption. CSOs/NGOs were criticized for the method of drafting the initial draft, 119 of which prompted the Ministry of Justice to extend the deadline for comments on the draft. A new and substantially revised draft, which took into account several of the comments raised, was released in June 2019 and submitted to the Prime Minister's Office following consultations with stakeholders.

The Criminal Code 2003, as amended 120 criminalizes the main types of illegal conduct, including active and passive corruption, attempted corruption, racketeering, influence-trading, bribing of foreign officials, money laundering, misuse of public sector positions, and unlawful enrichment. The Code of Criminal Procedure 1998, as amended lays out the rules of criminal procedure, including immunity. The Whistle-blowing Scheme Act in 2017 governs the defense of the rights of whistle-blowers, the whistle-blowing process related to cases of corruption, conflict of interest and violation of ethical laws, and financial disclosure.

Although the results for the quarter have not been summarized yet and there are no clear statistics yet, Economist claims that it is already possible to talk about a decline in investment. In this context, he is convinced that only after the settlement of the political situation in the country will investment activity increase.

Under a minimalist concept, the rule of law implies that the rules on civil and criminal activity in a state are written, relevant and publicly enforced and that they are impartially implemented by the judiciary and all other state institutions (North, Wallis and Weingast, 2009; O'Donnell, 2004, page 33). The rule of law curtails the arbitrary use of force and institutionalized tampering in its ideal form (Krygier, 2016). Stein builds on this, adding that under the rule of law, "superior to all members of society" is stable, codified law; "is just and protects human rights and dignity"; and that in the sense of democratic practices, law is developed and perfected. Expanded concepts of the rule of law can also face political pushback from domestic communities, especially if external actors are affected by the limits of the rule of law. For example, people in many countries in Latin America fear how state authorities will use the law to achieve improper ends.

In a January 2019 interview at the Davos World Economic Forum, Prime Minister Pashinyan addressed the transformation of Armenia's transition from a political to an economic transition. He outlined goals such as regulatory simplification, tax code reform and tax relief, and occupational welfare initiatives. He also addressed in this context that Armenia is pursuing institutional support for 'social and political life change,' including renewed European Union support.

We mention his interview here to point out that changes to the rule of law will be consistent with the goals currently set by the Armenian administration in terms of strengthening contract compliance, regulation, and fair application of commercial law.

Voice and accountability index (-2.5 weak; 2.5 strong), 2000 - 2019: The average value for Armenia during that period was a minimum of -0.8765 points in 2009 and a maximum of 0.05 points in 2019.

Political stability index (-2.5 weak; 2.5 strong), 2000 - 2019: The average value for Armenia during that period was a minimum of -0.6836 points in 2000 and a maximum of 0.2372 points in 2003.

Government effectiveness index (-2.5 weak; 2.5 strong), 2000 - 2019: The average value for Armenia during that period was a minimum of -0.5158 points in 2000 and a maximum of 0.069 points in 2013.

Regulatory quality index (-2.5 weak; 2.5 strong), 2000 - 2019: The average value for Armenia during that period was a minimum of -0.1166 points in both 2000 and a maximum of 0.349 points in 2012.

Rule of law index (-2.5 weak; 2.5 strong), 2000 - 2019: The average value for Armenia during that period was a minimum of -0.546 points in 2006 and a maximum of -0.12 points in 2016.

Control of corruption (-2.5 weak; 2.5 strong), 2000 - 2019: The average value for Armenia during that period was a minimum of -0.759 points in 2000 and a maximum of -0.18 points in 2019.

Summary of all the governance quality indicators with avarage points during the period of 2000-2019 are below:

Table 5: Governance quality of Armenia 2000-2019

Year	**Voice and Accountability**	**Political Stability and Absence of Violence/Terrorism**	**Government Effectiveness**	**Regulatory Quality**	**Rule of Law**	**Control of Corruption**
2000	-0.3746	-0.6836	-0.5158	-0.1166	-0.4786	-0.7595
2001	-0.4095	-0.4705	-0.3036	-0.0385	-0.4509	-0.7530
2002	-0.4444	-0.2575	-0.0914	0.03949	-0.4233	-0.7465
2003	-0.4674	0.2372	-0.1563	0.20979	-0.3026	-0.57
2004	-0.5722	-0.1169	-0.0922	0.1291	-0.4226	-0.6105
2005	-0.5914	-0.0675	-0.1399	0.08348	-0.4002	-0.6741
2006	-0.7422	-0.2627	-0.2546	0.28461	-0.5464	-0.6708
2007	-0.7594	0.15045	-0.3758	0.2718	-0.4984	-0.7424
2008	-0.8576	-0.0094	-0.1727	0.33787	-0.3405	-0.7081
2009	-0.8765	0.22777	-0.0297	0.29626	-0.4759	-0.6198

2010	-0.8476	0.07186	-0.1838	0.30948	-0.4886	-0.6963
2011	-0.6908	-0.0639	-0.129	0.27321	-0.441	-0.6569
2012	-0.5705	0.15479	-0.0423	0.34934	-0.4179	-0.5878
2013	-0.588	0.11039	0.06901	0.25261	-0.3442	-0.5319
2014	-0.5621	-0.2971	-0.1981	0.21342	-0.3659	-0.524
2015	-0.5363	-0.2523	-0.1608	0.24181	-0.3879	-0.5338
2016	-0.5793	-0.6623	-0.1582	0.25006	-0.1191	-0.572
2017	-0.5608	-0.6207	-0.1044	0.28049	-0.1556	-0.5605
2018	-0.1133	-0.4359	-0.0243	0.33139	-0.1502	-0.3491
2019	0.05004	-0.5064	-0.0668	0.24952	-0.1313	-0.1842

Source: https://info.worldbank.org/governance/wgi/

At 'B+' with a stable outlook, Fitch Ratings has confirmed Armenia's long-term foreign and local currency Issuer Default Ratings (IDRs). The issue ratings on the senior unsecured foreign currency bonds of Armenia at 'B+' were also reported by Fitch. At 'BB-', the Country Ceiling was affirmed.

It claimed that the 'B+' rating represents the following factors: the ratings of Armenia are backed by its relatively high indicators of human development and governance, favorable business climate and growing economic resilience. They are, however, weighed down by external shock vulnerabilities, high levels of external and foreign currency debt and political concerns.

The forecasts by Fitch for the budget deficit and growth results are consistent with the medium-term gradual reduction of government debt. In 2017, public debt increased to 59% of GDP, marginally below the 60% 'B' median but 10pp above the 'BB' median. In 2018, we expect debt to decrease slightly to 58.4% and to continue a steady decline thereafter. Because 81% of the public debt is denominated in foreign currencies, it is subject to fluctuations in exchange rates.

"The "B+" LT Int. was affirmed by Fitch Ratings Size (local currency) credit ranking on June 15, 2018 for Armenia. The outlook is favorable.

