Important Aspects of the Macroeconomic Stability and Competitiveness of a Small Open Economy

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Abstract

The last decades featured significant changes in the world economy. Besides the economic aspects, political, social, ecological and other factors are getting more active, which modifies the traditional perspectives. The most distinctive shifts in the economic system began at the end of the last century, in the form of post-communist transformation, one of the most important political and economic processes. The process affected certain group of countries, which had to transition from the command economy into the market economy. Thus, there was an inevitable necessity to adjust the existing institutions and establish new type of market relations. The process of reforming was also influenced by non-economical factors, such as the level of sociopolitical development in the society, the experience accumulated by the State, national mentality, leadership and etc.

Georgia was overburdened with the whole complexity of the transformation process and suffered from the shocks of the economic and political systems. The most pressing challenge was creating competitive economy. Creating, preserving and developing a competitive economy are crucial issues for a small size open economy. The lack of internal resources makes these countries more dependent on foreign investments. It must be emphasized, that getting interest from investors of the large scale, requires relevant legislation, modern infrastructure, steady macroeconomic environment and assurance of the political safety. In this regard, Georgia has made a significant progress. As a result of simplified bureaucratic procedures and investments in important infrastructural projects Georgia has notably advanced in world rankings. According the World Bank ranking in 2015 "easiness of doing business" Georgia resides on the 24th place between Portugal and Poland. However, it should be noted, that despite relatively high rates of economic growth, the model of economic development in Georgia is rather consumer model, than innovative model. And the development of the real sector of economy is one of the most crucial factors for ensuring macroeconomic stability. Georgian government has formulated a strategy for socio-economic development, which is based on three main principals: ensuring rapid and efficient economic growth, which is oriented towards development of the real sector of economy; pursuing economic policy, that stimulates inclusive economic growth; and ensuring ecological safety and sustainability, and rational usage of natural resources.

Purpose of the article: The aim of this paper is to describe and analyze the difficulties, problems and challenges that occurred during last quarter of a century. We will try to focus on issues of macroeconomic regulations and the role of a government in sustainable development of the country, considering government's active participation in economy as a taken.

Methodology/methods: In the process of research were used the methods of analysis and synthesis. The data used for analysis was taken from the websites of the official, nongovernmental and international organizations. The mathematical and econometric apparatus was used in order to identify and describe interrelations between various indicators. Various scientific articles, legislative acts, reports of the international organizations and other works have been studied in the process of writing this paper.

Scientific aim: The paper highlights the importance of European integration for Georgia, also analyzes the reasons for which the process of excepting Georgia in European Union was delayed, unlike other post-Soviet countries. Also, describes the future European integration perspectives and the approaches to increase competitiveness of the country. The paper presents whether Georgian economic strategy and the principals of European Union are equivalent or not, and to what extent Georgia has succeeded in approximation of legislation to the EU standards.

Findings: There was no exact prescription for the economic transformation, from command economy towards market-based one, at the initial period of transition, nor such formula exists even in modern economics. Therefore, mistakes were made by the countries themselves, and by international organizations as well. The countries with better initial conditions and more aggressive approaches to reforms achieved stabilization more quickly. The transformation process became complicated and dragged out in countries with conflicts and institutional obstacles to market reforms. Unfortunately, these countries included Georgia. Also, it must be emphasized, that there is no specific and generally accepted criteria, by which it is possible to determine whether the transformation process is already completed or not. Becoming a member of the European Union is considered to be one of the criteria. If EU decides that the economy of the country, which is in the process of transition, is ready to be the Union member, it most likely means that the post-communist transition has completed and the economy of the country operates according to the market principals.

Key words: Transformation, European integration, Government macroeconomic policy, Competitiveness, Sustainable development

JEL Classification: B15, C40, E52, E62, F15

Introduction

The most distinctive shifts in the economic system began at the end of the last century, in the form of post-communist transformation, one of the most important political and economic processes. This process affected certain group of countries, which had to transform from the command economy into the market one. Thus, there was an inevitable necessity to adjust the existing institutions and establish new type of market relations.

There was no exact prescription for the economic transformation, from command economy towards market-based one, at the initial period of transition, nor exists such formula even in modern economics. Therefore, mistakes were made by the countries themselves and by international organizations as well. International monetary institutions were helping post-socialist countries in various forms, such as financial resources, technical assistance and recommendations. The support of the international institutions was very important, since without their assist the post-socialist countries themselves had neither the resources not the experience to implement drastic reforms and transform into the market economy. Thus, the international financial organizations have an important role in the process of post-communist transformation, in establishment of the market based institutions and in organizing the basis for economic development of these countries.

The countries with better initial conditions and more aggressive approaches to reforms achieved stability more quickly. The transformation process became complicated and dragged out in countries with conflicts and institutional obstacles to market reforms. Unfortunately, these countries included Georgia.

Also, it must be emphasized, that there is no specific and generally accepted criteria, by which it is possible to determine whether the transformation process is already completed or not. Becoming a member of the European Union is considered to be one of the criteria. If EU decides that the economy of the country, which is in the process of transition, is ready to be the Union member, it most likely means that the post-communist transition has completed and the economy of the country operates according to the market principals.

The process of European integration became more active during 1990s, and as a result of strengthen and deepen partnership, several of the post-communist countries were accepted in EU as the members (Poland, Czech Republic, Lithuania, Latvia, Slovakia and Slovenia), followed by Bulgaria and Romania (2007) and Croatia (2013). These countries have advanced and successfully completed the transformation process, while in other countries, including Georgia, this process was relatively delayed. Georgia was overburdened with the whole complexity of the transformation process and suffered from the shocks of the economic and political systems.

