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The Business Environment of Georgia and Ukraine: Approaches to a Comparative Analysis

Abstract

The formation of a favourable business environment and the intensification of entrepreneurial activity on this basis is one of the priorities of economic policy of governments around the world. The aim of this article is to conduct a comparative analysis of some of the characteristics of the business environment of Georgia and Ukraine. The theoretical basis of the study is the understanding of the business environment as a necessary prerequisite for the implementation of entrepreneurial initiatives in a particular country. In the process of our research, the following methods were used: comparative analysis, generalisation, content analysis, correlation, and regression analysis. The authors studied the business environment of Georgia and Ukraine on the basis of an analysis of the following components; that of general economic, political and legal, financial, and fiscal. The results of the study show that Georgia's business environment is more favourable than Ukraine's. It is noted that between 2011–2020, Georgia made significant progress in the fight against corruption, in simplifying the procedures for starting a business, and bettering access to finance. Both countries are reforming their tax systems towards liberalisation and democratisation, and they declare the functioning of special tax regimes. According to the Paying Taxes indicator, which is calculated within the Doing Business rating, Georgia improved its result from 61st position in the ranking in 2011 to 14th position in 2020, while Ukraine improved its result from 181st place in 2011 to 65th place in 2020. It is indicated that between 2011–2020, Ukraine showed significant positive dynamics in in-

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flation targeting. The authors note that the weakest elements of the business environment in Ukraine are its efforts to ensure the independence of the judiciary and the fight against corruption. In conclusion, the authors note that the policy of the governments of Georgia and Ukraine should be aimed at the further democratisation of relations with businesses in order to increase the level of a favourable business environment.

Keywords: Business Environment, Entrepreneurship, Macroeconomic Indicators, Inflation, Democratisation, Market Factors

Introduction

The modern history of Georgia and Ukraine has many common features. Both countries were part of the USSR, and almost simultaneously embarked on the path of the democratisation of society and economic reform. Since gaining independence, Georgia and Ukraine have recognised the development of entrepreneurial initiative as one of the main elements of economic policy, which was itself reflected in the regulations of the early 1990s. At the same time, under the influence of internal and external factors, the processes of economic reform and the creation of a favourable business environment were rather declarative in nature and did not acquire priority status until the mid-2000s. At the same time, the practice of creating a favourable business environment in many post-socialist countries, first of all, Slovenia, along with Estonia and Poland, indicates its significant positive impact on economic development and improving the welfare of their populations. In this context, it is interesting – from a scientific point of view – to study certain business environment characteristics of the Eastern Partnership countries, namely Georgia and Ukraine.

Methodology

The aim of the article is to perform a comparative analysis of some characteristics of the business environment of Georgia and Ukraine.

The theoretical basis of the study is the understanding of the business environment as a necessary prerequisite for the implementation of entrepreneurial initiative in a particular country. When comparing the indicators that characterise the business environment of Georgia and Ukraine, the comparative analysis method was used. The generalisation method was used in the study of the general features of the business environment of Georgia and Ukraine. The processing, systematisation, and interpretation of information from reporting documents and survey results was carried out using the content analysis method. The correlation and regression analysis method was used to study the degree of interdependence between indicators. Calculations were performed using EViews 6.0 from IHS Markit.

The study used reporting information and the results of surveys organised by the Organization for Economic Co-operation and Development, Transparency International, the American Chamber of Commerce in Ukraine, Bertelsmann Stiftung, The World Economic Forum, and The World Bank Group.

Literature Review

The issue of the business environment, its impact on the pace of development of both individual companies, and countries as a whole is the subject of research for many scientists. For example, the general principles of the business environment and its individual elements are considered in the work of Worthington and Britton (Worthington, Britton, 2009).

The influence of the business environment on entrepreneurs' choice of organisational forms of doing business depending on the level of economic development of countries has been covered by a team of authors (Demirguc-Kunt, Love, Maksimovic, 2006). The authors' study covered 52 countries, and the results of the study showed that in countries with an effective legal system and a developed financial sector, companies choose the corporate organisational form. It is interesting to note that in countries with a favourable business environment, the corporate form of business is more efficient than other forms due to easier access to financial resources, fewer cases of corruption, and the mitigation of legal barriers to doing business.

