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Free Economic Zone in Poti – a Good Idea?

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While the public is anxious to know the winner of the tender for the lease of Black Sea Port of Poti and its adjacent 400 hectares of land to establish a free economic zone, the initiative remains one of the most highly disputed of Mikheil Saakashvili's presidency.

On February 19 when Prime Minister Lado Gurgenidze presented government's 50-day action plan aimed to surge foreign investment, reduce unemployment and purge poverty, he said the government would announce the frontrunner in the tender in April.

The idea of creating a free economic zone came into being before the Rose Revolution. Former Adjaran leader Aslan Abashidze's Revival Party initially proposed the concept although it wasn't met with an enthusiastic response as Tbilisi thought it would strengthen the Abashidze clique even further.

In the aftermath of the 2003 Rose Revolution that swept Saakashvili to power, the new administration embraced the initiative, sparking heated debate.

On July 3 parliament approved a draft law on Free Economic Zones (FEZ) with 110 votes to one. The law stipulates that a FEZ, which should cover at least 10 hectares, can be established at the initiative of the Georgian government, a legal entity or a private individual.

Companies operating in the zone are exempt from profit and property tax as well as VAT. Goods exported from the zone or sent to other parts of Georgia will also be exempt from customs duties. The zone will also see simplified license and permits-related procedures and a multi-currency regime.

A task for the operator

The Ministry of Economic Development has announced tenders for two projects: leasing of the Poti Port and 49-year management right of Poti FEZ area.

The management rights, under the tender terms, will be awarded to an operator with a commitment of a good faith payment of USD 60 million for the Poti Port and USD 10 million for the 400 hectares of adjacent land, according to the National Investment Agency.

The ministry says the investor will be required to develop essential infrastructure, establish the relevant procedures and rules and manage the zone in accordance with Georgian laws. But the key demand is that the selected investor attracts investment from international companies, providing a potential for an increased cargo flow. Hence, a well-developed overall plan has been emphasized as a decisive factor.

Why Poti is attractive

Founded 150 years ago, Poti Sea Port is one of the largest ports on the Black Sea coast and largest dry cargo handler in the Caucasus.

When inviting bids for the tender, the Economy Ministry underlined the opportunities for potential investors, including that Poti lies on the TRACECA corridor, and thus making an “essential part” of the Caucasus transit transport network.

Specifically, the port provides direct waterway access to major ports of Europe and Asia, including ferry connections to major Black Sea Ports of Ukraine, Russia and Bulgaria as well as a direct connection with the country’s railway network and motorway links with a number of Georgian cities.

When the government announced the tender for the port, it said that it dealt with 7 million tones of cargo in 2006, 9.1% more than in 2005. And in 2008, Poti Sea Port administration claims even higher growth for 2007 at 16%, bringing the figure to 7.7 million tons.

The government puts the potential capacity at 25 million tons.

The bidders for FEZ in Poti

On January 25 the government officially announced the three companies and one consortium that have remained in the competitions.

The bidders, according to the Ministry of Economy, are a consortium of UAE’s Dubai Ports and Jafza free economic zone in Dubai; the Investment Authority of the UAE’s Ras Al Khaimah emirate; Germany’s Hamburger Hafen und Logistik; and the UK-based Hutchison Westports, which is part of the Hutchison Port Holdings Group.

Initially, twelve companies submitted bids including companies from France, Israel, Turkey, the Philippines and South Korea. Vakhtang Lezhava, the first deputy economy minister, has said many times that competition is “high.”

Frontrunners of the tender however, have been bidders from UAE Dubai Port World, a subsidiary of Dubai World, a holding company owned by the Dubai government and Rakeen, state-owned real estate development firm from UAE’s Ras Al Khaimah emirate. The latter has already launched its USD 1.5 billion investment projects in Georgia’s real estate.

In mid-February, Prime Minister Gurgenidze visited the UAE for a three-day working visit to meet with executives from the Saqr Port in Ras Al Khaimah and Dubai World, as well as officials from the Jafza free economic zone in Dubai. According to the UAE media the meetings focused on ways to advance investment and trade ties. But Georgian media linked the visit to the controversial tender.

Will the pros outweigh the cons?

Georgia is not an oil-rich country. Nor does it have much in the way of natural resources to trade with other states. The largest export commodity during the latest years has been ferroalloys, scrap metal, copper ores and concentrates. In this light, the government believes that the key to Georgia's prosperity is providing a liberal tax regime and investment climate in order to attract serious capital.