In 1991, after collapsing the communist regime, Poland was one of the first countries, where the process of transition into market economy has started with the method of “Shock Therapy”. Poland was followed by Russia, in the January of 1992 Russia began to realize “Shock Therapy”, and one month later realization of the Russian version of the Balcerowicz Plan began in Georgia as well. It should be mentioned, that the impact of Polish experience and Polish economists on the executed (and not accomplished) economic reforms in independent Georgia is significantly large.

The Balcerowicz Plan could not be executed in Georgia, because of a number of objective and subjective reasons. The execution of the “Shock Therapy” requires consistent use of the Monetary and Fiscal institutions. In the case of absence of these institutes, the method of “Shock Therapy” can’t be used fully, and every attempt is doomed to failure. This thesis can be proved with Georgian experience.

Famous Georgian economist, Vladimer Papava has studied the transformation period thoroughly. In his book “Macroeconomics of Post-Communist Transformation” (Papava, 2005) he has analyzed each paragraph of the Balcerowicz Plan and the possibilities and difficulties of implementation of this plan in Georgia. We will try to formulate the main problems that Georgia has encountered in the beginning of the transformation process. First, we will discuss the example of Poland.

During the initial stage of “Shock Therapy”, the following measures have been executed simultaneously in Poland:

1. Deliberate encourage of the inflation processes in order to achieve equilibrium on the market;
2. “Strict” restriction of the population incomes;
3. Significant increase of the interest rates, reduction of the quantity of money in circulation (saving incentives);
4. Reduction of budget expenditures, at the expense of reducing capital investments and subsidies for the unprofitable enterprises;
5. Emission of the government bonds to cover the deficit of the state budget;
6. Regulation and unification of the tax system;
7. Introduction of unified exchange rate of Zloty to US Dollar, provision of conversion of Zloty on the internal market;
8. Introduction of new customs duty to restrict the import and stimulate the export;
9. Provision of the public assistance within the actual capability of the government;
10. Elimination of the monopolistic structures and rejection of administrative interference in business activities by the state.

After reviewing the original Balcerowicz Plan we can analyze on what extent it was adopted in Georgia. We will discuss each direction of the “Shock Therapy” separately:

1. In order to achieve the market equilibrium, the regulated prices on goods and services in Georgia have significantly increased, only in 1991 CPI was 180%, and for 1992 this index increased up to 25 times. It can be said, that the first paragraph of the Balcerowicz Plan was carried out in Georgia.
2. In spite of the fact, that there was not taken any harsh regulatory measure in Georgia (as it was carried out in Poland) that would restrict the growth of the wage fund, the increase of salaries and social assistance had been evidently behind the price growth. Therefore, it can be considered that the second paragraph of the Balcerowicz Plan more or less was executed in Georgia.
3. In 1991-92 Georgia had not have its own monetary system (there were circulating Rubles of the dissolved Soviet Union and newly introduces Russian Rubles), thus it was essentially impossible for Georgia to restrict the quantity of money in circulation by

increasing interest rate. Georgia had managed to accumulate some amount of money on deposits with condition of doubling the funds, but in the second half of 1992 due to complications of bringing cash from Russia (Russia had remained the money issuer), the money accumulated on deposits had been used to pay salaries and pensions. Thus, execution of the third paragraph was a failure.

4. In 1992 the share of the state capital investments in state budget had not declined, while the volume of the donations had increased up to 5 times. Actually the fourth paragraph was not fulfilled as well.
5. Government bonds practically had not been used as the instrument to cover the deficit of the state budget;
6. The regulation of the tax system in Georgia had already begun in the summer of 1991, therefore the sixth paragraph of the "Shock Therapy" can be considered as accomplished.
7. In 1992 Georgia had not have national currency, so it was practically impossible to execute the seventh paragraph.
8. In 1992 unified customs duty had been introduced, the rate of import duty was 2%, and the rate of export duty was 8%. These rates could neither restrict the import nor stimulate the export. So, neither the eighth paragraph was executed.
9. In 1991-92 there had not existed any special assistance programs for low income families in Georgia, and the social security system did not recognize assistance differentiation according to income levels of the families. Therefore, unfortunately, the ninth paragraph could not been carried out.
10. In 1992 for the first time, Georgia had adopted legislative and governmental decisions about restriction of monopolistic activities and encouraging development of the competitive market. As expected, the execution of these decisions within short period of time could not be realized comprehensively and with large scale.

Consequently, only 3 paragraphs out of 10 paragraphs of Balcerowicz Plan, the classical scheme of the "Shock Therapy" for post-communist countries, have been accomplished in Georgia. Could not be executed such important measures as abolishment of budget subsidies and strict reduction of the quantity of money in circulation.

In the first half of 1990s the output decreased significantly, trade linkages and internal economic relations collapsed. The inflation has increased to such extent, that the regulation of exchange rate became meaningless. Because of the hyperinflation, the National Bank was trying to adopt a strict monetary policy. The National Bank intended to regulate inflation and provide economic growth and currency stability. This goal was prevented by the fiscal crisis in Georgia and external factors, such as economic crisis in Russia and other partner countries of the regional organization - The Commonwealth of Independent States (CIS).

In 1998 the economic crisis in CIS countries deepened. In the conditions of strong external shock and deepened internal fiscal crisis the behavior of the economic agents changed drastically. Changes in behavior reflected in excessive demand for foreign currency. In 2000 the global financial and economic situation has improved. The reforms, implemented during first decade of transformation process had paid off and after the beginning of 2000s the countries achieved macroeconomic stability. And more intensive integration into the global economy increased capital flows to these countries. The foreign direct investments (FDI) had positive subsequent effects, such as new jobs, access to advanced technologies, appearance of new products and new market segments. Tax privileges and simplified bureaucratic procedures are not enough measures to interest the investors of large scale. As the international practice shows, in case of temporary tax privileges majority of investors leave the country after expiration of this privileges. Besides, the implemented reforms often were inconsistent and spontaneous. Despite high economic growth in last several years, benefits did not reach the majority of population.