The long-term ratings of the issuer default (IDR) of Armenia in foreign and national currency were verified by the American company Fitch Ratings at the level of 'B+' with a 'Positive.'

On 30 November, Fitch posted a message on its website confirming Armenia's sovereign rating. Armenia's ratings represent a robust monetary policy framework, a reduction in external imbalances, a rise in per capita income, but high budget deficits, on the other hand, reflect the growth of public debt, high external debt and tensions with some neighboring countries. The positive outlook reflects Armenia's higher growth prospects and the start of the fiscal consolidation process, which, according to Fitch's expectations, would lead to a gradual reduction in the medium-term public debt and a modest deficit in the current account.

Fitch Ratings, the US-based international credit rating agency, has upgraded the long-term foreign currency issuer default rating of Armenia from B+ to BB- with a stable outlook on the country's economy.

Fitch Ratings revised the sovereign credit rating of Armenia to 'BB-' from 'B+' on 22 November 2019 and assigned a positive outlook. The Rating Agency referred to the fact that the Armenian institutions have promoted a stable and orderly political transition and could be further improved by structural reforms as key drivers of the revision.

Table 6: Financial stability index of Armenia 2014-2019

Long term Rating			
Foreign currency		**Local currency**	
Date	**Rating(Outlook)**	**Date**	**Rating**
15-10-20	B+	15-10-20	B+
05-10-20	B+ (Stable)	05-10-20	B+
03-04-20	BB-	03-04-20	BB-
22-11-19	BB- (Stable)	22-11-19	BB-
24-05-19	B+	24-05-19	B+
30-11-18	B+	30-11-18	B+
15-06-18	B+ (Positive)	15-06-18	B+
15-12-17	B+ (Positive)	15-12-17	B+
30-06-17	B+ (Stable)	30-06-17	B+
20-01-17	B+ (Stable)	20-01-17	B+
22-07-16	B+ (Stable)	22-07-16	B+
22-01-16	B+ (Stable)	22-01-16	B+
24-07-15	B+	24-07-15	B+
30-01-15	B+	30-01-15	B+
01-08-14	BB- (Stable)	01-08-14	BB-
14-02-14	BB- (Stable)	14-02-14	BB-

Source: https://countryeconomy.com/ratings/armenia

CHAPTER III. THE IMPACT OF GOVERNANCE QUALITY AND FINANCIAL STABILITY RISK OVER FDI FLOW: EMPIRICAL ASSESSMENT

3.1. Data and methodology

Analysis data is primarily derived from secondary sources. The data was collected on an annual basis from 2000 to 2019.

It is aim to uncover critical factors affecting Foreign Direct Investment in the region, such as institutional quality and financial stability risk.

3.1.1. *Measuring Governance quality*

Control of corruption: This measure assesses the extent to which bureaucratic power is abused for individual gain. It includes not only minor but also major forms of mistreatment, as well as political and private interests "capturing" the government. It also assesses the consistency and effectiveness of a country's policy and institutional framework for preventing and combating bribery. The following factors are used to rank countries:

• The prevalence of large-scale and small-scale government fraud at all levels;

• The impact of bribery on a country's "attractiveness" as a profitable market;

• The estimated cost of corruption as a percentage of a company's annual sales; the amount of out-of-pocket fees associated with special government licenses, permits, facilities, tax assessments, and court decisions; nepotism, cronyism, and bribery in the civil service; the estimated cost of corruption as a percentage of a company's annual sales;

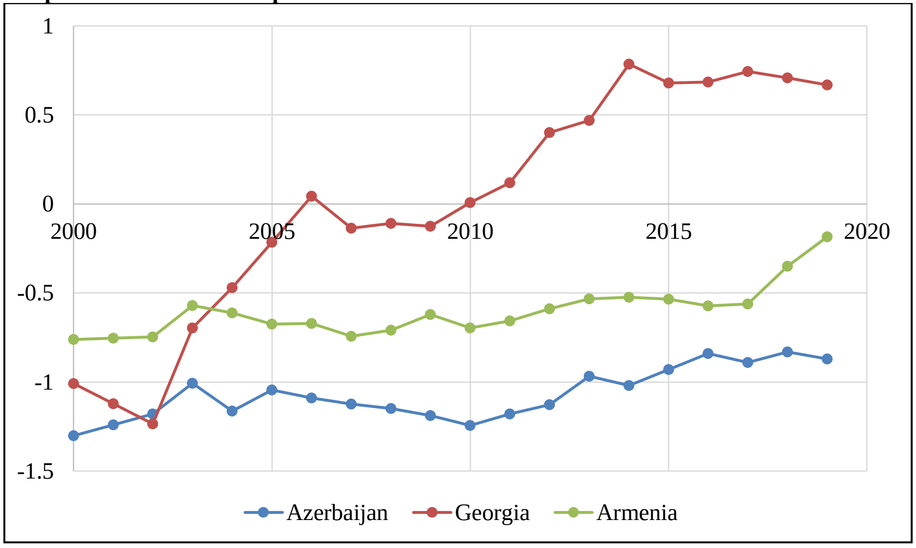
• Suspected corruption involving government agents, border officials, tax inspectors, prosecutors, and magistrates.

• The strength and effectiveness of a government's anti-corruption laws, programs, and structures;

• Public confidence in politicians' financial honesty;

Corruption discourages economic growth by increasing premiums, decreasing productivity, deterring investment, eroding public confidence, limiting the formation of small and medium-sized businesses, weakening public financial management structures, and undermining health and education spending.

Graph 6: Control of Corruption



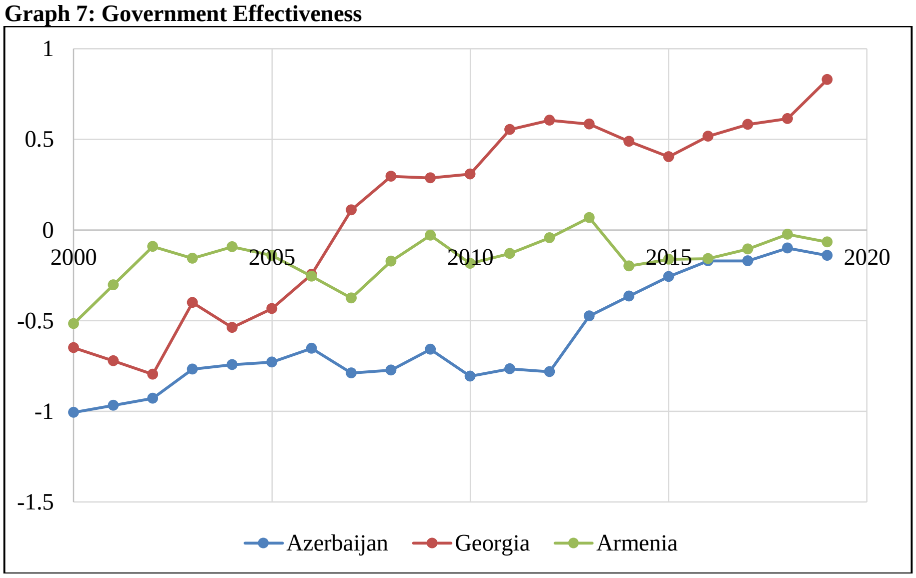
Source: https://data.worldbank.org

Bribery can also escalate poverty by stifling economic growth, distorting public spending in favor of the rich and well-connected, concentrating public investment in ineffective initiatives, promoting a more regressive tax structure, diverting funds away from critical public services, and increasing the risk associated with low-income investment decisions.