During the recent year high customs dues have been cut and issuing of licenses and permissions to start up a business has considerably simplified. In sum, the number of taxes has been reduced from 22 to seven. Currently, only three rates of import duties exist in Georgia—zero, 5% and 12%, and nearly all goods, except for some agricultural products and construction materials, are taxed at the zero rate.

At some point these efforts have yielded impressive results—separate international ratings have ranked Georgia high above the world or regional average in terms of investment freedom and business-friendly opportunities and Georgia's DFI has been soaring.

Hence, offering even more attractive investment climate is the very motivation behind the government's efforts to create free industrial zones in the country.

Kakha Bendukidze, former minister in charge of economic reforms, who moved to the State Chancellery in the latest cabinet reshuffle, has argued that FEZ would benefit entrepreneurs greatly.

He explains that customs warehouses set up in the Poti FEZ would serve not only Georgia, but also Armenia, Azerbaijan, Russia, Bulgaria and Ukraine.

"Investors from Dubai might take interest and create a local alternative to Dubai's warehouse zones," Bendukidze said in an interview with Tbilisi-based Alia newspaper in July 2005.

The second opportunity, as Bendukidze has specified in his press comments, is giving better opportunities for starting up a processing business. This, in his opinion, allows entrepreneurs to bring in parts for producing light industry machines like irons and computers so that they would not have to undergo customs procedures for each separate part. Rather, the entrepreneurs would have to go through customs duties only when bringing the ready-made item out of the zone for selling.

Bendukidze's enthusiasm is shared by PM Gurgenidze who told reporters during his recent visit to Poti that the FEZ will encourage the export of Georgian produce and will increase the country's transit function. Other benefits, according to him, will be economic growth, new jobs, and better-developed local infrastructure.

The Poti FEZ has been included in the government's five year programme which aims to transform Georgia into the region's main financial center. The programme says the initiative will attract investment amounting to some USD 1.5 billion and provide approximately 20 000 jobs.

Back in July, the only MP voting against the draft law was Vladimer Papava, a senior fellow at the Tbilisi-based think-tank Georgian Foundation for Strategic and International Studies (GFSIS), who was a Deputy Chair of Parliaments' Finance and Budget Committee at the time.

International experience, Papava says, shows that FEZs are successful when a country's economy is liberal and it is a destination of excessive foreign investment since in such cases in order to keep investments inside the country.

Therefore, he argues that while Georgia is offering a liberal regime across the country, creation of special zones with special privileges would harm the country's economy in general since all the investors would flock to FEZs alone.

"While Georgia suffers from a lack of investment, it is a bad idea to create FEZs…even local entrepreneurs would invest only in FEZ areas, meaning Poti will flourish but at the expense of Rustavi, Kutaisi, Akhalkalaki and so on," he says.

Speaking about potential risks, Papava notes that since Georgia is a multi-ethnic country with integration troubles, setting up special areas with some restrictions would only result in disintegration. Moreover, he says, the neighboring countries would try to create such zones on the territories adjacent to their borders which in light of the existing territorial problems would further aggravate the situation.

One more peril, according to him, is that such zones, could also become an oasis for money-laundering or other uncontrolled operations.

Papava was against FEZs in Georgia way back when former Adjarian leader Abashidze was around. The draft law proposed at that time under the name "Special Economic Zones" envisaged halving profit tax.

As the government is looking forward to announce the successful bidder, Papava stands firm in his viewpoint. "I would support stepping-up efforts to further liberalise the economy as it is by far easier to push the whole economy ahead in smaller-sized countries than keeping separate areas more liberal," he told GBW.

Jaroslav Romanchuk, founder of the Scientific Research Mises Center in Belarus, who is a follower of libertarian and free market ideas, said in an e-mail interview with GBW that ideally, he would also welcome establishing one free trade area in the whole country, but that establishing FEZ in Poti would be a good start.

"Many things can be done only in mainland Georgia—not in the port. If your investment is in catering, hotels, tourism, agriculture, banking or wine you can not move your business to the port…Of course Georgia cannot build its wealth only in Poti and similar projects but it can be a powerful catalyst for the breakthrough in the necessary structural reforms," he said.

Another argument in favor of the FEZ, he says, is that it does not contradict WTO regulations while free market solutions for the whole country are not welcome by the world community. "Georgia should compete for FDI and international merchandize flows with Dubai, Singapore, China and it could become the hub of these countries' and other investors' money. So given the current situation I'd support this project."