Thus, the Georgian government has formulated a strategy for socio-economic development – "Georgia 2020", which is based on three main principals: ensuring rapid and efficient economic growth, which is oriented towards development of the real sector of economy; pursuing economic policy, that stimulates inclusive economic growth; and ensuring ecological safety and sustainability, and rational usage of natural resources.

The priority of Georgian government is to solve the problems which obstruct the economic policy from achieving its primary goal – inclusive economic growth. After analyzing the economic conjuncture, some problems were revealed, which hinder economic growth, such as low competitiveness of the private sector, incompetent human resources and limited access to financial resources. Thus, the measures of Georgian economy policy are directed to stimulation of the private sector, development of the human resources and ensuring access to financial resources.

Georgian macroeconomic policy`s aspects

Macroeconomic policy has a number of important goals: economic growth, full employment, economic efficiency, price stability, social peace, balanced and positive balance of payments and others.

As we know economic growth is directly related to the growth of the capital, herewith important issue is the effective use of this capital. Capital growth can be at the expense of investments in both physical and human capital. In order to cover the insufficiency of internal resources many countries try to attract foreign capital. This goal may be achieved through a direct loan, emission of bonds on foreign markets and attracting foreign direct investments. FDI does not create financial obligations for the government, capital inflows establish new enterprises, new jobs, thus the budget revenues increase. Decrease of the unemployment rate reduces social tension and the pressure of social benefits on the budget. Along with the FDI new knowledge may enter the country in the context of management and production. The inflow of founds increase the amount of foreign currency and thus increases reserves of the National Bank.

As the chart shows, almost half of foreign direct investments in Georgia come from EU countries. After the integration process has deepened this percentage stabilized and is growing every year.

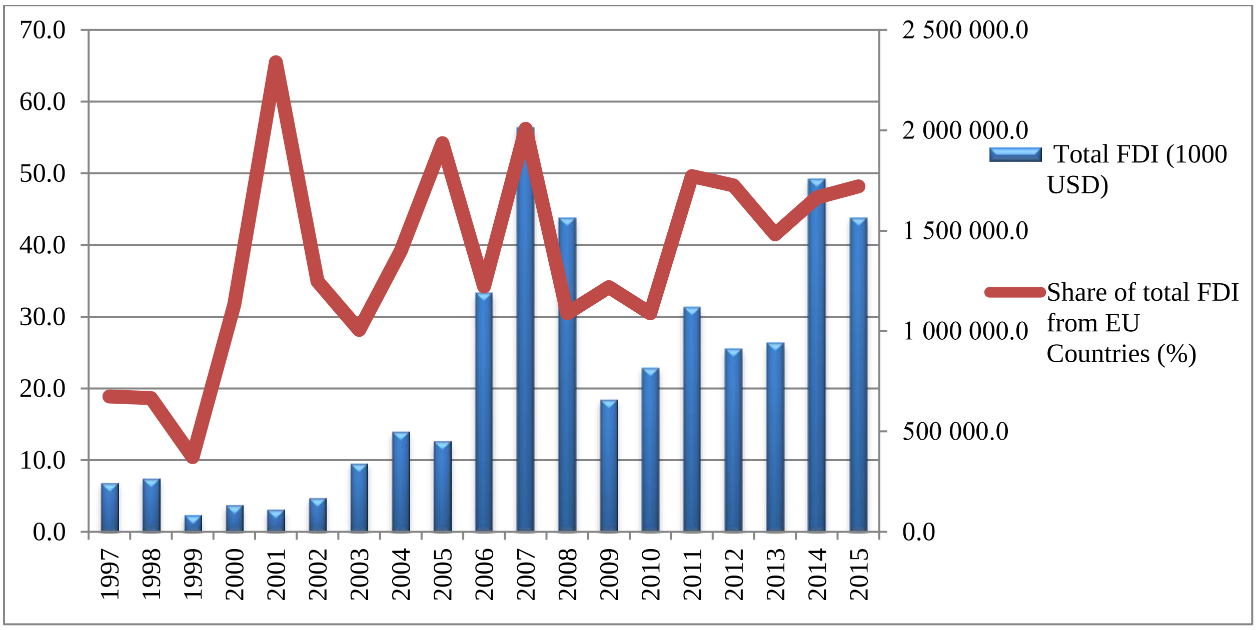

Chart 1.1 *Total FDI of Georgi and the share of Total FDI from EU Countries (1997-2015). Source: The National Statistic Office of Georgia*

Considering that Georgia is small open economy with scare resources, the volume of foreign investments is crucial. Another matter that should be considered is the direction of investments, in which sectors of the economy are accumulated major investments.