Government effectiveness: The World Bank created this index to assess the quality of government services, the efficacy of public policies, and the implementation of those policies. A total of 47 variables are used in the index computation (such as quality of bureaucracy, distribution of infrastructure, goods and services).

While Azerbaijan has improved significantly in this ranking since 1996, it is worth noting that it is still far behind Georgia's government in terms of effectiveness, according to the World Bank.

Graph 7: Government Effectiveness

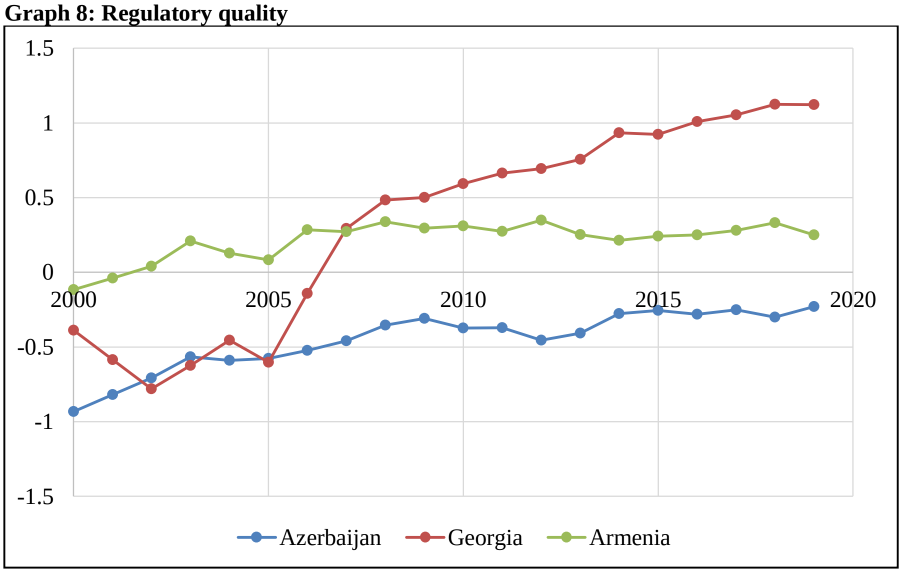


Source: https://data.worldbank.org

Regulatory quality: This index assesses the country's legal framework, as well as its application and compliance. A country's ranking increases when it has property rights and international investors are covered by a just and independent legal system.

Over the past few years, the country's government leaders have announced and adopted new ways to address the issues that have arisen as a result of poor governance. Among the steps are the digitization of government services, the implementation of cashless payments, and the requirement of independent audits of financial statements for organizations registered as public legal entities.

Graph 8: Regulatory quality

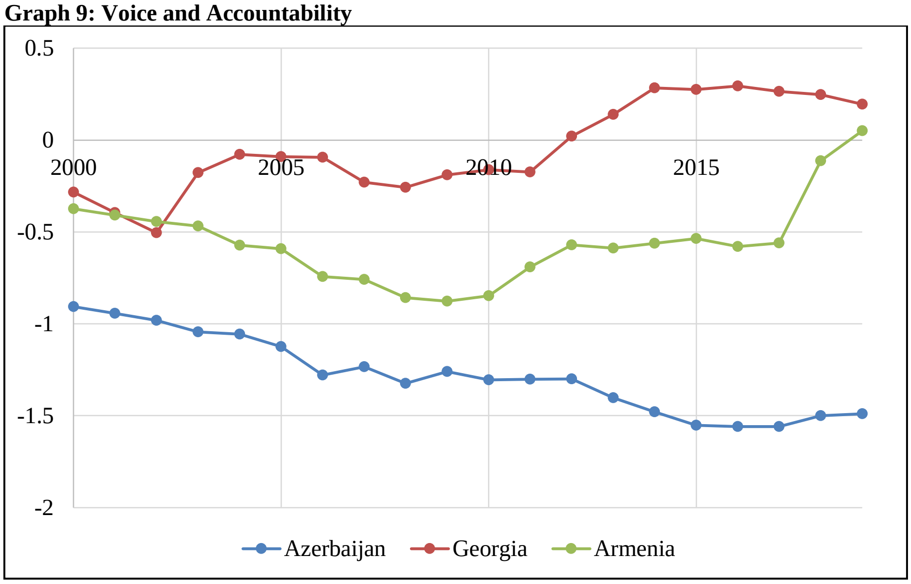


Source: https://data.worldbank.org

Voice and accountability: The voice and accountability index is one of the indicators of good governance. The index assesses how democratic the government's institutions are, ensuring that the voices of all people (regardless of social status) are heard and sufficiently responded to by the authorities. According to the model, it is the most important aspect that international capital holders consider before making investment decisions. This index is one of the fundamentals used by investors to assess the economic system's trustworthiness.

Every investor wants to reduce their uncertainties and face as few unpredictable circumstances as possible. As a result, having a country with a higher voice and accountability ratio means potential investments would be less risky.

