

**Why Doesn't Georgia Export More to Europe:  
An Assessment of the Challenges of Enhancing Georgian Trade with the  
EU**

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This product represents the analysis and opinions of the GeoWel team and not those of EBRD. Please send any comments or questions to: [george.welton@gmail.com](mailto:george.welton@gmail.com).

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## List of abbreviations

AA	Association Agreement
AI	Artificial Intelligence
BOG	Bank of Georgia
BPO	Business Process Outsourcing
CAB	Conformity Assessment Bodies
CEP	Country Economics and Policy
CIS	Commonwealth of Independent States
C-level	Chief Level
CMC	Construction Management & Consulting
CNFA	Cultivating New Frontiers in Agriculture
CRM	Customer Relationship Management
DCFTA	Deep and Comprehensive Free Trade Area
EBRD	European Bank for Reconstruction and Development
ENPARD	European Neighborhood Program for Rural and Agricultural Development
EoDB	Ease of Doing Business
EPG	Economics, Policy and Governance
ERPC	Economic Policy Research Centre
EU	European Union
FDA	Food and Drug Administration
FDI	Foreign Direct Investment
FinTech	Financial Technology
FTA	Free Trade Agreement
GAC	Georgian Accreditation Center
GDP	Gross Domestic Product
GEL	Georgian Lari
Geostat	National Statistics Office of Georgia
G-HIP	Georgia Hazelnut Improvement Project
GITA	Georgian Innovation and Technology Agency
GIZ	Gesellschaft für Internationale Zusammenarbeit (Society for International Cooperation)
GNFC	Georgian National Film Center
GoG	Government of Georgia
GSP	Generalized Scheme of Preferences
HACCP	Hazard Analysis and Critical Control Point
ICT	Information and communications technology
IP TV	Internet Protocol Television
IPR	Intellectual Property Rights
ISO	International Organization for Standardization
ISP	Internet Service Provider
JSC	joint-stock company
LLC	Limited Liability Company
Ltd	Limited Liability Company

MSME	Micro, Small and Medium Enterprises
NBG	National Bank Of Georgia
NFA	National Food Agency
OECD	The Organization for Economic Co-operation and Development
PDO	Protected Designation of Origin
PGI	Protected Geographical Indication
RDA	Rural Development Agency
SCP	South Caucasus Pipeline
SCPX	South Caucasus Pipeline Expansion
SME	Small and Medium-sized Enterprises
SPS	Sanitary and phytosanitary
TAM	Tbilisi Aircraft Manufacturing
UK	United Kingdom
UNDP	United Nations Development Program
UNESCO	United Nations Educational, Scientific and Cultural Organization
USAID	United States Agency for International Development
USD	United States Dollar
WB	World Bank

## Executive summary

In spite of the Association Agreement and considerable efforts by the EU, if copper and hazelnuts are extracted, then exports to the EU in 2019 were only 13% of Georgia's total exports. This is slightly lower than the 16% average for the last 10 years, and significantly down from the 2015 high of 24%. Between signing the Association Agreement and 2019, these exports have gone down in absolute terms.

This is clearly not what was hoped for. The Association Agreement between Georgia and the EU was signed in June 2014. As a result of the agreement, the push to bring Georgia into alignment with EU standards has become the biggest driver for legislative reform in the Georgia, particularly as it relates to business environment issues.

As these reforms came into effect, it was hoped that Georgian business people would seize the opportunity presented by the 500-million-person EU market. If that happened, Georgian exports to the EU and foreign direct investment into Georgia related to those products would increase.<sup>1</sup> This would seem to offer a pathway for accelerated economic growth, of the kind enjoyed by South-Asian countries that gained access to the US market in the 60s and 70s, and EU accession states that gained access to the EU in the early 2000s.

This has not happened partly because the Association Agreement has not changed Georgia's terms of trade with the EU very much, but mostly because of the inherent challenges of producing for the EU-market. Georgian producers find the EU a very difficult market to orient towards, and the foreign partnerships that might facilitate this process have been rare.

Producers who want to export to the EU are competing with a well-developed eco-system of existing companies. They need to produce according to EU standards, understand particular national tastes and develop networks of clients for their products. They then need to make products and get them to market in consistent quality and volume for those clients. Each of these challenges – production, standards, marketing, client-relations, transport and logistics and much more – are made more difficult by Georgia's physical distance from the EU and lack of networks in the region. Given the challenges, it is perhaps unsurprising that relatively few Georgian companies have managed it so far.

One of the clearest routes to overcoming these challenges is through partnership and investment from foreign companies. Developing new export-oriented sectors often starts with international production relationships since the foreign partner has the production understanding, client-relationships, understanding of the EU market environment, the certification to produce according to EU standards and much more.

But generating foreign investment in the tradable sector has been slow. Georgia's 'sales pitch' as the best country for investing and doing business in the region is often repeated. This usually highlights Georgia's strong business environment, low tax environment, free trade agreements with many countries and regions (including the EU), cheap labor costs and low utility costs.

This 'sales pitch' is right, but misses the weaknesses, in particular poor transport infrastructure, low labour skills, lack of value chain penetration, financing which is focused on bank loans, and challenges with the competence of the judiciary and government bureaucracy.

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<sup>1</sup> For the purpose of this report, we will act as though the UK is still in the EU, since most of the report predates the country's departure, and the terms of trade agreed with the UK in 2019 have given the country a very similar level of access to that agreed upon under the Association Agreement.



These challenges take different forms in different sectors and do not negate the positives that are usually highlighted. However, the challenges that are often discussed, do start to clarify that the value proposition offered by Georgia to investors is not as simple, nor as unqualified, as those promoting the country would often like to suggest.

From the point of view of our research question, one of the main reasons why Georgia does not export more to the EU is that Association Agreement alignment, by itself, is not sufficient to make Georgia attract large foreign companies that are looking for new supply-chain extensions. This therefore necessitates efforts on the part of the Georgian Government to strongly support existing and new investors in the tradable sector.

This is already happening to some degree. Enterprise Georgia has a range of products and services to attract investors and support investments. However, until recently, these efforts have not particularly targeted the tradable sector and have had a fairly limited set of tools for providing support, risk-abatement and public-private partnership.

This has changed with the recent addition of FDI grants. These aim to attract and support export-oriented FDIs in particular sectors. These provide interest-rate subsidies and grants to resolve specific issues (like human resources and physical infrastructure). Ideally, this should be supplemented with support to accelerate processes for cutting through red-tape on land sales, approvals for construction and factories and developing training programmes as well as opportunities for PPP and government equity involvement. It is too soon to say whether the current formulation is aggressive or generous enough to create a sea-change in FDI attraction, but it is certainly a step in the right direction.

### Shifting patterns of trade and investment

The aggregate picture of Georgia-EU trade has fluctuated quite a bit in recent years. These fluctuations are mostly determined by large trends that have little to do with Georgia-EU bilateral relations. For a start, over the last decade, Georgia's trade patterns have been most significantly shaped by trade with CIS countries, particularly Russia.

Russia put in place a trade embargo in 2005/2006 that dramatically reduced Georgian exports to the region. This was removed in 2012/2013, starting a strong recovery in exports to the region. However, at the end of 2014, the region was rocked by a dramatic decline in oil and gas prices. As a result, exports from Georgia to the CIS declined precipitously that year. The CIS region has been recovering since that time, and prior to covid held the same relative position (more or less) as it did in 2013/2014. In some ways, EU trade movements have merely been the inverse of that bigger picture, with EU trade proportions going up as the share of the CIS goes down, and vice-versa.

The other dynamic pushing the aggregate export picture has been shifts in exports of 'commodities'. Georgian exports are dominated by a small number of commodities, including copper (though excluded here), manganese, fertilizer and precious metals. The movement in sales patterns of these commodities have more to do with world markets and global prices than specific trade relationships. Therefore, these movements are largely DCFTA-neutral in the sense that the DCFTA is unlikely to encourage producers to export more.

There have been some gains in Georgia's few value-added exports to the EU. Food and beverages (even excluding nuts), have increased. Wine has shown steady increase, as have apparel and wooden and paper products. There are also some indications that there is growth in small business activity, which could bode well for the future. However, there is little evidence that the Association Agreement specifically and the changes that it has brought with it have stimulated much of this growth. Out of the 100 or so companies and

investors we spoke to for this project, almost none could identify positive material benefits from the Association Agreement.

Benefits do exist, but they are more complicated than is often presented. In our discussions, we found quite a few instances where Georgians' ability to move free of visa restrictions to the EU, has been a huge boon, allowing business people to easily build relationships and facilitating more travel back-and-forth with the EU. This increases training in the EU, travel of companies to trade shows and has indirect benefits like helping language skills improvements and building cultural familiarity. The increasing familiarity with EU standards, even if rarely in force, provides further 'orientation' to EU ways of doing business and a range of development programmes have emerged to help build business-to-business ties. However, these changes are incremental and have not created major changes in patterns of trade and business relations so far.

## FDI

In FDI, EU involvement is also modest compared to other blocs. This seems contrary to published data, but published FDI 'country-origin' numbers are based on the registration of the company doing the investment and does not track the ultimate beneficial owner. Out of the top 24 companies listed by Geostat as receiving the biggest investment from the EU, in the last 7 years, somewhere between 6 and 10 (depending on exactly who you count) can be seen as investments originating from the EU and negligible investment occurred with an explicitly EU export-orientation. The rest were companies generally acknowledged to be owned and managed by Russians, Ukrainians, Georgians and a mix of others.

This may miss a broader benefit. The effect of the Association Agreement's impact might not just be seen in EU investors. The Association Agreement, by bringing Georgia into line with international standards, will hopefully make Georgia more attractive generally for international investment that may not originate in the EU.

Assessing the impact of EU alignment on investment attractiveness is very difficult, so we generally looked at the size and composition of FDI. For several years now, the reported story of FDI in Georgia has been one of decline. However, we found that this characterization is unfair. Recent reductions in FDI are partly explained by the decline in BPs investment, reflecting the completion of the SCPX upgrade. Also, compared to pre-2008, FDI is a lot lower globally. If one takes account of these changes then, relative to other countries, Georgia's FDI has not declined.

That said, greenfield investment has declined dramatically and investment generally has only stayed so high because 'retained income' (the profits from foreign owned companies that are not repatriated to the foreign owner) almost doubled from 2016 to 2017. This is almost certainly as a result of Georgia adopting the Estonian model of corporation tax at the beginning of 2017. Under this model, profit-tax only applies at the moment of distribution. This creates a big incentive for reinvestment, since profit held inside the company is essentially tax-free.

If we look at the composition of FDI over the last 10 years, it has been focused on transport (mostly BP), telecoms, the financial sector, energy, real-estate, construction and tourism. Investment in the tradable sector, particularly in agriculture and manufacturing, has been extremely thin over many years and seen little or no growth. Manufacturing FDI has been 10% of the total over the last 10 years, but that has been concentrated in old Soviet manufacturing through companies like Georgian Manganese (that we can probably think of as extractive), Azot (producing fertilizer), the Georgian Railway Manufacturing Company, Borjomi (mineral water) and Rustavi Steel. In agriculture, the only large investments have been the large Italian

confectionary manufacturer Ferrero's hazelnut investments, one company that recently invested in growing pistachios and one large wine company.

When asked about the weakness in tradable investments, investors will point out three problems. First, investments in manufacturing do not expect a quick pay-off or easy exit, and so need political and business environment stability in the medium to long-term. A hotel or power station may be a salable asset as soon as it is built, but a factory for auto-parts is probably only valuable within a given supply chain. That is to say, it has little value to anyone but the company that built it. Georgia has certain inherent challenges when looked at in terms of long-term stability because of the troubled neighbourhood in which it is located. Concerns about the judiciary, changes to foreigner property rights (recently on agricultural land and a highly changeable political space have also not encouraged confidence in long-term stability.

Second, Georgian banks and venture capitalists have been resistant to provide capital for greenfield investments. The banks have high collateral requirements. These are particularly difficult for projects that include expensive production machinery that has low resale value.

Finally, local VC companies generally point out, in line with the rest of the research presented below, that most VCs don't want to build businesses and, even where they do, export-oriented businesses bring particular challenges. Therefore, for Georgia-interested VCs to connect to tradables, they need partners with existing supply chains, who can also bring production expertise and access to clients/customers.

It is troubling that so little investment is going into tradables development, because almost everyone agrees that the development of tradables is crucial to increasing economic growth. Also, all of the major growth areas of the Georgian economy, including energy, finance, utilities, healthcare and tourism have all be transformed with the injection of foreign expertise which tends to come along with foreign capital.

### The Association Agreement

If the Association Agreement is not generating the improvement in trade and FDI that was hoped for, it is clearly important to understand why. For a start, it is important to realise that while they are fundamentally different agreements, and the DCFTA is probably more reliable in the long-term, the trade liberalisation offered by the DCFTA provided very little improvement on the GSP+ regime that already existed in terms of simple market access. After comparing GSP and the DCFTA we found that the only major exportable that had seen a significant tariff reduction was wine. Almost all industrial goods already had full market access under GSP+ and the kind of services that Georgia exports were also largely unregulated before 2014.

However, the Association Agreement also sets the terms for economic alignment of the two economies, particularly in the business environment. This covers everything from labour standards, to competition law, environmental standards, financial management, public procurement, intellectual property rights, consumer rights, corporate governance, industrial policy and has particular chapters for transport, energy, financial services, agriculture and tourism.

We tried to identify the areas of EU alignment which would provide the most help to a Georgian company's ability to export to the EU. After reviewing the assessments of EU implementation conducted by the Georgian Government, civil society and the EU itself, three main areas stood out: customs, EU direct business support and the development of standards in the country.

First, alignment on customs procedures and associated government agencies seems to be largely completed, and will have an aggregate benefit on trade with the EU, but will mostly help importers or those transiting

Georgia to other countries. In our discussion with exporting companies, while transportation costs were routinely highlighted as a problem for Georgian businesses, Georgian customs was almost never mentioned.

Second, the EU has provided a range of programmes that support EU export orientation, including ‘ready to trade’ and the EBRD DCFTA adaptation programme. However, most of the EU business support projects have been aimed at general improvements of the business environment, rather than EU export-orientation in particular. This includes most of the EU4Business Scheme, the work through Enterprise Georgia to provide direct supports to businesses, cluster developments and cooperatives and the work in rural communities. This work also focuses on Georgian SMEs, that mostly do very little export, particularly to the EU. As a result, the impact of this work on EU-oriented export has been modest. This work may well be sowing the seeds of future success but short-term export gains remain modest.

Finally, the work on technical barriers to trade is probably the most obvious and important for export promotion. This ultimately aims to bring Georgia into alignment with the EU on production and product standards, and includes work with the National Food Agency (for sanitary, phytosanitary), the Georgian National Agency for Standards and Metrology (for production alignment), the Georgian Accreditation Center (to support the development of Conformity Assessment Bodies) and the Georgian Technical and Construction Supervision Agency and Market Surveillance Agency (for policing product standards on the market place).

This has clearly been challenging work and while the technical assistance for these government agencies has certainly progressed, the adoption of EU production and product standards by companies has been extremely slow.

The main reason for this is that the Georgian Government and companies both face a chicken-and-egg dilemma. Companies generally don’t want to adopt standards unless they are being enforced, as Georgia is a price-sensitive market and standards adoption brings cost increases that place them at a price disadvantage vis-à-vis their competitors. The government does not want to enforce standards if few companies have adopted them, as this would result in many companies closing.

Standards adoption also requires the development of an ecosystem of privately operated ‘Conformity Assessment Bodies’ to provide the testing and certification, but development has been slow because of low demand.

As a result, the only people looking to adopt EU standards are those few producers targeting the ‘high-end’ Georgian market (which is very small), or those who are looking to export. These groups routinely complain that standards adoption and certification is unduly burdensome and expensive partly because the local ecosystem has not been developed.

This is difficult because chicken-and-egg problems probably mean that Conformity Assessment Bodies will not emerge without government support. But which areas should the government support and how? Again, what is probably needed is a sophisticated approach that would identify the most significant categories of Conformity Assessment Bodies and possibly offer them support, or in the short-term offer sectoral associations support to negotiate group-deals with foreign companies. This is very complicated terrain and certainly needs more research.

### [Georgian export sectors and the challenges they face](#)

The first half of this report focuses on a review of macro issues. In the second half, we utilise existing sectoral assessments and our own interviews with senior business people to evaluate the challenges faced by aspiring Georgian exporters in all of Georgia’s main potential export-growth sectors.

In this analysis we break down sectors not according to strict economic categories, but in order to provide the greatest explanatory value. We break down food and beverages into wine/beverages, nuts, and fresh and processed fruit and vegetables. Manufacturing we breakdown into 'traditional-manufacturing' (based on former Soviet infrastructure), 'regional manufacturing' and a 'new industrial sector' (particularly electronics, auto and aerospace), as well as light manufacturing (which is mostly apparel). We also consider service sector exports (apart from tourism) including customer relations management/call centers, architecture, IT and the film industry. A summary of this analysis is included here.

### Agriculture

Total domestic exports in the agri-food sector were 710 million USD in 2019, about one-third of total domestic exports. Therefore, if we exclude minerals and metals, since they involve limited value addition, that makes agri-food the most important export category in Georgia. It has also increased by about 2.5x in the last 10 years, which is far better than most other value-added categories.

However, that growth has not been steady, mainly because of two shocks. Exports in the sector declined sharply between 2014 and 2015, because of the regional financial crisis. Beverage sales, which accounted for 55% of food and beverage exports at the time, were particularly badly hit because of their dependence on the Russian market. Beverages have gradually recovered since then, but the sector took another hit in 2016 when the brown marmorated stink-bug (hereafter 'stink bug') decimated nut production. This problem has taken several years to get under control, but this year's harvest is seeing significant recovery.

Exports to the EU have been largely concentrated in hazelnuts, wine, processed food and mineral water. There are more or less no fresh fruit and vegetables being exported to the EU at the current time. FDI has been a factor in the improvement of the Georgian wine sector and transformative in the case of Georgia's hazelnut sector. Agricultural FDI has been small, but disproportionately impactful. Unfortunately, this has now been stalled for the last 5-7 years because of the current ban on foreign ownership of agricultural land and the government's inability to generate an exception regime for highly socially beneficial projects.

### Wine

Georgia exports wine and spirits/brandy. Spirits/brandy is a category that includes brandy as a bottled export and a grape-based alcohol that is a bulk commodity export sold to other brandy makers to be used in their production. Between them, these are by far the biggest export category in the food and beverages sectors, with wine exports totaling \$222 million in 2019 and brandy/alcohol counting for \$83 million. Of the wine, 60% went to Russia, 10% to Ukraine and 9% to China. For the EU, wine went to Poland (\$9m), Latvia (\$4m), Germany, Estonia and Lithuania (\$2m each) and the UK (\$1m). For brandy/alcohol, in 2019 almost all of it went to Russia, Ukraine and Belarus. France has imported significant grape-based alcohol in previous years, including USD 19 million in 2013 and USD 13 million in 2018, but this is a commodity subject to big changes in location and volume of sales and France imported more or less none of this product in 2019.

Looked at generally, wine sales have been largely driven by the situation in Russia and the Georgia-Russia bilateral relationship. The 2006 embargo hit wine sales hard. When the market re-opened in 2012, there was swift recovery, only to be hit again in 2015 by the regional economic crisis.

These dramatic fluctuations have driven diversification of Georgian wine sales and forced Georgia to upgrade its wine quality. It has also driven many to insist that wine exports need to be more oriented to markets outside of the CIS. Growth in exports to the EU, and even more quickly to China, have supported this view. For those

who envisage a push into Europe and America in particular, cross-branding Georgia as a tourist destination, the home of wine and a gastronomic destination has obvious synergies.

On the other side, the largest wine producers still point out that Russia has a long history of drinking Georgian wine so that both wine tastes and commercial relationships are already established. As a result, while wine may, on average, sell at a lower price in the CIS region, there are no high-end niche markets in the West (or Asia for that matter) that are likely to buy Georgian wine in sufficient quantities to substitute the Russia market anytime soon. Finally, they point out that Georgia's production profile is towards semi-sweet wine which requires different production methods to dry wine and is not really demanded in the West.

Which side of this argument will win out is hard to judge. Unlike the more industrial sectors the challenges here seem to be more about building brands than standards or the skill of producers as this is a mature market. There do seem to be good reasons for supporting Georgia's expansion into higher-value markets, including supporting Qvevri (organic/traditional) production and cross-branding with the tourism sector. Transport is also an issue and one that will need attention if one is to encourage producers to make the effort to sell to the West. In particular, if small-scale exports are to be sustainable, there needs to be an effort to support transport and logistics. One obvious idea would be an EU-based bonded warehouse for re-shipping for small retailer sales in Europe and direct sales.

### **Other beverages**

In addition to wine, the project also briefly reviews 'other beverages', including mineral water, lemonade and beer. These are strongly regional products, which are exportable to Russia/Ukraine because of long-established brand loyalty, and are hampered in expanding beyond that group due to lack of brand recognition and also due to a weight/value ratio that makes transport prohibitively expensive.

As with all of the categories listed as 'regional' in our research this is not a fixed characterisation, and there might be space for expansion in key beverage areas. As the regional bottler for several soft drinks, large scale successful lemonade and recently beer production as well, there is capacity for expansion on the back of widely established production skill-sets. But this would probably require risk-sharing or PPP mechanisms by the government to get started.

### **Nuts**

Georgia has a long history of nut production. However, the recent dramatic growth can largely be connected to the arrival of the Italian confectionary producer Ferrero. In 2007 Ferrero bought land in the Samegrelo region and planted new hazelnut trees with the intention of diversifying their global supply chain. After setting up their facility they also worked with local farmers, by themselves and within development projects like USAID's Georgian Hazelnut Improvement Project. Prior to their arrival in 2006, Georgia's nut exports were around \$56m. At its peak, a decade later, this had reached \$183 million, almost all hazelnuts.

More recently, however, the sector has been decimated by the arrival of the stink bug. This insect first emerged as a major problem in the 2016/2017 growing year and was reflected in the 2017 harvest and exports. In 2017 exports were reduced by 55%. The following year was worse and exports declined to less than one-third of their previous high, though most of that is still exported to the EU. In 2019, hazelnuts went to Italy (\$14m), Germany (\$11m) with the Czech Republic, Lithuania, France, Spain and Poland (\$3-4m each).

The government, supported by the international community, has responded to the stink bug with support for disease management, and there seems to be consensus that the situation is gradually being brought under



control. At the time of writing the results are extremely encouraging, with significant increases in exports at the end of 2020, much of it going to the EU. Before the stink-bug there were also signs that the sector was upscaling, with government support programme encouraging the planting of more trees.

There have also been some new investments since Ferrero. Aric, an internationally backed investment, is currently growing 1000 hectares of pistachios, which should start significant production next year. Adjara Group, a local investor, has 2600 hectares which are growing new almond trees. The Co-investment Fund, a local VC fund that is now London-listed, is growing 500 hectares of hazelnuts, and has a contract with Ferrero to buy what they produce. There are also other international players, some who are finalizing investment agreements and others who will invest when the government enacts changes to the law on land ownership and allows exemptions from the ban for certain kinds of investments.

Again, due to the scale and maturity of the sector, while there are issues relating to the adoption of standards, these generally relate to training of farmers in production and disease management. In processing and trading there seem to be a few complaints about accessing the EU market, although several complained to us about the cost and reliability of transportation.

### **Fruits and vegetables (fresh and processed)**

Apart from the big export categories of wine, nuts and mineral water, exports of agricultural products are fairly modest, but have been the focus of quite a lot of attention. Fresh fruit production and export goes almost entirely to the CIS region, with around 70% going to Russia. In 2019, Russia imported mandarins (\$12m), peaches (\$12m), apples (\$4m), tomatoes (\$2m), cucumbers, mushrooms and persimmons (\$1m each) and other fruits and vegetables (\$4m). There are more or less no fresh fruit and vegetable exports to the EU.

Processed fruits and vegetables are more international with preserved/dried fruits and nuts (Germany \$4m, Russia \$2m), juices (Germany and USA - \$2m each, Australia, Israel and Greece - \$1m each) and jams (Germany \$2m, Belgium \$1m).

As in other agricultural sectors, most of the farmers are very small, so it is the larger companies that are usually connected to wholesalers or to processors rather than primary producers. Aric and Adjara Group will be exceptions to this when they hit full capacity, and there are a fairly wide range of mid-scale Georgian companies and individual entrepreneurs currently undertaking modest initial investments, often with big plans. There also seem to be other producers in Georgia, like Nergeta who produce kiwis for export to Japan, who are gradually scaling-up and could be significant producers/exporters in the next few years.

Our interviews with companies and experts did confirm that in regular agriculture, only a very small handful of companies are thinking about the EU market. For the export of fresh fruit and vegetables, as already suggested, distance and transportation challenges are compounded by the very specific constraints that the EU market places on the producer. To sell to the EU not only does one need to produce extremely high quality goods, in large volumes, reliably and at a low price, but the form of delivery requires products to be 'shelf ready' with more or less zero defects, making transport from Georgia incredibly difficult.

Apart from nut sellers, all of the Georgian agricultural producers we spoke to who export to the EU process their product in some way. This, of course, alleviates the transportation problem, since the processed goods

are no longer as perishable, but it means that the product is a lot more commoditised and removes some of the comparative advantage generated by Georgia's physical proximity to the EU.

Producers/processors are therefore accepting that they will sell a low-value highly-commoditised export, or they are looking for ways to upscale their brands. Organic production is routinely cited as a potential route to achieving higher value Georgian branded primary products, though many experts question whether this is a stretch for producers struggling to adopt regular Western farming methods, as organic production is far more difficult.

### Manufacturing

It is surprising to many people that 'manufacturing' is one of Georgia's biggest sectors, worth around 10% of GDP in 2019, only beaten by 'trade' (mostly import/export or the activities of small shops) and 'real estate' as GDP categories. By official statistics, manufacturing is therefore a greater contributor to national income than construction, agriculture or financial services. For the purpose of this analysis we break 'manufacturing' down into 'post-Soviet heavy industries', 'regional industries', 'new industry' and 'light manufacturing'. This breakdown is intended to allow us to think about different groups of opportunities and challenges in different areas.

### Regional industry

The biggest categories of manufacturing in Georgia are heavy industries that date back to the Soviet system; this includes manganese, steel, fertilizer, aerospace, automotive, trains, electrical wire and other metal products. These sectors gain their comparative advantage from different sources. In all of these cases, Georgia was a large industrial manufacturer during the Soviet Union, and enough of the previously existing infrastructure was left after the Soviet collapse to allow the continuation of very much paired-back production.

Production in these categories is usually regionally oriented (auto, plane and railway) or highly commoditised (manganese and fertilizer). They are considered here because while they do not seem likely areas for EU-export, they are vital for Georgia's export base and should not be discounted too easily.

More recently, Georgia has expanded its manufacturing but many of these products are also regional, though for different reasons to those of the former-Soviet companies. Pharmaceuticals, for example, export almost entirely to the CIS because the pharmaceutical companies are mostly making pills out of imported chemicals and essentially re-exporting those chemicals to long-established clients in the region.

Some more recent regional production includes product categories where value addition is so low and weight is so high that production does not usually take place a long way from consumption. In Georgia, steel, concrete and building materials and glass bottles generally fit this category. As we have seen, fresh agricultural products face a similar challenge, as do beverages like beer and soft-drinks which have a low value to weight ratio.

The idea of 'regional products', as was mentioned above, is not fixed. Steel rebar may be a largely regional product, but when Rustavi Steel does some more value addition, then the seamless steel pipes that they produce are certainly valuable enough to justify long-distance transportation. Similarly, many aspects of the Soviet legacy may have provided infrastructure and know-how such that an upgraded facility would change the business model and widen the market.

Some of the challenges that these heavy industry manufacturers face in expanding may spring from regional challenges. Rustavi Steel, Heidelberg Cement and Geosteel have often complained that if the Azerbaijani market were truly open to Georgian goods, then they would be very cost competitive in those markets. Mina,



the glass bottle producer, originally hoped that the low energy costs in Georgia would make them price competitive to export to some parts of the region, but this changed with the drop in gas prices and the decline of the Turkish Lira.

As large producers with a very particular market position, it is therefore probably worth considering these business for government support. The businesses themselves will argue that given the right inducements/support, they still represent an opportunity for considerable scalability. Given that these are far larger businesses than most other potential growth sectors, this could be an area of relatively fast growth. However, given that these products are not particularly EU-oriented we do not consider these sectors further here.<sup>2</sup>

### **New industrial manufacturing**

Enterprise Georgia has set new industrial manufacturing as a priority. In particular, they have focused on electrical/electronic and automotive/aerospace. Other than the general set of Georgia's advantages as an investment environment (ease of doing business, taxes etc.) recounted earlier, Georgia's demonstrated comparative advantage for these kinds of businesses seems to rely upon a relatively small number of fairly new companies. In this analysis we have considered these companies and the sectors they represent to see what challenges they face.

In the areas of electrical/electronic, total export is \$14m to the region, and the companies that are usually referenced are Atlantic Group, AE Solar, Kockablo and MyGPS. Atlantic Group produces water heaters for the region and mostly have a positive experience of working in Georgia. Their biggest complaint is about sourcing local inputs. The company say that in other places, they would be able to source many inputs locally, while in Georgia they have had to import or make them themselves. This includes pipes for water heaters, water heating elements, packaging and plastic injections.

On top of that they highlight that the relationship with Russia is a problem, both because it means that the Stepantsminda border with Russia is slow, but they also worry what would happen if the relationship got worse, as their main sales market is Russia.

AE Solar is probably the most referenced of the new export-oriented companies in Georgia. Before coming to Georgia, the main company, AE Invest, had been producing solar cells in China for use on domestic residences in the EU. However, the EU had a trade restriction which put a price floor on domestic solar cells coming from China. AE Solar, therefore, wanted to use Georgia as a cheap labor, low bureaucracy, production facility with access to the EU market, partially to avoid the tariff.

Unfortunately for AE Solar, the EU changed its regulations while the factory was being built, and by the time the company entered production, the EU no longer had the tariff on Chinese solar cells, and so Georgia had lost some of its comparative advantage. However, the company realised that the US *does* have restrictions on Chinese produced cells and therefore the company shifted its sales focus to the US.

They had no major complaints about doing business in Georgia. The German owners had recruited plant managers from Uzbekistan and so the managers are comfortable with the general environment. Also, they

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<sup>2</sup> GeoWel Research has, however, looked at this sector in more detail, GeoWel (2013), The Importance of Heavy Manufacturing and the Need for an Industrial Policy in Georgia, Tbilisi ([http://geowel.org/index.php?article\\_id=83&clang=0](http://geowel.org/index.php?article_id=83&clang=0)). Note that this work was done as a piece of advocacy work for Rustavi Steel.

have enlisted ethnic Georgian line managers from Poland and Germany. They did acknowledge that local staff don't have the skills they need and it costs 90,000 euros per person to train staff to the necessary level.