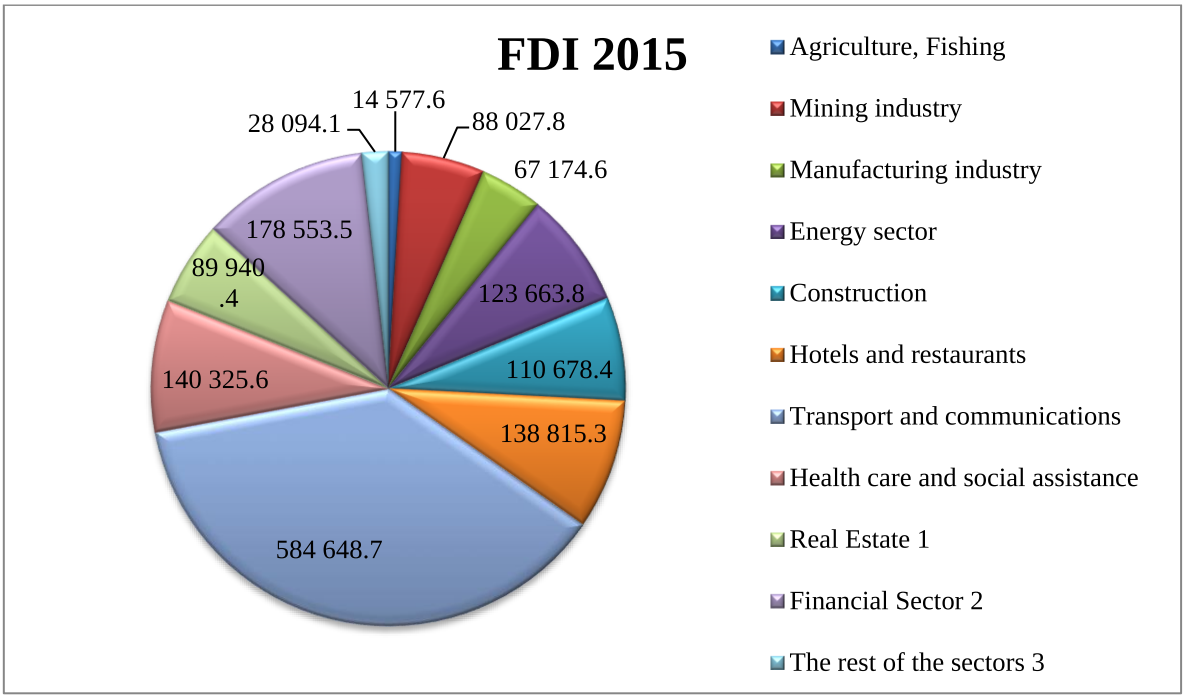

Chart 1.2 *FDI of Georgia by Economic Sectors (2015).*
Source: The National Statistic Office of Georgia

The largest sector is Transport and communications. Infrastructural projects are important for developing countries, as are the precondition for economic development, besides well equipped infrastructure in the country will attract more investors.

Unfortunately, one of the largest sectors consists of the social benefits, this demonstrates that significant part of population of Georgia is socially vulnerable and needs support. While one of the most important sectors of economy, the agriculture is smallest sector. It should be mentioned that the investments and output in agriculture has increased in last 3 years. Partly it is due to government programs, which are directed to development of regional infrastructure and promotion of small business.

The growing sector of Energy is also notable. Unfortunately, a large part of the capacity of Georgia has not been utilized yet. However some large-scale projects are planned and already began. This will increase energy security of Georgia, besides growth in export will increase incomes of the country. It should be emphasized that interest in investments in green, environment-friendly projects grows more and more.

One of the most pressing problems Georgia faces is the consumer model of economy. Unfortunately, economic development policy usually is directed to the stimulation of consumption, not to the growth of productivity. Without developed real sector it is impossible to achieve economically strong country with stable macroeconomic. In the consumption-oriented economy of Georgia import exceeds export more than three times. This imbalance is financed partly by foreign direct investments, partly by revenues from tourism and also from the transfers of Georgian citizens who live abroad.

For the promotion of Georgian export and development of the economy in general, advancement in the process of European integration has a significant meaning. In this regard, Georgia has succeeded. On June 27, 2014, Georgia signed an Association Agreement with the European Union, and one of the most important parts of the agreement is DCFTA – Deep and Comprehensive Free

Trade Area. Negotiation processes for DCFTA had already begun in 2009. After signing this agreement Georgia has undertaken obligations in various fields, such as: intellectual property rights, sanitary and phytosanitary measures, food safety strategy and the program of approximation of the legislation.

The modern world is inconceivable without deepening interrelations, which is concomitant process of globalization. That is why the regional aspects of the problem should be highlighted. As for Georgia, EU integration is fundamental matter for both, domestic and foreign policy.