The team of authors (Ward et al., 1995) propose the business environment be considered as a set of elements: the local labour market, the cost of doing business, and the level of competition and dynamism (market volatility). Each of the elements of the business environment is detailed and described by the authors in the example of Singapore. The results of the study revealed a strong relationship between elements of the business environment and options for operational strategy, determined by competitive priorities. The authors emphasise that, under the influence of the same factors of the business environment, economically successful companies choose other competitive priorities than companies that are less efficient.

Practical issues of improving the business environment are discussed in an article by Albaladejo (Albaladejo, 2001). The author analyses, in detail, the economic situation and business practices in Latin America.

On the one hand, this allowed him to identify the main obstacles to the development of business initiative; currency devaluation, hyperinflation, import restrictions, and the complexity of the registration procedure. On the other hand, the generalisation of information allowed the author to formulate a list of areas that will contribute to the formation of a favourable regulatory framework for business structures.

A study by Huang (Huang, 2005) examines the advantages of foreign companies over local ones in the country of doing business. The author analysed the following elements of the business environment; business licensing procedures, the procedure for conducting foreign trade operations, the rules of currency regulation, the tax system, environmental regulations, and fire safety rules. The results of the study showed that foreign companies have regulatory advantages that depend on the level of corruption in the country. Thus, Huang (Ibidem) found that in more corrupt countries, regulatory benefits for foreign companies are more significant.

The business environment at the regional level is discussed in an article by Brixiova and Ncube (Brixiova, Ncube, 2013). The authors analysed the statistics contained in the World Bank Doing Business Report (World Bank Doing Business Report, 2013), the Africa Competitiveness Report and others, and on this basis identified the main obstacles to doing business, especially at the start-up stage. Among the most significant are the following; access to finance, corruption, ineffective government regulation, and ineffective mechanisms to protect property rights. Thus, the authors draw our attention to the existence of a positive correlation between the number of regulatory requirements for starting a business and the number of newly formed companies. The authors substantiate the thesis that improving the business environment will contribute to the creation of highly productive companies.

Djankov, La Porta, Lopez-de-Silanes & Shleifer (Djankov et al., 2002) present the results of an analysis of the conditions for starting a business in 85 countries, noting that there are significant barriers to such endeavours. In countries with less democratic governments, the regulation of business start-ups and market entry are important, while in countries with governments that promote competition and enforce rights, there is less regulation at the entry level.

Quite an interesting issue is considered in an article by Laeven and Woodruff (Laeven, Woodruff, 2007). The authors explore the relationship between the effectiveness of the legal system and company size. The results showed a disproportionate distribution of the employed population in companies depending on their size, and the authors found that increasing the quality and efficiency of the legal system leads to a 10–15% increase of the average size of companies in a given country.

The impact of elements of the business environment on the labour market in Europe and Central Asia is disclosed in an article by Lopez-Garcia (Lopez-Garcia, 2006). After analysing the indicators of 28 countries, the author substantiates the thesis that the most significant factor is the indicator reflecting access to finance. In addition, the costs of starting a business, tax, and market regulation also have a significant impact on employment.

A trio of authors (Papiashvili, Saksonova, Rupeika-Apoga, 2017) proposes assessing the favourable investment environment using three indices: the Index of Economic Freedom, the Corruption Perceptions Index, and the Ease of Doing Business Index. In addition, in their opinion, it is important to take into account the specifics of a particular country. The authors note that this approach is useful for determining the degree of liberalisation of investment activity.

Agreeing in general with the conclusions of the authors, it should be noted that the use of only generalised indices allows one to form a general idea of the degree of a favourable business environment in a particular country, which should be supplemented by an analysis of a set of socio-economic indicators.

In support of this, the team of authors (Pinheiro-Alves, Zambujal-Oliveira, 2012) investigated how sufficient it is to use EDBI (the Ease of Doing Business Index) to make investment decisions. The authors, using the methods of factor analysis and the scientific approach of (Cronbach, 1951), concluded that EDBI does not fully describe the state of the business environment in a particular country. According to the authors (Pinheiro-Alves, Zambujal-Oliveira, 2012), improving the reliability of EDBI will require an improvement of its components.

Results and Discussion

We propose studying the business environment of Georgia and Ukraine on the basis of an analysis of the following components; general economic, political and legal, and financial and fiscal.

A study of these components of the business environment allows one to form an idea of the degree of a favourable business environment and to conduct a comparative analysis of individual indicators that characterise it. We additionally propose supplementing a comparative analysis of the components of a business environment by calculating the correlation coefficient. The effective indicator in this case may be the number of registered organisations by year.