They do not expect to export to the EU, because the EU is very competitive in their field and the certification costs are high. One way around this is that they are trying to develop a joint project with a Japanese manufacturer who may start producing with them in Georgia under a joint venture. They already have EU certification.

The final company that fits into this category is MyGPS, which produces lighting fixtures. They are the only fully Georgian company and a good example of how hard it is to build-up manufacturing companies from scratch. Over the last decade or so, MyGPS have been producing for local clients and trying to get into the EU market, but have found the EU market impossible to penetrate, particularly for government procurements, which differs from country to country.

In planes and automotive, there are only two companies that Enterprise Georgia referenced as examples. For Aerospace, the Georgian Partnership Fund and Israeli Defence manufacturer Elbit systems have built an 'Aerospace Technologies Cyclone' factory in Georgia to produce carbon composite parts for the Boeing 787 Dreamliner. This seems to be an ideal example of how a government-financed PPP can work as a proof of concept, as the Israeli investor says that they have benefited not only from 66% government ownership/financing of the project, but also support in bureaucracy, so that the factory has been built quickly.

On the other end of the spectrum, we spoke to a company in the automotive sector which entered the market knowing more or less no-one, and which has struggled significantly with identifying and securing a site, government bureaucracy in approving a production facility, staffing, residency for international managers and much more.

The contrast between these two as well as the other areas strongly underpin the need for international partners in starting local facilities, and strong government support in facilitating set-up.

#### Light manufacturing

Much of the industrial manufacturing targeted by Enterprise Georgia is new and therefore it is hard to judge its efficacy. However, Georgia has considerable track record in local production, connection to international supply chains and considerable exports in light manufacturing. Apparel is by far the most interesting in this area, with \$98 million exports in 2019, which has been a steady growth and is 4x higher than it was 10 years ago. While about three-quarters of the exports go to Turkey (though, often to be re-exported to the EU), this has also seen significant growth in Europe, with exports increasing about 8x over the same 10 years and rising in that time from 10% to 25% of the total, with particularly strong growth in Italy.

The market started growing in 2004 when Turkish investors started to move into the country to take advantage of the improved business environment, inexpensive labor, low inputs and transportation costs. Most of the market is in 'Cut-Make-Trim' (CMT), for 'fast fashion', where proximity to the EU is useful for sample development and delivery.

The biggest producers are either Turkish-owned, or produce under contract to Turkish companies. There are also CMT companies that have relationships with European retailers or intermediaries. These companies offer varying levels of value-addition with the Turkish contractors being at the low-end, as they merely provide sewing services. At the highest level of value addition are designers who make fashion clothing, shoes and sometimes jewelry high-end boutiques, mostly in Asia but also in Europe.

The challenges that these companies face depend upon their position in the value chain. Almost everyone in the sector complains of a lack of skilled sewers, particularly as the market has expanded and the locally labour pool has been exhausted. For companies connected to Turkish supply chains, this is their only real complaint, as everything else is taken care of by the Turkish holding company or partner. This complaint, however, is critical, because for this group of the biggest producers, low wages and low taxes are the two biggest reasons to be in Georgia. Monthly salaries in Georgia are about around USD 250 compared to USD 500 in Turkey. Also profit tax in Turkey is 40% compared to Georgia where the same tax is zero for reinvested earnings and 20% for distributed earnings.

For Georgian companies trying to develop broader relationships, particularly in Europe, they also say there is a dearth of qualified people who can draw patterns based on designs. They also have complaints about transportation costs and rules of origin. In transportation, this is not only a complaint about the general cost and price of transport, but also concerns the costs for express transit of one or two items. This is important because in fast fashion there can be a lot of back-and-forth in the development of new products. Many use DHL-like firms for this, which is expensive. This is another area where government intervention may be useful.

Generally, for those who are trying to build a broader base of relationships in the EU, helping to connect with potential buyers is also key. This is doubly so in the high-fashion area, where high margins mean that they are less concerned with costs than sales generation.

All of the groups exporting to the EU or working in contract to EU producers complain about rules-of-origin requirements. These rules preclude apparel from being imported if inputs are worth more than 40% of the final product value. This is a problem for most 'cut-trim-make' producers, for whom inputs are usually around 50%. This should not be a problem since Georgia signed an agreement with the EU to accept Turkey (where most inputs originate) as an 'EU' input for the purpose of showing origin. However, Turkey has not ratified this agreement. As a result, most apparel produce in Georgia cannot actually receive a Georgia origination label. Rather than pay the 12% tax that this creates, most of these companies provide sewing as a chargeable service, rather than importing/exporting products.

On top of regular apparel, Enterprise Georgia has produced multiple investment proposals for footwear. It is a fairly interesting area, with USD 2.9 million of exports and fairly rapid growth in recent years. This project did not consider the category separately since, at the current time, the majority of Georgia's footwear exports are sold to Azerbaijan and Kazakhstan.

Looking at the composition of Georgian apparel production, one reason why it might be interesting in the medium term is that the country has the appropriate design skills to potentially move up the apparel value chain. One way this might happen is by leveraging Georgia's vibrant fashion exports. Georgia has been becoming a location of interest in the sector for almost a decade now. This has been helped by growth in local 'fashion weeks' as well as the international success of several prominent Georgian designers. On the back of this, one hope is that Georgia could duplicate Turkey's experience and move from 'cut-make-trim' to being a producer of its own labels, keeping more of the value addition in Georgia.

In addition to apparel, there are a few other areas of interest in light manufacturing. Furniture production is highlighted as a potential investment sector by Invest in Georgia, mainly because of high local demand and low labor costs. Up until now it has not been a large exporting sector, showing significant fluctuation, and Georgian Products Ltd, a producer of pet furniture, is the only 'furniture' manufacturer listed in Georgia's list of top 100 exporting companies.

Georgian Products and Geo Provision are companies that respectively produce pet furniture and pet food. The pet furniture company is the strongest example that this project came across that attributed its success to the Association Agreement. Founded in 2014, the company was conceived of precisely because of the Association Agreement, noting 'we are babies of the Association Agreement'. Ironically, however, their product category did not see improved access to the EU because of the Association Agreement in any clear way, and they are still waiting for approval to export pet food to the EU.

The entrepreneurs who started the company conceived of it because of a connection with an EU-buyer. They now have 425 employees on the pay-roll and export mainly to the EU 'Zoo Plus' retail chain, but are currently opening up trade channels with the US.

Rules of origin may pose a big problem for furniture. A KPMG report suggested that local value addition for furniture producing would be less than 20%, and that inputs would be around 70%. This would preclude Georgia from being able to export these goods as 'made in Georgia'. Georgian Products says that this is not a problem for them, as they have 70% value addition. Efforts are underway by the EU to ease these restrictions, but the impact is too soon to tell.

Toy manufacturing is similar to textiles and furniture, in that it is a relatively low capital investment, has a high labour contribution, depends on good design and an ability to build closer relations with EU buyers. Several small companies we spoke to have had success with boutique and very high-end handmade kids clothes and toys – perhaps most interesting is the fact that they have found clients relatively easily through trade fairs.

The medical sector has also come up as an export category, though again this seems to connect to very specific niche sub-sectors. The Georgian company Aptos has the patent on a thread that is used for non-surgical face-lifts. They are currently building a large factory (with the EBRD's support) which will increase their export potential and could help stimulate the whole sector, as they are also building facilities for commercial sterilization of medical products, which is a vital piece of the supply chain currently not available in the region.

Bacterial phages also come up as an opportunity. Bacterial phage is a set of bacteria-eating viruses that can be used to treat infection and can work as an alternative to antibiotics. One of the oldest laboratories of phage science in the world is at the Eliava institute in Tbilisi. The institute has the world's largest library of known phages, and their staff have been producing commercially available phage drugs for the countries of the former USSR for decades.<sup>3</sup> They supply German farms with phage preparations for poultry and veterinary applications, as well as aquaculture.

The Phage Therapy Centre, an American-owned subsidiary is bringing foreign patients to Tbilisi for phage treatments on infections connected to diabetes, burns, ulcers, and drug-resistant infections such as MRSA.<sup>4</sup> Additionally, BioChimPharm, a Georgian private company offers products to treat various bacterial infections including streptococcus, staphylococcus, e-coli and others<sup>5</sup>, but it does not have the infrastructure to develop, test and manufacture phage drugs on a large scale. In discussion with the Ministry of Economy, we have been told that when McKinsey assessed Georgia for the Ministry of Economy a few years ago, they concluded that bacterial phage was the most valuable IP in the country.

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<sup>3</sup> Eliava Institute, Bacterial Strain and Phage collection. <http://eliava-institute.org/bacterial-strain-and-phage-collection/> (Reviewed August 2020)

<sup>4</sup> Investor.ge (2020), How Georgian phage science might pave the future of biotech, [http://www.investor.ge/wp-content/uploads/2020/02/2019\\_6.pdf](http://www.investor.ge/wp-content/uploads/2020/02/2019_6.pdf) (Reviewed August 2020)

<sup>5</sup> Biochimpharm, About us. <http://biochimpharm.ge/en/about-us/> (Reviewed August 2020)

## Services

Initial assessment would suggest that the Association Agreement did not have much of an effect in general on the export of services. Trade restrictions for services are fairly low and continue to be largely connected to issues like recognition of qualifications. For that reason, when this project was originally planned, it was unclear whether services should be included. However, the export of ‘business process outsourcing’ (BPO) has been a large growth area and a big success story for government supported private investment in recent years, therefore we decided to include it here.

We considered CRM/call centres, IT, architecture and film service provision. In the ‘call centre’ space, Evolution Gaming is the biggest single example of a large foreign new-entrant, with around 3,000 employees. This is an online gaming/call-centre facility that includes mock-ups of actual casino situations with croupiers etc. We were unable to talk to Evolution Gaming for this project, as they have been struggling to shift their business model to one that allows for distance working.

The second company that is commonly referenced in this context is Majorel, that provide call-center services particularly to the German speaking world. They opened in 2016 because they needed German language operators and labour costs in Romania and Estonia, where they had been sourcing these services, were going up significantly. The company now employs around 2000 people across three locations in Georgia and has recently made agreements to expand.

Georgia’s greatest strength for Majorel is the availability of foreign language speakers. They also like the low-tax environment. English is of limited interest to them, as English-language CRM is generally covered more cheaply by the Asian market. The principal bottleneck is finding people with the right language skills, though they say that this is helped by visa-free travel to the EU.

A representative of Majorel Georgia said that while it is a struggle to find enough German language speakers, he likes operating in Georgia because a call-center job is considered a ‘good-job’ in Georgia and so he can attract motivated and enthusiastic staff. This is helped because people like the office environment and salaries are high, reaching about 2,000 GEL per month six months after people start and reaching 4,000 to 5,000 GEL for middle managers.

One obvious area of service-export is IT. We talked to six companies in the sector. Three of these were pure service-export oriented. The details of the businesses do not seem to be the key issue. They all said that they could find clients depending on the level of skilled professionals that they could find. Georgia’s lack of coders is a real problem, in this area. On top of which, high demand in the relatively well-developed banking and gaming sectors creates a very competitive environment. All of the companies we spoke to train their own staff, but are still entirely constrained by the lack of people with core skills.

What seems clear in this market is that talent is everything and geography is largely irrelevant. Usually, one might expect that if neighbouring countries have a comparative advantage in a given product, this would disadvantage the local market, as the neighbours would be competitors. But that is not the case here. The fact that Belarus, Ukraine, Russia and Armenia are known for IT outsourcing is a benefit to Georgia, as Georgia may get discovered by other companies operating in the region in these areas. This seemed like a key area where government support would be helpful. However, improvements in its area will almost certainly not work through Georgia’s traditional vocational education, since training is carried out at the post-graduate level. Improvements in training in this area probably need government finances to be provided to companies that will then pay for their own training of staff directly.

Architectural services are also listed by Enterprise Georgia as a focal area. We only found one company that matched the description of providing exportable services in this area, but it is worth considering. Base4 is US-based firm that in 2016 was looking for a branch office. Enterprise Georgia gave them a good sales pitch about Georgia and offered to help them in finding staff, in paperwork and in set-up. Following a test office of two people they scaled-up and just before Covid had 25 staff (though in April 2020 they had reduced this to 14 due to Covid). The representative said that an office of 100-500 people may be possible in Georgia.

Interestingly, they did not say that finding staff is a problem, since Georgian universities are producing trained architects who, according to a representative of the company, are good enough to train for their company's particular needs.

Finally, we talked to people in film and animation. This sector gained the attention of this project because it has been supported by tailored large-scale co-financing support from the Georgian Government and continues to be a target-sector for Enterprise Georgia (though financial support is currently under re-negotiation). It has also received considerable international development support.

The Georgian film sector has been built-up over the last 15 years or so, first with Georgia developing a reputation for its own films, then providing production facilities for Bollywood films and more recently hosting the production of Hollywood films like *The Fast and the Furious*.

There are two kinds of service-exporting companies in this area. The first provide services to international companies that make films in Georgia. In our discussion with them, this group were almost entirely obsessed with highlighting the importance of the 'Film in Georgia' scheme, run by Enterprise Georgia. This scheme offered a range of supports to film makers but, in particular, offered a 20-25% cash-back scheme for qualified expenses that occurred in-country, after filming had been completed. This was a big draw for international film companies and most industry experts suggest that without it the sector will not develop.

The second category of company we talked to were firms involved in post-production. These companies may have emerged because of the development of the first group, but were not supported directly by the rebate scheme. They are really equivalent to the IT firms or architectural firms, as they are generally providing technical skills that do not need to be done for clients in the country. This sector seems to be in its infancy, and the companies are very small, but it is a way that Georgia is making good use of a core in arts/design. The biggest limiting factor on this sector seemed to be, as in IT, the availability of skilled staff.

In general, therefore, the project found that while companies have not expanded their exports to the EU in the way that many hoped, there is clearly far more going-on in new business development and in key export areas than many people in the business community realise. Across the spectrum, from large industrial producers, to small service exporters, there are business-people who are innovating and aggressively looking for new markets. There are also great success stories. These companies do seem to hold the possibility to transform the country, as the World Bank called it, 'from reformer to performer'. With the right government supports and the right improvements in business environment, this could happen far more quickly.



## Recommendations

### General

- Redoubling efforts for business environment reform – particularly improvements streamlining approval supports for new facilities and investor protections.
  - o The government should agree to international arbitration on any dispute that they get into if it is requested by the other side.
  - o Bilateral treaties should be updated to ensure investor protections are well spelled out.
- Current support policies for private firms should be assessed for cost/benefit of different interventions and should make more effort to target ‘break-through’ sectors.
- Support policies should have a strong export component. This means that there should be:
  - o A loan/grant mix should partially finance provable training costs for firms that will employ the people that they train.
  - o Loans that specifically support proven exporters in expanding their exports.
- Attracting green-field investment in new supply chains.
  - o Supports for new supply chain investments – should offer an easy path for PPP, or risk sharing of some kind.
  - o Needs strong support in navigating the bureaucracy.
  - o Needs support in training staff.
  - o Export processing zones need to be ‘build-ready’ and early discussions should set clear timelines for completion of approvals, subject to business-person input.

### Agriculture

- The government needs to approve the regulations allowing for the foreign ownership of land, where the proposed investments offer significant employment or technical transfer.
- Government should complete land registration as soon as possible and, following that, set up a register of ‘land for sale’ that is available to investors.
- Particular support should be provided to any investors trying new, high-value, crops.
- PPP could be considered for large-scale investments where export concepts need to be proven, for example, in beverages.

### Manufacturing

- Attracting new value chains to Georgia will need a far stronger level of government support and involvement than currently imagined.
- Even where PPP is not interesting/viable – strong support on navigating bureaucracy is key.
- Co-financing for training and considerable flexibility to the employing company needs to be offered in staff development.
- It may be worth reviewing some of the large industrial manufacturers in Georgia and seeing if they face particular hurdles to new investment, upgrade and upscaling. These sectors may be dated but still have scale.
- Continued support, and particularly bilateral ties through donors and foreign government agencies, should be used for facilitating client connections for new businesses.

### Services

- Language development/support programmes should be supported in the same way as industrial training and have strong state subsidy.
- Enterprise Georgia should provide co-financing for IT training that does not have to run through state training institutions, but offer considerable flexibility to the private company about what and how to train.

### Standards development

- Government needs to assess 'conformity assessment body' needs and regional/international availability based on existing and likely near-time exports – to prioritise the most important areas for work and support.
- Government can then provide a varying range of supports for companies and CABs, this could include government subsidies for services delivery in ramp-up period for local CABs.
- In areas where local CABs are deemed unlikely, government could help collectively negotiate better priced deals with foreign providers.
- Government should adopt EU standards for state procurement, where it may help create incentives for adoption of the wider market.

### Transport and logistics

- Support for transport and logistics should look beyond the building of infrastructure to the support of service provision. This is already happening in some areas, like cold storage, but could apply in other areas as well.
- A government supported bonded warehouse, somewhere in Europe, probably in Germany, possibly with support for trucking/shipping to get there, would be helpful for wine sales, textiles and a number of light manufacturing goods.
- The Government should support express post services. The research came across private subsidiaries whose Georgia partners were able to gain huge discounts from UPS and DHL because of the discount rates that the holding company was able to negotiate. The Georgian Government could do the same, and make the rates available for pre-approved companies. This would have obvious value for the textiles sector (for samples) and for companies looking for product certification.
- There needs to be government efforts to support more companies to provide partial truck space. Again, this could be combined with the Central Europe bonded warehouse idea above.

### Skills

- There need to be a more aggressive push to do private sector-led VET, where private sector entities get to dictate the form of the course, be involved in hiring and remunerating staff, selecting students, etc.
- There should be separate financial support from government to subsidise training of staff in internationally recognised courses.
- Discussion of skills in Georgia needs to be more sensitive to areas where people want to work. Office jobs, suggesting BPO, are generally seen as higher status and better jobs than factory jobs, even if the factory jobs are better paid.
  - o Effort needs to be made to raise the status of IT, agricultural skills, manufacturing, etc.
  - o No-one who wants to learn a foreign language should ever have to pay for it.



#### Financing

- Financing and risk-sharing for supply chain investors and innovators – including Green Field financing for unbankable projects.

#### Regulatory environment

- Effort needs to continue to get Turkey to ratify rules of origin which will allow Turkish inputs to count as EU.

## Background

This research project is intended to analyse the opportunities that have been created by Georgia's signing of the Association Agreement with the EU. It is undertaken by GeoWel Research and will contribute to EBRD's Country Diagnostic development process.

Country diagnostics are a flagship product of the European Bank for Reconstruction and Development and are used as a tool to help shape the Bank's strategic priorities and policy selection within new country strategies and to coordinate the Bank's policy engagement with the authorities. The diagnostics are also an important part of the implementation of the Bank's six qualities of transition (Competitive, Green, Inclusive, Integrated, Resilient and Well Governed). Country diagnostics are produced by the Country Economics and Policy (CEP) team of the Economics, Policy and Governance (EPG) department in collaboration with many other teams. The EBRD has been working on the Georgia Diagnostic in September 2020 and will be finished in 2021.

This study is being conducted because EBRD would like to help Georgia better take advantage of an apparent opportunity. The Association Agreement between Georgia and the EU was signed in June 2014. A large part of the agreement is the Deep and Comprehensive Free Trade Area (DCFTA) which is designed to provide increased access to the EU markets at the same time as requiring Georgia to align with EU standards in a range of areas. As a result of the agreement, coming into alignment with the Association Agreement and DCFTA has become the biggest driver for legislative reform in the Georgia, particularly as it relates to business environment issues.

It was hoped that as these reforms came into effect, Georgian business people would be able to seize the opportunity presented by increased access to the 500-million-person EU market, so that the Georgian export of products to the EU and foreign direct investment into Georgia would increase. This opportunity would seem to offer a pathway for accelerated economic growth, of the kind enjoyed by South Asian countries that gained access to the US market in the 60s and 70s, and EU accession states, that gained access to the EU in the early 2000s.

This project is important, since detailed and in-depth analysis of this kind has not been done before. Therefore, EBRD believes that a systematic and practical analysis is needed, that looks at why growth in EU-export orientation and export-related FDI has not occurred, what opportunities might exist that are being missed, and what barriers are there to Georgia taking better advantage of any increased access.

This report should inform the reader about the composition and direction and dynamic of Georgia's trade patterns, of Georgia's current FDI, of the current state of implementation of the Association Agreement, particularly as it relates to trade issues and should provide a detailed overview on a sector-by-sector basis of the current composition of Georgia's exportables sector and the challenges facing its possible expansion, particularly vis-à-vis the EU market.

The ultimate goal is to provide the EBRD with an independent overview of trade and trade-related issues within the context of the Association Agreement. This should assist the team in identifying strategic priorities to be implemented over the coming country strategy period aimed at developing a more competitive and sustainable corporate sector in Georgia.

## Methodology

The project was made up of detailed desk research on export flows, FDI, the structure of the Georgian economy, the operation of the DCFTA and the operation of Georgia's main tradable sector. Trade data was

sourced from Geostat, rather than Eurostat.<sup>6</sup> This has been combined with extensive semi-structured interviews with senior business people, government officials and experts. Around 110 in-depth semi-structured interviews were conducted.

The first step of the research had been to identify focal sectors, and these were agreed upon with EBRD, to try and help ensure that the project, which was already broad in its scope, did not become entirely unmanageable. The criteria for assessing the sectors are discussed below.

Business people were identified from these sectors for interview through the networks of the team leader, Dr George Welton, who also runs the American Chamber of Commerce in Georgia, as well as through introductions facilitated by networks within the EU, French, German and Turkish business associations, the Georgian Chamber of Commerce and Industry and Enterprise Georgia, as well as a range of development programmes supported by the EU and US Governments. We also reached out to companies based on various lists provided by Georgia's National Statistics Office (Geostat). Geostat provided, on request, a list of Georgia's 200 largest exporters and the 100 largest exporters to EU, as well as the three biggest named country-exporters for each large 4-digit sub-category of Georgian exports.

Personal networks and introductions were by far the most effective of the two strategies in gaining interviews, though the Geostat generated leads did generate some helpful interviews as well.<sup>7</sup> A network-based methodology of identifying companies allowed for the interviewers to talk to CEOs, CFOs and other C-level directors, who were able to provide insights into business models and challenges at the strategic level. Companies were particularly identified on the basis of whether they were exporting to the EU, or were in a sector deemed potentially able to export to the EU, or companies that were associated with investments in tradables generally.

During desk research we also compared the change in tariffs between DCFTA and GSP+ which was Georgia's agreement with the EU preceding the DCFTA. For this we used the European Commission EU Tariffs database<sup>8</sup>. We looked at 220 product categories where Georgia has significant exports. Many of which had multiple sub-codes or sub-commodities, and in total we compared over 1000 product categories.

In terms of comparison in trade with the EU, we also identified the new commodities that appeared in Georgia's domestic exports to the EU since 2013. For this we analyzed Geostat's data on domestic exports which was accessible going back to 2009. We looked for the 6-digit product categories that had no export value in 2013 and had more than absolute 0 export value between 2014-2019.

## Focal sectors

The first stage of the research came up with some general principles to demarcate which sectors we did NOT consider interesting. By looking at domestic exports, rather than national exports, we excluded re-exported goods. However, beyond that, we decided that other export categories had little value for development-oriented research of the kind we were trying to undertake.

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<sup>6</sup> There are some striking differences between Geostat and Eurostat, mainly due to what each considers 're-export'. For the purposes of our analysis, we relied on Geostat. There are on-going efforts to align the two agencies in terms of statistical methodology.

<sup>7</sup> As we will see the 'biggest exporter' lists were problematic because they were generally heavily loaded with companies exporting non value-added products, or re-exports, neither of which were of interest to us.

<sup>8</sup> European Commission, Market access Database <https://madb.europa.eu/madb/euTariffs.htm> (Reviewed July 2020)

With that in mind, first, we generally excluded global commodities, particularly in extractive/mined products. Globally, the two biggest Georgian extractive exports from Georgia are copper and ferroalloy/manganese. The total value of these was around 1 billion USD in 2019.<sup>9</sup> This is around one-quarter of all Georgian exports. Copper is the largest EU import from Georgia and at USD 462 million is more than half of the total Georgian exports to the EU.

While substantial, this category of exports was deemed largely uninteresting for our project, because these products involve relatively little value addition, but more importantly, because global commodities face a global price that will not change much through access to the EU. As much as Georgia produces of these products, they will be sold somewhere at global prices. In a sense, it does not really matter to Georgia whether these exports are sold to the EU or not, as it is unlikely to significantly alter overall exports.

A number of other categories also seemed likely to add to this list, particularly fertilizer, which is produced in one old Soviet-era facility and acts like a commodity in a range of ways. Nuts, though a commodity in many ways, were included since they do involve value addition, and have capacity for upscaling.

A second category of products NOT interesting to this project were exports which are oriented to specific geographies that are unlikely to include the EU. There are three main reasons why other products might be 'regional'; they operate using a dynamic or business model that is tied into the region; the products value or uniqueness is connected to its reputation in the region, or; it is particularly transport-cost dependent.

Live animal exports, for example, emerged after 2007 because of increasingly stringent animal rights practices in the West, that restrict the shipping of live animals internationally. This made it impossible, for example, for Australia or New Zealand, to export live sheep internationally. This created unsatisfied demand, in Azerbaijan and Gulf states in particular, who demand live animals particularly for the Haj and Ramadan. This market is unlikely to create an export category of goods for the EU, because of the same animal rights concerns, though the associated products of chilled meat/halal meat may be a possible growth area.

Pharmaceuticals also seem to largely make sense as a regional product because to a large extent it is a re-export where the actual drug is imported and only the packaging is done locally. Also, Georgia's historic manufacturing, includes railways that are still significant and is the continuation of the old Soviet producers and still largely produces for the region, as well as auto and auto-parts, which no longer export in any significant volumes.

For regional reputation, mineral water, wine and lemonade stand out. Georgia is known and has a reputation for all of these things, in the region and particularly in Russia, which it is hard to establish elsewhere, giving them a natural regional market. Whether Georgia can break out of this region for any of these products is an area of contention. There is a clear effort to expand beyond the region for wine, and this might be possible for a range of reasons discussed below. However, lemonade and mineral water, as relatively low value goods, with little to distinguish them in non-regional markets, seem less likely.

In terms of transportation costs creating regional markets, steel and certain basic construction materials like cement seemed to be distance constrained. It is also unclear whether most fresh fruits and vegetables fit into this category or not. At the current time, they seem to, but this may change if Georgia ever produces at the scale required by European markets.

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<sup>9</sup> Though, according to the German Economic Team, there is some question about how much of copper should be counted as re-exports.

Of course, almost none of these products are *necessarily* 'regional'. Business models can change so that factories which produce for a regional market can re-tool for other markets. Georgia can market its different beverages outside the region and become known in new markets. Concrete and steel can have greater value-added in country, making them valuable enough to export long distances. And transportation costs can go down to make that easier as well.

Therefore, while the project did exclude most commodities, it has actually taken a more flexible approach to 'regional' products, looking at some of them to see which ones might be subject to change. Beyond these two categories, the project tried to consider 'everything else', although many of these might also be heavily oriented regionally or at the developing world.

Most of the business-sector oriented research therefore took its lead from trade data, excluding some categories for the reasons suggested above. We also reviewed a number of other sources, particularly government policy (which in turn is driven by analysis from other institutions) to identify new sectors or sectors that had been identified as having great potential. Preliminary discussions also suggested that several service categories were worth consideration. In particular, ICT and Business Process Outsourcing.

It is also worth taking a second to explain the way that trade data is presented in this report. In much of what follows, we present the summary of the trade data which we believe to be most useful for the analysis in hand. This does not simply maintain the convention of organizing information according to customs code – with differing levels of detail offered in the 2, 4 or 6-digit levels. Instead, we group the information to make it more explanatory. For example, in our first summaries, we started by reviewing the available data from Geostat at the two-digit level. But even that this high level, it provides us with 99 different sub-categories, 54 of which have exports of over 1 million USD. Either one of these offers more information than is useful. But cutting out some categories because they are below certain levels excludes groups that can be significant when grouped differently.

Also, some 2-digit category labels are confusing. At the two-digit level 'ferro-alloy' is classified with iron and steel, but it is really 'manganese'. Also, at that level, most of copper exports are classified under the unhelpful label of 'Ores, slag and slash' (as it is copper ore and not processed copper being exported). In what follows we have tried to group exports in a way that is as illuminating to the reader as possible, grouping different sub-categories and offering additional detail on larger-value line-items.

It is also difficult to provide information about product categories and countries at the same time, since the static two-dimensional medium of a written report lacks the number of dimensions required. Our correction to this is to provide consecutive summaries that offer product and country information and that mix them in summaries. This does not make for the most elegant data presentation. However, as this document, in its current form, is intended for EBRD experts, we felt that data-detail was currently more important than presentation. This can be corrected if EBRD decide that they want to publish a version of this report.

### Analysis and structure of the report

The research and analysis start with an overview of trade patterns. This was done using Geostat data, and the information is structured to try and provide the greatest explanatory value. Therefore, we use domestic data (which excludes re-exports) rather than 'national'. We also combine 2-digit, 4-digit and 6-digit data, so that we provide a level of detail with the highest explanatory content.

The second section provides an overview of FDI, and combines different published information on FDI with information on the 15 and 50 largest FDI companies for 2009-2019. We also received from BP information

about their contribution. Combined, this allowed us to make deductions about the direction of FDI. We also looked at FDI/GDP ratios provided by the WB, for international context. Finally, we review the quality of FDI by looking at the impact of FDI in a range of sectors.

The third section provided an overview and assessment of the implementation of the Association Agreement. This operates at two levels. First, we review the literature that tried to assess the impact in the past, and which has looked at the impact since 2014 and we compare the tariff regime which applied to Georgia under the previous GSP system with the tariff regime of the DCFTA.

We then look at the work relating to the DCFTA generally, by reviewing the Association Agreement document itself, the strategic plans for its implementation and the Georgian Government, EU and civil society reporting. Finally, we look in a little more detail at the Association Agreement's work relating to technical barriers to trade, as this covers standards and certification, which is routinely cited as one of the biggest remaining barriers to Georgian export growth to the EU.