Graph 9: Voice and Accountability

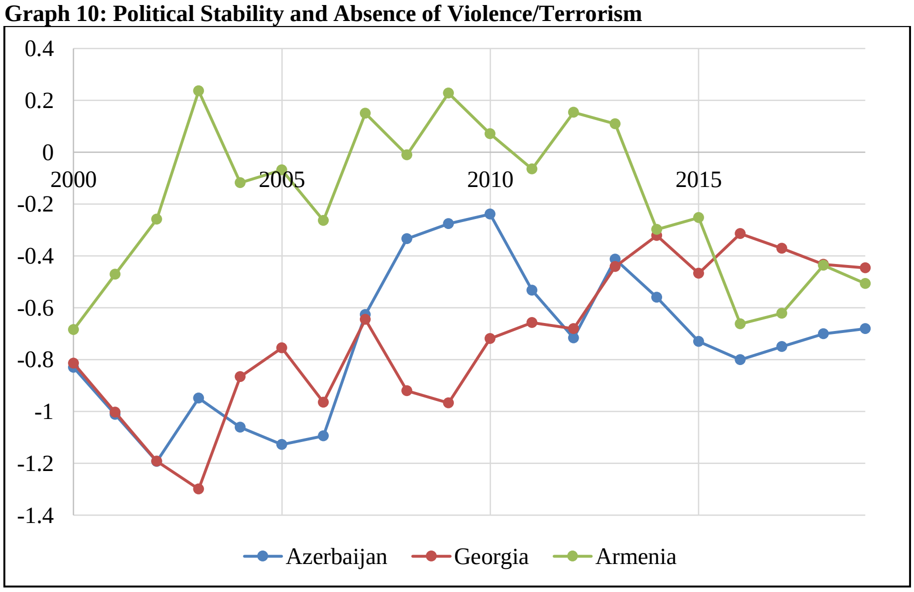


Source: https://data.worldbank.org

Political stability: This indicator is supposed to be one of the most important factors in an investor's potential capital allocation decisions. Risk-averse investors, in particular, will be reluctant to invest in economies where political stability is merely a pipe dream. This assumption, however, is not valid in all cases, especially when returns are significantly higher than expected losses due to an unstable political climate. Furthermore, in exceptional circumstances, governments can build "heaven" for foreign investors in a specific industry when the country is in the midst of political turmoil.

Despite the country's continuing dispute with Armenia over Armenia's invasion of Nagorno Karabakh, Azerbaijan has remained politically stable over the analyzed period. More than a million refugees live in the country, which is occupied to the tune of 20% of its property. Despite the fact that there are many UN resolutions on the Nagorno Karabakh dispute, Armenia refuses to implement any of them, and as a result, the bloody invasion is far from over. Having such violence in the country's territory not only discourages certain risk-averse investors from investing large sums of money in the country's economy, but it also limits the country's spare funds to further improve the economy, which were actually spent on military.

Graph 10: Political Stability and Absence of Violence/Terrorism



Source: https://data.worldbank.org

Rule of law: This is an example of a long-lasting system of rules, institutions, norms, and community engagement that ensures responsibility. Investors are able to put their money into countries where "the law is the king, not the king is the law." They need assurance that an impartial court system can provide justice in any legal disputes that their business may face. This expectation of investors is confirmed by our model. It suggests that if all other factors remain constant, a 1% increase in the rule of law index will result in a 34% increase in FDI into the country. This finding may be critical for policymakers in attracting more foreign direct investment into the country.

To help countries struggling to maintain a high degree of rule of law, the United Nations Development Program has made the following recommendations (United Nations Development Program, 2011):

a) Deal with heirloom conflict

b) Promote individual protection

c) Assist in expanding access to the justice system for all citizens

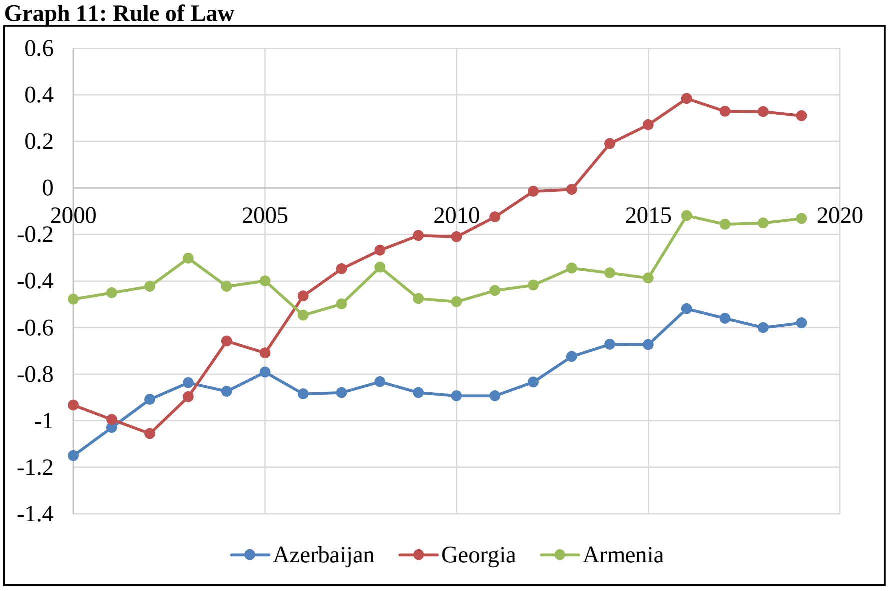
d) Distribute assurance and fair treatment to women

e) Measure the impact

f) Accelerate collaborations among various interest groups

Unfortunately, the country's foreign reputation in terms of rule of law is not particularly positive. The holding of free and fair elections, the independence of the judiciary, in some cases unfair treatment of political parties, and media freedom are all major issues on which the country is heavily criticized.

Graph 11: Rule of Law



Source: https://data.worldbank.org

3.1.2. Measuring financial stability risk

As discussed in the previous chapter, Fitch ratings are used to assess financial stability risk. Fitch ratings display a country's credit rating, which is an important consideration for FDI. Every valuation has a significance that provides foreign investors with knowledge about the investment environment.

Table 7: Rating explanation

Grade	Prime	High grade			Upper medium grade				
Fitch	AAA	AA+	AA	AA-	A+	A	A-		
Grade	Lower medium grade			Non-investment grade speculative			Highly speculative		
Fitch	BBB+	BBB	BBB-	BB+	BB	BB-	B+	B	B-

Source: https://countryeconomy.com/ratings

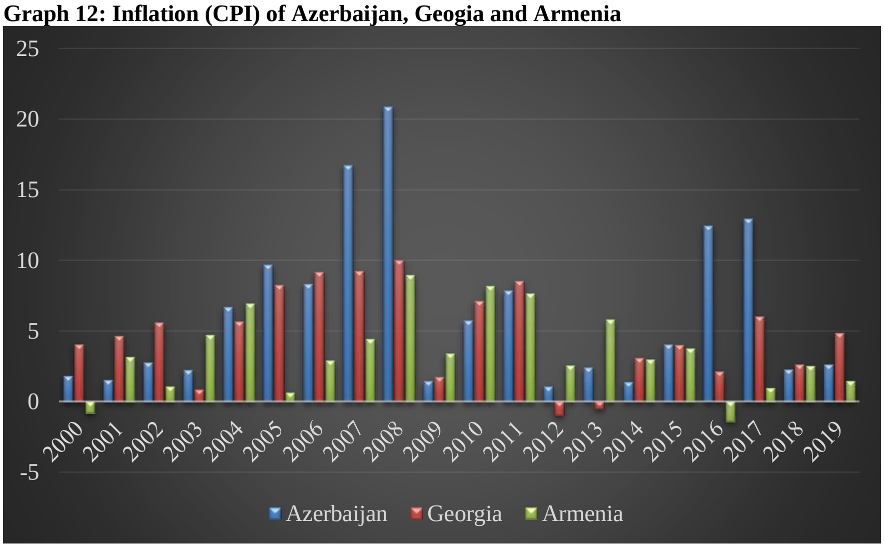
We need to measure these values in order to find a correlation and analyze how credit rating changes affect FDI inflow. Basically, they are coded from 1 to 16, with 1 denoting a lower rating (B-) and 16 denoting a higher score (AAA). However, since this investigation is only focused on three countries with the highest BBB- ranking, the estimation value will range from 1 to 7 points.