Calculations of correlation coefficients showed a very strong correlation only between the number of registered organisations in Georgia and the unemployment rate (R = -0.94). The calculated value of the coefficient of determination indicates a strong relationship between the indicator Number of registered organisations and the indicator Unemployment rate (R-Squared = 0.89). The correlation with the Consumer Price Index is not characterised by the required closeness.

Table 1: The dynamics of separate macroeconomic indicators of Georgia and Ukraine

Year	*GDP per capita, USD*		Consumer Price Index, %		Unemployment rate, %		Number of registered organisations by year – total cumulative, thousand	
	Georgia	Ukraine	Georgia	Ukraine	Georgia	Ukraine	Georgia	Ukraine
2011	4021,7	3569,7	8.5	4.6	27.2	8.6	370,9	1701,6
2012	4421,8	3855,4	-0.9	-0.2	26.7	8.1	497,9	1600,1
2013	4623,7	4029,7	-0.5	0.5	26.4	7.7	533,5	1722,0
2014	4739,1	3104,6	3.1	24.9	23.0	9.7	570,6	1932,1
2015	4014,1	2124,6	4.0	43.3	21.9	9.5	595,7	1974,3
2016	4062,1	2187,7	2.1	12.4	21.7	9.7	633,2	1865,5
2017	4358,5	2640,6	6.0	13.7	21.6	9.5	678,6	1805,0
2018	4722,0	3096,8	2.6	9.8	19.2	8.8	722,4	1839,5
2019	4696,2	3659,0	4.9	4.1	17.6	8.2	765,5	1350,6
2020	4274,6	3725,2	5.2	5.0	18.5	9.5	802,5	1395,4

Source: Consumer Price Index Georgia (2021), Consumer Price Index Ukraine (2021), Unemployment rate (2021), Unemployed population (2021), GDP per capita in Ukraine (2021), Gross Domestic Product (2021), Business Register (2021), Entities in the Unified State Register (2021)

The general economic component of the business environment indicates the existence of basic macroeconomic prerequisites for the implementation of business projects.

A data analysis of table 1 shows that during 2011-2020, the GDP per capita indicator in both countries increased, in Georgia by 6.2%, and in Ukraine by -4.3%. The Consumer Price Index in Ukraine was characterised by significant volatility: from deflation of 0.2% in 2012 to inflation of 43.3% in 2015. In Georgia, the fluctuations were much smaller and ranged from -0.9% to 8.5%. The unemployment rate in Georgia was much higher than in Ukraine, but had a downward trend, decreasing by 8.7% during 2011–2020. In Ukraine, the maximum unemployment rate was observed in 2014 and 2016 and was 9.7%.

The average salary in Georgia for the period 2011-2020 increased by about 4 US dollars and amounted to 389 US dollars (per month) at the end of 2020. During the same period, the average wage in Ukraine increased by approximately 99.2 US dollars and in 2020 amounted to 429.9 US dollars. Market factors (productivity, competition) were dominant for Georgia. The main factor that determined the growth of the average wage in Ukraine is the increase of state social standards. Thus, the minimum wage in Ukraine during 2011–2020 increased by 59.3 US dollars and amounted to 185.4 US dollars at the end of the period. At the same time, market factors are now beginning to more actively influence the process of labour cost formation in Ukraine. This is due to the liberalisation of the labour movement in Europe, and also as a result of visa-free travel to EU countries.

In our opinion, the general economic situation in Georgia is more favourable for starting a business than in Ukraine. This is due to the fact that lower average wages and a lower inflation volatility level create more favourable starting conditions for business projects.

The degree of a favourable business environment directly affects the dynamics of business start-ups in a particular country.

Confirmation of this is the dynamics of the number of business entities given in Table 1. Thus, during 2011–2020, the number of business entities in Georgia increased by 216.3%, whereas in Ukraine it actually decreased by 18%. In 2011, the ratio of business entities in Georgia and Ukraine was 1 to 4.5, and in 2020 it was 1 to 1.7.

We propose considering the political and legal component of the business environment in the context of the regulatory framework of entrepreneurial activity, the state of corruption, the effectiveness of judicial procedures and the political situation.