Having looked at these issues in the general, the second half of the report looks at specific sectors. It reviews government policy to support different sectors and various analyses identifying which sectors have the greatest opportunity for tradable growth, before offering a review of many of these sectors, combining our trade analysis, existing value chain analysis and our interviews with business people in the sectors.

## The covid context

Between March and September 2020, Georgia gained plaudits for its efforts in combatting Covid-19. While the country is currently undergoing a surge in cases, infection rates had previously been well contained with a total mortality count (as of September 1, 2020) of 20 deaths (or around 1 for each 200,000 of the population). This is about 100x lower (relative to the population) than the US or the UK (at the time), and 20x lower than Germany. This was fairly remarkable given Georgia's proximity to the EU - a "hot-zone" for infections in spring and early summer 2020. Even the least hard-hit EU state, Latvia, still has 3x Georgia's death rate, per capita.

However, this has changed dramatically in recent months and Georgia now (November 2020) has a surge in cases that is amongst the highest in the world relative to the size of its population. As with so many other places in the world, the winter months will be challenging.

The ultimate impact of Covid on Georgia's economy is hard to predict. As elsewhere, it will depend upon how long the virus continues, the development of treatments and, of course, when the vaccines can be widely distributed, as well as the virus' impact on global trade, unemployment, travel and consumption in the short, medium and long-term.

Even when the disease was largely under control in the country, the economic impact on Georgia was severe because of the economy's dependence on the hard-hit tourism sector, commodity exports, European and Russian remittances and FDI. As a result, the IMF predicted a 5% decline in GDP in 2020 - a 10.1% drop compared to the growth of 2019.

Figure 1: 2019 Growth and 2020 Growth Predictions

Country	2019 GDP Growth	2020 Predicted GDP Growth	Difference
Georgia	5.1%	-5%	10.1%
Azerbaijan	2.2%	-4%	6.2%
Russia	1.6%	-4.1%	5.7%
Moldova	3.6%	-4.5%	8.1%
Belarus	1.2%	-3%	4.2%
Turkmenistan	6.3%	1.8%	4.5%
Uzbekistan	5.6%	0.7%	4.9%
Kazakhstan	4.5%	-2.7%	7.2%
Kyrgyz Republic	4.5%	-12%	16.5%
Tajikistan	7.5%	1%	6.5%

Source: IMF (Reviewed Nov 2020)

As one can see the predicted decline in Georgia is one of the biggest reversals in the region, and worse than Azerbaijan, Russia, Moldova, Belarus and all of Central Asia.<sup>10</sup> Also, for a highly dollarised and import dependent country, Georgia took another hit from a 10% decline in its currency value, which was also one of the largest declines in the region.<sup>11</sup>

These jolts are reflected in the research that was conducted through a collaboration of PwC/EBRD and the Investors Council, financed by the UK Good Governance Fund and which was first conducted in April and repeated again this autumn. The initial research showed two-thirds of surveyed companies reported a fall in demand, one-third had reduced their staff by 75-100% and around 80% said that they expected to require more financing.<sup>12</sup>

The follow up research that was conducted in late September presented many of the same problems at very similar levels (except on the financing issue).<sup>13</sup> It is worth noting that the Covid situation has deteriorated significantly since this latter research was conducted.<sup>14</sup>

In the September research, 68% of companies said that they were negatively affected by a decrease in demand, 50% by difficulties related to the devaluation of the GEL and 35% by late payments from clients.

<sup>10</sup> IMF historical numbers and predictions (2019 and 2020) - [https://www.imf.org/external/datamapper/NGDP\\_RPCH@WEO/OEMDC/ADVEC/WEOWORLD](https://www.imf.org/external/datamapper/NGDP_RPCH@WEO/OEMDC/ADVEC/WEOWORLD)

<sup>11</sup> Based on NBG currency rates from December compared to now.

<sup>12</sup> PwC (May 2020), Georgian Business in the Face of the Covid-19 Pandemic

<sup>13</sup> PwC (October 2020), Covid 19: Follow-up survey of Georgian Business in the Face of the Covid-19 Pandemic.

<sup>14</sup> The daily new cases from the end of September were about 10% the level in mid-November.

As a result of this, 78% of companies reported some drop in revenue, with 38% of the companies reporting a revenue drop of more than 50% for May-July. Accommodation and food service companies were the worst hit with 84% reporting a greater than 50% drop, followed by 59% in agriculture and 36% in construction.

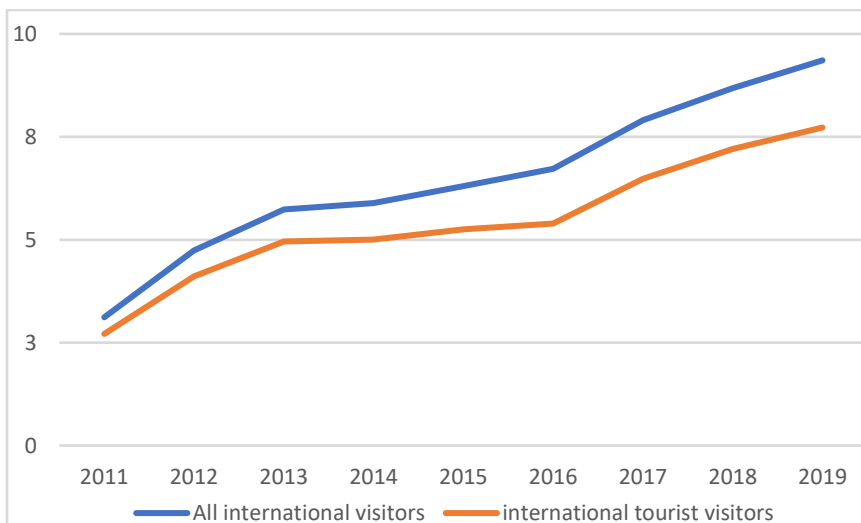
As a result, almost 44% of surveyed companies report reducing their staffing levels since Covid started, with 11% having fired/furloughed their entire staff and 21% reporting a greater than 50% reduction in staffing.

On a slightly more positive note, due to a range of interventions, from furloughing of staff, to debt restructuring, liquidity issues seem to have reduced. In the first survey 28% of companies said that they expected to face liquidity issues in the next six months. In the September survey, this had reduced to 10%.

This final element is interesting. Larger companies have managed to improve their liquidity situation better than smaller companies, partly because they simply have better access to more sources of financing, but also partly because they have better relationships with a more diverse range of partners like IFIs and investors. This highlights the benefits of capital market diversification and more experienced management in weathering the challenges of uncertain times, and is highly relevant to this study.

Georgia's high level of tourism dependence has made it particularly exposed to the economic impacts of Covid.

Figure 2: Georgian International Tourism Numbers – million visitors (2011-2019)



Reference: Geostat (Reviewed September 2020)

In recent years, tourism numbers have grown sharply. As a result, by some estimates, tourism is as valuable to the country as all its other exports combined.<sup>15</sup> The Georgian National Tourism Administration estimates that the contribution of tourism to GDP is around 8%.<sup>16</sup>

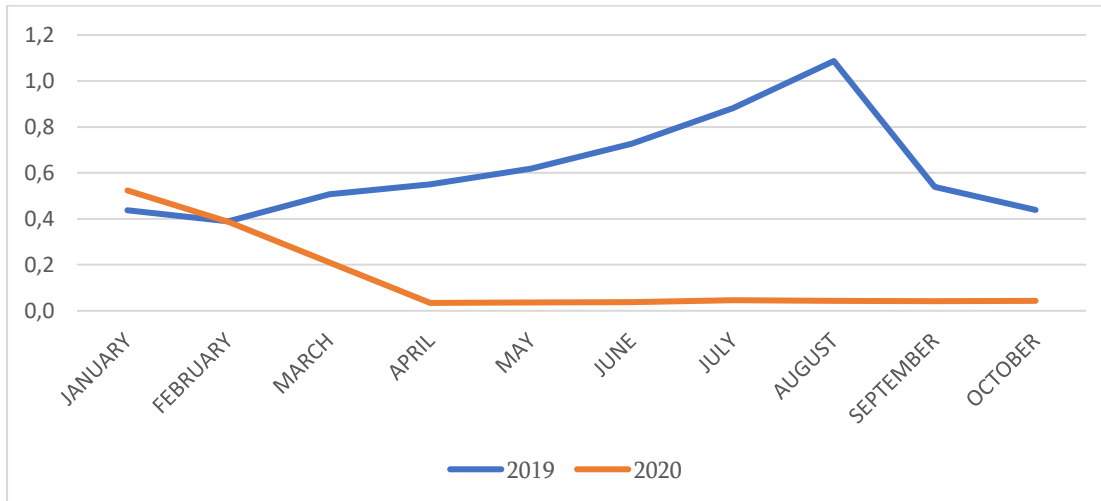
<sup>15</sup> Atlas of Economic Complexity: What Did Georgia Export in 2018 (reviewed Sept 2020), Harvard University (<https://atlas.cid.harvard.edu/explore?country=82&product=undefined&year=2018&productClass=HS&target=Product&partner=undefined&startYear=undefined>)

<sup>16</sup> GNTA (reviewed November 2020), Economic Indicators: Tourism Value Added, <https://gnta.ge/statistics/>



Incoming tourism has been eviscerated by the pandemic and while the summer of 2020 has seen an increase in local tourism, this has not come close to making up the short-fall and has not helped tourism facilities based in Tbilisi.

Figure 3: Georgian International Tourism Numbers by month in 2020 compared to 2019



Reference: Geostat (Reviewed, Sept 2020)

In response, the government has cancelled income tax and property tax in the tourism sector for 2020. The big question moving forward is the extent to which the market as a whole will rebound in 2021. Without a widely distributed vaccine, this will be impossible. But even with a vaccine, there are questions about the speed of recovery. Some believe that “pent-up” demand will lead to a very rapid rebound, others suggest that recovery may take years due to high unemployment and depressed consumer demand.

Other major drivers of economic growth in Georgia have been banking and construction, two sectors which are significantly connected because of the mortgage industry. So far, this sector has taken less of a hit than was expected thanks to the fact that construction sites were able to quickly return to work. Also, the government has supported both of these sectors by offering an interest-rate “hair-cut” for individuals getting mortgages for new properties.

This has resulted in a surprisingly strong mortgage and property sector, with Galt & Taggart actually suggesting that real estate sales were up, YoY in September, by 14%, compared to a 15% reduction in July and a 16% reduction in August.<sup>17</sup>

In addition to the support for tourism, banking and construction, the Georgian Government has been able to offer a fairly extensive range of support for companies and people affected by Covid-19. This has been made possible by the fact that Georgian Government finances were fairly solid at the beginning of the year, and the fact that Georgia’s strong relationship with the international development community has led to significant Covid-related aid. Budget support has been particularly significant, with IFI support translating into at least a couple of billion USD. To get a sense of scale, the Georgian economy is about 1000x smaller than the US, so this would be the equivalent of a couple of trillion dollars in US terms.

<sup>17</sup> Galt and Taggart (October 30, 2020), Tbilisi Real Estate Market Watch Quarterly Update (<https://galtandtaggart.com/upload/reports/23374.pdf>)

One particular area worth noting is the expansion of Georgian Government financing support for new investments. This reflects the government's desire to facilitate a fast recovery and to take advantage of any new opportunities that might be created by the post-covid situation. Two, apparently contradictory, trends seem to generate different opportunities. First, the pandemic has obviously brought a significant increase in teleworking. This may accelerate trends for service-exports that have been progressing for years, allowing lower cost markets like Georgia to expand their service-exports. It may also increase the number of 'digital nomads', workers who choose to live as expats in cheaper countries with better living and working environments. Georgia already has programmes to attract such people, but is expanding its offerings in the context of Covid.

The other direction of change is the increased importance of physical proximity. This has been presented as 'shortening the supply-chain', 'near-shortening' or 'reducing dependence on China', but suggests that both producers and governments may change their attitudes to globalisation, preferring certain categories of production to stay closer to the consumer, to make disruption less likely. This adds to a trend that was already underway, before the pandemic, to reduce dependence on China.

This may have benefits to Georgia because of Georgia's proximity to the EU, as well as the CIS and the Middle East. Proximity could also be a benefit for tourism, since Georgia is relatively close to the EU, for tourists who want to avoid long-haul flights but still want a low-cost destination.

Another opportunity provided by the pandemic is that afforded by an acceptance of stimulus spending. This is a double-edged sword, as higher investment and borrowing may require 'belt-tightening' in the future. But an expansion in infrastructure spending provides opportunities to move the country forward in key sectors and to potentially 'build back better' with a more forward-looking vision of economic development that takes better account of environmental change and technological opportunity. Also, one part of current increases in government spending have been increases in government subsidies for business investments in a range of sectors. If well targeted, this could provide seed-investment in target sectors and set the ground work for significant improvements in export orientation.

## Expected benefits of the DCFTA – and other assessments

One of the reasons for the current project is that it was and remains widely assumed that the Association Agreement and the DCFTA would have a significant positive impact on the Georgian economy. There are many reasons why Georgia signed the Association Agreement, and they are not just economic. Most experts recognise that one of the biggest motivations was the desire to integrate with Western economies and political structures for security, political and cultural reasons.

Nonetheless, as we will discuss below, a large portion of the Association Agreement relates to the formation of a Deep and Comprehensive Free Trade Area, and most of the legislative reform of the AA relates to business environment issues. This was done because it was assumed that gaining access to the 500-million person EU market would be a huge driver for the economy, most obviously through increased production and exports to the EU, in turn improving employment and raising incomes.

There is a precedent to this. EU accession countries more or less universally saw a big boost to their GDP growth in the years running up to membership of the EU, and the immediate years thereafter. Similarly, the Asian 'economic miracle', a term coined to describe the growth of East Asian economies from the 1950s into the 1980s was always assumed to be trade driven. Of course, opinions differ on the particulars, but there is general agreement that the 'four tigers' of Japan, South Korea, Taiwan and Hong-Kong managed their

miraculous growth because they were export-orientated and because (thanks to the Cold War) they were given preferential access to the Western (particularly the United States') market.

This makes sense from first principles. If a country only sells to the local market, then production growth can only increase with growth in local consumption. If a country sells to foreign markets, on the other hand, then that country is only constrained by its ability to gain market share in those markets. In addition, if a less developed country sells to a country that is more developed, then the less developed country can produce and sell goods with higher levels of value addition. This generates more income for the country than the lower costing and less capital-intensive goods consumed locally are likely to generate.

In turn, building exports can then attract FDI, which is also not constrained by the limitations of the local market, to invest more in the export-oriented market. This was certainly the logic behind the business environment reforms that put Georgia on the map as a 'star reformer', particularly from 2004-2008. However, as the World Bank's most recent diagnostic explains:

(Georgia) has yet to make the most of its business environment, partly due to a lack of complementary connectivity and skills inputs. To reach the next stage of economic development, Georgia will need to connect with the world economy and develop through exports. This is the only way for a small open economy to create a virtuous circle through which: (i) productivity gains make it attractive to invest in export-oriented production; and (ii) exposure to the global marketplace drives further productivity gains. Given demographic trends and limited fiscal space, there are few alternative options.<sup>18</sup>

Trade agreements are clearly supposed to be part of what allows that access to the world. If one is export oriented, the benefit of getting preferential access to a large market is obvious. If the rest of the world faces a 10% import tariff (for example), but your country does not, then you gain a 10% improvement in price competitiveness. Over time, a strong orientation towards a particular market can also stimulate growth dynamically, as the exporter better understands the needs of the importer, and develops better networks through which to sell.

Based on a similar assessment the DCFTA was roundly assumed to be a stimulant for growth. Interestingly, the EU's own analysis only expected modest gains. Prior to the 2014 signing, Ecorys conducted an assessment of the likely impact of the Association Agreement (conducted for the EU Commission) and suggested that there would be a 4.3% boost to GDP over the 'long-term' and that this would come from a shift to manufacturing with a 62% growth in chemicals, rubber and plastics and a smaller increase in other machinery categories. This growth would be driven by a 12% increase in exports (again, in the 'long-term').<sup>19</sup>

They also suggested that there would be an 8-24% reduction in livestock and meat products, other processed foods, electronics & computers, and other manufacturing. This would be driven by a 7.5% increase in imports.<sup>20</sup> Given the starting relative size of exports and imports, they suggested that this change might result in the trade deficit between Georgia and the EU actually going up.

Surprisingly, there has been limited assessment of the impact of the AA and DCFTA since the agreement was signed in 2014, and what there has been is mostly fairly superficial. In accordance with its multi-annual

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<sup>18</sup> World Bank Group (2018), *Georgia: from Reformer to Performer*, p xv

<sup>19</sup> Ecorys (2012), *Trade Sustainability Impact Assessment in Support of Negotiations of a DCFTA between the EU and Georgia and the Republic of Moldova*, written for DG Trade, the European Commission, p13 and 14

<sup>20</sup> Ecorys (2012), *Trade Sustainability Impact Assessment in Support of Negotiations of a DCFTA between the EU and Georgia and the Republic of Moldova*, written for DG Trade, the European Commission, p13 and 14

evaluation plan, the EU’s DG Trade has already launched an independent post evaluation to provide an overall assessment and evidence of the achievements of the DCFTA, but that research has yet to be published.

The German Economic Team has provided one assessment of the impact of the AA on Georgia, Moldova and Ukraine. They ‘estimate the impact of the DCFTA on the three countries by comparing relevant indicators in 2018 and 2013’ and conclude that ‘the overall impact seems to be positive, but major differences exist between the countries’.<sup>21</sup> Specifically, they suggest:

Figure 2: The major effects of the DCFTA on the Economies of Ukraine, Moldova and Georgia according to the German Economic Team

	Ukraine	Moldova	Georgia
Exports	++	+++	+
Commodity composition of exports	+	0	++
FDI	0	+	+

Reference: Ricardo Giucci, Veronika Movchan and Woldemar Walter (2019), The economic effect of the DCFTA on Ukraine, Moldova and Georgia. A comparative analysis, Berlin Economics, financed by the Federal Ministry of Economic Affairs and Energy, slide 2

As one can see, this shows a big export effect for Moldova, but smaller in Ukraine and smallest in Georgia; no change in commodity composition of exports in Moldova, a small change in Ukraine and a significant change in Georgia, and; a modest impact on FDI in the Georgia and Moldova, but none in Ukraine.

We will look at recent changes in trade and FDI below. The biggest problem with this analysis, however, is that it more or less assumes that any change that happened after signing the AA must be caused by it. This is a fairly well acknowledged fallacy of social sciences, sometimes summarised by the Latin *post-hoc ergo propter-hoc* (after, therefore because of).

They are aware of this and say in a footnote, ‘Significant improvements of indicators in this period are interpreted as a positive DCFTA effect; this does not necessarily imply causality’.<sup>22</sup> This is problematic since ‘effect’ is more or less synonymous with ‘cause’. Nonetheless, a generous interpretation of the analysis above would highlight shifts that are curious rather than, by themselves, demonstrating an effect/cause.

In this analysis we also look at existing trade patterns and draw similar conclusions about the limited evidence for the impact of the DCFTA. However, even where there are changes, there are a range of reasons why one should not take these changes to necessarily mean an impact of the AA. First, the years from 2014 to 2019 have been tumultuous in the region, which has been rocked by an on-going war between Russia and Ukraine and a regional financial crisis precipitated by the drop in oil price in 2014 and made worse by Western sanctions against Russia.

Additionally, for Georgia, its high dependence on a small range of commodities means that the overall picture is routinely significantly impacted by changes in the dynamics of a single industry. For the EU, shifts in copper-ore exports (probably originating from Armenia) distort the overall picture, as does the impact of hazelnut exports precipitated by stink bug that decimated hazelnut crops in 2017.

<sup>21</sup> Ricardo Giucci, Veronika Movchan and Woldemar Walter (2019), The economic effect of the DCFTA on Ukraine, Moldova and Georgia. A comparative analysis, Berlin Economics, financed by the Federal Ministry of Economic Affairs and Energy, slide 2

<sup>22</sup> Berlin Economics (1 July 2019), The economic effect of the DCFTA on Ukraine, Moldova and Georgia: A Comparative Analysis, Berlin Economics, p5

Even more fundamentally, however, connecting the DCFTA with economic changes requires an explanation of the pathways through which it happens. This is far more problematic than most writing suggests and we will go into this in detail in the section of this report on the Association Agreement.

Most of the other analysis that will be considered here tends to simply assume that the EU is an enormous opportunity. Almost all government documents highlight the DCFTA as a huge reason for Georgia's comparative advantage, without ever considering that while efforts persist to help companies, huge practical hurdles persist in accessing that market. Other assessments about the opportunity, from a wide range of actors, tend to do the same. This will be discussed in the 'sectoral analysis' section below.

## Trade in Georgia

When considering trade and the potential for its growth, it is first worth considering where the level of export stands now, and how trade fits into the wider economy.

*Figure 3. Overview of Georgia's some of the main economic indicators, 2010-2019 (billion USD)*

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
GDP at current prices, billion USD	12.2	15.1	16.5	17.2	17.6	14.9	15.1	16.2	17.6	17.7
Exports	1.7	2.2	2.4	2.9	2.9	2.2	2.1	2.7	3.4	3.8
Imports	5.2	7.1	8.1	8.0	8.6	7.3	7.3	8.1	9.4	9.5
Balance of Trade	-3.6	-4.9	-5.7	-5.1	-5.7	-5.1	-5.2	-5.3	-6.0	-5.7
Exports excluding re-export	1.3	1.6	1.6	1.8	1.8	1.6	1.6	2.0	2.2	2.3

Reference: Geostat national and trade data available online

While exports have grown faster in percentage terms since imports are so much larger to start with, they have continued to grow in absolute terms. As a result, the balance of trade deficit has increased significantly in recent years.

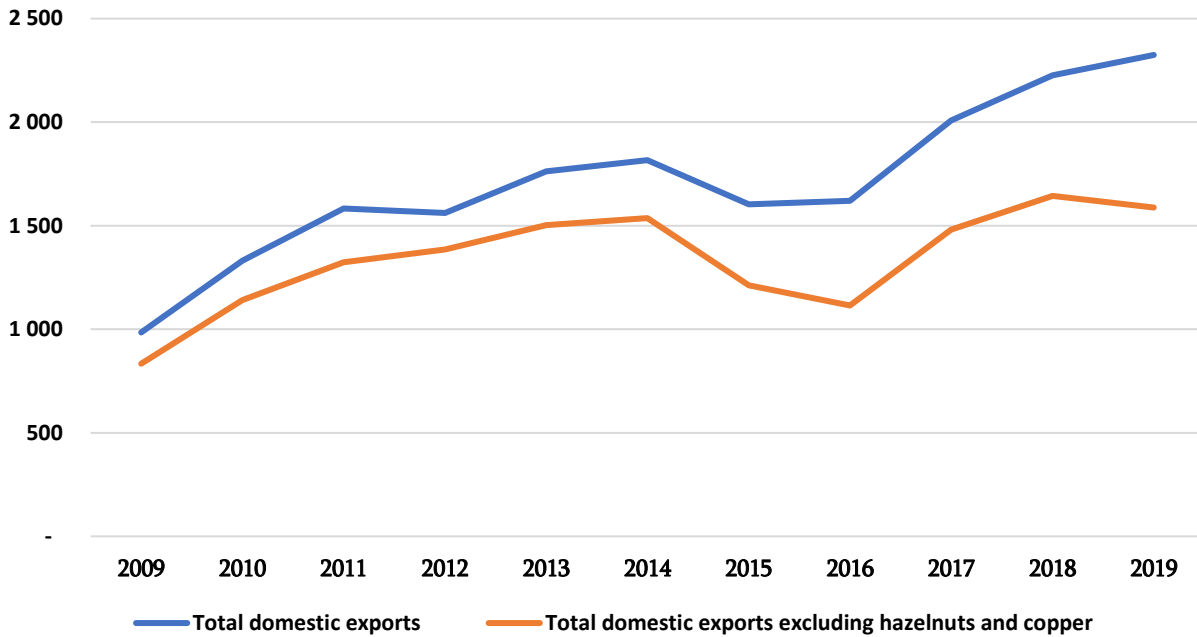
Georgian merchandise exports (excluding re-exports) of goods are around 10% of Georgian GDP. This is low<sup>23</sup> and is a problem because small countries like Georgia are generally more trade dependent as they cannot produce a wide range of goods at scale. To have considerable local consumer choice, they therefore have to import and export. For developing countries, trade is necessary if a country is to grow faster than local consumption. Therefore, trade is all but essential if Georgia is to grow quickly.

## Trade patterns

While it is not possible to deduce the impact of the Association Agreement on trade simply by looking at trade statistics, this is a necessary starting point. In the following tables we offer a summary of Georgia's main exports for the last 10 years, the products and countries to which Georgian producers export. Below one can see the growth in aggregate domestic exports. We show total domestic exports, and total domestic exports, without hazelnuts and copper, for reasons which will be explained below.

<sup>23</sup> It is hard to quantify how low this is compared to other countries. The World Bank makes a comparison of countries, but this includes goods and services, and it is clear that services dominate.

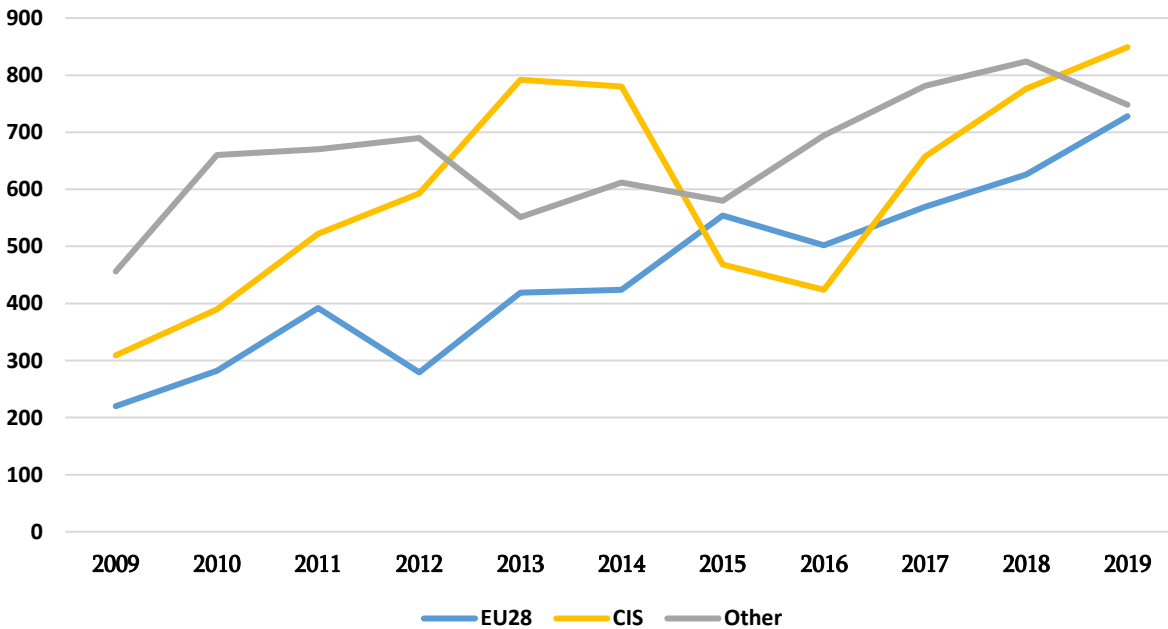
Figure 4. Total domestic exports with and without copper and hazelnuts, 2009-2019 (million USD)



Source: Geostat (provided on request, July 2020)

If we simply take the aggregate exports and break it down by country group, we get the following:

Figure 5. Domestic exports, including hazelnuts and copper, by country group, 2009-2019 (million USD)



Source: Geostat (provided on request, July 2020)

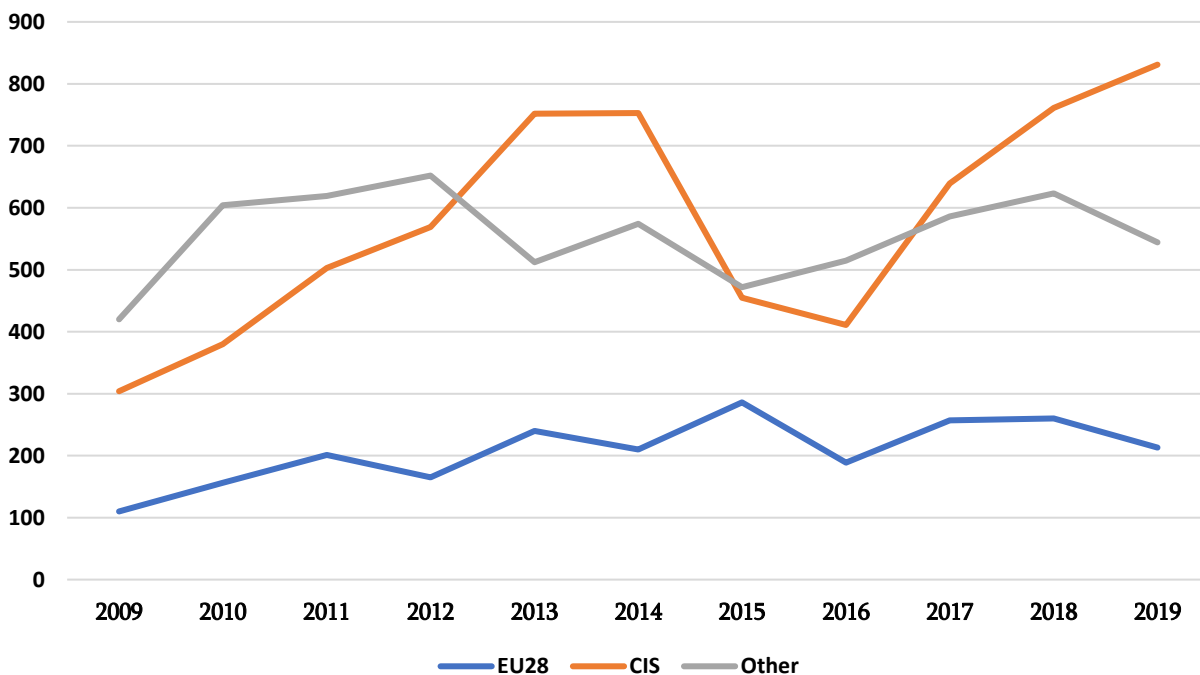
If we include hazelnuts and copper, the increase in exports to the EU in recent years seems pretty impressive. In 10 years, it has increased 231% or a year-on-year growth rate of 12%, compared to global increase in trade

of 136%. This has seen Georgia’s percentage of exports to the EU going up from 22% of total exports to 31%. Since 2013, the year before the Association Agreement was signed, exports have gone up by 74% or a year-on-year growth of 9.2% compared to an increase in exports to the world of 4.6%.