3.1.3. Other variables

Foreign Direct Investment: When an investor from one country invests in a company based in another, this is known as foreign direct investment. In contrast to tightly controlled economies, foreign direct investments are most generally made in open economies with a qualified workforce and above-average growth opportunities for the investor. Foreign direct investment usually entails more than just a cash outlay. It can also contain management or technological requirements. The main characteristic of foreign direct investment is that it maintains either effective control over or at least significant influence over a foreign company's decision-making. For developing economies and emerging markets, where businesses need capital and resources to grow their international revenues, foreign direct investment is critical. Private investment in infrastructure, electricity, and water is a key economic factor, as it helps to boost jobs and wages.

Infation: There does not seem to be agreement on a common concept of inflation among scholars, economists, and practitioners. A number of scholars, on the other hand, describe the construct as a sustained or continuous rise in the general price level, or, alternatively, a sustained or continuous decline in the value of money. Many analysts and practitioners believe that inflation has an effect on economic growth in countries around the world. However, there are differing viewpoints in the literature on the effect of inflation rates on country economic development.

Graph 12: Inflation (CPI) of Azerbaijan, Gеogia and Armenia



Source: https://data.worldbank.org/

3.1.4. Descriptive overview

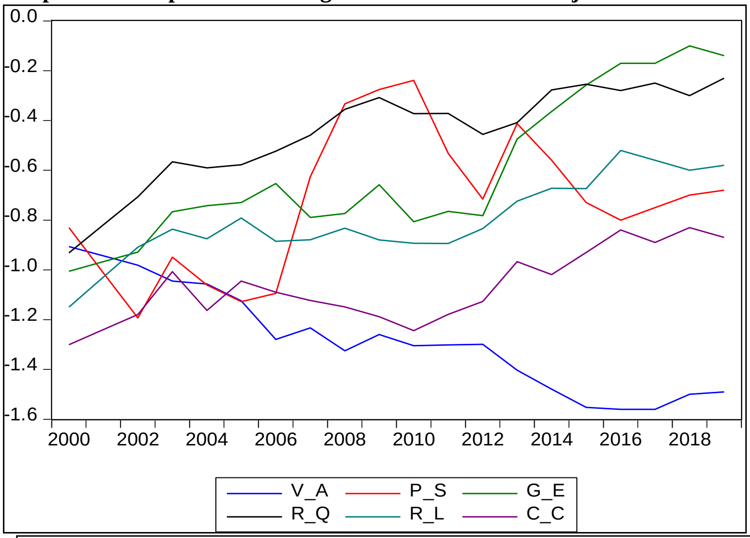
Table 8: Descriptive statistics of the variables

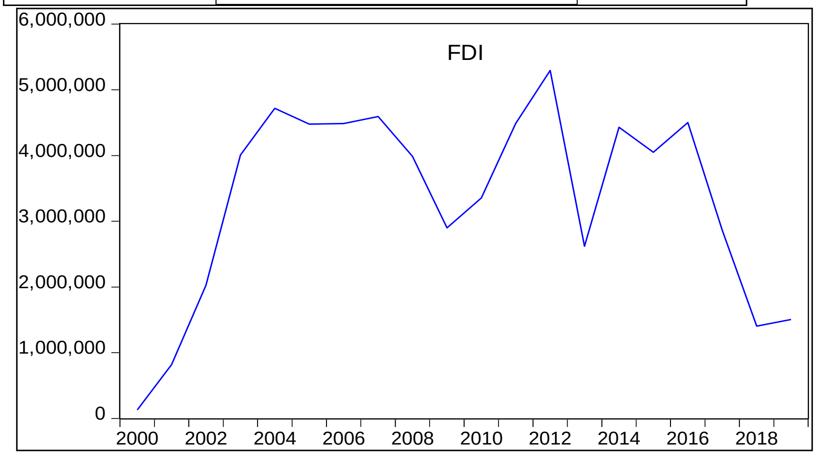
PANEL A: Azerbaijan					
Variable	**Observations**	**Mean**	**Maximum**	**Minimum**	**Std. Dev.**
FDI	20	3332347	5293250	129937	1478800
FRS	20	5,750,000	7,000,000	4,000,000	1,118,034
V_A	20	-1,280,233	-0.9062	-1,560,000	0.212237
P_S	20	-0.7310	-0.2385	-1,193,200	0.285202
G_E	20	-0.6023	-0.1	-1,006,000	0.29635
R_Q	20	-0.4519	-0.23	-0.9319	0.197397
R_L	20	-0.8009	-0.52	-1,149,980	0.16156
C_C	20	-1,068,982	-0.83	-1,300,600	0.143582
INFL	20	6,240,358	2,084,909	1,066,213	5,698,621
PANEL B: Georgia					
FDI	20	1043214	1918136	109871.6	617961.3
FRS	15	3,666,667	5,000,000	3,000,000	1
V_A	20	0	0.2952	-1	0.245812
P_S	20	-0.7135	-0.3133	-1,298,700	0.288846
G_E	20	0.1203	0.8299	-1	0.530843
R_Q	20	0.3288	1125840	-0.7803	0.677289

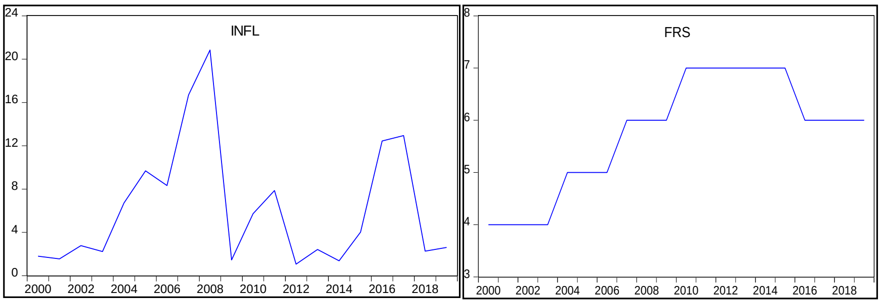
R_L	20	-0.2537	0.3837	-1,056,000	0.48707
C_C	20	0	0.7859	-1,234,000	0.650445
INFL	20	4,804,002	9,999,488	-1	3,263,361
PANEL C: Armenia					
FDI	20	374684.7	943733.1	69868.5	239455.5
FRS	14	3,714,286	5,000,000	3,000,000	1
V_A	20	-1	0.05004	-1	0.231081
P_S	20	-0.1877	0.2372	-1	0.302278
G_E	20	-0.1565	0.06901	-1	0.131553
R_Q	20	0.2124	0.34934	-0.1166	0.128174
R_L	20	-0.3671	-0.1191	-1	0.130894
C_C	20	-1	-0.1842	-1	0.141365
INFL	20	3,490,497	8,949,953	-1,403,608	2,885,823