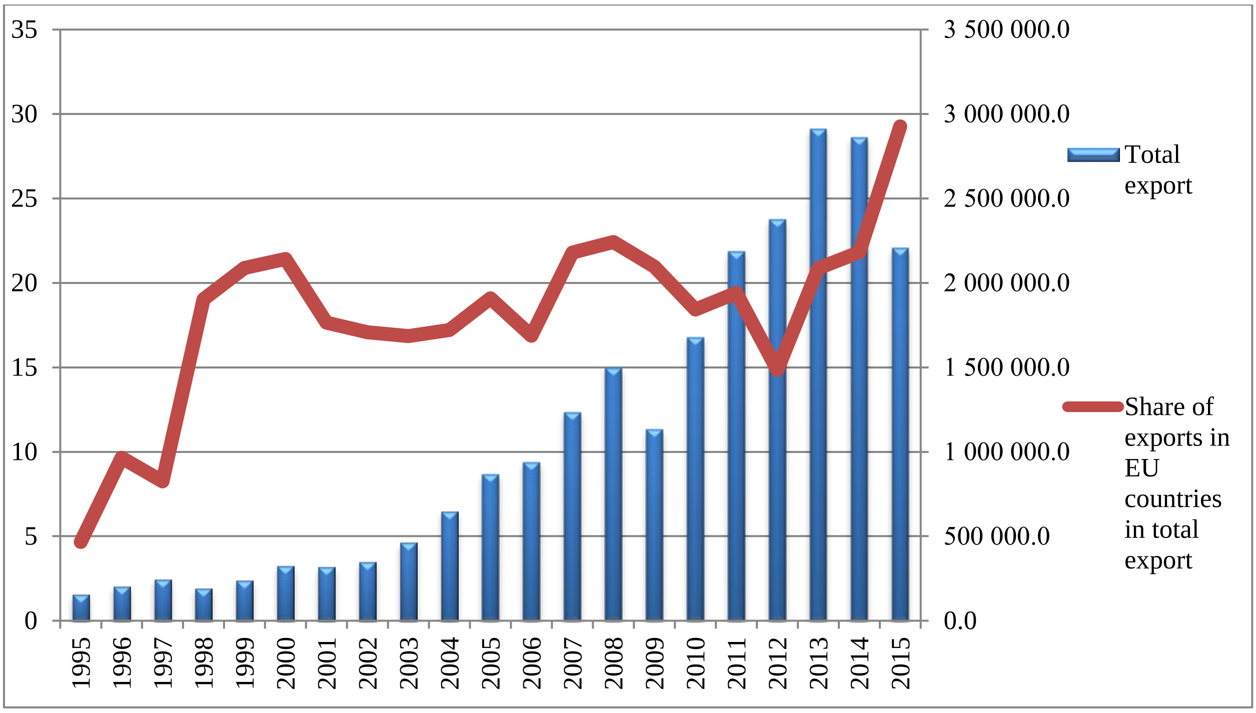

Chart 1.3 *Total Export of Georgia and the share of Export in EU Countries in Total Export (1995-2015). Source: The National Statistic Office of Georgia*

As the chart shows, export has kept growing steadily, but in 2015 it significantly declined. It can be explained by economical fluctuations in partner countries, despite the fact that the real effective exchange rate of Georgian Lari depreciated significantly, it did not reflected on export. The chart also shows the share of export in European Union member countries in the total export of Georgia. It can be observed that this indicator has kept growing during last 4 years. The DCFTA gives Georgia great opportunities, but unfortunately, Georgian enterprises can't use all these advantages, Georgian products hardly compete with the European products. Goods that are meant for European market must meet some specific requirements. Government tries to overcome this obstacle with various measures, such as informing manufacturers about the specific requirements, introducing new regulations and establishing new institutional bodies. New regulations include food security improvement, quality care and sanitary and phytosanitary standards.

Another weak point of Georgian export is significant dependence on the several products and this creates additional risks. In order to support export, it is important to develop production capacity, particularly in such fields, on which there is high foreign demand. In this context it should be mentioned, that Georgia has great potential to produce organic products. It is important to diversify export products, as focusing on some specific products increases the risk of reduction of export volume.

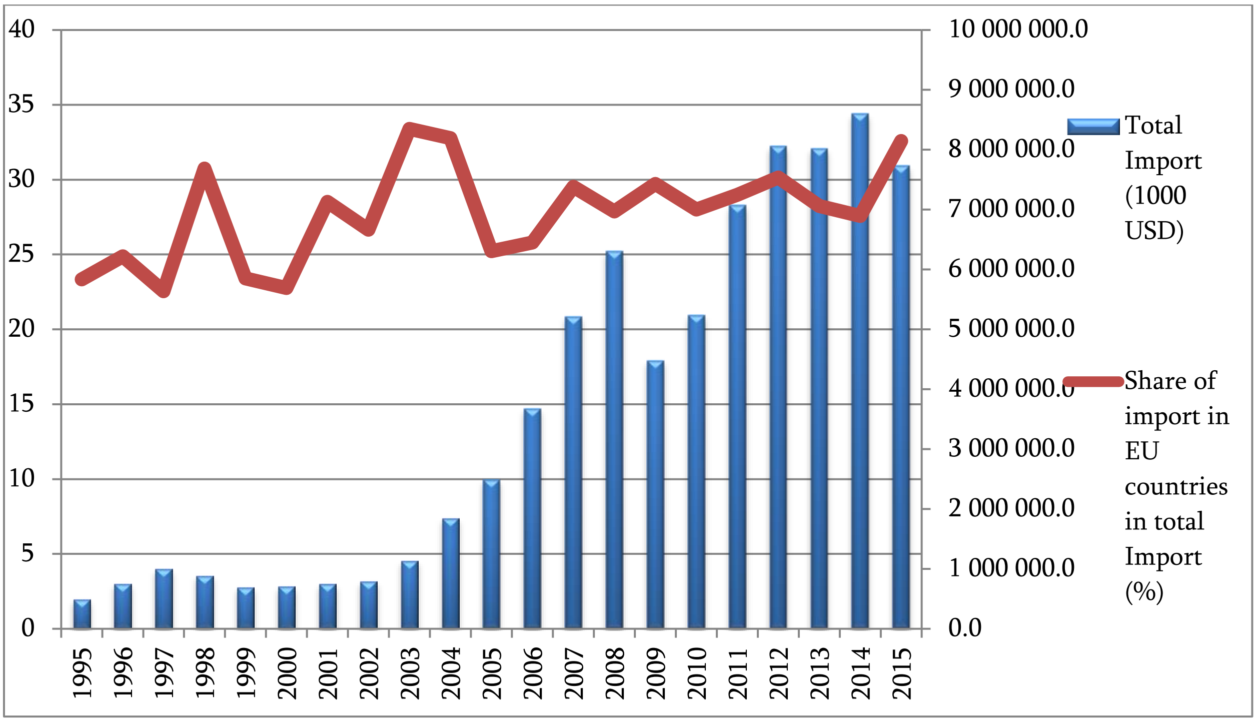

Chart 1.4 *Total Import of Georgia and the share of Import from EU Countries in Total Export (1995-2015). Source: The National Statistic Office of Georgia*

Until 2003 years import was steadily less than 800 million USD, and after that it began to rise. In 2009 in accordance of economic decline import decreased as well, however from the second year rapid growth can be observed. In 2011 there was unprecedented growth with 1.8 billion USD, 2013 year turned out to be relatively positive, import growth has not been observed at all, although with the data of 2014-16 years, import keeps increasing.

When import reaches 48% of GDP this indicates the weakness of the economy. But it is not right to accuse economy in everything, corruption and interest groups (monopolies, lobby) should be taken into account as well.