However, this can be entirely explained by an increase of copper ore, which is probably a misclassified re-export from Armenia and which mainly goes to Romania and Bulgaria.<sup>24</sup> Even if it is not, as an extractive that is unaffected by the Association Agreement (as we will see later) there is no reason to count it here.

We have also think that when looking at the impact of the Association Agreement, one should probably exclude hazelnut exports from our aggregate analysis. Exports of hazelnuts to the EU are currently 65 million USD and have dropped by 113 million USD since the stink bug decimated crops.<sup>25</sup> It is excluded from the overall picture since this decline has nothing to do with the EU. If we take these two commodities out of the domestic export figures then we are left with the following breakdown.

Figure 6. Domestic exports by country group, excluding hazelnuts and copper 2009-2019 (million USD)



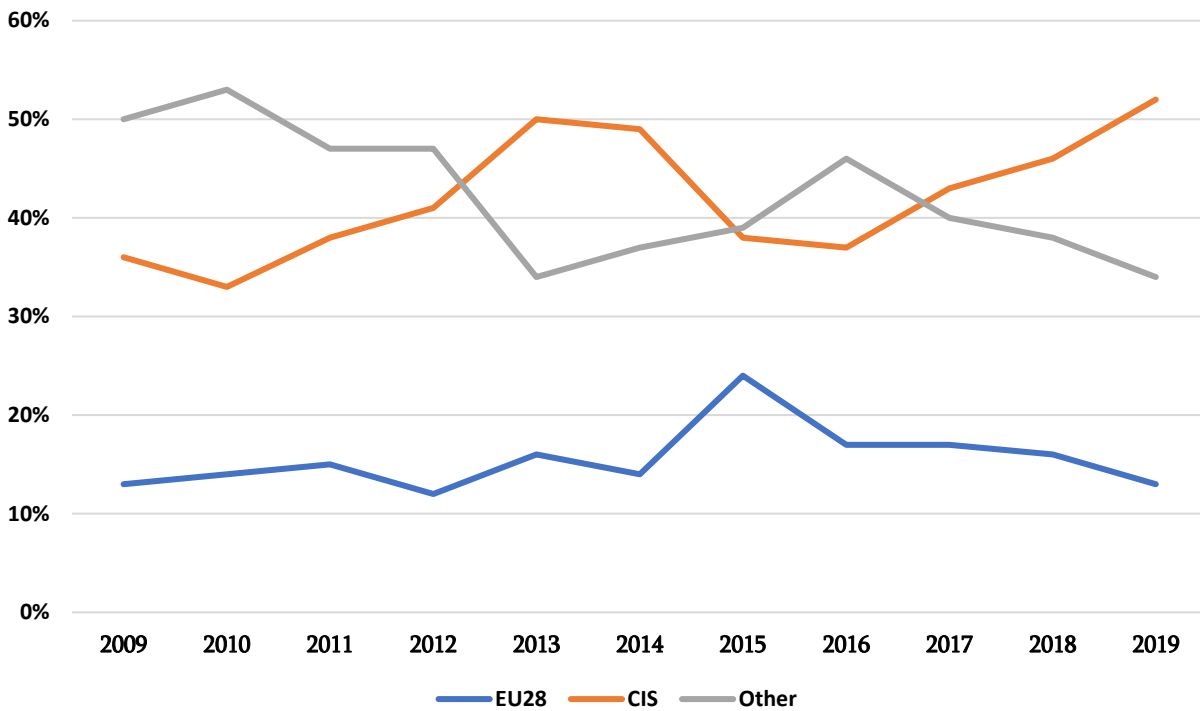
Reference: Geostat (provided on request, July 2020)

As we can see, without hazelnuts and copper, overall exports to the EU had gone up very marginally between 2013 and 2018, as reported by the German Economic Team, but then reduced in 2019 so that they are now below the 2013 level. If we look at how exports to different regions have changed, relative to one another, then the story of EU exports is even worse.

<sup>24</sup> This follows the example of the German Economic Team (2019), The Economic Impact of the DCFTA on Georgia, Ukraine and Moldova, slide 23. In correspondence with the author, they argue that significant changes in Georgia’s copper exports in recent years are likely a misclassified Armenian re-export..

<sup>25</sup> At the end of September 2019, hazelnut exports have increased by 74% in volume terms compared to the previous year, but this information is not included here. This still leaves them significantly below their previous highs, but is still a strong one-year recovery.

Figure 7. Domestic exports by country group, as a percentage of the total (excluding hazelnuts and copper) 2009-2019



Reference: Geostat (provided on request, July 2020)

These numbers certainly seem to suggest that, if anything, the EU’s trade importance to Georgia has been declining over time. Alternatively, we can see the last decade as a turbulent case of the CIS countries asserting their natural dominance. The CIS, as a market, was depressed prior to 2012 because of the Russian trade embargo. This corrected quickly from 2012-2014, but diminished again due to the regional financial crisis that started at the end of 2014. Since then, the CIS’ relative importance (and Russia in particular) has been occurring to the detriment of the EU and the rest of the world (in relative terms).

This does not mean that the EU Association Agreement has had no impact. However, as we will see, it clearly does mean that it has not created a transformative change in aggregate. Nonetheless, to gain meaningful insights from this data, it is necessary to look on a country-by-country basis, and to consider sectoral changes. We will, therefore, leave a review of the big picture until providing an overview of sectors in aggregate and by country.

First, we will start by reviewing the major commodity exports.



Figure 8. Domestic exports to the world from Georgia by for regrouped commodities, 2009-2019 (Million USD)

Commodity	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Live animals and meat	34	33	43	60	63	48	39	52	69	75	56
Other animal products	4	7	5	3	6	5	11	12	5	5	6
Nuts	70	75	127	82	166	183	175	178	80	54	65
Fruits and vegetables	18	18	10	13	25	20	18	18	21	28	43
Other food	53	43	51	88	108	98	89	93	107	110	87
Wine and spirits	71	76	97	120	194	232	122	152	231	280	305
Other beverages	35	52	64	83	126	167	101	92	114	146	162
Copper	81	116	133	94	92	97	214	327	446	528	672
Ore (excl. copper)	73	88	102	87	93	86	137	84	93	60	41
Chemicals and pharm (excl. mang)	21	19	31	59	42	34	27	25	35	44	38
Fertilisers	60	84	144	137	131	138	110	66	77	93	96
Wooden and paper products	21	13	20	26	25	24	19	28	38	32	34
Apparel	26	29	27	40	53	78	81	76	85	85	105
Precious metals	118	125	119	101	90	49	73	88	77	82	88
Manganese (ferro- alloys)	132	270	260	266	238	292	200	175	312	360	313
Iron and steel (excl. ferro-alloys)	71	159	195	127	165	131	51	40	71	78	65
Other metals	10	22	28	23	23	24	20	21	28	31	27
Electrical machinery	8	8	9	13	13	7	19	11	14	16	14
Railway	15	16	19	13	29	22	15	4	2	6	13
Other	63	78	100	126	79	82	81	78	103	113	96
<b>Total</b>	<b>985</b>	<b>1 332</b>	<b>1 583</b>	<b>1 561</b>	<b>1 762</b>	<b>1 816</b>	<b>1 603</b>	<b>1 620</b>	<b>2 008</b>	<b>2 226</b>	<b>2 325</b>

Reference: Geostat (provided on request, July 2020)

Figure 9: Domestic Exports from Georgia by regrouped commodities for the EU28, 2009-2019 (million USD)

Regrouped commodity	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Live animals and meat	0.0	-	0.0	-	-	0.0	0.1	0.0	0.0	0.0	0.0
Other animal products	-	0.0	0.1	-	0.0	0.1	0.1	0.0	0.1	0.0	0.0
Nuts	46	46	99	49	116	143	149	145	52	35	44
Fruits and vegetables	0.3	0.5	0.8	0.7	0.5	0.9	0.9	1.0	1.1	1.2	1.4
Other food	5	11	12	17	14	21	20	23	25	26	19
Wine and spirits	6	7	8	17	31	19	13	15	23	39	24
Waters	7	10	12	14	10	12	11	13	14	17	17
Copper	64	79	93	65	63	72	120	168	260	330	470
Ore and minerals (excl. copper)	15	31	40	29	42	34	79	29	51	21	12
Chemicals and pharmaceuticals (excl. manganese)	0.5	1.9	1.9	1.9	1.6	1.4	0.6	1.6	3	1.7	1.2
Fertilisers	44	38	70	41	52	32	66	24	44	46	37
Wooden and paper products	2.6	2.2	2.9	3	3	5	4	10	12	12	14
Apparel	3	4	5	4	10	16	15	15	15	12	21
Precious metals	1.1	7	7	9	16	10	9	6	5	8	11
Manganese (Ferro-alloys)	7	21	15	5	31	30	25	22	21	20	17
Iron and steel (excl. ferro-alloys)	2.8	7	6	6	5	4	1.9	1.8	6	11	5
Other metals	1.1	1.7	2.9	1.5	1.6	1.2	4	6	6	8	5
Electrical machinery	2.0	1.7	1.9	2.1	2.6	3	7	2.3	4	3	1.4
Railway and parts	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.1	0.6	0.1	0.1
Other	12	11	16	14	19	20	30	19	26	33	26
<b>Total</b>	<b>220</b>	<b>282</b>	<b>392</b>	<b>279</b>	<b>419</b>	<b>424</b>	<b>554</b>	<b>502</b>	<b>569</b>	<b>626</b>	<b>728</b>

Reference: Geostat (provided on request, July 2020)

Here, we can see pretty clearly that the misclassified copper dwarfs everything else. But also, from commodities, while modest relative to the global total exports, export to the EU of fertilizer, precious metals and manganese are still significant. Food is probably the biggest real value-added category that exports to the EU. This is dominated by nuts, processed foods and wine and water. In manufacturing apparel and wooden products dominate with electrical and machinery very small categories.

In terms of dynamics other than copper and nuts, which have been explained before, wine and spirits have fluctuated a lot, growing strongly to 2018 but dropping back in 2019, due to a decline of \$13 million in spirit sales to France. Water has seen growth, though not consistent. Other than that, pharmaceuticals, wooden products and apparel have seen consistent growth. Electrical machinery and railway parts have seen some decline.

Below we provide the country breakdown of our reorganised commodity groups, so that one can roughly see where most products are going.

Figure 10. Commodity groups by main export country and value, 2019 (million USD)

Regrouped commodity	2019 Export Value	Main country of export		
		EU	CIS (and Ukraine)	Other
Live animals and meat	56	-	Azerbaijan (\$17m), Armenia (\$3m)	Iran and Iraq (\$12m each), Saudi Arabia (\$5m), Kuwait (\$4m), UAE (\$2m), Qatar (\$1m)
Other animal products	6	-	Armenia (\$2m), Azerbaijan (\$1)	Vietnam (\$1m)
Nuts	65	Italy (\$14m), Germany (\$11m), Czech Republic (\$4m), Lithuania, France, Spain, Poland (\$3m each), Latvia (\$1m)	Russia (\$4m), Belarus and Ukraine (\$2m each), Kazakhstan (\$1m)	China (\$3m), Tunisia (\$2m), Canada, Iraq, Mexico, Brazil, Switzerland (\$1m each)
Fruits and vegetables	43	Germany (\$1m)	Russia (\$30m), Armenia (\$6m), Ukraine (\$4m)	-
Other food	87	Germany (\$10m), France (\$2m), Belgium, Greece, Czech Republic, Netherlands, Romania and Bulgaria (\$1m each)	Russia (\$17m), Armenia (\$8m), Azerbaijan (\$7m), Ukraine (\$3m), Turkmenistan and Uzbekistan (\$1m each)	Turkey (\$13m), China (\$4m), USA (\$3m), Taiwan (\$2m), Iraq, Israel, Iran, Australia and Chile (\$1m each)
Wine and spirits	305	Poland (\$9m), Latvia (\$5m), Lithuania (\$3m), Germany and Estonia (\$2m each), UK (\$1m)	Russia (\$168m), Ukraine (\$54m), Belarus (\$15m), Kazakhstan (\$10m), Moldova (\$4m), Armenia and Kyrgyzstan (\$1m each)	China (\$20m), USA (\$3m), Israel, Japan, Mongolia and Canada (\$1m each)
Other beverages	162	Lithuania (\$15m)	Russia (\$73m), Ukraine (\$24m), Kazakhstan (\$16m), Belarus (\$10m), Azerbaijan (\$8m), Armenia (\$4m), Uzbekistan (\$3m), Moldova, Tajikistan, Kyrgyzstan and Turkmenistan (\$1m each)	USA (\$2m), Israel (\$1m)
Copper	672	Bulgaria (\$268m), Romania (\$167m), Spain (\$32m), Lithuania and Netherlands (\$1m each)	Russia and Belarus (\$4m each), Ukraine (\$1m)	China (\$172m), Turkey (\$15m), Korea (\$3m), Hong Kong and India (\$1m each)
Ore and minerals (excl. copper)	41	Bulgaria (\$7m), UK (\$3m), Italy (\$1m)	Armenia (\$6m), Uzbekistan (\$4m), Ukraine and Russia (\$2m each), Azerbaijan and Belarus (\$1m each)	Turkey and Switzerland (\$4m each), China (\$2m), Singapore and UAE (\$1m each)
Chemicals and pharma (excl. manganese)	38	Latvia (\$1m)	Armenia (\$8m), Azerbaijan (\$7m), Uzbekistan (\$6m), Tajikistan (\$2m), Ukraine, Kazakhstan, Russia and Turkmenistan (\$1m each)	Turkey and Tanzania (\$3m each), Cuba, Saudi Arabia, Iraq and Kenya (\$1m each)

Fertilisers	96	Lithuania (\$11m), Romania (\$10m), Bulgaria and UK (\$5m each), Italy (\$3m), Spain (\$2m), Greece (\$1m)	Ukraine (\$36m), Turkmenistan (\$7m), Azerbaijan (\$5m), Armenia (\$4m), Uzbekistan (\$1m)	Peru (\$6m)
Wooden and paper products	34	Germany (\$4m), Poland (\$3m), Italy and Belgium (\$2m each), Netherlands, France and UK (\$1m each)	Armenia (\$9m), Azerbaijan (\$1m)	Iran (\$7m), Turkey (\$2m)
Apparel	105	Italy (\$13m), Poland and Germany (\$3m each)	Azerbaijan (\$2m), Russia and Kazakhstan (\$1m)	Turkey (\$79m)
Precious metals	88	Lithuania (\$6m), UK and Italy (\$2m each), Czech Republic (\$1m)	-	Switzerland (\$65m), UAE (\$6m), Japan (\$4m), Turkey (\$2m)
Manganese (Ferro-alloys)	313	UK and Spain (\$4m each), France (\$3m), Netherlands (\$2m), Italy (\$1m)	Russia (\$116m), Azerbaijan (\$5m), Kazakhstan (\$2m)	USA (\$117m), Turkey (\$19m), Iran (\$14m), Brazil (\$7m), Chile and Peru (\$4m each), Colombia (\$3m), Uruguay (\$1m)
Iron and steel (excl. ferro-alloys)	65	Germany (\$2m), Italy, Netherlands and UK (\$1m each)	Azerbaijan (\$12m), Armenia (\$4m), Turkmenistan (\$3m), Ukraine (\$1m)	Turkey (\$34m), USA, Iran, Kenya, Tanzania and India (\$1m each)
Other metals	27	Poland (\$2m), UK, Netherlands and Hungary (\$1m each)	Russia and Armenia (\$1m each)	Turkey (\$12m – lead and aluminium scrap), Japan (\$4m), India and China (\$1m each)
Electrical machinery	14	-	Azerbaijan and Armenia (\$4m each), Russia (\$1m)	Israel and UAE (\$1m each)
Railway and parts	13	-	Kazakhstan (\$9m), Russia (\$3m)	-

Reference: Geostat (provided on request, July 2020)

First, there are commodities. This includes copper (mostly copper ore), manganese (Georgia's biggest export category for many years), precious metals (mostly gold) and other metals. These generally have wildly varying export numbers that are suggestive of commodity dynamics. Fertilisers could probably be put in this category and also have shifting export numbers that seem to have no particular internal logic. Together, they amount for about half of all Georgian domestic exports (49% without fertiliser, 52% with it). The total for this category has about doubled since 2013, though copper ore, which has increased by around 500 million USD in that time, can explain much of that shift. If the German Economic Team are right, and this is significantly made up of a misclassified re-export, then commodities have not grown very much at all.

In terms of geography, the large volume commodities, as one would expect, show fairly shifting export patterns, presumably based on price arbitrage. Ferroalloy mostly goes to the US and Russia with many other countries across the world and small but significant importers. Precious metals mostly go to Switzerland, with smaller amounts spread to the EU and globally. Fertiliser is also sold widely in the EU and the region. Copper mostly goes to Bulgaria, Romania and China

Food and beverages are worth about one-third of all domestic exports, though at the current time two-thirds of that (around 20% of the total) is beverages and food is only 11%. This has not always been the case. Beverages had a big reduction in 2015, due to the regional financial crisis that started at the end of 2014 and hit wine and mineral water, as they are mostly sold to the region. Beverages have recovered since then,

particularly driven by growth in exports to Russia, but in 2017 food generally was hit by reductions in nuts that followed the stink bug.

For food, the biggest live animal importers are Iran, Iraq and Azerbaijan, but smaller volumes go to Armenia and the Gulf states. The EU is the biggest importer of nuts, with Italy and Germany the biggest importers, but nuts are also sold both regionally and globally. Fresh fruits and vegetables overwhelmingly export to the region, as do wines and spirits and mineral water. For processed foods, while Russia is the biggest importer and Turkey is the second biggest, the EU and particularly Germany are significant importers. For wine, the EU states of Poland, Lithuania and Latvia are the biggest importers. Lithuania is also a significant importer of water.

In the realm of more regular value-added manufacturing goods, at scale we have pharmaceuticals, wooden products, apparel, iron and steel and electrical and other machinery, as well as railway carriages/parts, which are worth considering separately. In 2019, these were only worth 12% of Georgia's exports, so it is easy to see why shifts in other areas can swamp these numbers. Along with agricultural productions, these categories are largely what the country is hanging its hopes on. From that point of view the aggregate is not encouraging, since it has seen a significant aggregate decline since 2013, though with considerable variation.

Pharmaceuticals see most of their exports to the region and the world, but still have some exports to the EU. For wood and paper products, the EU is a (slightly) bigger importer than any of the other groups, though Azerbaijan and Iran are the two biggest countries. For apparel, Turkey is by far the biggest importer with the EU taking about 20%. Steel products mostly go to Turkey and the region, with small amounts going to the EU and the rest of the world. Electrical machinery and railway parts go almost entirely to the region and the rest of the world, with no exports to the EU.

If we just look at the EU portion of this and try to aggregate a little, we can also see the following:

Below we present the same information, the other way around, so that one can see the major composition of each country.

*Figure 11. Top exporter countries by country group, 2009-2019 (million USD)*

#	Country	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>World Total</b>		<b>985</b>	<b>1 332</b>	<b>1 583</b>	<b>1 561</b>	<b>1 762</b>	<b>1 816</b>	<b>1 603</b>	<b>1 620</b>	<b>2 008</b>	<b>2 226</b>	<b>2 325</b>
<b>EU28 Total</b>		<b>220</b>	<b>282</b>	<b>392</b>	<b>279</b>	<b>419</b>	<b>424</b>	<b>554</b>	<b>502</b>	<b>569</b>	<b>626</b>	<b>728</b>
1	Bulgaria	82	67	93	69	81	94	178	157	186	258	282
2	Romania	12	30	19	3	5	4	27	37	75	58	178
3	Spain	15	32	23	15	33	33	42	41	57	49	43
4	Germany	23	35	46	35	68	58	70	76	39	44	42
5	Lithuania	10	11	18	17	19	25	27	21	31	40	41
6	Italy	23	26	76	53	81	85	73	73	60	42	40
7	Poland	5	5	8	5	7	10	28	8	19	15	24
8	UK	8	18	14	19	25	17	20	11	11	14	21
9	France	6	11	27	17	34	22	17	15	14	25	15
10	Other EU	36	48	67	46	67	78	72	63	77	81	42
<b>CIS Total</b>		<b>309</b>	<b>390</b>	<b>522</b>	<b>593</b>	<b>792</b>	<b>780</b>	<b>468</b>	<b>424</b>	<b>657</b>	<b>776</b>	<b>849</b>

1	Russia	21	33	31	30	143	253	155	191	357	383	432
2	Ukraine	83	103	136	156	184	135	55	61	75	114	130
3	Azerbaijan	110	118	192	205	207	169	90	48	86	116	87
4	Armenia	46	71	82	94	106	95	87	62	72	78	83
5	Kazakhstan	16	26	39	57	92	71	38	26	24	37	43
6	Belarus	13	22	27	32	38	32	19	15	19	20	33
7	Uzbekistan	6	2.6	5	5	8	13	8	10	11	17	16
8	Turkmenistan	10	10	4	4	5	5	9	4	8	4	13
9	Other CIS	4	4	8	8	10	7	7	6	6	7	11
<b>Other Countries Total</b>		<b>456</b>	<b>660</b>	<b>670</b>	<b>690</b>	<b>551</b>	<b>612</b>	<b>580</b>	<b>694</b>	<b>781</b>	<b>824</b>	<b>748</b>
1	China	4	27	29	25	34	23	88	171	190	184	202
2	Turkey	216	197	216	124	175	226	178	168	207	232	188
3	USA	37	186	140	218	134	200	102	67	120	159	129
4	Switzerland	1.4	0.1	1.6	13	3	9	11	50	65	67	71
5	Iran	6	15	16	15	18	8	11	28	48	50	39
6	Iraq	11	8	7	5	5	9	9	38	29	18	15
7	UAE	13	25	27	13	8	5	7	9	13	11	11
8	Other	167	202	232	275	173	132	174	162	107	103	92

Reference: Geostat (provided on request, July 2020)

Again, if we take each country in turn, we can see the overall picture for each country.

Figure 12. Top exporter countries by main export commodity groups and value, 2019 (million USD)

#	Country	2019 Export Value	Main commodity of export
<b>World Total</b>		<b>2 325</b>	
<b>EU28 Total</b>		<b>728</b>	<b>Copper (\$470m), Nuts (\$44m), Fertilisers (\$37m), Wine and spirits (\$24m), Apparel (\$21m), Other food (\$19m), Other beverages and Manganese (Ferro-alloys) (\$17m each), Wooden and paper products (\$14m), Ore and minerals (excl. copper) (\$12m), Precious metals (\$11m)</b>
1	Bulgaria	282	Copper (\$268m), Ore and minerals (excl. copper) (\$7m), Fertilisers (\$5m), Other food (\$1m)
2	Romania	178	Copper (\$167m), Fertilisers (\$10m), Other food (\$1m)
3	Spain	43	Copper (\$32m), Manganese (Ferro-alloys) (\$4m), and Nuts (\$3m), Fertilisers (\$2m)
4	Germany	42	Nuts (\$11m), Other food (\$10m), Wooden and paper products (\$4m), Apparel (\$3m), Wine and spirits and Iron and steel (excl. ferro-alloys) (\$2m each), Fruits and vegetables (\$1m)
5	Lithuania	41	Other beverages (\$15m), Fertilisers (\$11m), Precious metals (\$6m), Nuts and Wine and spirits (\$3m each), Copper (\$1m)
6	Italy	40	Nuts (\$14m), Apparel (\$13m), Fertilisers (\$3m), Wooden and paper products and Precious metals (\$2m each), Manganese (Ferro-alloys), Iron and steel (excl. ferro-alloys), and Ore and minerals (excl. copper) (\$1m each)
7	Poland	24	Wine and spirits (\$9m), Apparel, Wooden and paper products and Nuts (\$3m each), Other metals (\$2m)

8	UK	21	Fertilisers (\$5m), Manganese (Ferro-alloys) (\$4m), Ore and minerals (excl. copper) (\$3m), Precious metals (\$2m), Other metals, Wine and spirits, Iron and steel (excl. ferro-alloys) and Wooden and paper products (\$1m each)
9	France	15	Manganese (Ferro-alloys) and Nuts (\$3m each), Other food (\$2m), Wooden and paper products (\$1m)
10	Other EU	42	Wine and spirits (\$9m), Nuts (\$6m), Other food (\$5m), Wooden and paper products and Manganese (Ferro-alloys) (\$4m each), Other metals (\$2m), Fertilisers, Copper, Iron and steel (excl. ferro-alloys), Chemicals and pharmaceuticals (excl. manganese), Precious metals and Other beverages (\$1m each)
<b>CIS Total</b>		<b>849</b>	<b>Wine and spirits (\$253m), Other beverages (\$141m), Manganese (Ferro-alloys) (\$125m) and Fertilisers (\$52m), Fruits and vegetables (\$41m), Other food (\$39m), Chemicals and pharmaceuticals (excl. manganese) (\$27m), Iron and steel (excl. ferro-alloys) (\$21m)</b>
1	Russia	432	Wine and spirits (\$168m), Manganese (Ferro-alloys) (\$116m), Other beverages (\$73m), Fruits and vegetables (\$30m), Other food (\$17m), Nuts and Copper (\$4m each), Railway and parts (\$3m), Chemicals and pharmaceuticals (excl. manganese), Ore and minerals (excl. copper) (\$2m), Apparel, Other metals, Electrical machinery and Chemicals and pharmaceuticals (excl. manganese) (\$1m each)
2	Ukraine	130	Wine and spirits (\$54m), Fertilisers (\$36m), Other beverages (\$24m), Fruits and vegetables (\$4m), Other food (\$3m), Ore and minerals (excl. copper) and Nuts (\$2m each), Iron and steel (excl. ferro-alloys), Chemicals and pharmaceuticals (excl. manganese) and Copper (\$1m each)
3	Azerbaijan	87	Live animals and meat (\$17m), Iron and steel (excl. ferro-alloys) (\$12m), Other beverages (\$8m), Other food and Chemicals and pharmaceuticals (excl. manganese) (\$7m each), Manganese (Ferro-alloys) and Fertilisers (\$5m each), Electrical machinery (\$4m), Apparel (\$2m), Other animal products, Ore and minerals (excl. copper), Wooden and paper products (\$1m each)
4	Armenia	83	Wooden and paper products (\$9m), Other food and Chemicals and pharmaceuticals (excl. manganese) (\$8m each), Fruits and vegetables and Ore and minerals (excl. copper) (\$6m each), Other beverages, Fertilisers, Electrical machinery and Iron and steel (excl. ferro-alloys) (\$4m each), Live animals and meat (\$3m), Other animal products (\$2m), Wine and spirits and Other metals (\$1m each)
5	Kazakhstan	43	Other beverages (\$16m), Wine and spirits (\$10m), Railway and parts (\$9m), Manganese (Ferro-alloys) (\$2m), Chemicals and pharmaceuticals (excl. manganese), Apparel and Nuts (\$1m each)
6	Belarus	33	Wine and spirits (\$15m), Other beverages (\$10m), Copper (\$4m), Nuts (\$2m), Ore and minerals (excl. copper) (\$1m)
7	Uzbekistan	16	Chemicals and pharmaceuticals (excl. manganese) (\$6m), Ore and minerals (excl. copper) (\$4m), Other beverages (\$3m), Other food and fertilisers (\$1m each)
8	Turkmenistan	13	Fertilisers (\$7m), Iron and steel (excl. ferro-alloys) (\$3m), Other food, Chemicals and pharmaceuticals (excl. manganese) and Other beverages (\$1m each)
9	Other CIS	11	Wine and spirits (\$5m), Other beverages (\$3m), Chemicals and pharmaceuticals (excl. manganese) (\$2m)
<b>Other Countries Total</b>		<b>748</b>	<b>Copper (\$193m), Manganese (Ferro-alloys) (\$171m), Apparel (\$80m), Precious metals (\$77m), Iron and steel (excl. ferro-alloys) (\$39m), Live animals and meat (\$37m), Other food (\$29m), Wine and spirits (\$27m)</b>
1	China	202	Copper (\$172m), Wine and spirits (\$20m), Other food (\$4m), Nuts (\$3m), Ore and minerals (excl. copper) (\$2m), Other metals (\$1m)
2	Turkey	188	Apparel (\$79m), Iron and steel (excl. ferro-alloys) (\$34m), Manganese (Ferro-alloys) (\$19m), Copper (\$15m), Other food (\$13m), Other metals (\$12m), Ore and



			minerals (excl. copper) (\$4m), Chemicals and pharmaceuticals (excl. manganese) (\$3m), Wooden and paper products and Precious metals (\$2m each)
3	USA	129	Manganese (Ferro-alloys) (\$117m), Wine and spirits and Other food (\$3m each), Other beverages (\$2m), Iron and steel (excl. ferro-alloys) (\$1m)
4	Switzerland	71	Precious metals (\$65m), Ore and minerals (excl. copper) (\$4m), Nuts (\$1m)
5	Iran	39	Manganese (Ferro-alloys) (\$14m), Live animals and meat (\$12m), Wooden and paper products (\$7m), Iron and steel (excl. ferro-alloys) and Other food (\$1m each)
6	Iraq	15	Live animals and meat (\$12m), Other food, Chemicals and pharmaceuticals (excl. manganese) and Nuts (\$1m each)
7	UAE	11	Precious metals (\$6m), Live animals and meat (\$2m), Electrical machinery and Ore and minerals (excl. copper) (\$1m each)
8	Other	92	Manganese (Ferro-alloys) (\$21m), Live animals and meat (\$10m), Other food (\$8m), Other metals, Copper, Chemicals and pharmaceuticals (excl. manganese), Fertilisers, and Nuts (\$6m each), Wine and spirits and Precious metals (\$4m each), Iron and steel (excl. ferro-alloys) (\$3m), Other beverages and Other animal products (\$2m each), Electrical machinery, Ore and minerals (excl. copper) and Fruits and vegetables (\$1m each)

Reference: Geostat (provided on request, July 2020)

Presented in this way, this document is even harder to summarise. Therefore, we have tried to provide a country-by-country summary of the major changes that have happened for each EU country in the table below.

**Bulgaria:** Georgia's domestic exports to Bulgaria have more than tripled since 2013, from \$81m to \$282m in 2019. This was almost solely due to increase in copper exports, which went up from \$48m in 2013 to \$268m in 2019. Exports of ore and minerals (excl. copper) also increased from almost \$0 to \$7m in this period, while fertilisers decreased from \$32 to \$5m.