Source: Author's own compilation

Graph 13: Time profile of the logs of variables in Azerbaijan

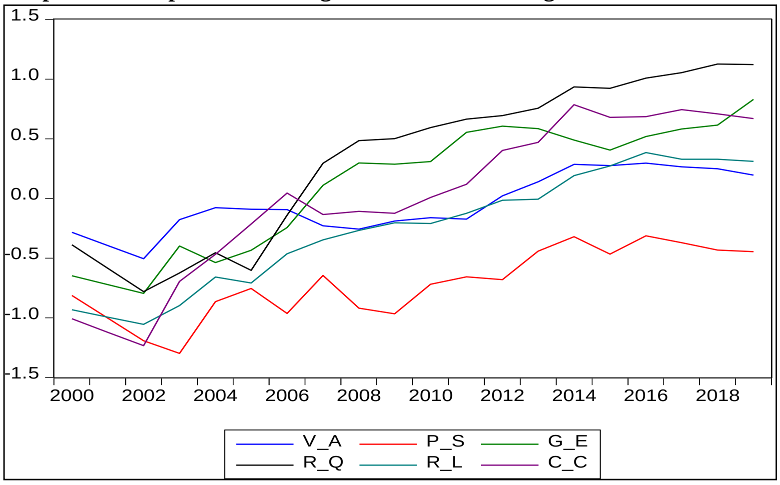


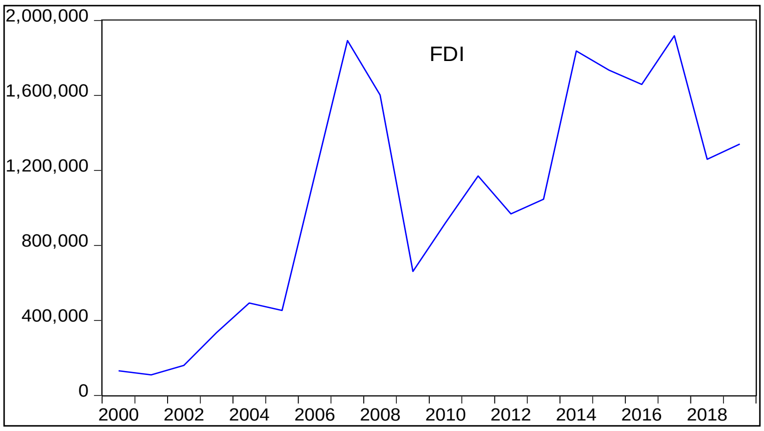




Source: Author’s own compilation

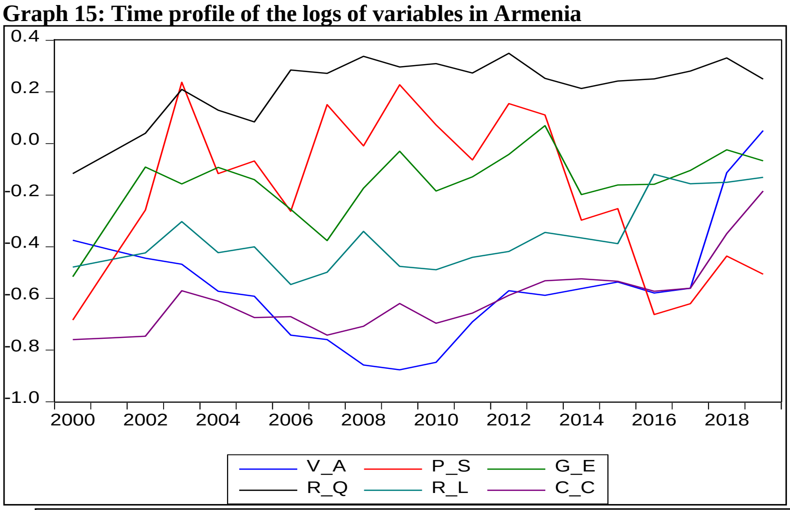
Graph 14: Time profile of the logs of variables in Georgia

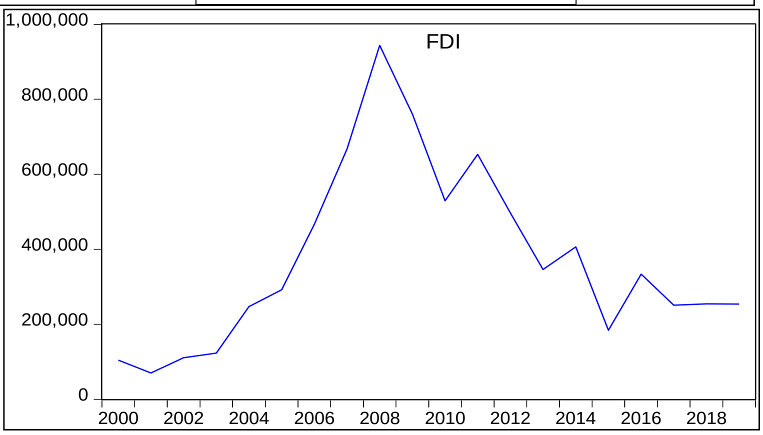


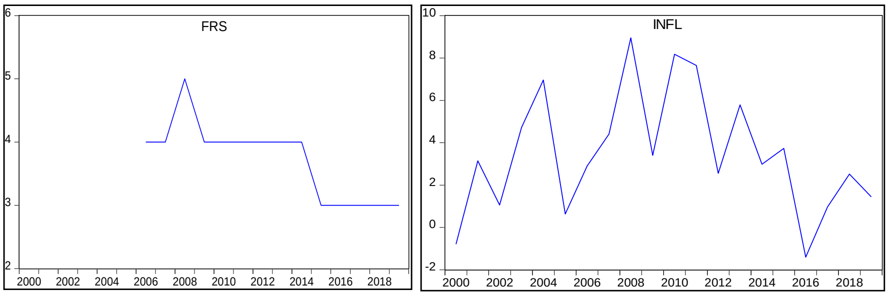


Source: Author’s own compilation

Graph 15: Time profile of the logs of variables in Armenia







Source: Author’s own compilation

3.1.5. Model building

A lineat logarithm model representing the relationship of our dependent variable, as well as our independent variables, and equation below show chosen regression specification:

$$\log(FDI)_t = \alpha_i^k + \beta_i^k * X_{i,t}^k + \gamma_i^k * FSR_t + \delta_i^k * infl_t + u_i^k$$