In order to describe macroeconomic stability of the country Economic Discomfort Index (EDI) can be used, which is the sum of inflation and unemployment. The upward trend of EDI indicates macroeconomic instability and fragility. Georgia has more or less reliable statistics on inflation since 1996, and on the work force since 1998, thus Economic Discomfort Index for Georgia can be calculated since 1998.

Despite some positive changes, the EDI of Georgia, as well as in its components, has growing trends since 2000. The large share of the EDI (3/5) comes on unemployment rate, the impact of inflation on its formation is relatively low, than in other South Caucasus countries and United States.

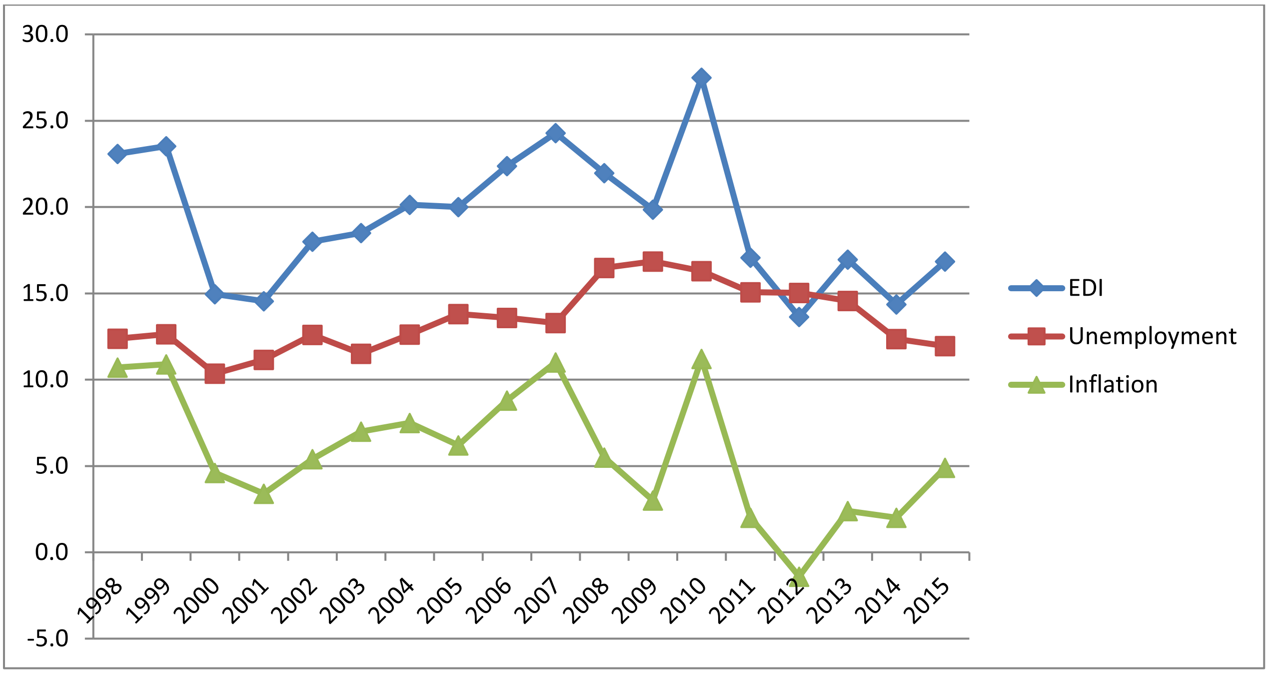

Chart 1.5 *Economic Discomfort Index of Geirgia, Unimployment Rate and Inflation (1998-2015). Source: The National Statistic Office of Georgia*

Besides, because of the high rate of self-employment in Georgia (as well as in other South Caucasus countries) Philips curve is practically unusable. While in developed countries this curve indicates inverse dependence between inflation and unemployment rate. In Georgia increase in inflation, as a rule, does not impact reduction in unemployment, and vice versa. Inflation has relatively modest share in formation of EDI, which is caused mainly by high rate of unemployment and the prices of imported goods.

Macroeconomic stability and competitiveness of the country have a considerable importance in the process of EU integration. As for macroeconomic regulation, the essential factors are coordination of monetary and fiscal policy, possibility to predict short-term and long-term value of the national currency and etc. All the factors mentioned above have positive or negative influence on the competitiveness of the country. At this rate, it’s interesting to analyze the economic policy of the National Bank of Georgia and the Ministry of Finance and the exchange rate of Georgian Lari.

After the National Bank of Georgia was established in 1991, is has carried out number of activities that provided creation and improvement of macroeconomic tools. Some of the important and crucial reformed should be emphasized.

- First of all, since 2006 in order to increase efficiency of the bond market and monetary tools, the National Bank of Georgia started to issue Certificates of Deposit (CD). This allowed the National Bank of Georgia to remove excess liquidity without extra costs.
- Since August of 2008, the National Bank implemented a new tool of monetary policy - one-week refinancing loans (with which was replaced another tool of the National Bank - one-week Certificates of Deposit). This instrument allows the National Bank to have the short-term interbank interest rate under control.
- Since 2009, the monetary policy regime of the National Bank of Georgia is inflation targeting. Before implementation of the inflation targeting policy, the monetary policy of the National Bank was based on monetary targeting, that means achievement of the favorable growth rate of the money supply.

Inflation targeting has many benefit, some of them should be emphasized:

- ➢ Reduced volatility of the inflation;
- ➢ Reduced inflationary impact of shocks;

- Increased anchoring of inflation expectations.

As the monetary policy regime of the National Bank of Georgia has changed since 2009, the data in the model is taken from 2009 to 2015.