**Romania:** Georgia's domestic exports to Romania in 2019 was 35 times higher than in 2013 – exports increased from \$5m to \$178m. This was due to commencement of copper exports in 2016 with \$10m value, reaching \$167m in 2019. Before that the main export commodity to Romania was ore and minerals (excl. copper) and fertilisers. Export of ores and minerals was unsteady, for instance, in 2010 it was \$25m, between 2012-2014 it was under \$100,000, in 2016 it jumped to \$22m again and plummeted to \$19,000 in 2019. The export value of fertilisers increased from \$6m to \$10m between 2013-2019, with a slowdown in 2012-2014.

**Spain:** Since 2013 Georgia's domestic exports to Spain increased by \$10m – from \$33m to \$43m. Copper exports increased from \$10 to \$32m, while manganese(ferro-alloys) and nuts decreased from \$9 and \$6m to \$3m for both commodities.

**Germany:** Since 2013 Georgia's domestic exports to Germany have decreased from \$68m to \$42m in 2019. This was mainly due to a decrease in nut exports – from \$47 to \$11m in the same period. Meanwhile, the export of other food items increased from \$7m to \$10m, and of wooden and paper products – from \$19,000 to \$4m. Apparel exports was steady \$3m for each year. There was a slight increase in wine and spirits, iron and steel (excl. ferroalloys) from less than a million to over \$2m and for fruits and vegetables - from less than a million to over \$1m.

**Lithuania:** Between 2013-2019 Georgia's domestic exports to Lithuania doubled from \$19m to \$41m. This was mainly due to an increase in the export of waters (from \$8m to \$15m) and fertilisers (from no export at all to \$11m). Export of precious metals also increased from \$2m to \$6m. Export of nuts and wine and spirits was steady (mainly \$2m and \$3m, respectively).

**Italy:** Georgia's domestic exports to Italy decreased from \$81m to \$40m between 2013-2019. This was mainly due to decrease in exports of ore and minerals (excl. copper) – from \$41m to just \$1 million. Meanwhile, apparel exports increased from \$6m to \$13m. Fertilisers seem to be doing better too from just under \$1m to \$3m in 2019.

**Poland:** Georgia's domestic exports to Poland have more than tripled from \$7m to \$24m between 2013-2019. The largest increase was in wine and spirits, with a steady annual rise from \$3m to \$10m. The export of apparel was decreasing every year from \$33,000 in 2013 but suddenly jumped to \$3m in 2019. Exports of wooden and papers products have been slightly increasing from little under \$1,000 to \$3 million in 2019. Nuts exports were steady around \$2m.

**UK:** Georgia's domestic exports to UK were yearly decreasing between 2013-2018 from \$25m to \$14m but recovered in 2019 to \$21m. Between 2013-2019 nut exports decreased from \$3m to \$0.1m, precious metals decreased from \$6m to \$2m; fertilisers increased from \$1m to \$5m, with no export in 2016-2017.

**France:** Georgia's domestic exports to France was yearly decreasing from \$34m to \$15m, with a slight spike of \$25m in 2018. This spike was due to \$13m export of wine and spirits, while this commodity had smaller [\$6m and less] exports in all years since 2013 [when it was \$19m]. Export of nuts also decreased since 2017 from \$6m in 2013 to \$3m.

**Netherlands:** Georgia's domestic exports to Netherlands were \$9m in each year of 2013, 2014 and 2019 with high figures in between [highest being \$21m in 2015]. However, if we look at the commodity breakdown, there is no large rise/fall pattern to report. The only obvious pattern is nuts which were increasing from \$2m to \$4m between 2013-2015, went downhill from there and in 2019 amounted to absolute 0. The largest spike was in 2015 in 6-digit product category 'Helicopters; of an unladen weight exceeding 2000kg' accounting for \$10 million in exports. Wooden and paper products was close to 0 in 2013, jumped to \$4m in 2016 and then gradually decreased to \$1m in 2019.

**Latvia:** With Latvia, Georgia has a stable pattern of domestic exports with 1 or 2 million-dollar YoY positive or negative difference for total or commodity figures, mainly wine and spirits, nuts, chemicals and pharmaceuticals (excl. manganese) and other food items.

**Czech Republic:** Domestic exports to the Czech Republic decreased twice in size since 2013, from \$15m to \$7m in 2019. This was mainly due to a decrease in nut exports – from \$9m to \$4m, but also due to decrease in precious metals from \$5 to less than \$1m.

**Belgium:** With Belgium Georgia has stable pattern of domestic exports with 1 or 2 million dollar positive or negative YoY difference for total or commodity figures, with most commodities having less than \$1m export value. The ones over \$1m are wooden and paper products and other food, both of which went over \$1m only since 2017.

**Greece:** Georgia's domestic exports to Greece annually decreased from \$15m to \$3m since 2013 – mainly due to manganese/ferro-alloys which decreased from \$7m to absolute 0 between 2013-2019. Also, fertilisers decreased from \$5m to \$1m, and nuts from \$2 to \$0.5m.

**Estonia:** Domestic exports to Estonia are stable, with max \$1m YoY positive or negative difference so minimum of \$2m and maximum of \$4m each year. Wine and spirits are the only commodity with stable \$1m export each year. \$2m and \$3m fertilisers were exported in 2017 and 2018 respectively. Nut exports were over \$0.5m until 2017 – in 2018 and 2019 Estonia did not import nuts.

**Austria:** Domestic exports to Austria are sporadic - random spikes in several commodities, but nothing over \$5m. the most “persistent” large export category is Other food, with \$2, \$5 and \$3m in 2015, 2017 and 2018. Nuts was the highest in 2014 – \$4m, then decreased to absolute 0 in 2016, then increased to \$1m in 2018. Iron and steel (excl. ferro-alloys) was \$1m in 2018.

**Hungary:** Domestic exports to Hungary increased from \$0.3m to 1m between 2013-2019. Largely due to ‘other metals’ - \$0.6m.

**Slovakia:** In 2014 domestic exports to Slovakia amounted to \$11m – almost double of 2013 – but has been decreasing since, amounting to just below \$1m in 2019. This was mainly due to nuts –from \$10m in 2014 to \$0.4m in 2019. Other food category is relatively stable with \$1m each year except for 2013 and 2019 where it was less than \$0.5m.

**Denmark:** 2013-2019 domestic exports to Denmark vary between \$0.4m and \$1.6m [\$0.4 was in 2015]. The largest category is “other food” mainly between \$0.5m and \$1m. Apparel was \$0.5m in 2015. The rest – small figures.

### Changes in the composition of trade

Notwithstanding modest changes in volumes of trade, there has been some suggestion that the composition of trade may have changed in the last five years. This is one of the findings of the German Economic Team analysis of Georgia’s economy between 2015 and 2019 and is picked up in the EU’s analysis of the Association Agreement implementation. It was also mentioned in our discussion with the EU.

The German Economic team highlight three numbers to suggest the change in the composition of exports between 2013 and 2018 (not including copper and hazelnuts),

- An increase in the number of exports from 499 to 627
- 333 new goods (gross number) between 2013 and 2018
- A change in the concentration of good by 43%
- A decrease in the share of raw materials (from 20-6%), a decrease in semi-processed materials (from 46%-34%) and an increase in processed goods from (34% to 61%) of the total<sup>26</sup>

We duplicated the exercise for 2019 and found that the change was smaller, but GET uses Eurostat data and we used Geostat so that may explain the difference. We found that there were 429 product categories, at the four-digit level in 2013 and 473 in 2019. This resulted from a loss of 88 commodity categories and an increase of 132, so giving a net 44 product group (or around 10%). It is hard to know what to make of this, as with so much change this might not mean very much. Also, out of the 132 new, only 12 involved the increase of products of greater than \$1 million. These categories are listed below.

*Figure 13: Categories of exports, exported from the EU to Georgia in 2019, but not before 2013*

#	Code	Commodity	2014	2015	2016	2017	2018	2019
1	2603	Copper ores and concentrates	-	-	10	58	51	167
2	2616	Precious metal ores and concentrates	-	-	-	-	-	7

<sup>26</sup> Ricardo Giucci, Veronika Movchan and Woldemar Walter (2019), The economic effect of the DCFTA on Ukraine, Moldova and Georgia. A comparative analysis, Berlin Economics, financed by the Federal Ministry of Economic Affairs and Energy, slide 10-12

3	4421	Other articles of wood	0.0	0.2	0.4	2.5	3	4
4	6204	Women's or girls' suits, ensembles, jackets, trousers and similar clothes	-	0.0	0.0	0.1	0.2	2.5
5	7304	Tubes, pipes and hollow profiles, seamless, of iron or steel	0.9	0.3	0.1	1.3	3	2.3
6	7801	Unwrought lead	-	-	-	0.7	2.3	2.0
7	7601	Unwrought aluminum	-	-	0.5	1.9	1.6	1.9
8	8419	Machinery, plant or laboratory equipment, whether or not electrically heated	-	-	-	-	-	1.5
9	2007	Jams, fruit jellies, marmalades, fruit or nut pure or pastes	-	0.0	-	6	3	1.5
10	7404	Copper waste and scrap	-	0.4	0.2	1.1	0.4	1.5
11	6102	Women's or girls' overcoats, car-coats, capes and similar articles	0.1	0.0	0.1	0.1	0.3	1.2
12	6206	Women's or girls' blouses, shirts and shirt-blouses	-	-	0.0	0.0	0.0	1.0

Reference: Geostat (provided on request, July 2020)

Relatively little of this would suggest new 'break-out' exports, though the export of wooden articles (probably 'Georgian Products'), the expansion of apparel and jams are worth noting. The size of the new companies is generally fairly modest.

Figure 14: Size of new export categories in 2019

Export value range	2019
< \$1,000	168
\$1,000 - \$10,000	109
\$10,000 - \$100,000	108
\$100,000 - \$1 million	37
> \$1 million	12

Reference: Geostat (provided on request, July 2020)

Taken together, the increase in industrialisation of exports (not including nuts and copper) is significant and is supported by the general picture of exports to the EU simply described earlier. With growth in wine, processed food, apparel and wooden products, there is some indication of growth to the EU market in some interesting value-added sectors, where the country hopes to build growth in the future. However, at the current time the growth is small and it is certainly too soon to tell if these newer value-added categories will have a significant impact on the overall picture moving forward.

## FDI in Georgia

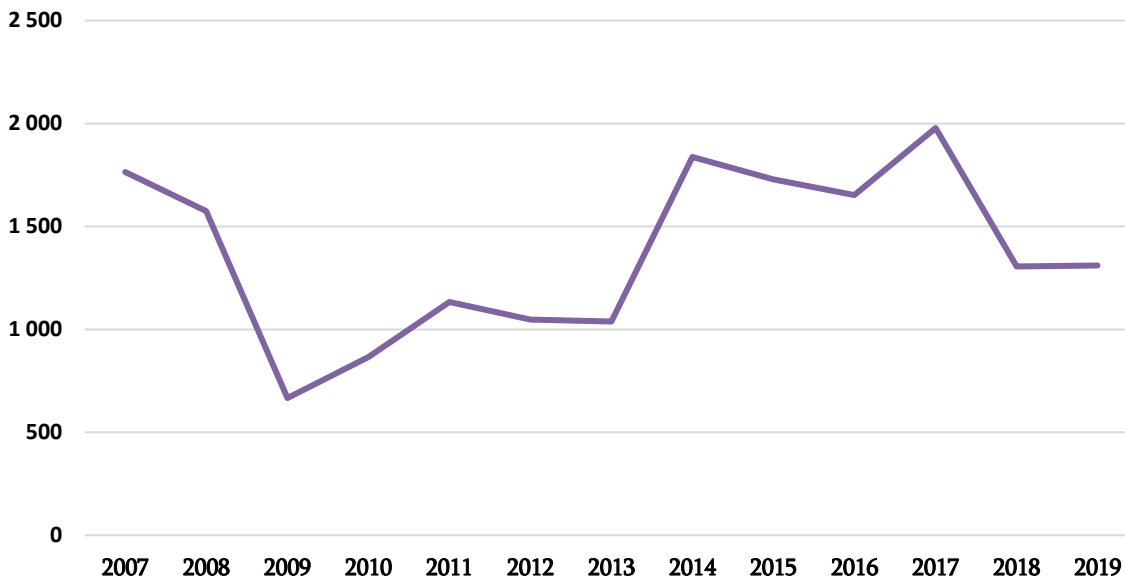
The connection of FDI's to export-orientation can be made in a range of ways. FDIs can be incredibly useful as a source of capital, but more importantly for export generation and for growth (as we will see later) FDI is particularly important for providing technical expertise, connection to value chains and access to clients. Together, these can make FDI economically transformative.

As always, in consideration of economic issues, FDI attraction and encouraging a strong interaction between Georgian economies and the West also has broader goals political, security and cultural goals. Encouraging

foreigners from the West to invest in Georgia can be part of a strategy for enmeshing a country into international relationships, and so can be seen as a significant component in geopolitics.

For both economic and broader geostrategic reasons, FDI has been a strong focus of Georgian Government policy for many years. For those reasons the recent apparent decline in FDI has been a major source of concern. A quick review of FDI since just before the 2008 financial crisis does seem to suggest recent decline.

Figure 15. FDI in Georgia, (million USD, 2007-2019)



Reference: Geostat (Reviewed August 2020)

Public data will not tell us exactly which company was responsible for which investment in a given year, as that is proprietary, but it will break this data down in three ways. First, Geostat provides information on FDI by sector.

Figure 16: Breakdown of FDI by Sector, 2007-2019 (million USD)<sup>27</sup>

Sectors	2007	2009	2011	2013	2015	2017	2018	2019
Financial sector	152	50	168	174	202	308	271	262
Energy sector	332	-2	213	246	124	281	121	194
Hotels and restaurants	223	38	30	-7	170	107	78	158
Construction	158	105	80	80	144	173	173	118
Manufacturing	283	130	120	107	105	99	140	102
Transports and communications	311	99	130	152				
Transports					607	475	203	71
Communications					1	49	-40	45
Mining	83	15	60	44	88	52	62	69
Other	224	232	333	243	288	419	258	248
<b>Total</b>	<b>1765</b>	<b>667</b>	<b>1134</b>	<b>1039</b>	<b>1729</b>	<b>1963</b>	<b>1265</b>	<b>1268</b>

Ref: Geostat (Reviewed June 2020)

<sup>27</sup> Note that the years are shown intermittently to make the chart easier to review. Also, 'transport and communication' was presented as one category until 2015, when they were split.

A few things stand out from this table. ‘Transport’ is one of the biggest consistent categories (included in transport and communication before 2015). That is because of the BP investment and particularly the expansion of the SCP pipeline (known as SCPX). This will be discussed in more detail below. After that, one can see three major elements: the financial sector, which is mostly related to the large banks; the energy sector, which is both distribution and new energy installation, and; ‘hotels and restaurants/construction’, which is really just the classification of two kinds of construction, and which together has been one of the biggest players over many years. Compared to any of these three, ‘manufacturing’ is fairly small.

The next breakdown of FDI is per country.

*Figure 17: Breakdown of FDI by country (2007-2019)*

	2007	2009	2011	2013	2015	2017	2019
<b>Total</b>	<b>1 765</b>	<b>667</b>	<b>1 134</b>	<b>1 039</b>	<b>1 729</b>	<b>1 963</b>	<b>1 268</b>
UK	132	72	57	55	399	247	248
Turkey	80	98	78	51	75	256	237
Ireland	-2	0	0	1	1	0	133
United States	68	-10	35	54	19	79	99
Panama	6	75	2	26	10	24	78
Netherlands	275	34	245	159	165	355	53
Russia	75	10	58	8	52	51	51
China	6	-2	30	101	67	19	40
Japan	30	-31	23	29	-35	18	39
Azerbaijan	20	30	69	85	582	462	38
Luxembourg	8	9	43	92	127	101	36
Denmark	145	0	3	10	12	-4	31
Other countries	922	381	490	369	255	354	185

Reference: Geostat (Reviewed June 2020)

The chart of FDI by country is extremely problematic as the country listed is based on the country of registration of a company doing the investment and does not necessarily track with the ultimate beneficial owner of the company. Therefore, any attempt to track ‘EU Investment’ by looking at this data is a waste of time. For example, the lists often show Luxembourg, the Netherlands and the UK as big investors, since companies are often registered there for other tax or arbitration purposes, even though neither the ultimate beneficial owner nor any meaningful business operation take place in those countries.

To further validate this problem, we asked Geostat to send us a list of the top 15 FDI companies for each of the last few years. They were able to give us the list back to 2013. On that list, 25 companies were listed as receiving FDI from European sources. The list is below.

Figure 18: List of Large EU-listed FDI investments in Georgia (2013-2019)

Company Name	Sector	Registration of investor	Likely UBO	Description	Year(s) when company was in top 15 for that year
Adjaristsqali Georgia Ltd	Energy	Netherlands / Norway / IOs	Norway/India	Hyrdo electric dam	2013-2015, 2018
Bank of Georgia Group	Finance	UK	EU/UK	UK listed Georgian Bank	2015, 2016, 2018
Black Sea Terminal	Transport and communication	Netherlands	UK/EU/Azerbaijan	SOCAR Subsidiary investment is BP/Socar	2013, 2014
Canargo Georgia	Mining	UK	US	Oil exploration and extraction company	2015
Caucasus Online	Transport and communication	UK / Virgin Islands	Georgian/UK/US	ISP recently mostly bought by Georgian telecoms provider Magticom which does have UK/US investors	2013
CBD Development	Construction	Netherlands	Unclear. Not EU	Owners of East Point Mall	2014, 2015
City Loft LLC	Other	Ireland	EU/Irish	Purchaser of the online betting Adjarabet	2019
Energo-pro Georgia	Energy	Czech Republic	Unclear	Large producer and distributor of energy in Georgia	2013-2018
Georgia Health Group	Healthcare	UK	EU/UK	UK listed Geo Healthcare – Bank of Georgia spin-off	2015, 2016
Georgia Capital	Finance	UK	EU/UK	UK listed Investment Fund – Bank of Georgia spin off	2019
Georgian Co-investment Fund	Different sectors	Luxembourg	Georgian/International	Georgian Co-investment Fund – each project done with different partners so nationality hard to establish	2014, 2016-2019



Georgian Manganese	Manufacturing	Cyprus / Luxembourg	Ukrainian	Largest Georgian Manganese miner/processor/exporter. Owned by the shareholders of Ukrainian PrivatBank	2013, 2014, 2017, 2018
IDS Borjomi Georgia	Manufacturing	Netherlands	Russian	Large mineral water bottler and distributor – general accepted to have been bought by Russians.	2013-2019
JTI Caucasus Ltd	Real estate	Netherlands	Japan	Japanese tobacco producer	2013
Lomisi	Manufacturing	Netherlands	Turkish	Turkish investor in Natakhtari	2014
Medea Operating Company	Real estate	Malta	Georgian	Seems to be part of Silkroad Group	2013
Poti Sea Port (APM terminals Poti)	Transport	Denmark	EU/Denmark	Danish investment in Poti terminal	2019
RMG Copper and RMG Gold	Mining	Netherlands	Russian	Copper extraction and sale. Board and GM are Russian.	2016, 2018, 2019
Rustavi Azot	Manufacturing	Luxembourg	Russia/Georgian	Producer of fertilizer. Owned by Roman Pipia an ethnic Georgian businessman based in Russia	2014, 2016
Rustavi Steel Ltd	Manufacturing	Netherlands	EU/Georgian/International	Largest steel producers. Owned by the ethnically Georgian but now London based Patarkatsishvili family	2019
SOCAR Georgia Gas Distribution	Other	Cyprus	Azerbaijan	Large Azeri state energy producer and one of the lead investors in South Caucasus Pipeline and upgrade (SCPX)	2015
TAV Urban Georgia LTD	Transport	UK / Turkey	Turkey	Turkish airport operator	2015, 2016
Turinvest	Hotels and restaurants	UK	Ukrainian	Wide ranging investments in hotels and real estate in Batumi - address of holding company is Ukraine	2015

Veon Georgia LLC	Communication	Virgin Islands (UK) / Luxembourg / Russia	Russian/International	Owner of Beeline though some management is UK	2015
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Reference: Taken from top list provided by Geostat on request, that shows 15 FDIs for each year from 2013-2019. Data on individual deal is deduction based on researcher market knowledge and online research about the activity of the company. UBO is best judgement based on public information.

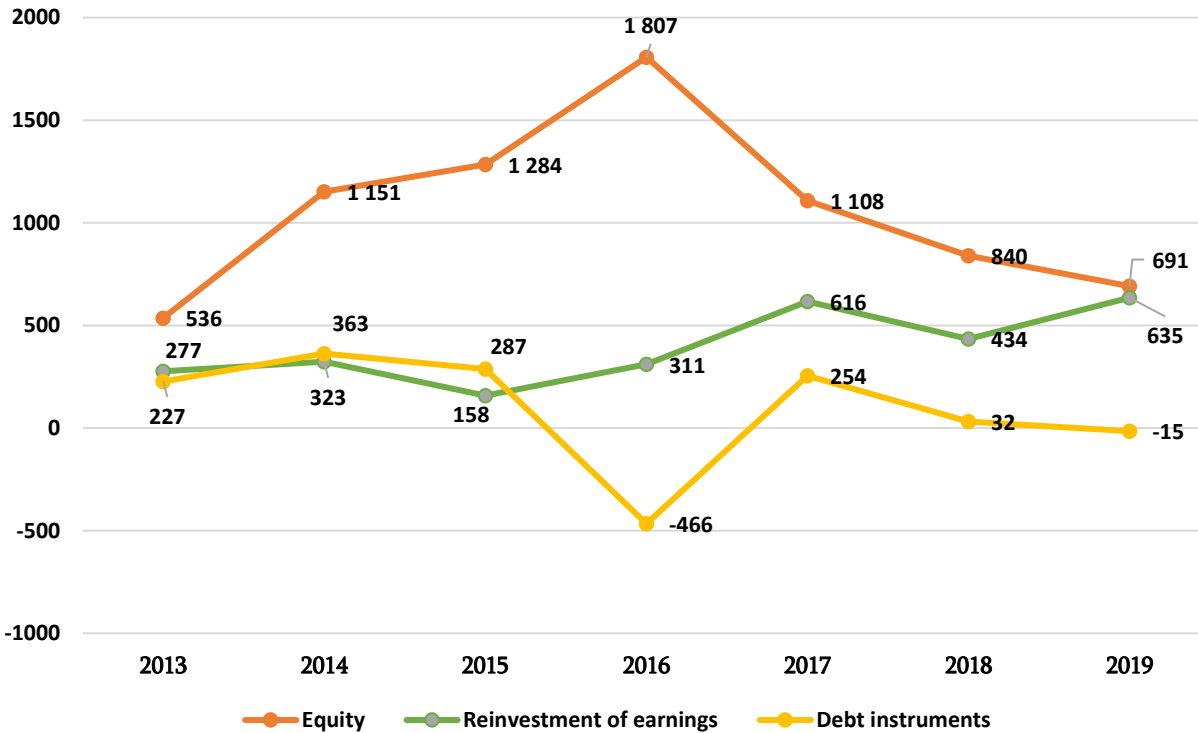
As we can see 8-10 out of these 25 companies could constitute real FDI investment in Georgia and that includes BoG and two spin-offs. At least half of the list are very definitely companies that have nothing to do with the EU, and something like two-thirds of the list probably have little involvement. Excluding the London flotations (which as they are public companies, tell us nothing about UBO), leaves us with 5-7 investments in 7 years.

The problems of company-registration not reflecting ultimate owner is also important to keep in mind because it means that official statistics not only certainly overestimate the importance of the UK, Panama, the Netherlands and Luxembourg, they also underestimate the countries with investors that register their companies in that way. Most obviously this would include Russia, which is a significantly larger investor in Georgia than official numbers would suggest<sup>28</sup>, the rest of the CIS and the Middle East.

All of that said, the official country breakdown can be useful for highlighting changes in investment relating to companies that are not usually used for off-shore/tax/arbitration and have nothing to do with SCPX. The arc of Turkish and Chinese investment particularly stands out. Turkey, after fairly modest levels of investment has seen a very big increase in recent years and this is consistent with experience, which shows the Turkish to be prominent in tourism, real-estate, textiles, furniture and more. China, conversely, saw one large investment over the 2013 to 2015 years, but has not really increased from there.

The third breakdown of FDI is to look at it 'by component'.

Figure 19: Breakdown of FDI by component (million USD)



Source: Geostat (reviewed July 2020)

The component breakdown is extremely important in understanding how the dynamic of FDI has changed over the years. Most people tend to think of FDI as new foreign equity investment in Georgian companies, but it has three components. In the table above 'equity' is a reference to new outside investment of the kind most people think of.

<sup>28</sup> For a great overview of Russian investments in Georgia, see Nata Dzelishvili and Tazo Kupreishvili (May 2015), Russian Capital in Georgian Business, Damoukidebloba.com, (<https://docs.google.com/viewerng/viewer?url=https://idfi.ge/public/upload/russiancapital.pdf>)

‘Reinvestment of earnings’ is a reference to foreign-owned companies that make a profit in a country. Since the profit is owned by the foreign owners, if they choose not to repatriate those profits, then they become part of the capital of the company and are treated as new investment.

Debt instruments are also included in FDI and include debt from foreign banks, IFI debt to private companies and any other loan made by a foreign entity. As this is a net number, even if the yearly amount were to stay constant, one would expect the number to go down, as companies repaid earlier debt.

There are several shifts in the ‘components’. First, reinvested earnings are generally up. This could definitely be seen as a good thing, since it suggests that business confidence amongst experienced investors in Georgia is high. It is also probably the result of a change in Georgia’s tax code. On January 1, 2017 Georgia changed its corporate tax code so that corporate profits are only taxed at the moment of distribution as dividends. As long as the profits stay in the company, they are not subject to tax. This has created a strong incentive for companies to keep their profits in the company and in the country, and may explain a lot of why reinvested earnings more or less doubled in the first year that the new law came into effect.

On the other hand, this big increase means that equity investments have gone down even more than the headline numbers would suggest. As will be suggested below, it is hard to assess the extent to which this reflects diminishing interest in Georgia, or a declined appetite for this kind of investment globally. However, it does highlight Georgia’s inability to attract investment for new export-oriented sectors.

Finally, debt instruments have been erratic, though it is hard to know what this means. Depressed foreign debt/FDI might mean that new foreign debt is down, but this is a net figure, so it might mean that since it has been high for a number of years, repayments are now reaching a point where they cancel out new debt.

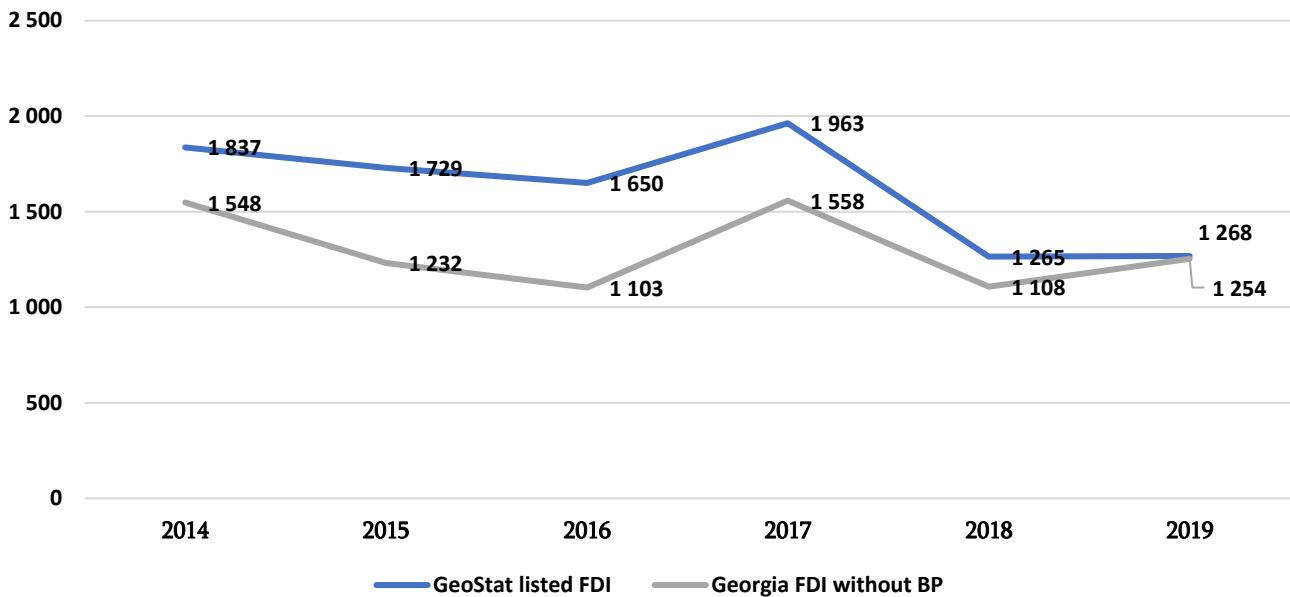
Most of the commentary on Georgia’s FDI has focused on its apparent decline. One common part of the explanation of this decline is BP’s investment. BP undertook the expansion of the SCP gas pipeline in Georgia (the expansion is generally referred to as SCPX), with most of the work taking place between 2014 and 2017. The total of the costs was USD 2.3 billion, with around \$2.1bn occurring in Georgia.<sup>29</sup>

If one does accept the fact that BP’s FDI should be considered ‘exceptional’, and adjusts for that FDI, then that gives the following.

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<sup>29</sup> Information from direct communication with BP, June 2020.

Figure 20: FDI for 2014-2019 excluding BP SCPX investment (million USD)



Reference: Geostat (Reviewed June 2020) and email exchange with BP (June 2020)

This adjustment does partially explain the 2014 to 2018 uptick, and seems to suggest that rather than seeing 2018 and 2019 as significant declines in recent history, the pattern since 2014 has seen four years with USD \$1.1 to \$1.25bn, with 2014 and 2017 as positive outliers at around \$1.5bn.

Those outliers may also be explained by other ‘exceptional’ deals. It is always hard to pinpoint the exact reason for FDI uptick in a given year, as Geostat does not give a breakdown of their total by company. However, Geostat will provide a list of the companies responsible for the biggest FDIs in a given year, and if we combine this information with sector and country information for the FDI we can make some reasonable deductions about who is responsible for the big FDI in a given year.<sup>30</sup>

Using this process, one can examine high FDI years for ‘exceptional’ big investments. Doing this we can see that in 2014 China was one of the biggest investors, spending \$220 million, and construction investment was particularly high this year. JSC Hualing is the only Chinese registered company that is in the list of top 15 FDI contributors that Geostat provided for that year.