The legal framework that governs doing business in both countries is based on their Constitutions, codes, laws, and regulations. Georgia, in the second half of the 2000s, more radically reformed its legal framework for business, leaving virtually nothing of the Soviet legacy. Legislation still applies in Ukraine, which regulates certain aspects of entrepreneurship formed before independence, in particular, the Labour Code of 1971, the Commercial Procedure Code of 1991, the Law of Ukraine "On Consumer Rights Protection" of 1991, and others. Given the dynamism of civilisational development, the legislation of the former USSR can not effectively regulate social relations in the economic sphere. For example, only in early 2021 was there a law passed that would regulate the issue of telework to replace the 1981 normative act.

Overall, the general approaches to the standardisation of business activity in Georgia and Ukraine are similar. Thus, Articles 6 and 26 of the Constitution of Georgia provide freedom of enterprise and promotion of competition. Similar provisions are contained in Articles 42 and 91 of the Constitution of Ukraine. Almost simultaneously, Tax Codes were adopted in both countries, and business ombudsmen began work. Also, the similarity of approaches can be traced in the interpretation of the essence of entrepreneurial activity by the legislation. The Law of Ukraine "On Entrepreneurship" (On Entrepreneurship, 1991) defines entrepreneurship as a directly independent, systematic, at-one's-own-risk activity for production, doing work, and the provision of services for profit, which is carried out by individuals and legal entities registered as business entities in a manner prescribed by legislation. According to the Law of Georgia on Entrepreneurs (Legislative Herald of Georgia, 1994), entrepreneurial activity shall be a legitimate and repeated activity carried out independently and in an organised manner to gain profit.

The stability of the provisions of the main legislative acts on business in Georgia is higher than in Ukraine. Thus, in particular, the basic Law of Georgia on Entrepreneurs was amended on the basis of 24 regulations, the Law of Ukraine "On Entrepreneurship" – on the basis of 63 regulations. The situation is similar with regard to legislation on guarantees to investors.

The Georgian Law on Promotion and Guarantee of Investment Activity (On Promotion and Guarantee, 1996) protects foreign investors from changes in legislation for 10 years. A similar rule is contained in the Law of Ukraine "On the Regime of Foreign Investments" (On the Regime of Foreign Investments, 1996), but the practice of its application does not favour investors.

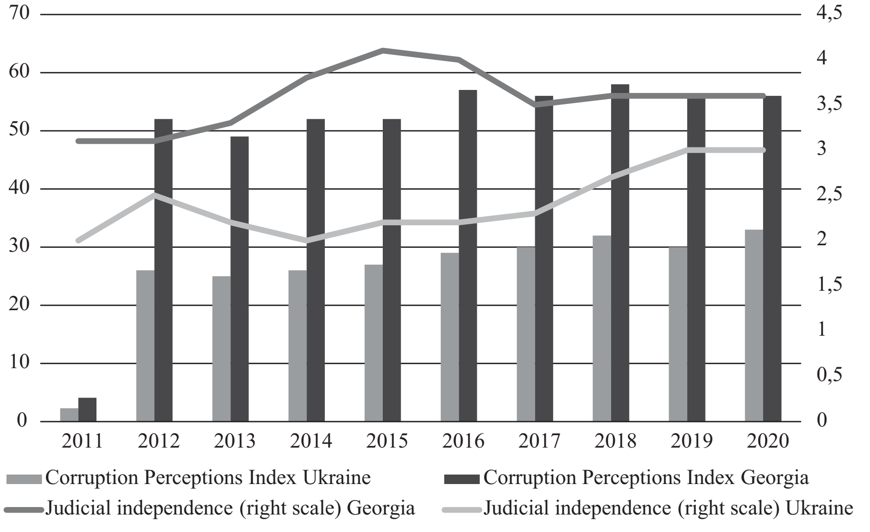
Along with the general positive practice of reforming the legal system in Georgia, experts note (OECD, 2020) that legislation in the field of competition protection is underdeveloped. In particular, it lacks effective tools for investigations and sanctions, which are in line with international best practices (Ibidem).

Taking into account that businesses protect their rights in the courts, analysing the effectiveness of the judiciary is critical to understanding the business environment in a particular country.

It is hard to disagree with Van Dijk and Vos (Van Dijk, Vos, 2018) in that the independence of the judiciary is the basis for the proper functioning of this system. It creates the preconditions for judges to make impartial decisions based solely on the rule of law and evidence, protecting them from outside influence from other branches of government, the public, or the private sector. Van Dijk and Vos (Ibidem) note that dispute resolution using only the rule of law is a critical component of the rule of law and is important for a prosperous and democratic society.