Where,

k –describe which country mentioned to find relationship between dependent and independent variables (Azerbaijan-1, Georgia-2 and Armenia-3)
$X_{i,t}^k$ *– Means which governance quality indicator mentioned. Sometimes we include quadratic relation between FDI and governance quality*
*i – Is differentiation based on which variable are used (i=1,2,3…6)**
**V_A – 1*
P_S – 2
G_E – 3
R_Q – 4
R_L – 5
C_C – 6
α_i *– Intercept*
t *– means which year are mentioned*
FSR_t *– Shows countries financial stability risk indicators by times*
Infl – Shows countries inflation indicator by time
β, δ, γ *– Coeffients of related independent variables, shows how changes in variables effects FDI*

3.1.6. Unit root test

The following regression provides ADF statistics value as the t-ratio on b1, for a time series variables that expressed as “y”.

$$\Delta y_t = \beta_0 + \varphi trend + \beta_1 y_{t-1} + \sum_{i=1}^{k} \alpha_i \Delta y_{t-i} + \varepsilon_t$$

β0 means as constant term and Δ is first difference operator. K indicates the number of lags. Trebd explain linear time trend, whereas i is the lag order.At the end εt is a white noise residuals. We don't go into depth about the test because of limited space.

3.2. Emprical results

3.2.1. Unit test results

Table 1 reports unit root tests results with-and-without trend. Test results shows that for all three countries variables are always I(1) in either trend included or not. However, without trend, in all countries INFL, in addition, in Azerbaijan R_Q, in Armenia G_E and R_Q are added to the regression. FRS and P_S in Georgia, FRS, G_E and INFL in Armenia, on the other hand are I(0) with trend.
Because unit root test can be estimated by using combination of I(0) and I(1) variables, we can move on to the next estimation stage of the analysis.

Table 9: Unit root test results

Variable	I(0)		I(1)	
	Intercept	Trend and intercept	Intercept	Trend and intercept
		Panel A: Azerbaijan		
FDI	-2.556	-2.173	-4.099***	-4.893***
FRS	-1.624	-0.778	-1.298	-4.205**
V_A	-1.617	-2.838	-4.535***	-4.862***
P_S	-2.031	-2.018	-3.503**	-3.430*
G_E	-0.518	-1.672	-4.292***	-4.159**
R_Q	-2.917*	-2.995	-3.386**	-3.458*
R_L	-1.887	-2.426	-4.192***	-4.047**
C_C	-1.502	-2.689	-5.812***	-5.627***
INFL	-2.832*	-2.706	-4.567***	-4.524**
		Panel B: Georgia		
FDI	-1.909	-2.935	-4.398***	-4.415**
FRS	-1.171	-4.183**	-4.396***	-2.848
V_A	-0.972	-3.067	-3.598**	-3.468*
P_S	-1.326	-3.881**	-4.856***	-4.612**
G_E	-0.756	-1.622	-4.192***	-3.756**

R_Q	-0.413	-1.993	-3.488**	-9.183***
R_L	-0.802	-1.868	-4.396***	-4.466**
C_C	-1.246	-3.238	-3.775**	-4.385**
INFL	-3.122**	-3.250	-5.012***	-4.826***
Panel C: Armenia				
FDI	-1.548	-1.318	-3.099***	-4.287**
FRS	-1.226	-3.398*	-4.670***	-4.565**
V_A	0.197	0.159	-2.591	-4.516**
P_S	-2.298	-2.701	-5.383***	-5.837***
G_E	-3.974***	-4.279**	-4.779***	-4.519**
R_Q	-3.108**	-2.518	-4.840***	-5.372***
R_L	-1.295	-2.259	-5.576***	-4.079**
C_C	1.819	-0.837	-3.076**	-3.031
INFL	-3.655**	-3.675**	-7.182***	-7.111***

Note: ***, **, * denote statistical significance at 1%, 5% and 10% level of significance respectively.

Source: Author's own compilation

3.2.2. Regression estimation results

In this part we can interpret of coeffients from the equation in detail. After this, we can exactly find which indicatior are important and which part need to be improvement to get high FDI flow.

Besides Azerbaijan and Georgia, FRS is a most important variable for Armenia. As you can see from Table 9, FRS is statistically significant in all 6 models. Which it means, 1% rise of financial stablity risk leads FDI increase 56% on avarage. However, in Azerbaijan significance of FRS a bit complicated. Financial stability risk is statistically significant under Political stability and Rule of Law of governance quality are used in model. Even in second model, 1% increase of FRS results 82% increase in FDI, which is huge effect. On the other hand, FRS is mostly significant factor for FDI Georgia. If we look at model 3, which G_E are used, 1% increase financial stability risk couse 48% increase in FDI. It is 38% and 37% in model number 4 and 5 respectively.

Inflation has a positive correlation with FDI in Azerbaijan and Georgia, but negative correlation in Armenia. Besides that, In Azerbaijan and Armenia inflation doesn't have any significance over FDI. However, inflation plays important role for Georgia, it has positive and statistically significant correlation with FDI. For example, in model 2, 1% increase of inflation leads 5.1% increase in FDI. Also, when Rule of Law are considered in model number 5, 1% change of inflation cause 7.4% effect over FDI.

After analysing estimation results, we have found that relationship between governance indicators and FDI is very crucial for Azerbaijan. As table shows, there is also quadratic correlation in all six indicatiors which all of them are statistically significant. Quadratic correlation means there is diminishing or increasing margin between FDI and governance quality. First of all, we could find it is either diminishing or increasing by looking coefficients are negative or positive. In our estimation, for Azerbaijan there is diminishing margin correlation, besides political stability model. Diminishing margin means after some point which is called threshold, icreasing governance quality will effect positively on FDI. After that one point which has no effect, if governance quality increase from that point it causes FDI will decrease. For example, if we take voice accountability model, to find from which point it starts diminishing, we should find derivatives that equal zero:

$\frac{\Delta FDI}{\Delta V\_A} = 100 * (-38.06 - 2 * 13.16 * V\_A) = 0$

V_A = -1.435.

Here we can see that, Voice and Accountability will effect positively till it gets -1.435. But after that, increasing V_A will cause diminishing in FDI value. We can use this formula for all of the indicator to find from which point governance quality indicators effect negatively or positively over FDI flow.

$\frac{\Delta FDI}{\Delta P\_S} = 100 * (3.63 + 2 * 3.96 * P\_S) = 0$

P_S = -0.45.

As above mentioned, only Political Stability indicator is increasing margin that till -0.45 point P_S changes effects negatively to FDI, after that point increasing Political stability will also increase FDI.

$\frac{\Delta FDI}{\Delta G\_E} = 100 * (-13.51 - 2 * 11.53 * G\_E) = 0$

G_E = - 0.58.

$\frac{\Delta FDI}{\Delta R\_Q} = 100 * (-11.05 - 2 * 13.43 * R\_Q) = 0$

R_Q = -0.41.