This would suggest that up to 200 million of the FDI for 2014 comes from the mixed-use hotel/retail/residential mixed-use facility built around Tbilisi Sea that Hualing build between 2011 and 2015 (in total valued at around

<sup>30</sup> In addition to the public data on FDI, Geostat will give one the ‘top’ FDI invested companies in a given year. We received the top 50 company list and the top 15 company list for 2009 to 2019. They do not have this information for earlier years. This data includes company, sector and registration company for investing FDI. By cross referencing this information with the preceding public data and looking up public information on big deals, one can deduce quite a bit about what the big deals are in a given year.

\$500 million). Also, the Netherlands is the biggest FDI source that year, and so Borjomi's (whose investor is listed as Dutch) reported sale for \$300 million around that time could also significantly impact the number.<sup>31</sup>

For 2017, the financial sector is listed at \$307m. The only financial sector investment for that year is Bank of Georgia, which demerged and listed Geocapital as a separate entity, so that could be a major contributor. Energy was also a big factor in FDI that year, and Adjaristqali, probably stands out, though it is impossible to know the scale of their investment. But Adjaristqali is the only energy FDI in that year registered in the Netherlands, and the Netherlands accounted for \$354m and energy for \$280 million, so it is likely to be a big contributor (particularly since other energy sector investors cannot make up much over \$100 million). In construction (\$172m) we can identify a range of players. In real estate Rakeen's Uptown Development, which is the only major UAE investor listed, is probably responsible for most of the UAE's \$145m.

It is easy to get lost in this detail. But the more one gets into this analysis, the more it seems that identifying 'exceptional' and 'unexceptional' investments in Georgia is probably methodologically suspect. However, it is probably worth noting that individual big deals in FDI can have a significant impact on a given year, so these numbers may not be the bell-weather for investor confidence that people imagine them to be.

Nonetheless, whether there is a positive or negative trend and how Georgia's general level of FDI compares to other countries is not going to stop, therefore it is good to try and find a rigorous approach. Another way of looking at it is to look at FDI as a proportion of GDP and compare it to other countries. The World Bank provides this, and below, we show an FDI to GDP ratio and the ranking that this suggests in the WB list.

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<sup>31</sup> Geostat data shows IDS Borjomi as significant FDI for the first time in 2014. Borjomi is also a manufacturing company listed in the Netherlands and Geostat data shows a spike in FDI from the Netherlands in 2014 (\$420m) and in the sector of manufacturing sector, that year. Geostat (reviewed 2020). Also, Nata Dzvelishvili and Tazo Kupreishvili (May 2015), Russian Capital in Georgian Business, Damoukidebloba.com, p34 (<https://docs.google.com/viewerng/viewer?url=https://idfi.ge/public/upload/russiancapital.pdf>)

Figure 21: FDI as a proportion of GDP and ranking in World Bank Ranking with and without BP investment 2007-2019<sup>32</sup>

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
FDI/GDP (%)	19	13	6	8	8	6	6	10	12	11	12	7	7
Ranking	17	25	56	41	38	53	38	17	18	20	13	24	12
FDI/GDP (%) without BP		12	6	7	8	6	6	9	8	7	9	6	
Ranking without BP		32	57	43	40	56	39	25	29	34	21	27	
No of countries in the list	184	182	183	184	184	184	184	184	182	181	181	179	96
Ranking in % of countries – without BP	9%	14%	31%	22%	21%	29%	21%	9%	10%	11%	7%	13%	13%

Reference: FDI/GDP ratio provided by World Bank Ranking of FDI. Adjusted with reference to original FDI information (Geostat reviewed May 2020). BP information provided by email correspondence with BP (for 2014 to 2019) and from BP Sustainability reports for 2004 to 2014.

This table takes quite a bit of explaining. First, it is best to ignore 2019, because the data is incomplete.

But, if one were to just look at the top figure it would really suggest something is wrong with FDI/GDP since at 7%, it is almost 3x lower in 2018 and 2019 than it was in 2007 at 19%.

However, if we look at ranking, we see that this change only represents a fall in ranking from 17<sup>th</sup> in 2007 to 24<sup>th</sup> in 2018, which is far smaller. This is, of course, because FDI is simply lower world-wide now than it was in 2007. The average level of FDI/GDP in the World Bank list in 2007 was 14%, in 2018 it was 8%. This makes sense given that the years that ran up to 2008 are generally considered a financial boom, which included unsustainable levels of investments that in some ways precipitated the financial crisis.

In the 'ranking with no BP' we took out the BP investment and assessed what ranking Georgia would have had if BP investment had not been present. The final line then corrects the sheet to give us a percentile. If one then looks at the percentiles, 2009-2013 are low, as they are all in the 21% to 31% percentile range. 2014-2019, by comparison, are strong as they all fall in the 7-13% range, comparing well to Georgia's pre-war high of 2007, which was 9%.

This is also confirmed by the fact that Georgia has higher levels of FDI stocks compared to GDP, than other countries in the region, and significantly higher than the EU.

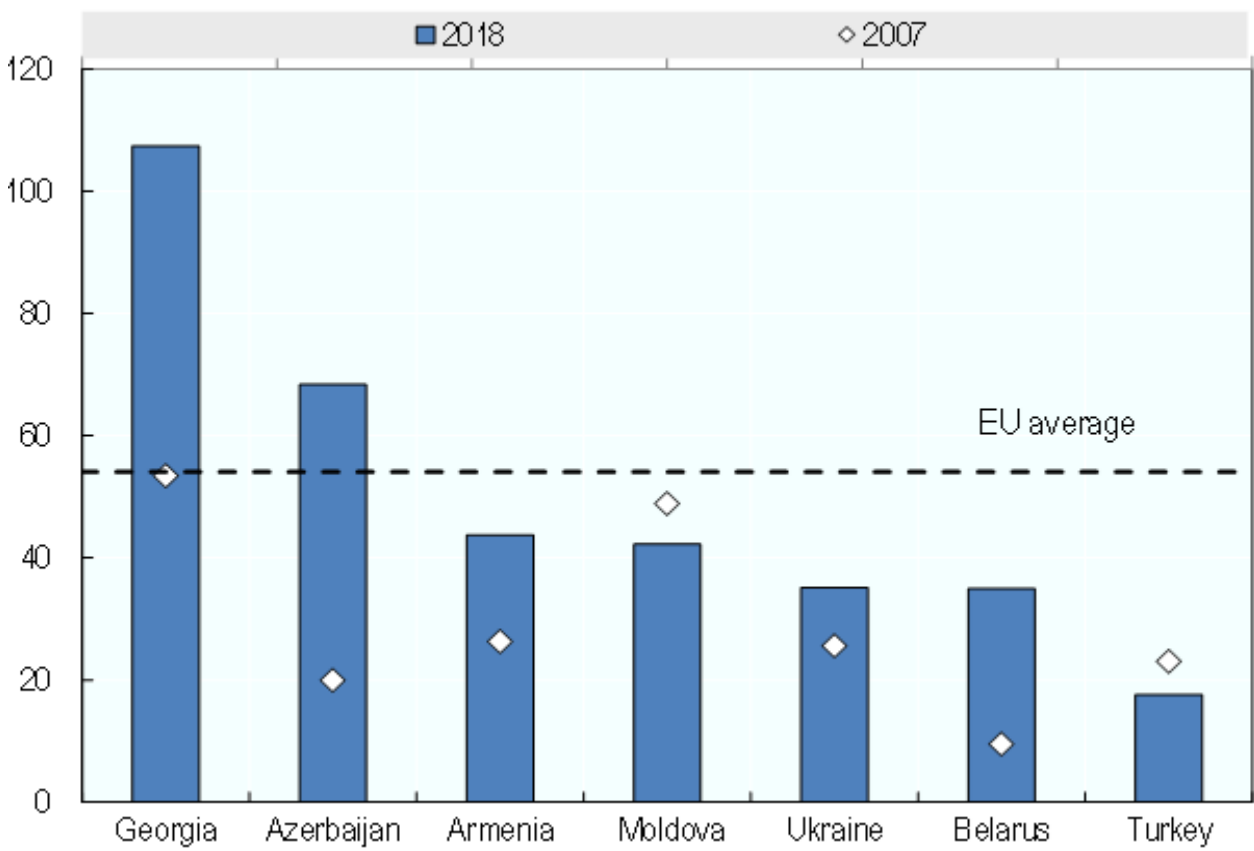
<sup>32</sup> This is based on the World Bank ranking, but has been modified to exclude non-country entities in that list. The FDI percentage without BP investments is based on correspondence with BP for the provision of capital investment (mostly SCPX) from 2014 (as above) and BP Sustainability Reports for 2008-2013.

<https://data.worldbank.org/indicator/BM.KLT.DINV.WD.GD.ZS> (Reviewed July 2020)

BP In Georgia Sustainability Reports 2005-2014, [https://www.bp.com/en/global/corporate/sustainability/reporting-centre/sustainability-report-archive.html#tab\\_Georgia](https://www.bp.com/en/global/corporate/sustainability/reporting-centre/sustainability-report-archive.html#tab_Georgia) (Reviewed July 2020)



Figure 22: FDI Stocks/GDP 2018



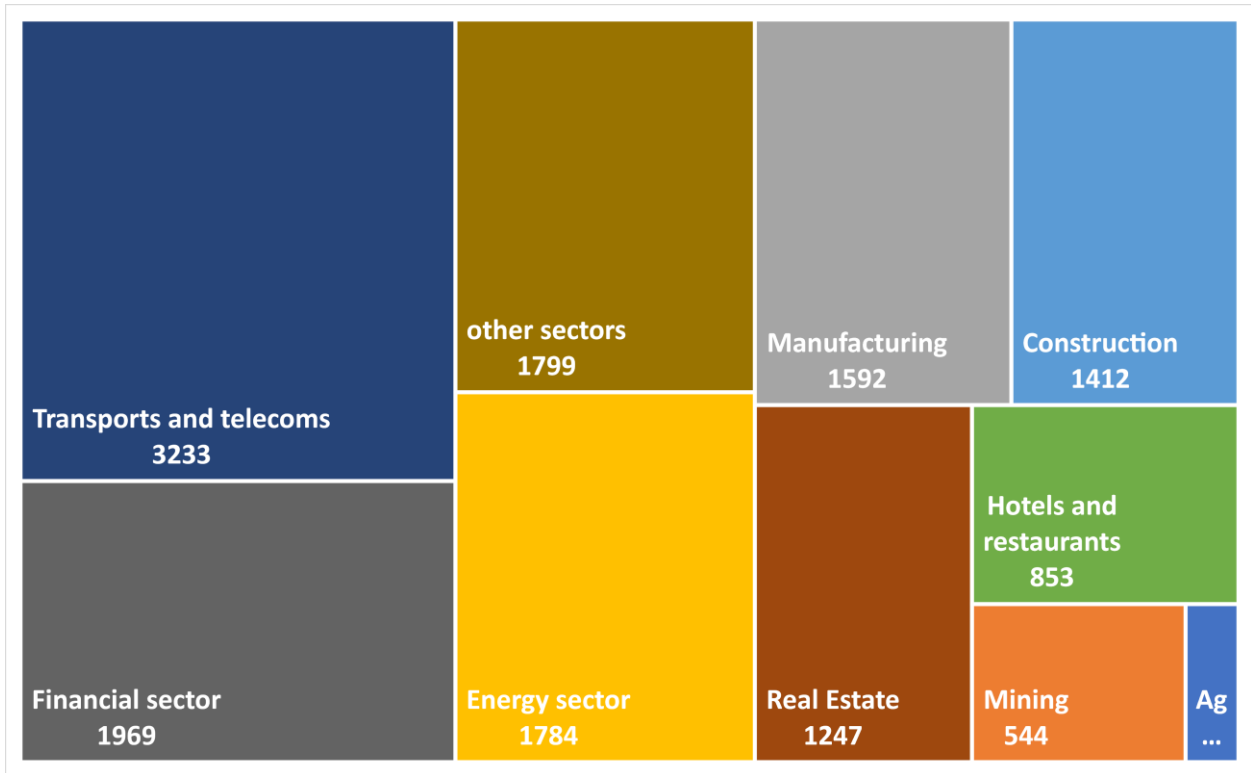
Reference: OECD (2020) Investment Policy Review: Georgia 2020, draft, p. 30 (cited UNCTAD)

Altogether, therefore, there does seem good reason to argue that while little of the FDI originates from the EU, volumes have been fairly solid in the last 5 years. One can also consider the quality of FDI.

### Assessing the quality of FDI

The aggregate picture, therefore, is not too bad. For most of the last 12 years Georgia has performed pretty well comparatively in the world in terms of FDI, and that continues to be the case. However, a number of commentators have highlighted that Georgian FDI has been heavily concentrated in particular sectors for a long time. If we review the aggregate FDI over the last 10 years, one can see the following:

Figure 23: Total FDI by Sector 2009-2019 (USD Millions)



Reference: Geostat (Reviewed August 2020)

This shows, as was commented in the recent 2018 World Bank Assessment, that investment is largely going into hard infrastructure and there is limited investment happening at the firm level. Nonetheless, one can still see that in the heavily invested sectors, FDI and foreign expertise have been drivers for change. If we work down the major categories of FDI, financial services were transformed with western investments into TBC Bank and Bank of Georgia, intensive management involvement from long-standing financiers and later with the flotation in London.

In the energy sector, foreign investors were the drivers for new hydro development and AES Telasi, a Canadian company, were responsible for much of the infrastructure development that (even though they went bankrupt) restored electricity to Tbilisi, developing a model that was then rolled out to the rest of the country, with USAID support and a subsequent second privatisation. The developments of new hydro have, across the board, occurred in partnerships with large internationals.

In the tourism sector, the most profound impact probably came with the first international hotels, starting with Sheraton and then Marriott, and if we look at service delivery in the Georgian tourism sector, there is almost nobody that would argue that the injection of international expertise has ‘upgraded’ the Soviet-style poor service culture to the contemporary far higher service culture that has helped to drive tourism growth more generally. Later hotel investments have been more local, though there is a continued heavy reliance on international brands, and even the recent development of local brands, like Rooms, that leverage Georgia design skills, has been built on expertise developed under international brands.

Construction, real-estate and tourism have also driven each other, with many construction companies gradually turning into tourism companies that are owner-operators of multiple hotels and developers of their

own real estate. This is something we see as a natural synergy and is most obvious in the Turkish company Maqro Construction and the Investment Fund Georgia Capital, but has also become apparent in local companies like Redex, Element Construction and CMC. Collectively, this has also helped to support construction as a continuing driver of economic development.

Under normal circumstances, in the absence of major demographic changes or a bubble, one would expect housing construction to maintain pace with economic development generally. However, in Georgia for quite a few years, growth in the construction sector has significantly outpaced GDP growth generally, driven by local government infrastructure projects, local and foreign real-estate expansion (driven by significant increases in mortgage debt in country) and the boom in the tourism sector.

Export in non-tradables continues to be the big weakness. Manufacturing is around 10% of all FDI for the last 10 years and that is concentrated in old Soviet sectors like manganese (that we can probably think of as extractive), Azot, railway manufacturing, Borjomi and Rustavi Steel. From the list of the top 50 FDI companies in the last six years we only have the following companies that do not fit the description above of ‘old Soviet’ companies.

*Figure 24: List of companies from our ‘top 50 FDI companies’ who are in the ‘manufacturing sector’. Excluding Manganese, Fertiliser, Railway, Borjomi and Rustavi Steel.*

2013	Embawood	Furniture
	Khareba	Winery
2014	Wimm Bill Dan	Food/Dairy
	Natakhtari	Beer and Lemonade
	Karmen	
	Mina	Bottle producers
	Geospirtom	Winery
2015	Heidelberg	Concrete
	Elita/Cyclone	Airplane parts
2016	Sante	Food/Dairy
	Heidelberg	Concrete
	Olam Georgia	Hazelnut processing
2017	Geosteel	Steel
	Atlantic Georgia	Heaters
2018	Heidelberg	Concrete
	Geosteel	Steel
	Atlantic Georgia	White goods
2019	Cyclone	Airplane parts

Reference: Geostat (provided on request, March 2020)

In agriculture, in the top 50 investors, only Agri Georgia, a subsidiary of Ferrero, is listed for 2009, 2017 and 2019 and Agro Development LLC is listed for 2014 and 2015.

Weaknesses in FDI in the manufacturing sector are problematic because FDI in these ‘new sectors’ is vital. As the World Bank report says,

To lower “discovery costs,” attracting FDI will be critical. Scarce information on business opportunities, the specificities of exporting to a given country, foreign consumers’ preferences, or the regulatory complexities associated with serving foreign markets may be limiting the growth potential of firms and

affecting export survival. Initiatives to make information more easily available to firms can be a useful step. Experience suggests, however, that attracting foreign investment is key.<sup>33</sup>

Talking to many of the big investors, including Geocapital, the Co-investment Fund, Hunnewell Partners, Gazelle and other individual investors, they offer a number of explanations why tradables, and particularly export-oriented tradables manufacturing has not been a commonly FDI-invested sector.

The first and simplest explanation for the limited investment in manufacturing is that the nature of the investment has a range of built-in risks and financing challenges. In terms of risks, a factory is not a fungible asset in the way that an apartment or a hotel may be. Outside of a particular company and supply chain it may have limited value, so that a manufacturing investor really has to be confident that they can invest for the long-term. That makes such investments particularly sensitive to political risk. A couple of investors mentioned that Eastern European investments in manufacturing only took off when EU-accession commitments provided Brussels as a fallback arbiter and a hedge against political uncertainty.

Green-field manufacturing investments, it was also pointed out, can be difficult to finance. Due to the aforementioned infungible assets, banks are not prepared to accept full asset value as collateral. If the production is capital intensive this may make the situation worse, since the fungible parts of the asset, like land and buildings, may be a small part of the investment.

The second reason that venture capital firms said that they do not want to invest in this area is that they do not want to build companies. Funds like the Co-investment Fund or Geocapital want to invest in already existing and (ideally) proven companies. However, there is a very small pool of manufacturing companies which export and operate at the scale to make investments interesting.

Finally, investors generally highlighted and as is suggested in the World Bank quote, FDI in exportable manufacturing requires foreign clients, understanding of manufacturing processes, connections for raw material or inputs supply and understanding of the particular governance and standards environment into which the company ultimately wants to sell. Therefore, for a new manufacturing facility to be plausible, it generally needs to have a foreign partner. This is even more the case if the facility plans to export. So, in that situation, the issue is not finding generic investors with money but rather finding businesses that want to move some of their production to Georgia

## Association Agreement and the DCFTA implementation and what it means

The most common implied logic that explains why signing the DCFTA would have created significant benefit for Georgia is the generally held belief that it facilitated considerable increase in access to the EU. Most writing and general conversation on the subject seems to suggest that the signing of the DCFTA, with its requirements of EU-alignment, would bring with it increased access to the EU's 18 trillion dollar and 500-million-person market (2019 IMF estimates).

However, this is based on a false assumption that the EU market was, in any simple sense, closed to Georgia before 2014 and that the AA coming into effect meant the removal of those barriers. But this is a misrepresentation. As we will see below, Georgia did not face significant tariffs and quotas for goods and services before 2014, so there were no tariff or quota barriers to remove. It does face non-tariff barriers, but

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<sup>33</sup> World Bank Group (2018), Georgia: from Reformer to Performer, p25

these are a lot more complicated, and cannot simply be removed by a government agreement. We will discuss these in turn.

### DCFTA, GSP+ and market access

The simple answer to why Georgia has not increased its exports to the EU is that there has been very little discernible change in the trade restrictions. The EU maintains a common external tariff regime that applies to most countries outside the EU and no countries inside the EU, and these tariffs can be onerous in some areas. However, Georgia was a member of a General System of Preferences (GSP+). This is a trade agreement which removes tariff and quota barriers on most industrial goods, and is maintained by the EU with countries which it wants to support by giving them preferential access to the EU market. Georgia's was called GSP+, as it gave even greater access than GSP. The EU also has a GSP+ arrangement with Armenia.

The key question is: how much more open (in terms of tariffs and quotas) is the EU now compared to the GSP+ provisions under which it existed before?<sup>34</sup> To answer this question, we reviewed the trade restrictions on 220 product categories. This covered all export categories (at the 6-digit level) with greater than \$1 million in exports. Since the import tariff often varied within the 6-digit category we often had to look at a lot more detail to understand the range of tariffs that were applicable. In all, we reviewed over 1,000 product categories, comparing the GSP tariff/quota with Georgia's Association Agreement tariff or quote.

Out of the 220 6-digit categories, 146 categories, or about two-thirds saw a significant improvement compared to WTO-3<sup>rd</sup> party access. However, compared to GSP access, only 20 products saw an improvement, all of them in the agricultural sector. These 20 are listed below.

Figure 25: Comparison of EU Association Agreement Level Tariff and GSP Level Tariff (Thousand USD)

Export category	Value of exports	Value of exports to the EU 2013	Value of exports EU 2019	Georgia Association Agreement Tariff or minimum quota	GSP Tariff or minimum quota <sup>35</sup>
Live cattle	22 201	-	-	0%	10.20% + 93.10 EUR / 100 kg
Frozen beef	1 352	-	-	0%	12.80% + 221.10 EUR / 100 kg 12.80% + 304.10 EUR / 100 kg
Frozen pork	2 378	-	-	0%	46.70 EUR / 100 kg 86.90 EUR / 100 kg
Frozen Chicken	4 031	-	-	0%	18.70 EUR / 100 kg 102.40 EUR / 100 kg
Chicken eggs	1 096	-	-	0%	35.00 EUR / 1000 p/st
Tomatoes	2 295	-	15	0% + 29.80 EUR / 100 kg	14.40% + 29.80 EUR / 100 kg

<sup>34</sup> Note that since joining the Association Agreement the EU has given access to the EU markets to a few goods that previously had no access at all. The EU documents list black sea fish, honey and raw wool as product categories that have changed in this way. They are not considered here, since their export volumes to the EU have remained negligible.

<sup>35</sup> Note that the upper value is the lowest level of the tariff, and the lower number is the highest value of the tariff, depending upon which sub-category.

Cucumber and gerkins	1 113	-	-	0% 0% + 37.80 EUR / 100 kg	12.8% 0% + 37.80 EUR / 100 kg
Other vegetables	3 971	669	1 085	0%	0% 9.40 EUR / 100 kg
Bananas	5 360	-	-	0%	16% 114.00 EUR / 1000 kg
Oranges	1 511	-	27	0%	3.2% 12%
Apples	4 593	-	19	0% 0% + 23.80 EUR / 100 kg	4.80% + 23.80 EUR / 100 kg
Peaches and nectarines	12 480	-	18	0% 0% + 13.00 EUR / 100 kg	17.60% 17.60% + 13.00 EUR / 100 kg
Cereals	1 140	-	-	0%	93.00 EUR / 1000 kg
Chocolate	1 077	-	30	0%	0% + EA MAX 18.70% + ADSZ
Fruit jam	3 739	30	3 236	0%	0% + 4.20 EUR / 100 kg 0% + 23.00 EUR / 100 kg
Apple juice	1 586	1 679	1 251	0%	0% 0% + 18.40 EUR / 100 kg 0% + 19.30 EUR / 100 kg
Other fruit juice	3 675	769	713	0%	0% 0% + 12.90 EUR / 100 kg 0% + 20.60 EUR / 100 kg
Sparkling wine	4 351	50	158	0%	32.00 EUR / hl
Wine	218 208	10 145	20 633	0%	32.00 EUR / hl
Aluminium	10 337	52	1 895	0%	6.0%

Reference: Geostat; European Commission Market Access Online Database, EU Tariffs (Reviewed July 2020)

Interestingly, people who are trading are often unaware of the nature of the impact of these agreements on their business. For example, many nut exporters suggested to us that the Association Agreement had brought with it relief from an EU import tariff (3% on hazelnuts and 5% on walnuts). However, both GSP and the AA have no tariff on imports, and the barriers to which they were referring only applied to WTO rules, so should not have applied to them for many years. It seems likely that these exporters were simply not exporting directly to the EU at the time and so have no reason to know what the situation was before.

It is also worth noting that this comparison of tariffs is also premised on the ability of the producer to demonstrate that a product was largely produced in the country with the trade agreement.

Obviously, both countries in a trade agreement need a way to ensure that goods operating under the trade agreement are not originating elsewhere outside of the parties to the agreement. This is demonstrated by a 'Certificate of Origin' which is generally determined by 'Rules of Origin'. A 'rule of origin' generally determines how much economic value addition takes place in a given country.

Rules of origin for the EU are laid out in the Regional Convention on Pan-Euro-Mediterranean Preferential Rules of Origin.<sup>36</sup> We reviewed these to see the regulations for significant Georgian manufacturing exports like textiles and toys, or potential areas like automotive and electrical and found that in most areas, there is a limit of 40-50% of the value of a good being from imported inputs.

This means that if more than 40-50% of raw materials originate outside of the EU then that product will not be counted as 'made in Georgia' and will be subject to WTO, rather than AA tariffs.

As we will see, this is a particularly big problem for Georgia since Georgia lacks the industrial base to source its primary or intermediary materials locally. As a result, many manufactured goods find it hard to reach this threshold. Apparel, for example, suffers from this problem. According to the DCFTA, Georgia should be subject to no tariff for export into the EU for apparel. This was also the case under the previous GSP. However, almost all of Georgia's fabric is sourced from Turkey and China and this usually makes up enough of the value of the final product that, even if stitched in Georgia, it cannot be labelled 'made in Georgia'.

This is particularly unfortunate because Georgia signed an agreement with the EU and Turkey that raw materials from Turkey can be counted towards the Georgian percentage for rules of origin, but Turkey has not ratified this agreement, in spite of direct lobbying from the Georgian Prime Minister to the Turkish President. It is generally believed that the failure of Turkey to ratify the agreement is an effort to ensure that Georgian companies cannot compete with Turkey. As a result, most Georgian apparel faces a 12% WTO import tariff when entering the EU.<sup>37</sup>

### Association Agreement and EU Alignment

The simple removal of tariff and quota trade barriers has not only improved EU access under the DCFTA for some agricultural products. However, has it helped other forms of alignment that facilitate market access to the EU? This is a sentiment that is often expressed, usually in fairly vague terms, by people who are looking to promote the EU. However, whether it is meaningful is a very difficult question to answer.

The Association Agreement sets out the terms of Georgia's alignment with the EU in a whole range of areas. The 'Deep and Comprehensive Free Trade Area' (DCFTA) is really just a reference to the EU/Georgia area where the trade agreement applies. However, the "DCFTA" is usually used as short-hand for the economic provisions of alignment laid out in the Association Agreement.

Therefore, to understand what EU alignment means it is necessary to understand the terms of the Association Agreement. A sense of the emphasis of the document can be given by a review of the document itself.

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<sup>36</sup> Regional Convention on Parn-Euro-Mediterranean Rules Preferential Rules of Origin (reviewed August 2020), [http://www.economy.ge/uploads/files/2017/foreign\\_trade/pan\\_euro/regional\\_convention\\_on\\_pan\\_euro\\_mediterranean\\_preferential\\_rules\\_of\\_orig\\_.pdf](http://www.economy.ge/uploads/files/2017/foreign_trade/pan_euro/regional_convention_on_pan_euro_mediterranean_preferential_rules_of_orig_.pdf)

<sup>37</sup> This description of the situation was more or less universally presented by apparel producers except the Turkish companies, which do not face this problem as goods are shipped via Turkey as 'made in Turkey'.



Figure 26. Overview/Table of Content Georgia/EU Association Agreement (2014)

Association Agreement Heading	N of Pages
Preamble	5
Title I: General Principles	1
Title II: Political Dialogue and Reform, Cooperation in the field of Foreign and Security Policy	5
Title III: Justice, Freedom and Security	4
Title IV: Trade and Trade Related Matter	130
TITLE V: Economic Cooperation	5
TITLE VI: Other Cooperation Policies	33
TITLE VII: Financial Assistance, and Anti-fraud and Control Provisions	7
TITLE VIII: Institutional, General, And Final Provisions	11
ANNEXES	469
PROTOCOLS to the Association Agreement between the European Union and the European Atomic Energy Community and their Member States, of the one part, and Georgia, of the other part	193
<b>Total</b>	<b>863</b>

Reference: EU Association Agreement 2014

Two obvious elements stand out from this document. First, that the overwhelming majority of the document relates to trade and business environment issues. Out of the 177 pages which comprise Title II-VI, about three-quarters alone is related to Title IV on trade. Title V is also 'economic cooperation' and title VI 'other cooperation policies' is around two-thirds related to economic issues, including transport, energy, industrial policy, company law, financial services, tourism etc. Altogether, this is about 90% of the document.

If one looks particularly at the 130 pages of the document that relates to trade and trade related matters.

Figure 27: Chapter Breakdown of Title IV: Trade and Trade Related Matter

Chapter	N of pages
CHAPTER 1: NATIONAL TREATMENT AND MARKET ACCESS FOR GOODS	6
CHAPTER 2: TRADE REMEDIES	3
CHAPTER 3: TECHNICAL BARRIERS TO TRADE, STANDARDISATION, METROLOGY, ACCREDITATION AND CONFORMITY ASSESSMENT	3
CHAPTER 4: SANITARY AND PHYTOSANITARY MEASURES	14
CHAPTER 5: CUSTOMS AND TRADE FACILITATION	6
CHAPTER 6: ESTABLISHMENT, TRADE IN SERVICES AND ELECTRONIC COMMERCE	36
CHAPTER 7: CURRENT PAYMENTS AND MOVEMENT OF CAPITAL	2
CHAPTER 8: PUBLIC PROCUREMENT	6
CHAPTER 9: INTELLECTUAL PROPERTY RIGHTS	22
CHAPTER 10: COMPETITION	2
CHAPTER 11: TRADE-RELATED ENERGY PROVISIONS	3

CHAPTER 12: TRANSPARENCY	3
CHAPTER 13: TRADE AND SUSTAINABLE DEVELOPMENT	9
CHAPTER 14: DISPUTE SETTLEMENT	12
CHAPTER 15: GENERAL PROVISIONS ON APPROXIMATION UNDER TITLE IV	3

Reference: Georgia EU Association Agreement (2014)

Here, one can also see that a few prominent areas seem to stand out, particularly sanitary and phytosanitary, trade in services and electronic commerce, IPR and trade and sustainable development. In addition to these trade-related issues, Title V Economic Cooperation and title VI Other Cooperation Policies, also have elements that relate to the economy.