The following variables were used in order to analyze the effect of monetary policy: the refinancing rate, purchase and sale of US Dollar by the National Bank, the amount of national currency in circulation, reserves and net foreign assets of the National Bank and nominal effective exchange rate. For more reliability of the regression model, the data was taken monthly from January 2009 through October 2015. The correlation between variables used in the model and the exchange rate are quite high. The correlation between refinancing rate and the nominal effective exchange rate is negative (-0.5655), as for the national currency in circulation (0.7215), reserves (0.7792) and net foreign assets (0.7585) the correlations are positive. When the exchange rate of Lari depreciated drastically in November-December 2014 and the demand for USD increased significantly, the National Bank sold 80 million USD, but this amount was not enough to maintain the exchange rate. It should be noted, that International Monetary Fund (IMF) recommends the Central Banks to keep their international reserves at the amount of tripled value of one month import. The correlation between purchase and sale of the USD and the nominal effective exchange rate is very low. Despite having sold more than 200 million USD only in first quarter of 2015, the National Bank could not influence the exchange rate. We can summarize the impact of each variable in a multiple regression model.

$$y = 274{,}3196 - 4{,}3474x_1 - 0{,}00005x_2 + 0{,}00001x_3 - 0{,}00005x_4 - 0{,}00002x_5 + 0{,}00003x_6$$

Where: y is nominal effective exchange rate,

$274{,}3196$ - intercept,

x_1 - refinancing rate,

x_2 - sale of USD by the National Bank,

x_3 - purchase of USD by the National Bank,

x_4 - national currency in circulation,

x_5 - net foreign assets of the National Bank,

x_6 - reserves of the National Bank.

With significance level of 1% (and confidence interval of 99%) all the variables except x_5 are statistically significant. The coefficient of determination and the adjusted coefficient of determination equal - $R^2 = 0{,}7457$ and $\bar{R}^2 = 0{,}7254$.

The analysis of the fiscal policy is also significant. Annual payments of foreign debt principal and interests have become more and more important part of the budget expenditures, thus the budget deficit and growing national debt have become the center of economic problems. Since most countries try to pay off the debts with new ones, such policy increases interest rates, instead of reducing debts, and eventually this process turns into upside down pyramid, and the covering of the debt becomes more and more difficult as time goes by.

Georgia had begun to take foreign loans from the first years of independence. In 1992 Georgia took 1 credit, in 1993 – 2, in 1994 – 5, in 1995 – 4, in 1996 – 14, 1997 – 12 and so on. In 2003-2007 the foreign debt that Georgia should have paid was 1750 million Laris (approximately 843.82 million Dollars) this sum was equal to 35-40% of budget expenditures, naturally Georgia could not afford paying debts in these years. After negotiating with creditors the short-term debts were replaced with long-term debts, and since then Georgia was paying just interests, not the principal.

One of the mail principles and medium-term tasks of fiscal and macroeconomic policy in general is consistent reduction of the foreign debt to 25% of Gross Domestic Product (GDP) (the upper limit – 60% of GDP is already determined). In addition, the budget expenditures should not exceed 30% of GDP.

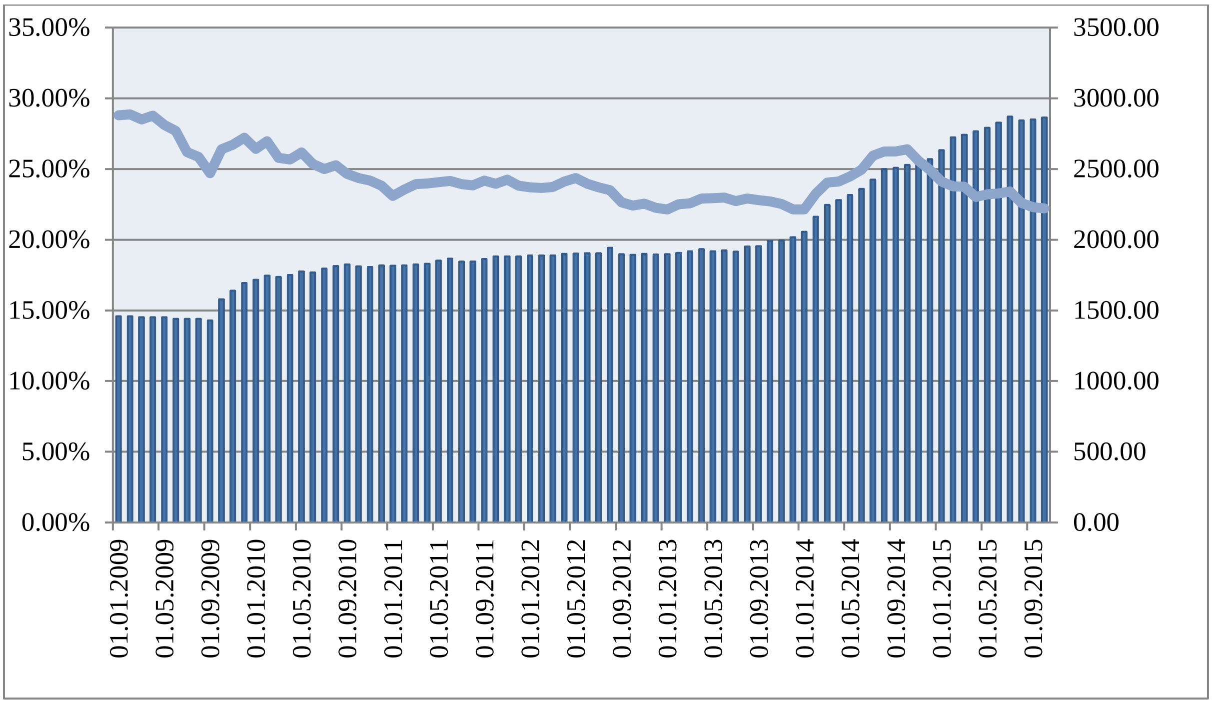

Chart 1.6 *Internal Debt (milion Lari) and the share of Internal Debt in National Debt (2009-2015). Source: Ministry of Finance of Geogia*

Growing domestic debt is considered to have impact on the value of national currency, as one of the tools of the fiscal policy. The increasing demand of the Ministry of Finance for Lari encourages the National Bank to supply commercial banks with additional mass of currency, thus this causes depreciation of the national currency. As the chart shows, in spite of the fact that the domestic debt steadily grows, the share of domestic debt in total national debt declines.