Analysing the dynamics of the Judicial Independence index (World Economic Forum, 2018, Schwab, 2019), one can note that Georgia, over the last decade, has made significant progress on this indicator (Fig. 1). Thus, in 2011 the value of the Judicial Independence index was 3.18, and at the beginning of 2020 it was 3.6. Although Ukraine has also shown progress, its pace has been much slower, with the Judicial Independence Index rising from 2.08 in 2011 to 3.0 in early 2020.

The level of corruption in Ukraine has a significant impact on the state of the business environment. The results of the analysis of the dynamics calculated by the Transparency International Corruption Perceptions Index, reports, and surveys of international experts and entrepreneurs (Gurkov, 2020) show a significant gap between Georgia and Ukraine (Fig. 1).



The indicator for estimated Judicial Independence 2020

Figure 1: Dynamics of judicial independence and corruption perceptions index for Georgia and Ukraine

Source: World Economic Forum (2018), Schwab (2019), Transparency International (2021).

For example, a survey of top managers conducted in October 2019 by the American Chamber of Commerce in Ukraine (Results of the AmCham

Ukraine Business Climate Survey, 2019) indicated that 41% of respondents had faced corruption in Ukraine, and 42% believed that the level of corruption itself had not decreased between 2017–2019. At the same time, 54% positioned the fight against corruption as one of the top areas that could improve the investment environment in Ukraine.

Research on corruption in Georgia prepared by the Bertelsmann Stiftung (Gurkov, 2020) points to the country's success in tackling domestic corruption, which has declined significantly, but measures put in place to reduce political corruption are not always effective.

The political situation in both countries is quite similar. The political steps of the governments of Georgia and Ukraine are aimed at deepening cooperation with the United States and the EU.

The next elements of the business environment are the financial and tax components. Generalised information on the financial component of the business environment can be obtained by analysing the relevant indicators of international indices, for example, Getting Credit (Doing Business, 2021), and supplementing it in consideration of other indicators (interest rate, basic tax rates).

Considering the financial component of the business environment, it is advisable to start with an analysis of the basic parameters of the tax system of countries.

The Tax Code of Georgia defines 6 taxes, 5 of which have the status of national taxes. The Tax Code of Ukraine defines 7 national and 4 local taxes and fees, with 1 fee being temporary (the military fee).

Table 2: Basic taxes and their rates

Country	Corporate income tax, standard %	VAT, standard %	Personal income tax, %	Social contribution, %
Georgia	15	18	20	4 (2 + 2)*
Ukraine	18	20	18	22**

* % of the employee's salary;

** % of the *minimal wage*.

Source: Ukraine. Corporate (2021); Georgia. Corporate (2021)

A data analysis of table 1 shows that the tax burden on businesses in Georgia is lower than in Ukraine. Both countries declare the functioning of special tax regimes, including on a territorial basis. For example, in Georgia there are 4 free economic zones: Kutaisi FIZ, Poti FIZ, Hualing Kutaisi FIZ, and Tbilisi FIZ. An FIZ Enterprise is liable to pay the following taxes (Free Industrial Zones, 2019):

- in case of the supply of goods to Georgian companies (except for FIZ Enterprises), an FIZ Enterprise is liable to pay tax at a rate of 4% on income;
- in case of the purchase of goods from Georgian companies (except for FIZ Enterprises), an FIZ Enterprise is liable to pay tax at a rate of 4% on the market value of goods (Free Industrial Zones, 2019).

In Ukraine, the regulatory framework for the functioning of free economic zones was established in 1992. However, the experience of free economic zones in Ukraine is rather controversial and ambiguous. At the peak of its rapid formation in the late 2000s, Ukraine had 11 free economic zones and 71 priority development areas. As of 2009, foreign investors invested 815.9 million US dollars (Lutsenko, 2009), which constitutes 7.4% of total foreign investment in Ukraine. After the abolition of special investment regimes in free economic zones and territories of priority development, a question arose regarding the expediency of their existence, as the implementation of new investment projects had virtually ceased. In December 2020, the Parliament of Ukraine adopted the Law on State Support of Investment Projects with Significant Investments, which provides the exemption from taxation of separate taxes on investment projects worth 20 million euros. However, today, the practice of its application does not exist, and therefore determining its impact on the business environment is not possible.