Figure 28: Other elements of the Association Agreement Relating to Business Environment

Section title	N of pages
TITLE V: Economic Cooperation	5
CHAPTER 1: ECONOMIC DIALOGUE	1
CHAPTER 2: MANAGEMENT OF PUBLIC FINANCES AND FINANCIAL CONTROL	1
CHAPTER 3: TAXATION	1
CHAPTER 4: STATISTICS	2
TITLE VI: Other Cooperation Policies	33
CHAPTER 1: TRANSPORT	2
CHAPTER 2: ENERGY COOPERATION	2
CHAPTER 3: ENVIRONMENT	2
CHAPTER 4: CLIMATE ACTION	2
CHAPTER 5: INDUSTRIAL AND ENTERPRISE POLICY AND MINING	2
CHAPTER 6: COMPANY LAW, ACCOUNTING AND AUDITING AND CORPORATE GOVERNANCE	1
CHAPTER 7: FINANCIAL SERVICES	1
CHAPTER 8: COOPERATION IN THE FIELD OF INFORMATION SOCIETY	1
CHAPTER 9: TOURISM	1
CHAPTER 10: AGRICULTURE AND RURAL DEVELOPMENT	1
CHAPTER 11: FISHERIES & MARITIME GOVERNANCE	3
CHAPTER 12: COOPERATION IN RESEARCH, TECHNOLOGICAL DEVELOPMENT AND DEMONSTRATION	1
CHAPTER 13: CONSUMER POLICY	1
CHAPTER 14: EMPLOYMENT, SOCIAL POLICY AND EQUAL OPPORTUNITIES	2
CHAPTER 21: REGIONAL DEVELOPMENT, CROSS-BORDER AND REGIONAL LEVEL COOPERATION	2

Reference: Georgia EU Association Agreement (2014)

The length of this document and the page numbers listed here do not even begin to suggest the scale of the changes that are implied by the Association Agreement, which is really a lot larger. The Association Agreement mostly stipulates the EU regulations (or 'Acquis') with which Georgia is committing to align. Behind the

Association Agreement there are, therefore, undoubtedly, thousands of legal amendments and literally millions of pages of legislation that need to be considered.

EU alignment has therefore been the biggest single task of the Georgian Government since the agreement was signed in 2014. On an annual basis, the Georgian Government prepares an action plan for the year, which highlights the main working areas as well as the government agencies responsible for working on the changes.

Reviewing the implementation process so far is therefore a huge task and detailed analysis goes beyond the scope of this project. However, it is possible to summarise existing reviews. Implementation of the Association Agreement is reviewed annually by the Georgian parliamentary committee on European Integration, Civil Society and the EU itself.

The review provided by the 'The Committee on European Integration of the Parliament of Georgia Report on Activities' carried out in 2019 provides a summary of the work of the committee, which includes, 'In 2019, the Committee held 29 meetings of the Committee, which discussed 98 draft laws, 2 draft resolutions and 5 international agreements'.<sup>38</sup>

The same report goes on to highlight changes in the development of draft legislation on a wide range of issues.<sup>39</sup>

- Forest Code
- Atmospheric Air Protection
- Energy and Water Supply
- Road Traffic
- Money Laundering
- Tobacco Control
- Promotion of Renewable Energy
- Financial Pledge, Mutual Purchase and Derivatives
- Energy Labelling
- Data Protection
- Energy Efficiency
- Consumer Rights

The assessments provided by civil societies have generally not focused on economic issues. The most recent review of the Association Agreement implementation that was published by the Open Society Georgia Foundation had sections that mostly related to human rights (though some of these areas also impacted on the economy, like labour rights and the environment).<sup>40</sup>

EPRC also provides a summary of the impact. This, which unusually acknowledges that,

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<sup>38</sup> Georgian Parliament (2020), Committee on European Integration of the Parliament of Georgia Report on activities carried out in 2019 (only available in Georgian), p3

<sup>39</sup> Georgian Parliament (2020), Committee on European Integration of the Parliament of Georgia Report on activities carried out in 2019 (only available in Georgian)

<sup>40</sup> This included chapters on Justice, Anti-Corruption Public Administration Reform and Public and Public Service, Trade Union Rights and Core Labor Standards, Equal Treatment, Children's Rights and Environment and Climate Change. OSGF (2018), Implementation of EU-Georgia Association Agreement Agenda 2017-2020: Assessment by Civil Society, Tbilisi.

Given the fact that prior to DCFTA, Georgia was already benefiting from the GSP+ that allowed it to use preferential trade regimes with the EU countries even though DCFTA has opened up the EU market on all goods and services, the immediate impact was not as high and was neutralised due to the preferential trade regimes that were already in place.<sup>41</sup>

It also points out the challenges that the EU has been facing in trying to facilitate Georgia's development of production standards. But most of its assessment is based on EU reporting, which will be considered at length below.

In order to provide a fairly comprehensive overview of the AA implementation, we reviewed the 2016, 2017, 2019 and 2020 reports provided by the Commission on the subject.<sup>42</sup> As already discussed, the Association Agreement lays out all of the elements of EU alignment that the EU considers important. This, therefore, combines requirements to democracy and human rights generally, as well as alignment with the EU on economic, political and security issues.

- **Democracy, Human Rights and Good Governance** – including subsections on the constitution, elections, the media, civil society, corruption, gender-based violence and equality, discrimination, children's rights, ill treatment and torture and public administration reform
- **Foreign and Security Policy** – including subsections on common security and defense strategy, the fight against terrorism, conflict resolution and the International Criminal Court
- **Justice Freedom and Security** – including subsections on judiciary, the police, the prosecution, juvenile justice, access to justice, migration, asylum and border management, organized crime, money laundering, data protection and drugs

As these sections are not really connected to the economy, we will not review the content here. Of the sections that relate to the economy, there are:

- Economic and market opportunities
- Economic development
- Connectivity, energy and climate
- Mobility and financial assistance

We will provide a summary of each of these below:

#### Economic and market opportunities

The economic and market opportunities review of the reports since 2016 considers technical barriers to trade, food safety, customs, services and digital issues. Technical barriers to trade and food safety cover EU conformity on agriculture and non-agriculture.

**Technical barriers to trade** include standards and metrology, accreditation and market surveillance. This is one of the most important areas of alignment for the purpose of this research project, so will be discussed in more detail below.

**Food safety** is considered one of the most important areas of the Association Agreement. In 2020, the EU summarised that the food safety agency has been working since 2010 to approximate and implement 272 agri-food regulations. These include from 'field to fork' tracking of food and tracing and management of food safety

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<sup>41</sup> ERPC (2020), Assessing prospects of Export of Separate Products and Services from Georgia to the EU

<sup>42</sup> European Commission (2020, 2019, 2017, 2016), Association Implementation Report on Georgia, Joint Staff Working Document, Brussels

and disease. EU reporting says that, to date, 101 standards have been implemented but they point out that 'implementation of SPS standards remains a challenge for farmers and food business operators'.

Under this provision, a few categories of food have gained access to the EU market since signing the DCFTA, particularly black sea fish, honey and raw wool.

**Customs** the 2019 and 2020 reports focus on the development of a new Customs Code, in line with the EU, as well as improvements in rules of origin, IPR border measures and improvement in application of rules of origin.

**Services and Digital Economy** highlight a new draft postal law and financial and maritime regulations alignment, which has 4-8 years to come into effect.

Other categories of alignment include the development of the State Procurement Agency, the development of Rules for Public Private Partnerships (and associated agency), work on intellectual property (with Sakpatenti) and development of competition policy and a new competition agency.

#### Economic development

As with the sections on democracy and human rights, many of the Association Agreement provisions and the EU's involvement in Georgia, does not relate to anything one could easily call 'EU-alignment' in a legislative sense, but rather to the notion of economic development more broadly understood. In consideration of the 'economic development' the AA reports on the ways in which the EU supports the government to develop and manage the economy, as well as reporting on specific programme interventions provided by the EU.

**Agriculture** in discussing agriculture, the EU highlights not only the work of the National Food Agency, but the EU has also focused work on the ministry of agriculture agencies like the Agriculture and Rural Development Agency, on support of wine and on the development of cooperatives.

**Industrial and Enterprise Development** is the catch all cover for support of Enterprise Georgia and support of particular sectors, through programmes that are run by GIZ, UNDP and others. Some of this work can be seen as encouraging DCFTA utilisation.

**Regional Development** is used as a sub-heading to cover fiscal decentralisation of government, and a rural development and market support programme outside of Tbilisi. This, therefore, includes a plan for decentralisation, legislative changes (and planned changes for the future) that give more responsibility to local government, technical assistance for local municipalities, and the development of 'Local Action Groups' that facilitate engagement between local business, government and civil society and local economic development support which takes a wide range of forms.

The EU has also pushed for the introduction of wide-ranging protections for large groups of people in the economy, that is also in line with EU standards. Under Employment and Social Policy and Occupational Health and Safety, they have not only developed the unemployment support system, but they have also pushed for very significant increases in labour protections, most recently requiring the formation of a labor inspectorate that has the right to police employment contracts and working conditions. This includes a labour safety code and labour code, which are both now passed.

They have also helped to develop a competition agency which is tasked with enforcing anti-competitive practices legislation. Again, this agency has quasi-judicial powers to investigate companies that are seen as abusing their market position.

Finally, they are developing consumer protections, though this only seems to have gotten to the first step in the process – with a draft law developed in 2019, but nothing reported by the EU since.

Other areas of alignment seem to have a more indirect impact on businesses, as they are more clearly aimed at government internal processes. They have provided technical assistance for the reform of the Public Internal Financial Controls, through the creation and support of the State Audit Office, alignment of Georgia's tax code with EU principles, work with Geostat on statistical reporting and with NBG.

### Summarising the impact

With such a wide range of reforms taking place in so many areas, each at different levels of development, it is incredibly hard to summarise the impact of all of this change. However, it is worth pointing out that from the point of view of this project, most of the technical assistance for alignment has been aimed at supporting government alignment, rather than financing businesses to cover the costs of local alignment, or supporting export-oriented alignment. Additionally, for some business people, the costs incurred from all of the alignment may reduce Georgia's likelihood to export to the EU, because by pushing up costs, they may make Georgian products less competitive.

The parts of this alignment which are explicitly aimed at facilitating exports to the EU can generally be broken into three parts. First explicitly legislative alignment to facilitate customs and trade. Second is the work that is done through EU projects, or EU supported government programmes, to directly support businesses in upgrading, innovating and accessing new markets. Third is the work on non-trade barriers, to ensure that Georgian businesses align with EU standards on production and product quality control.

For the first of these, the adoption of a new customs code and work with the Government of Georgia on customs alignments seems to suggest much of the legislative alignment on explicitly trade issues has now been completed.

Second, the EU's direct support for businesses. This is fairly wide ranging, and will be included in discussion of support for businesses generally in the next section. What is interesting, however, is that most of this support is not explicitly directed at helping companies export (or export to the EU). The biggest part of this support, through ENPARD and EU4Business, significantly predate the Association Agreement and should really be seen as extensions of the EU's economic development programming. These will be discussed in more detail in the 'sector support' section below.

Third, the alignment of the Georgian economy on EU product standards is almost certainly the biggest collective set of reforms that the EU is undertaking, and the one where the biggest impact *could* be felt. However, it also the least developed. This is discussed further below.

### Technical barriers to trade

The efforts to bring Georgia into alignment with EU product standards is encompassed under the title of 'Technical Barriers to Trade'. Under this provision, it is broadly understood that at some point in the future (nominally 2030 in the agreement) all products on the Georgian market (with a few exceptions) will be subject to the same EU standards as products in the EU. Note that this does not just include products 'made in Georgia' but all imported products as well.

This alignment has at least three parts. First, alignment requires the development of the government institutions to support EU-standard production, certification and policing. Second, alignment needs the development of local Conformity Assessment Bodies (CABs) that can provide the actual testing of products

and the necessary EU certification. Third, the private sector's need to adopt new production processes that are in line with EU standards and certify the final products.

Most of the reporting that the EU has carried out so far on developments in this area relate to the development of the first part of this process – the development of state institutions. There are four main institutions that are relevant here, the Georgian National Agency for Standards and Metrology, the Georgian Accreditation Center, the Georgian Technical and Construction Supervision Agency and the Market Surveillance Agency.

The Georgian National Agency for Standards and Metrology is responsible for providing companies with information on the standards by which their production facilities must abide and gaining international accreditation for Georgian government labs so that they can help verify the calibration of Georgian machinery and testing apparatus. The first part of this, the provision of standards, is completed, as the National Agency for Standards and Metrology is now partnered with international agencies that can provide them with this information. Development of government labs is slower. The 2019 and 2020 EU AA implementation reports highlight that two laboratories have obtained international recognition.

The Georgian Accreditation Center is responsible for accrediting 'Conformity Assessment Bodies'. These bodies are mostly private labs where companies actually send their products to be tested so that they can gain certification for safety. Conformity Assessment Bodies in food, for example, will test and certify that products do not have toxins or a high bacteriological content, amongst other things.

Most of the reporting of technical barriers to trade alignment highlights the weaknesses in conformity assessment bodies, but the focus of the EU's work has been the technical development of the Georgian accreditation centre. In particular, in 2017, they highlight that it became a signatory to the European Accreditation Bilateral Agreement allowing for its international recognition and in 2019 and 2020 they were noted as developing capacity in relation to information security management, occupational health and safety as well as for a range of specific devices.

Finally, the Georgian Technical and Construction Supervision Agency (GTCSA) is supposed to be responsible for policing the market. In areas where regulations have been adopted, it can go into the market and verify products have the appropriate labelling and certification and test the products to ensure that the certification is valid. EU reporting on Association Agreement alignment in 2019 and 2020 shows that it is progressing with the provision of market surveillance services for a range of industrial and consumer products, in particular as regards safety.

Of course, the Construction and Supervision Agency can only work on the market in places where regulations have come into alignment, which can also only happen after the first two institutions are working in a given area. It is, therefore, perhaps unsurprising, that the Construction and Supervision Agency is currently only policing a small handful of products, mainly in the construction sector.<sup>43</sup>

The second and third part of the system that need to develop are the network of private Conformity Assessment Bodies (CABs) and the private production companies themselves. It is generally accepted by all reporting that this certification is weak.

There are 229 entities that have been accredited by the Georgian Accreditation Center.

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<sup>43</sup> Based on discussion with the representative of the Georgian Accreditation Center (August 2020)



Figure 29: Conformity Assessment Bodies, Certified by the Georgian Accreditation Agency

Type of accredited bodies	Number of Accredited bodies
Inspection Bodies (Including: Vehicle Testing Centers and Verification Bodies)	111
Medical Laboratories	5
Personnel Certification Bodies	4
Product Certification Bodies	6
Testing and Calibration Laboratories	103
<b>Total</b>	<b>229</b>

Reference: Georgian Accreditation Center (Reviewed August 2020)

Around half of these are for vehicle inspection. Only 6 are for product certification. The 103 ‘testing and calibration’ laboratories are concentrated in a fairly narrow band of categories.

Figure 30: Testing and Calibration Laboratories, Certified by the Georgian Accreditation Center

Category of Testing and Calibration Laboratories	Number of entities
Construction	26
Food and beverages	15
Oil, gas	15
Soil, water	9
electricity, cables	6
Pharma	5
Metals	3
Forensics	2
Pipes	2
Various	3
Other	17

Reference: Georgian Accreditation Center (Reviewed August 2020)

According to most reviewers, including the EU and the Georgian Accreditation Center, there needs to be far wider development of local conformity assessment bodies and wider use by firms. Part of the problem is a ‘chicken and egg’ situation faced by private producer and CABs. For the private producer, until they are required to do so, it makes little sense for most producers to come into alignment with EU standards. To come into alignment will push up costs and the price of the product, and so they will not be price-competitive in a price sensitive market. Over the years, the researchers for this project have come across this phenomenon many times. In food processing, for example, companies have often upgraded facilities to find that when standards are not enforced, they are outcompeted by cheaper producers who did not carry out an upgrade but are allowed to sell their products anyway.

For the Conformity Assessment Bodies, this creates a second problem. If private companies are not motivated to upgrade products, then they don’t need their services, so that the CABs don’t have enough business to make a private lab commercially viable.

The second part of the problem is that unlike when the EU-accession countries went through this process in the mid-2000s, the EU offers Georgia no structural adjustment financing to allow their companies to come



into alignment with EU-standards. Most of the support for alignment is spent on technical assistance for the Georgian government bodies who are supposed to support and police the private sector. The EU does offer support for some private sector entities through its development programming, but at nothing like the scale to match the physical upgrade of facilities required.

The third big problem for EU alignment in private companies is that many, if not most, may be too small or too outdated in their production methodology to be able to conform to a higher standard. Or, to put it another way, they may simply not be profitable enough to justify the large one-off expenses required to come into alignment.

Unlike EU-ascension in the early to mid-2000s, there is not a structural adjustment fund to finance the costs to businesses of upgrading plants and equipment, modifying work practices, responding to new administrative demands, etc. And, even with EU accession, the alignment process was certainly too expensive for many producers and led to considerable consolidation in some sectors.

As a result, at the current time, in most areas, companies only go to the trouble of upgrading facilities and getting products certified if the final product is aimed at the small 'high-end' portion of the Georgian market, or if the good is intended for export. And given that the local accredited entities are few and cover only a small proportion of the tests and product categories that even a small manufacturing base would need, this testing and certification is usually done through foreign labs, which mean higher costs and creates timing bottlenecks.

The situation is made even more complicated because EU minimal (largely health and safety) standards may not be enough to get certain Georgian goods to EU markets. In the case of animal products, for example, even if Georgia has a strong SPS system in place, this will not be sufficient for Georgian products to be exported if the country cannot also demonstrate that it has ended a range of endemic animal diseases.

Also, the standards required by the customer may be considerably greater than EU standards. ISO, HACCP and other production standards, for example, may be required by consumers, even if they are not required by the EU as a whole.

For the foreseeable future it seems unlikely that the Georgian Government will aggressively pursue alignment on all local production. To do so would undoubtedly increase prices, putting many local producers out of business and forcing importers and retailers to buy/sell more expensive products. This would likely be unpopular in a very price-sensitive market, which has already seen a significant increase in import prices as a result of local currency devaluation.

Therefore, for standards development, in the short-term it will probably be necessary to identify strategies to encourage standards adoption, and to support both the CABs and the private sector entities in gaining certification and upgrading equipment.

One obvious area where the government could help push the market in the right direction is through government procurement. Currently, when the government makes purchases, they do not require that the standards of the products purchased are of any higher quality or certification than Georgian law would require. If they were to require EU certification, then this would be an encouragement to the sectors to adopt better standards.

One Georgian lighting fixture producer made this point explicitly, saying that Georgian Government contracts would have been the natural way for him to build a profile that would then allow him to sell internationally. But, in Georgia, he was always outbid by imports that did not subscribe to EU product standards.

For the Conformity Assessment Bodies, support probably requires a more systematic assessment of the most needed bodies, to see which ones make sense to source internationally, and which ones really need to exist locally. This could include some cost-sharing mechanism or collective purchasing in coordination with government agencies for CAB services, to help get past the ‘chicken and egg’ problem.

For support of manufacturing facility upgrade, this may also have to go beyond the existing generic enterprise support systems, though a more detailed cost-benefit calculation is needed to decide what structure of grants, subsidised loans and other supports may be valid.

## Broader challenges facing Georgian exports

We can see from the preceding analysis that while exports to the EU and FDI in the country have not declined significantly in recent years, engagement has certainly not grown in aggregate and the Association Agreement seems to have had very limited effect.

In the following section we will consider what some of the main limitations may be on export growth and why FDI in tradables is not growing faster. This analysis will start with a consideration of the broader economic context facing tradable products, before reviewing a few key export sectors to look at how exports have changed in recent years, and what may be setting limitations on growth.

The Georgian Government, Enterprise Georgia and the author of the present work are all well-rehearsed in the argument regarding why Georgia is the best country to invest and do business in the region. Most readers will be familiar with these arguments and so we will only consider them briefly here.

- Ease of Doing Business – ranking No7 in the World Bank Index (and 1<sup>st</sup> in the countries in Europe).
- Low and easy tax environment – most commonly highlighted by ranking No. 12 in the Heritage Foundation Index of Economic Freedom (6<sup>th</sup> amongst the countries in Europe). Also usually highlighting the Estonian tax model, where profit tax is only paid on disbursed earnings.
- Open economy with free trade agreements with the EU, Turkey, CIS, China and GSP with USA, Canada and Japan
- Young, skilled and competitively priced labor force (with salaries at around \$400 in the manufacturing sector)
- Low utility costs
- Various government support programmes to help with financing and some grants

To review the World Bank ranking:

*Figure 31: World Bank Ease of Doing Business 2020, Ranking Breakdown*

Categories	Ranking
Overall	7
Starting a Business	2
Dealing with construction permits	21
Getting electricity	42
Registering property	5
Getting credit	15
Protecting minority investors	7
Paying taxes	14

Trading across borders	45
Enforcing contracts	12
Resolving insolvency	64

Reference: World Bank (2020), Doing Business 2020: Georgia

These summaries and highlighted advantages certainly tell part of the story, and Georgia's position in these rankings have served to help Georgia come to the attention of a range of international investors over the years. However, it has widely been acknowledged in the Georgian business community that these rankings, and the rating as a whole, often do not feel like an accurate reflection of Georgian reality.

Part of the problem is that World Bank indicators put considerable emphasis on legislative requirements and limitations, rather than focusing on their practical implementation. Famously, when Kakha Bendukidze became Georgian Minister of Economy soon after the UNM government came to power in 2004, he told his staff to go through the business environment laws and make whatever cuts were needed to move Georgia up the WB ranking.<sup>44</sup>

On top of some uncertainty that may sit around the World Bank Ease of Doing Business ranking, there are also widely acknowledged practical challenges that are often not factored into the policy or analysis on business development and export promotion. Most notably the impact that poor transport and logistics, weak value chain penetration, low skill levels amongst workers, narrow financing options, a weak bureaucracy and weak judiciary can have.

For example, the openness of the economy and the range of free trade areas seem to be significantly undercut by poor transport infrastructure. While border management and customs regulations may have improved in recent years, in 2018 Georgia was still ranked 119 (out of 160) in the World Bank's Logistics Performance Index, ranking 95 for customs, 102 for infrastructure and 132 for logistics quality and competence.<sup>45</sup> For access to the EU, it is commonly commented upon that transport links to the EU are far worse than they are in Turkey. In terms of using Georgia as a connection point between the EU and Central Asia or China, while discussion of the Silk Road is common, most transportation experts will point out that it is generally cheaper and faster to connect from the EU through Eastern Europe and Russia than through the Caucasus.

Lack of value chain penetration exacerbates the same problem. As we will see in the sector discussions below, lack of value chain penetration in Georgia is one of the major hurdles to export growth. FDI in this area is essential to build both value chains and to connect producers to clients, understand production processes and navigate regulatory hurdles and standards in new markets.

Financing is always referenced as a problem. While rates have come down and willingness to lend has improved, Georgia is heavily bank-centric and the Georgian banking sector is very conservative in its lending. Practically, this translates into high capital requirements and short repayment periods for commercial loans. This makes the financing of new greenfield investments through debt very difficult. Government interest-rate subsidies and credit guarantees try to alleviate this problem. And, at the current time, while there is a growing pool of investing entities in Georgia, they seem to have a small appetite for new ventures.

The judiciary is also commonly highlighted as a problem that undercuts protections of contracts and the rights of minority shareholders. In minority rights, in particular, the legal protections for minority shareholders

<sup>44</sup> This is a commonly referenced story relating to the post-2004 reforms.

<sup>45</sup> World Bank (Reviewed August 2020) Logistics Performance Index 2018, <https://lpi.worldbank.org/international/scorecard/radar/254/C/GEO/2018#chartarea>

enshrined in the Law on Entrepreneurs now lays out informational rights, transparency on remuneration, related party transactions and the needs for super-majorities for structural corporate changes. These are generally looked upon favourably by lawyers as a set of legislative protections. However, the laws are only as effective as the system in place to enforce them, and the lack of skills of judges on commercial matters, long delays to hear cases, as well as a perception of growing judicial corruption in some areas has undermined faith in the ability of the laws to be predictably enforced.

Government bureaucracy and competence is another general category, since it can also undermine a business environment that might look great on paper. This has multiple components, but complaints of the government's reliability include the problematic follow-up on investor-care, the challenges that new investors have getting construction permits or clearing administrative hurdles for new construction facilities, an overly dynamic legislative space which can include major changes that impact the value of a business. For example, many foreign investors feel the ban on the foreign ownership of agricultural land undercuts the terms under which previous investments were made.

And finally, on labour skills, there is a strong acceptance that while salaries are low, skills levels and productivity are also low. While, as we will discuss below, it is not true that Georgia has no experience of industrial production, the experience base is small and extremely dated in technological orientation. And while there has been commitment to spend more in this area, and huge commitments from all donors to fund skills upgrading, the implementation of this policy has faltered, and there have so far been very little in terms of results.

None of this should be taken to suggest that Georgia is not a good place to do business. However, the determination to sell the country's strengths may have made it harder for the authorities to address its weaknesses. However, not only should government policy address these weaknesses, but a more honest appraisal of these weaknesses may allow better targeting of sectors and supports.

In the sections that follow, the research will continue thinking through the question of Georgia's practical areas of comparative advantage, looking at the business models and challenges in particular sectors, to try and highlight where opportunities for export, and particularly EU export, might exist and what support is needed to help it be realised.

### Sector assessments and selections in Georgia

There have been a wide-range of sectoral assessments done in recent years, some looking at the economy as a whole and some looking at particular sectors. One of the most influential of these analyses was the World Bank Sector Scanning, the results of which were published in 2019. The aim of the World Bank sector scanning was to prioritize sectors that are able to receive high quality FDI often associated with knowledge & technology transfer and creation of high value-add in the country (often called 'efficiency seeking').<sup>46</sup> This built on the 2018 country diagnostic that had highlighted the opportunities of agribusiness, apparel, hydropower and tourism.<sup>47</sup>

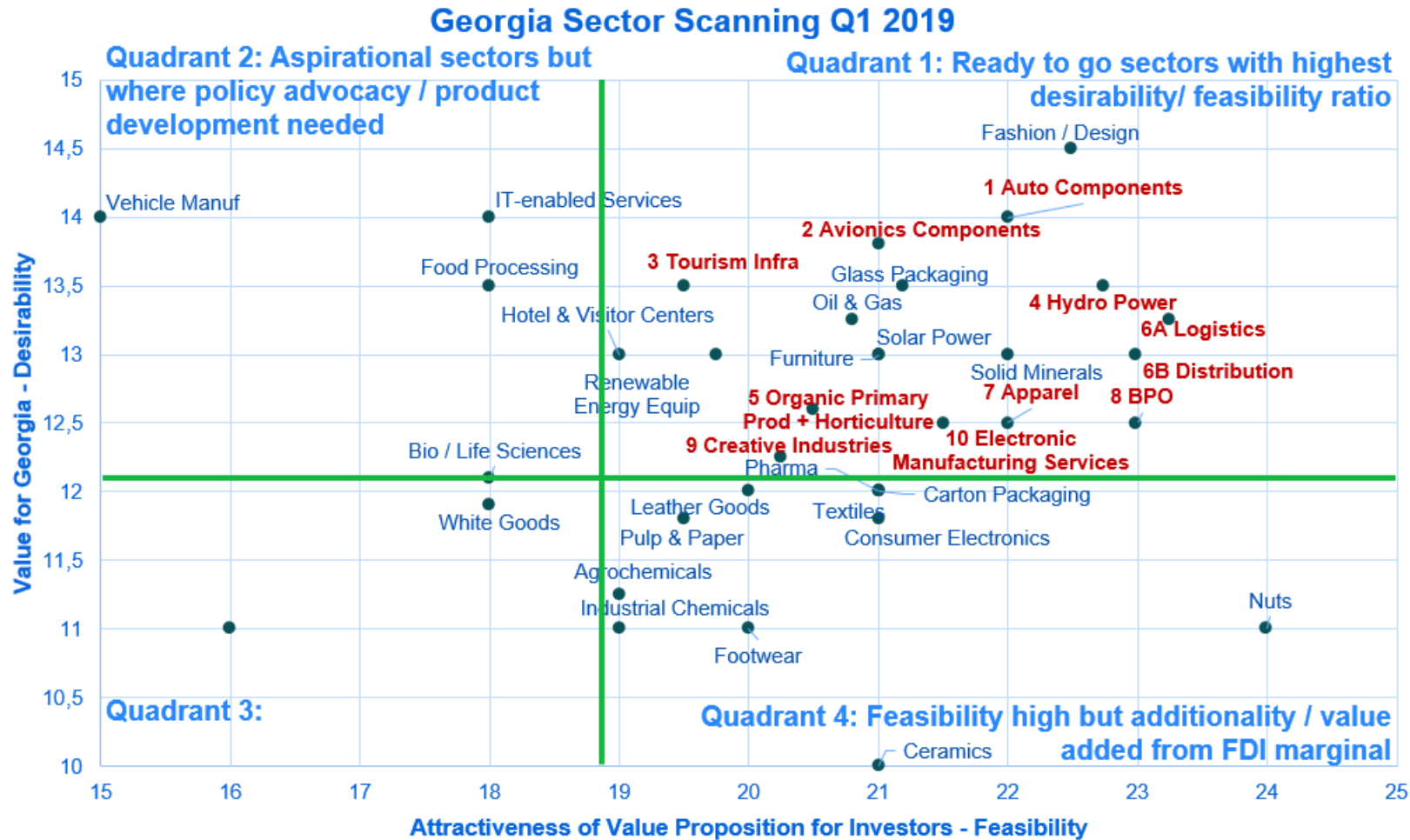
The sector scanning considers job creation potential, export potential, spill-over benefits, opportunities and connections to local resources as well as barriers to entry. They ultimately prioritise 10 categories/sub-categories.

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<sup>46</sup> World Bank (2019), Investment Policy and Promotion Stream, Sector Scanning Results, Georgia Trade, Investment and Agri-competitiveness Project, Enterprise Georgia, Tbilisi.

<sup>47</sup> World Bank Group (2018), Georgia: from Reformer to Performer.

Figure 32: World Bank Sector Scanning Summary



Reference: World Bank (2019), Investment Policy and Promotion Stream, Sector Scanning Results, Georgia Trade, Tbilisi, p15

This short-list of 10 is then reduced to a smaller short-list of six categories, upon which it is advised that Enterprise Georgia should focus:

- Agribusiness – organic primary products
- Apparel and footwear
- Automotive components
- Electronic Manufacturing Services
- IT-Enabled Services/BPO
- Tourism infrastructure

This research will not try to review the World Bank process. However, it is important to note that apart from apparel and tourism, these sectors are mostly fairly new for Georgia. A focus on the new sectors has occurred because the analysis highlights the market opportunities, global growth and high paying jobs in these sectors. It does not, however, score these sectors negatively on the basis that their newness might bring hurdles. For example, established businesses like wine and hazelnuts are given the same score in terms of ‘skill availability’ and ‘connectivity and infrastructure’ as new sectors like automotive and aviation.<sup>48</sup>

These sectors have been largely accepted as the key priorities of Enterprise Georgia for pro-active FDI attraction.