The following variables were used in order to analyze the effect of fiscal policy: budget revenues and spending, operational balance of the budget, national debt (domestic and foreign) and nominal effective exchange rate.

Budget spending policy was considered to be one of the main reasons of the depreciation of Lari. The correlation between nominal effective exchange rate and budget spending was quite low and equaled 0.5343, as for the revenues 0.5268. Fiscal policy effects on exchange rate with another channel as well – increasing domestic debt increases the demand on currency, thus, the National Bank has to supply commercial banks with additional amount of Lari, and as a result the currency depreciates. The correlation between nominal effective exchange rate and national debt is positive (0.6194), for the domestic debt is equals 0.6430 and for foreign 0.6068.

The summarized the impact of each variable in a multiple regression model will be:

$$y = 190{,}9266 + 0{,}01525x_1 + 0{,}01649x_2 + 0{,}02334x_3 - 0{,}00143x_4$$

Where: y is nominal effective exchange rate,

190,9266 – intercept,

x_1 – budget revenues,

x_2 – budget spending,

x_3 – domestic debt,

x_4 – foreign debt.

With significance level of 1% (and confidence interval of 99%) all the variables are statistically significant. As for the coefficient of determination and the adjusted coefficient of determination, they are quite low - $R^2 = 0{,}4521$ and $\bar{R}^2 = 0{,}4237$. This means that the variables included in model can explain only 42% of fluctuation of the nominal effective exchange rate.

Both, the fiscal and the monetary policy of Georgia were directed to strengthen Lari, but in last 2 years Georgian Lari is steadily depreciating, but it is mainly caused by external factors: sudden strengthening of USD depreciated the currencies of the partner countries, the currency shocks were followed by slowdown in economic growth, thus declined Georgian export and remittances from aboard as well.

With a view to establishing oneself in the global economy, the countries, with emerging economies, have to ensure rapid economic growth, which is impossible without developing industries based on innovations and research. As a small economy, Georgia is highly depended on external factors. In order to improve the competitiveness of such country innovation-based technologies are crucial factor. Under intense competitive environment of the global market every country has to develop and improve various segments of the national economy. In developed countries social problems, employment issues, regional disproportions and eradication of poverty are usually solved with conducting innovation policy. This should be exemplary for developing countries.

Compared to other countries, investment cost on research and development in Georgia is relatively low. That is why according the Global Competitive Index, which is calculated by 119 criteria, Georgia has the lowest rank (121th) in innovations. Also, the following areas are problematic: protection of property rights, secondary and higher education, science and research, the level of competition on the domestic market, access to finances, professional work force, public trust in politicians and political instability. It can be said that through implementation and support of innovations three of these problematic areas can be improved: secondary and higher education, science and research, domestic competition.

Innovation is a long term process, which starts with a different idea, and then requires substantial research. Gradually high technologies, technology start-ups, innovations and etc. have become organic for Georgia. The domestic economic policy of a developing country significantly determines the import, creation and dissemination of the new technologies. In this regard, Georgia has quite a breakthrough. Under the auspices of the Ministry of Economy and Sustainable Development and Georgia's Innovations and Technology Agency (GITA) the first Tech Park was opened in Georgia. 5 million Lari worth project has been successfully completed on 11^{th} January, 2016. The Tech Park provides: access to various types of high-technology equipment; services to develop Start-up companies; connections with the staff and experts who are necessary for the project implementation; access to the advanced knowledge and experience in innovations and new technologies (www.techpark.ge). It is a place equipped with modern technology, where start-ups and small companies are offered the resources, that where hardly available up till now. The popularity of Tech Parks is increasing all over the world. Not only the private, but the public sector is interesting in establishing one, as they contribute economic growth and development of relatively weak regions.

Conclusions

Macroeconomic stability is important not only for development of the economy, but also for attracting large-scale investors. In this regard, the volatility of the national currency is one of the crucial factors. As we know the main role in formation of short term exchange rate has expectations. In turn, the view of the measures taken by the government in some degree forms these expectations. Therefore, communication with public is important. The public should be informed about the measures already adopted, the future arrangements, the causes and consequences of implementation of these policies. This way, the behavior of economic agents won't change so drastically as in the end of 90ths.

The fully implementation of DCFTA will effect Georgian economy in the short, medium and long term period. It is expected that import from the EU countries will increase. Thus the market will be saturated with high-quality products and resources. These circumstances will lead to better living standards. With stabilized macroeconomic environment and modern infrastructure Georgia will become more attractive to the potential investors. The foreign investment have very important positive effects, such as new goods and market, job generation, advanced techniques and technology, new accounting standards, etc.

The export from Georgia in EU countries has increased in the recent years, but due to lack of compliance in standards and regulations, the growth of export is not significant yet. In the medium term industrial improvement and changes in the economic structure will importantly increase Georgian export. This will change the structure of the balance of payments.

Local enterprises will be stimulated to produce competitive product that complies with EU standards. For this Georgia will need more investments in the following years. For a small economy like Georgia private savings and local investments are very important factors for inclusive economic growth in the medium and long term period.

Changes are expected in labor market as well, wages and the employment rate will gradually increase.

Certain shifts are expected also in the banking sector, such as changing interest rates and profit margins, which in turn will influence capital flows and macroeconomic indicators.

Georgia has 4 years to complete the compliance of the legal base with European legislation.

Finally, we can conclude that the government macroeconomic policy can influence the use of the economic potential and increase competitiveness of the country on the world arena.

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