According to the Paying Taxes indicator, which is calculated within the Doing Business rating, Georgia improved its ranking, rising from 61st place in 2011 to 14th in 2020. During 2011–2018, Ukraine demonstrated progress in reforming the tax system, as a result of which it improved its positioning from 181st place to 43rd place, but slipped back down the ranking to 65th place in 2020 (Doing Business, 2021). In order to determine the availability of credit resources, we used the Getting Credit indicator, which is also part of the Doing Business rating. The authors of the Doing Business rating (Doing Business, 2019) noted that this indicator covers two aspects of access to finance; the strength of credit reporting systems and the effectiveness of collateral and bankruptcy laws in facilitating lending. An analysis of this indicator shows consistently high values in Georgia; from the lowest ranking of 15th place in 2011 and 2020 to the highest of 3rd place in 2014. According to this indicator, during 2011–2020, Ukraine had the best result in 2014 – making its way to 13th place, and its worst result – 37th place in 2020.

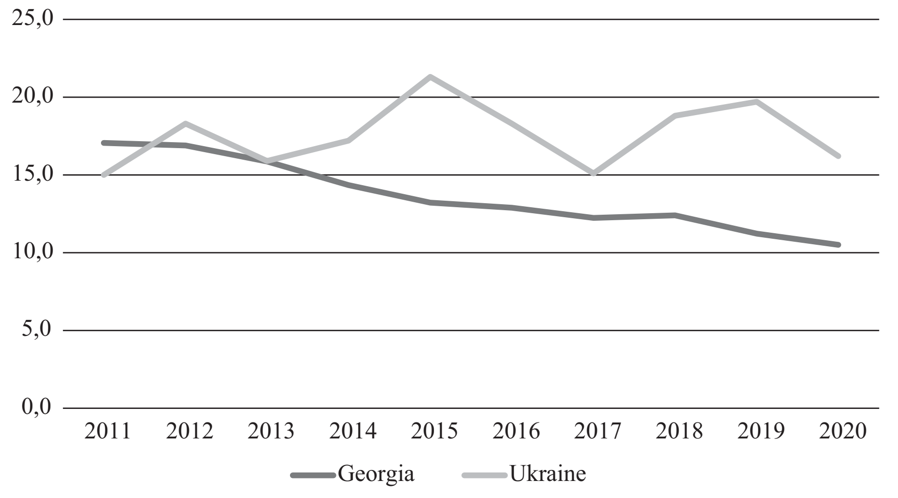


Figure 2: Annual weighted average interest rates on commercial banks' loans

Source: Cost of loans (2021), Annual Weighted Average Interest Rates (2021).

The dynamics of interest rates on loans to business entities in Georgia during 2011–2020 is downward, and in Ukraine it is characterised by significant fluctuations. The cost of credit resources in Georgia at the end of 2020 was 5.7% lower than in Ukraine.

The calculated value of the correlation and determination coefficients indicates a strong relationship between the indicator Number of registered organisations and the indicator Paying taxes (R = -0.92, R-squared = 0.85).

The correlation coefficient calculated on the basis of data for Ukraine showed a strong connection only between the indicator Number of registered organisations and the indicator Getting Credit is 0.8, and the coefficient of determination is 0.65.

Calculations of correlation and determination coefficients for other indicators for Georgia and Ukraine did not reveal a statistically significant relationship.

Conclusions

In the early 2010s, Georgia and Ukraine had fairly similar starting conditions for building a business environment. The results of the study show that Georgia has managed to create a more favourable business environment than that of Ukraine's. The most tangible steps taken to create a favourable business environment in Georgia have been the fight against corruption, a significant reduction of bureaucratic barriers to the implementation of business ideas, and access to finance. Between 2011–2020, Ukraine demonstrated significant positive dynamics in improving the tax system and inflation targeting. The weakest elements of the business environment in Ukraine are the independence of the judiciary and the fight against corruption.

Calculations of correlation coefficients showed a strong correlation between the number of registered organisations in Georgia and the amount of taxes paid along with the unemployment rate, whereas for Ukraine, it is between the number of registered organisations and the Getting Credit indicator.

In the context of the formation of the business environment, it is necessary to take into account the currently "frozen" military conflicts and socio-political uncertainty of the situation in eastern Ukraine and northern Georgia. The policy of the governments of Georgia and Ukraine should be aimed at further a democratisation of relations with businesses in order to increase the business environment's favourability.

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