$\frac{\Delta FDI}{\Delta R\_L} = 100 * (-19.89 - 2 * 15.41 * R\_L) = 0$

R_L = -0.64.

$\frac{\Delta FDI}{\Delta C\_C} = 100 * (-66.84 - 2 * 32.18 * C\_C) = 0$

C_C = -1.038.

Now we have threshold points for all 6 indicators which explains till that point changes of government quality indicators will affect positively, after that point it will negatively correlated except Political Stability model.

Table.10. Estimation results

Independent Variables	***Model specifications. Dependent variable is $Log(FDI)_t$***					
	1	**2**	**3**	**4**	**5**	**6**
Panel A: Azerbaijan						
FRS	-0.106	0.82^{***}	-0.369	0.035	0.38^{*}	0.20
V_A	-38.06^{**}	-	-	-	-	-
V_A^2	-13.16^{**}	-	-	-	-	-
P_S	-	3.63	-	-	-	-
P_S^2	-	3.96^{*}	-	-	-	-
G_E	-	-	-13.51^{***}	-	-	-
G_E^2	-	-	-11.53^{***}	-	-	-
R_Q	-	-	-	-11.05^{***}	-	-
R_Q^2	-	-	-	-13.43^{***}	-	-
R_L	-	-	-	-	-19.89^{**}	-
R_L^2	-	-	-	-	-15.41^{***}	-
C_C	-	-	-	-	-	-66.84^{***}
C_C^2	-	-	-	-	-	-32.18^{***}
INFL	0.003	0.051^{*}	0.036	0.008	0.024	0.032
@Trend	-0.114	-0.003	0.146	-0.046	-0.12^{*}	0.009
Panel B: Georgia						
FRS	0.32	0.206	0.48^{**}	0.383^{*}	0.37^{***}	0.204
V_A	-0.25	-	-	-	-	-
V_A^2	9.15^{**}	-	-	-	-	-
P_S	-	0.52	-	-	-	-
G_E	-	-	0.75^{*}	-	-	-
G_E^2	-	-	-2.21^{***}	-	-	-
R_Q	-	-	-	1.13^{***}	-	-
R_L	-	-	-	-	3.35^{***}	-
C_C	-	-	-	-	-	0.99

INFL	0.03	0.057*	0.066***	0.067**	0.074***	0.067**
@Trend	0.002	0.025	0.04	-0.08	-0.205***	-0.027
Panel C: Armenia						
FRS	0.568**	0.56**	0.57*	0.54**	0.48*	0.58**
V_A	-0.15	-	-	-	-	-
P_S	-	0.09	-	-	-	-
G_E	-	-	-0.01	-	-	-
R_Q	-	-	-	1.53	-	-
R_L	-	-	-	-	1.07	-
C_C	-	-	-	-	-	-0.28
INFL	-0.02	-0.02	-0.02	-0.02	-0.004	-0.02
@Trend	-0.027	-0.03	-0.03	-0.03	-0.07	-0.025

Source: Author's own compilation

If we look governance quality and FDI relationship in Georgia, like Azerbaijan, there are positive and significant relationships between them. But only Voice and Accountability and Governance Effectiveness have significant quadratic correlation. In addition, although there is positive correlation, Political Stability and Control of Corruption doesn't have significant impact over FDI in our model.

To analyse in detail, 1% increase of Requlatory Quality lead 113% increase in FDI and 1% increase in Rule of Law cause 335% increase in FDI. Just look at these percentages it easly shows that how Governance Quality plays huge role in Georgia. Even if government makes little bit improvement over these indicators, it leads huge impact for FDI flow. In addition, to find threshold point for quadratic equation we use same formula as used for Azerbaijan.

Starting with Voice and Accountability variable, as we see from formula and coefficient this is an increasing margin that starting from threshold point, indicator will affect negatively.

$\frac{\Delta FDI}{\Delta V\_A} = 100 * (-0.25 + 2 * 9.15 * V\_A) = 0$

V_A = 0.014.

Which means, till the point 0.014, changes in value of Voice and Accountability would affect positively, after that they have negative correlations.

$\frac{\Delta FDI}{\Delta G\_E} = 100 * (0.75 - 2 * 2.21 * G\_E) = 0$

G_E = 0.169

Due to coefficient value of Government Effectiveness is negative, relation of this indicator with FDI is diminishing. Therefore, changes of G_E value till the 0.169 threshold will positively, after that point negatively correlated.

If we take a look the estimation results of Armenia in case of governance quality, it is totally different from both Azerbaijan and Georgia. The models for these two countries shows that governance quality indicators plays main role for attract investment. However, our model estimation results shows that all six institutional quality indicators have statistically insignificant relationships with FDI. On the other word, increase or decrease value of any indicator do not effect changes over FDI in Armenia.

CONCLUSION AND RECOMMENDATIONS

South Caucasus region, as other emerging countries create new policies or yearly/quarterly economic plans and join global agencies trying to attract more investment in nation. Because it is a knowing fact that FDI plays a crucial role for economics in countries.

Azerbaijan has seen a significant increase in oversea capital inflows as a result of its significant energy reserves, especially after signing the so-called "Contract of the Century," a profit-sharing agreement between major global oil companies and the country's government. However, achieving more sustainable growth is entirely contingent on the country's ability to diversify its economy and raise the share of non-oil revenue in the state budget. Having said that, one of the country's top priorities is to attract international investors by improving the country's investment climate.

Government of Georgia and Armenia also create some new programs to create better environment for investors. For example, Armenian government create Anti-corruption policies is included 2014-2025 Armenia Growth Strategy. The new Government Program states that addressing corruption effectively needs the proper application of controls and balances, the implementation of current legislative and institutional structures and the introduction of new initiatives.

There are some variables that affect FDI flow, which Governance quality and financial stability risk are one of them. These two variables are the main reason for economic improvement, also investment inflows. Data from the World Bank and Fitch Ratings assessed both Government quality and sovereign risks of the countries, and a regression model was established to test their relationship with the FDI.

According to the results of this estimation model, the impact of governance quality on the FDI was positively significant for countries, except for Armenia. Which means an increase of value of Governance quality leads increase of FDI flow. This shows that both countries should pay special attention to these 6 indicators. Fantastic results have been achieved, especially in Georgia. It is not surprising that the main policy of the country is related to the development of these indicators. It is confusing when it comes to the fact that Azerbaijan has a quadratic relationship, so the country should pay special attention to any plan set for the development of these indicators, or it may lead to a number of problems with the income associated with this investment.

The FRS, in turn, is positively significant correlation with the FDI in all three countries. This is not very surprising, because the first consideration when investors want to invest in any business or country is its financial stability risk.

This report, as well as additional research on the topic, will help the government develop policies to attract foreign direct investment into the country. Since it unearths critical variables based on previous datasets, the research's credibility grows, and it opens the door to new applications.

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