Other sectoral approaches take a different route. EPRC, using an International Trade Center Methodology, analysed 46 fields and 17 commodity groups to identify areas with export potential (not including services). This methodology basically uses current exports and export trends as probably the biggest indicator for future export potential.<sup>49</sup>

They conclude that five different areas stood out: apparel, footwear, production of leather and related goods, wooden products, and furniture.<sup>50</sup> Within these categories they single out children’s clothing and wooden toys as areas with particularly high potential.<sup>51</sup> EuroChambers also focuses on existing sectors and highlights agricultural, wine, tourism, textiles and creative industries, suggesting that these have the greatest opportunities for EU growth.<sup>52</sup>

The German Economic Team applied a logic of grouping different exports together, basically judging that if you export A+B, you probably could export C – and determined that energy intensive products, some manufactured products, business services and various agricultural and food products, were all export growth possibilities.<sup>53</sup>

Other research has focused on the sub-sectors that make sense within a given large sector. Agriculture has received particular attention. The USAID Agricultural Project, conducted a sector selection exercise in the agricultural sector (not including wine), which will be discussed below.<sup>54</sup>

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<sup>48</sup> World Bank (2019), Investment Policy and Promotion Stream, Sector Scanning Results, Georgia Trade, Tbilisi, p12-14

<sup>49</sup> EPRC (2020) Assessing prospects of Export of Separate Products and Services from Georgia to the EU, p16. They apply five tests, four of them relate to the current composition of export.

<sup>50</sup> EPRC (2020) Assessing prospects of Export of Separate Products and Services from Georgia to the EU, p6

<sup>51</sup> EPRC (2020) Assessing prospects of Export of Separate Products and Services from Georgia to the EU, p7

<sup>52</sup> Eurochambers (2020), Georgia: Country Report 2020

<sup>53</sup> David Saha and George Zachmann, Georgia’s Economic Specialisation, Present and Future, Newsletter, Issue 3, GET Georgia, p1

<sup>54</sup> CNFA (2019), The USAID Agricultural Program: Sector Selection and Value Chain Assessment, Tbilisi

If we add to all of these sectoral analyses, the huge number of value chain analyses that have been done by Enterprise Georgia, PwC, Deloitte, EPRC, PMCG, ISET and (the firm conducting this research) GeoWel, Georgia has supported a cottage industry of sectoral analyses over the last few years. Most of this has been intended to identify what sectors the government should target for its support. However, while the analysis below may seem like it is setting out to do the same thing, the objective is different. Our goal is not to cherry-pick sectors, but to identify the kinds of hurdles that might exist in particular sectors, to explain the challenges that the different sectors have faced in expanding exports, and to suggest what the Georgian Government might want to do to fix these problems, or what organisations like EBRD may do to help.

## Support for tradable sector

The Georgian Government supports a fairly wide range of companies and business people through a range of different agencies. Roughly, this is divided sectorally. The main entity for supporting businesses is Enterprise Georgia. IT and innovation are supported by programmes under the Georgian Innovation and Technology Agency (GITA), both of these are part of the Ministry of Economy and Sustainable Development. Agricultural and food processing is mostly supported by the Rural Development Agency (ARDA – previously APMA). This is part of the Ministry of Environment and Agriculture. We will cover each of these in turn.

### Enterprise Georgia

Enterprise Georgia takes a sectoral approach to its business interventions. There are three main categories of activities undertaken by the agency; 'Business Development', 'Export Support' and 'Invest in Georgia'. The different programmes focus on the following sector.<sup>55</sup>

Figure 33: Support for different sectors from Enterprise Georgia's Different Programs

Sector	Specific sector	Business Development	Export promotion services	Invest in Georgia <sup>56</sup>
Agri/food	Food and beverages		X	
Agri/food	Fish	X		
Manufacturing	Paper and cardboard	X		
Manufacturing	Wood processing	X	X	X
Manufacturing	Metal products	X	X	X
Manufacturing	Chemical manufacturing	X		X
Manufacturing	Mechanical engineering/ automotive and aerospace	X		X
Manufacturing	Apparel production	X	X	X
Manufacturing	Electrical Equipment/electronics	X	X	X
Manufacturing	Rubber and plastics	X		X
Manufacturing	Construction materials		X	X
Manufacturing	Pharmaceutical		X	X
Services	Hotel and resort development	X		X
Services	Film	X		
Services	BPO - Finance and accounting		X	X

<sup>55</sup> This is slightly complicated because the different programmes don't have the same names for sectors so that under 'Business Development' they target 'Electrical Equipment' but under Invest in Georgia it becomes 'electronics'. Similarly, 'mechanical engineering' versus 'automotive and aerospace'.

<sup>56</sup> The division supports any investors from any sectors including agriculture, paper etc. However, it works proactively (reaching out to target companies/lead generation) only on number of sectors.



Services	BPO - HR Outsourcing		x	x
Services	BPO- CRM - Call center		x	x
Services	BPO - IT outsourcing		x	x
Services	BPO - Architecture, Design and Engineering		x	x

Reference: Produced based on data from Enterprise Georgia (<http://www.enterprisegeorgia.gov.ge/en>),  
Reviewed August 2020

'Business development' is a set of supports intended to encourage investment, particularly in manufacturing sub-sectors, as well as in tourism and film. For manufacturing it offers 11% co-financing of credit or 13% co-financing of leases, for the first 3 years, on loans between 50,000 and 10m GEL, as well as grants up to 10,000 GEL for technical assistance. Hotel development has similar subsidised credit and royalty co-financing.

These subsidised loans are the main direct support offered by the Georgian Government in the listed sectors. They work through commercial banks, providing a hair-cut on commercial rates. So, if a business would normally be charged 15%, the 11% subsidy means that this would be reduced to 4% for the borrower, for 3 years. For companies that might have difficulty securing loans due to a lack of collateral (particularly for greenfield investments) the credit guarantees are supposed to give the banks coverage.

This programme has been significantly upscaled in the face of Covid with a large increase in the subsidy, from 7% to 11.5%, a lengthening of the duration of support from 2-3 years and an expansion of the credit guarantee scheme.<sup>57</sup>

Film in Georgia has a 25-25% cashback scheme for companies filming in the country. The programme also offers a credit guarantee scheme. There are also small grants program for SMEs. The 2019 Enterprise Georgia report shows the following profile of spending in 2019

Figure 34: Government support within different 'Business Development' projects: 2019

Project	Projects 2019	Government support (million GEL) 2019
Business Development – Industrial	85	148 million GEL in loans
Business Development – Hospitality	59	140 million GEL in loans
Produce for a better future	14	285,800 GEL in grants
Small Hotels Support program	177	614,100 in grants
Film in Georgia	13	14-16m cash-back (on 55m expenses)
Micro and small business support	6,212 (not clear over which years)	Maximum support of 20,000 GEL per project

Reference: Enterprise Georgia (2019), annual report

Export promotion services offer support and financing for companies that are looking to enhance their exports. Through this scheme, Enterprise Georgia will provide cos-support for companies looking to attend international trade fairs and trade missions. They also aim to provide connections to companies trying to find foreign buyers and education on export promotion and export procedures. They also maintain a website [www.tradewithGeorgia.com](http://www.tradewithGeorgia.com) where exporters can register.

<sup>57</sup> Enterprise Georgia (2020), Enterprise Georgia: Updated Programs, Tbilisi



## Invest in Georgia

Investment promotion is the set of activities intended to attract FDI using a range of mechanisms, including the development of research and promotional materials for particular sectors, direct outreach to pre-identified companies and support services for aspiring investors. In addition to the sectors listed above, investment promotion also targets energy and transport and logistics, but these are not considered here.

In addition to the intangible supports of 'Invest in Georgia', Enterprise Georgia also supports foreign investors through the 'Business Development Schemes', 'Invest in Georgia' and 'Export Promotion', as these schemes are not restricted to Georgian-owned companies.

The most recently updated investment promotion strategy specifically takes into account the post-Covid context, and highlights the role of China in global supply chains, particularly pointing out China's role in computers and electronics, sports shoes and apparel. This includes a consideration of import tariffs to the EU at 14% for electronics and 12-17% for apparel.<sup>58</sup>

The investment promotion strategy includes identifying and contacting target companies, working with location advisors, working on sectoral rankings and publicity through research reports and analysis.<sup>59</sup> Interestingly, Invest in Georgia has not targeted many Chinese companies, as it is considered difficult to attract Chinese companies to Georgia, but many of the companies identified do have Chinese manufacturing facilities, so the hope is that they can be attracted to diversify their supply chain from China. There are 403 companies in the current list.<sup>60</sup> The companies targeted are from:

*Figure 35: Location of companies targeted by Enterprise Georgia*

#	Country	N of companies
1	USA	105
2	Germany	93
3	Japan	26
4	Italy	19
5	Switzerland	18
6	France	17
7	Turkey	15
8	UK	14
9	India	11
10	Austria	8
11	Netherlands	7
12	Canada	6
13	Spain	5
14	Taiwan	5
15	Other	54

Reference: Spreadsheet provided by Enterprise Georgia (June 2020)

<sup>58</sup> Enterprise Georgia (2020), Investment Attraction, Updated Strategy, p4

<sup>59</sup> Enterprise Georgia (2020), Investment Attraction, Updated Strategy, p7

<sup>60</sup> This is based on a list provided in the summer of 2020. This number has increased since then.






And the sector break-down of companies identified:

*Figure 36: Sector Breakdown of identified companies for FDI attraction*

#	Sector	N of companies
1	Electronics	109
2	BPO/SSC/IT	65
3	Automotive	61
4	Aircraft	59
5	Textile, Apparel & Leather	48
6	Pharmaceuticals	20
7	Footwear	15
8	Biotechnology and Life Sciences / R&D Laboratories	12
9	Hospitality/Tourism	12
10	Transport and Logistics	1

Reference: Spreadsheet provided by Enterprise Georgia (June 2020)

Figure 37: Enterprise Georgia: Georgia's Advantages in Priority Sectors

PROFESSIONAL BUSINESS SERVICES (BPO & IT)	ELECTRIC AND ELECTRONIC PRODUCTS (INCLUDING HOME APPLIANCES AND MEDICAL DEVICES)	PHARMACEUTICAL PRODUCTON AND MEDICAL RESEARCH SECTOR	APPAREL AND TEXTILE INDUSTRY	LOGISTICS (DISTRIBUTION, COLD STORAGE, WAREHOUSE, ETC.)
				
Cost of labor	Cost of labor	Cost of labor	Cost of labor	Geographic location
Knowledge of foreign languages	Skills of labor	Skills of labor	Skills of labor	Well-developed customs system
Level of sector development in the country	Level of industry development in the country	Level of sector development in the country	Level of industry development in the country	Level of sector development in the country
Geographic and cultural proximity	Free Trade Agreements	Free Trade Agreements	Free Trade Agreements	Free Trade Agreements
Well-developed communications (electricity, internet)	Integration into global supply chains	Integration into global supply chains	Integration into global supply chains	Integration into global supply chains
Offices and rental costs	Low operating costs (taxes, utilities)	Well-developed infrastructure (factory building, utilities)	Well-developed infrastructure (factory building, utilities)	Well-developed infrastructure
At least, one success story (Majorel)	Several success stories (Groupe Atlantic, AE Solar)	Low operating costs (taxes, utilities)	Low operating costs (taxes, utilities)	Operating costs (taxes, utilities)

Strong Position    
  Neutral Position    
  Weak Position

Reference: Enterprise Georgia (2020) Investment Attraction, Updated Strategy, p6. Note that this document was a draft developed in the middle of 2020 and is being updated in early 2021.

As one can see, the sectoral breakdown of Enterprise Georgia matches the assessments from many if not most of the sectoral overviews, and particularly the WB assessment.

### The Rural Development Agency

The Rural Development Agency provides support to the sector under a wide range of programmes. One of the main programmes to support expansion in the sectors that we will cover here (particularly nuts), is 'Plant the Future'. This has financing and technical assistance to individuals who want to plant nurseries, co-financing 50% up to a value of 150,000 GEL. Or, for those who want to plant perennial plants, they provide 70% of the financing for the purchase of seeds and saplings and 50% financing for the installation of drip irrigation (up to a value of 2,500 GEL per hectare). Between 2015 and 2017, this project financed 658 projects, with a financing value of 22 million GEL. Another RDA programme, finances smallholders and cooperatives with 40% of their project costs, up to a value of \$15,000, equivalent in GEL.

ARDA also finances several different projects that provide financing for storage facilities. This ranges from grants, up to 40% of 100,000 projects, in some instances, with preferential credit and co-financing options for projects up to 1.5 million GEL.

Processing is also supported through ARDA, again with a value up to 40% of co-financing with a maximum value of 100,000 GEL.

Other projects offer subsidies for buying diesel, starting and running cooperatives and modernising equipment.

### Georgian Innovation and Technology Agency (GITA)

GITA's focus is in technology and innovation companies, and particularly tech start-ups. Though there is a small overlap in its activities and the activities of Enterprise Georgia, as Enterprise Georgia also provides some support for the ICT sector.

GITA, based at the 'Technopark' in Tbilisi and with smaller 'Technopark's in eight other cities, acts as hubs for innovation and training, and provide subsidised office space for a small handful of technology companies. They work on innovation and network development as well as helping to evolve the innovation ecosystem and technology space in Georgia.

Part of this is a Business Incubator project, through which they provide participating teams with support, training and facilities up to 30,000 GEL in value.

In terms of direct support to companies, they have mostly supported start-ups through grant financing. At the high-end, through a World Bank financed scheme, they preferred Innovation Matching grants of between 150,000 and 650,000 GEL to start-up companies that had secured matching financing. They have also provided start-up grants with no matching funding requirements up to the value of 100,000 GEL and also provide 5,000 GEL small grants, these are intended for specific interventions including prototype development, and event attendance.

### International support for companies

The range of support offered by the international community for economic development is hard to summarise. Almost all of the major donors support economic development in some. Much of this is intended as poverty

mitigation, rather than economic growth, and so has limited effect on exports. However, it is hard to tell where benefits may work their way through, as even projects that do not directly target exporters can help them.

In agriculture, for example, as we will see below, while nuts and wine are exported by big companies, the majority of the supply comes from small growers, so support of these programmes may help exporters.

Georgia's two biggest donors are the US and the EU, who spend more than 100 million USD per year on a combination of technical support and grants. The EU spends closer to 120 million euros. The EU also gives direct budget support, tied to particular conditionalities. The US currently supports the Georgian agricultural sector generally with the Georgian Agriculture Project and the hazelnut sector with another Georgian Hazelnut Improvement Project (GHIP). They support the Georgian Business Sector through the Georgian Economic Security Project and the Economic Governance Program.

The EU has supported direct support for businesses. EU4Business, which has supported businesses between 2009 and 2017, has allocated 69 million euros through 23 projects. This has included the support of cluster, cooperatives, agricultural support projects and vocational education, working with Enterprise Georgia and improving information channels.

Assessing all of this development work is beyond the scope of this project. However, it is worth noting that much of the work should not be seen as trade promotion, and certainly not DCFTA utilisation specifically. EU4Business predated the Association Agreement by five years and ENPARD agricultural projects are a continuation of a long trajectory of pro-poor economic reforms.

Also, since much of the work has taken place through technical assistance to government entities, particularly in enterprise support through Enterprise Georgia and ARDA and accreditation support through the National Accreditation Center and the National Food Agency, to assess this work is to assess these agencies.

The one part of the project very clearly oriented to exports, the development of the [www.tradewithGeorgia.ge](http://www.tradewithGeorgia.ge) portal and the development of information materials on trading with Georgia, have seen extremely limited uptake, though upgrades at the end of 2020 may increase utilization.

## Agricultural exports

The project did not intend to make agriculture a focal area, since it faces a particular dynamic. However, agriculture continues to be one of the major categories that represents a very diverse set of opportunities and, contrary to popular consensus, this is an area that could be on the cusp of rapid commercial expansion. Also, existing research does not provide an integrated consideration of all agricultural products. Therefore, the research below provides a summary of existing research along with considerable interviewing and analysis on each of the major agriculture categories that seem interesting from an export and particularly EU-exportable perspective. We consider separately, wine, other beverages, nuts and fruits and vegetables. As an overview, below is a summary of domestic agri-food exports.

Figure 38: Breakdown of domestic exports for food and beverages (2- and 4-digit levels) 2009-2019 (million USD)

Category	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Live animals	34	33	43	58	62	47	39	48	44	35	39
Meat	-	-	0.0	2.4	1.1	1.0	0.3	4	25	40	18
Nuts	70	75	127	82	166	183	175	178	80	54	65
Fruits	18	17	9	13	25	20	18	18	21	28	43
Vegetables	3	5	5	6	10	8	7	10	15	15	11
Processed fruits and vegetables	4	8	9	15	11	18	18	16	23	25	19
Spices	3	4	4	5	5	7	8	8	8	8	10
Tea	1.6	1.1	2.0	2.3	2.2	3	2.4	1.4	2.1	4	4
Wine	31	40	52	63	126	177	93	112	170	195	222
Brandy and alcohol	40	36	45	57	69	55	28	40	61	85	83
Mineral water	25	37	48	59	107	137	82	80	96	118	133
Soft drinks	11	15	15	21	17	28	18	12	17	27	27
Other	39	28	32	56	59	39	41	50	47	44	36
<b>Total</b>	<b>279</b>	<b>299</b>	<b>391</b>	<b>439</b>	<b>661</b>	<b>723</b>	<b>531</b>	<b>576</b>	<b>608</b>	<b>678</b>	<b>710</b>

Reference: Geostat (provided on request, July 2020)

As one can see, total domestic exports in the agri-food sector were 710 million USD in 2019, about one-third of total domestic exports. Therefore, if we exclude minerals and metals, since they involve limited value addition, that makes agri-food the most important export category in Georgia. It has also increased by about 2.5x in the last 10 years, which is slightly stronger than domestic exports generally and a lot stronger than the rest of domestic exports, if you exclude minerals and metals.

However, that growth has not been steady. Exports in the sector took a sharp decline between 2014 and 2015 because of the regional financial crisis. Beverage sales, which accounted for 55% of exports at the time, were particularly badly hit because of their dependence on the Russian market.

Beverages have gradually recovered since then, but the broad-sector took another hit in 2016 when the stink-bug decimated nut production. This problem has taken several years to get under control and is only now seeing significant recovery.

Of all of these categories, nuts have been by far the biggest agriculture-related export to the EU. Wine has seen good growth from a low baseline, but the totals remain modest, and fresh or processed fruit and vegetables are extremely limited.

Figure 39. Food groups by main export country and value, 2019 (Million USD)

Commodity	2019 Export Value	Main country of export		
		EU	CIS and Ukraine	Other
Live animals	39	-	Azerbaijan (\$15m), Armenia (\$2m)	Iraq (\$12m), Saudi Arabia (\$5m), Kuwait (\$3m), Qatar (\$1m)
Meat	18	-	Azerbaijan (\$2m)	Iran (\$12m), UAE and Kuwait (\$1m each)
Nuts	65	Italy (\$14m), Germany (\$11m), Czech Republic (\$4m), Lithuania, France, Spain and Poland (\$3m each), Latvia (\$1m)	Russia (\$4m), Belarus and Ukraine (\$2m each), Kazakhstan (\$1m)	China (\$3m), Tunisia (\$2m), Canada, Iraq, Mexico, Brazil and Switzerland (\$1m each)
Fruits	43	Germany (\$1m)	Russia (\$30m), Armenia (\$6m), Ukraine (\$4m)	-
Vegetables	11	-	Russia (\$7m), Armenia and Azerbaijan (\$1m each)	-
Processed fruits and vegetables	19	Germany (\$6m), Belgium and Greece (\$1m each)	Russia (\$3m)	USA (\$2m), Australia and Israel (\$1m each)
Spices	10	-	Russia (\$4m), Ukraine (\$1m)	China (\$3m)
Tea	4	-	Azerbaijan (\$2m)	Turkey (\$1m)
Wine	222	Poland (\$9m), Latvia (\$4m), Germany, Estonia and Lithuania (\$2m each), UK (\$1m)	Russia (\$133m), Ukraine (\$23m), Kazakhstan (\$8m), Belarus (\$7m), Moldova and Kyrgyzstan (\$1m each)	China (\$19m), USA (\$3m), Japan, Mongolia, Canada and Israel (\$1m each)
Brandy and alcohol	83	Latvia and Lithuania (\$1m each)	Russia (\$35m), Ukraine (\$31m), Belarus (\$7m), Moldova (\$2m), Armenia and Kazakhstan (\$1m each)	China (\$1m)
Mineral water	133	Lithuania (\$15)	Russia (\$61m), Ukraine (\$23m), Kazakhstan (\$14m), Belarus (\$10m), Uzbekistan (\$3m), Azerbaijan, Moldova, Kyrgyzstan and Tajikistan (\$1m each)	USA and Israel (\$1m each)
Soft drinks	27	-	Russia (\$11m), Azerbaijan (\$6m), Armenia (\$4m), Kazakhstan (\$2m), Ukraine (\$1m)	-

Other	36	Germany (\$3m), France and Netherlands (\$1m each)	Azerbaijan (\$6m), Russia (\$5m), Armenia (\$4m), Ukraine (\$1m)	Turkey (\$7m) <sup>61</sup> , Vietnam, Iran, Iraq, Chile and USA (\$1m each)
<b>Total</b>	<b>710</b>	<b>Nuts (\$44m), Wine (\$21m), Mineral water (\$16m), Processed fruits and vegetables (\$11m)</b>	<b>Wine (\$175m), Mineral water (\$115m), Brandy and alcohol (\$78m), Fruits (\$41m), Soft drinks (\$25m), Live animals (\$17m), Other (\$16m)</b>	<b>Wine (\$26m), Live animals (\$21m), Meat (\$15m), Other (\$13m), Nuts (\$11m)</b>

Reference: Geostat (provided on request, July 2020)

The German Economic Team (GET) have done a relatively recent analysis of why Georgia has not seen much in the way of agricultural export increase to the EU.<sup>62</sup> This provides an excellent overview, though they generally do not cover hazelnuts or beverages, since these sectors are seen as fairly mature and presenting different mechanics to the rest of the sector. They focus on fresh fruit and vegetables.

GET highlight a range of barriers to exports. In particular, they list volume, certification, transport and logistics barriers. Perhaps most significantly, they suggest the following interventions:

- Focus on increasing volumes through targeted FDI, export acceleration and the use of the PEM convention
- Provide key logistics infrastructure (ferries, airport cargo terminals, logistics zones)
- Target vocational education to support exports
- Stimulate domestic demand for logistics, in particular by further development of GeoGAP quality standards
- Bundle interests and close information gaps

Other organisations that have analysed the sector have generally drawn similar conclusions. Talking to both of USAID's agricultural support projects implementers, CNFA, who manage the USAID Agriculture Program (which works with many supply chains) and the Georgian Hazelnut Improvement Project (GHIP), as well as Chemonics, who support the Zrda (Grow) programme and who work on rural productivity in MSMEs, did not paint an optimistic picture of the likelihood of Georgian exports.<sup>63</sup>

Along with the German Economic Team, none of these organisations suggest that exports to the EU are impossible, but it does become clear, both from reviewing analytical documents and talking to the project management, that highly perishables fruits and vegetables face huge challenges accessing the EU market, and (most importantly) far greater challenges than CIS countries with whom they have a strong comparative advantage or even the Gulf countries or other global markets. Our analysis supports these findings, across the board, but will give more consideration to how they work out practically in the different sub-sectors.

<sup>61</sup> This is made up of Animal or vegetable fats (\$5m) and animal feed (\$1m).

<sup>62</sup> Hans Gutbrod and Veronika Movchan (2020), Promoting Georgian Exports of Agro-Foods to the EU – the Role of Volume, Transport and Logistics, German Economic Team, Policy Brief.

<sup>63</sup> Interview with a representative of Zrda, Chemonics (2<sup>nd</sup> June 2020) and Interview with a representative of CNFA, USAID Agricultural Program and G-HIP (11 May 2020).



The analysis that follows leans heavily on existing research and discussions with both agricultural producers and exporters and investors. The remarkably low level of large commercial export in agricultural in Georgia has been an item of discussion for many years. Everyone has a view on why it has not happened and any explanation certainly includes small land plots, difficulties in land ownership, lack of technical skills in country, lack of capable labor, lack of financing, disease and weather risks, exposure to political or local community uncertainty and much more.<sup>64</sup>

However, for the purpose of this analysis, rather than trying to look at the failings of the entire sector, we will focus on the weaknesses that are particularly problematic for export. This is tricky since these issues are, of course, connected. In particular, many of the problems of exports are problems of scale. If the farms or processors were large enough then the transport, certification, training, storage and market connections, would be significantly smaller problems. However, we will review the analysis, accepting the current facts of production scale. We will start by reviewing wine and other beverages before moving on to nuts, fruit and vegetables and processed food.

## Wine

Wine and alcoholic beverages are, between them, the biggest export category in the food and beverages sectors.

Figure 40. Breakdown of domestic exports for wine and alcohol by top export countries (4-digit level) 2009-2019 (million USD)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Wine</b>	<b>31</b>	<b>40</b>	<b>52</b>	<b>63</b>	<b>126</b>	<b>177</b>	<b>93</b>	<b>112</b>	<b>170</b>	<b>195</b>	<b>222</b>
Russia	-	-	-	-	57	111	43	56	99	115	133
Ukraine	13	19	23	27	30	20	8	12	18	21	23
China	0.5	0.7	2.0	4	3	5	9	14	20	20	19
Poland	1.8	2.1	2.2	2.7	3	4	4	5	6	8	9
Kazakhstan	4	6	9	12	14	16	14	8	8	9	8
<b>Brandy and alcohol</b>	<b>40</b>	<b>36</b>	<b>45</b>	<b>57</b>	<b>69</b>	<b>55</b>	<b>28</b>	<b>40</b>	<b>61</b>	<b>85</b>	<b>83</b>
Russia	-	-	-	-	4	18	10	13	23	21	35
Ukraine	29	26	33	36	33	23	10	17	20	32	31
Belarus	5	5	5	5	3	3	2.8	2.8	4	4	7
Moldova	-	-	-	-	-	-	-	-	0.1	0.1	2.5
Armenia	0.1	0.0	-	0.0	0.1	0.6	1.0	4	2.5	2.1	1.4
France	0.0	-	0.0	2.3	19	6	0.3	0.3	3	13	0.0

Reference: Geostat (provided on request, July 2020)

We can also look in more detail at the EU specifically.

<sup>64</sup> The authors of this project have conducted numerous analyses of the agricultural sector over the years, most notably a 200-page overview of agriculture in Georgia, Armenia and Azerbaijan. This was written in 2013, but not a lot has changed since then. GeoWel Research (2013), Comparative Analysis of Agriculture in the South Caucasus, UNDP, Tbilisi.

Figure 41. Breakdown of domestic exports to EU for wine and alcohol by top export EU countries (4-digit level) 2009-2019 (million USD)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Wine</b>	<b>6</b>	<b>7</b>	<b>8</b>	<b>9</b>	<b>10</b>	<b>12</b>	<b>11</b>	<b>13</b>	<b>14</b>	<b>18</b>	<b>21</b>
Poland	1.8	2.1	2.2	2.7	3	4	4	5	6	8	9
Latvia	1.0	1.6	1.8	2.4	2.4	3.1	2.8	2.8	4	4	4
Germany	0.6	0.6	0.8	0.6	0.7	0.9	0.9	0.8	1.2	1.5	2.1
<b>Brandy and alcohol</b>	<b>0.2</b>	<b>0.1</b>	<b>0.4</b>	<b>7</b>	<b>21</b>	<b>7</b>	<b>1.5</b>	<b>2.1</b>	<b>9</b>	<b>21</b>	<b>3</b>
Latvia	0.1	0.1	0.2	0.2	0.2	0.3	0.5	0.4	0.8	1.2	1.4
Lithuania	-	0.0	0.0	0.1	0.0	0.5	0.4	0.4	0.6	0.6	1.0
Poland	0.0	0.0	0.1	0.1	0.1	0.1	0.2	0.1	0.3	0.2	0.4
France	0.0	-	0.0	2.3	19	6	0.3	0.3	3	13	0.0

Reference: Geostat (provided on request, July 2020)

As one can see, wine and alcohol exports were fairly modest a decade ago, mainly because a Russian trade embargo cut-off access to Russia in 2006. This was a huge problem because in 2005, 87% of Georgia's wine exports were going to Russia.<sup>65</sup>

It is now more or less universally accepted that the 'Westernisation' of the wine industry in Georgia forced it to develop in ways that are now really paying off. In particular, while the Russian wine embargo which existed between 2006 and 2012 was enormously damaging for many producers, it required producers to upgrade facilities and diversify their customer base, drawing on considerable western expertise to do it. Current wine exports, therefore, while not largely being sold to the EU, can be seen as an example of market transformation that is similar to that which the EU offers in other areas. The forced modernisation is ultimately paying dividends in terms of value-addition.

Georgian wine/alcohol exports are divided into wine and 'brandy'. Wine will be discussed below but 'brandy' is actually two products, a finished brandy product that is exported as 'brandy' and is mostly sold to Russia and Ukraine, and a grape-based alcohol, which is an input into brandy. This mostly goes to big brandy producing countries like Armenia and Moldova. One part of the decline in exports to the EU between 2018 and 2019 is that grape-based alcohol sales to France dropped from USD 13 million to zero in a single year. The composition of the sector is about one-quarter brandy and alcohol and three-quarters wine, at least in recent years and wine sales have been growing sharply.

Georgian wine production is structured around a large number of grape producers who sell to a modest number of grape processors, and production and export of wine is concentrated in a smaller number of companies. According to the Georgian wine strategy, in 2016, 18,922 grape growers delivered their grapes to 178 processing companies.

<sup>65</sup> Georgian Wine Agency (2020), Wine Sector Objectives

The sector has 380 operating wine producers, though 90% of them are small and producing mostly for the local market.<sup>66</sup> Revenue from the sector is 85% generated by exports, and exports are dominated by larger players.<sup>67</sup>

Out of the top 100 biggest Georgian exporters, 20 of them are wine exporters. The three biggest wine exporters in the country are Badagoni JSC, Telavi Wine Cellar JSC and Bolero & Company Ltd. Badagoni and Telavi Wine Cellar are also listed as amongst the biggest exporters of wine to the EU. Out of the 100 biggest Georgian exporters, two are spirits exporters (main economic activity being ‘Distilling, rectifying and blending of spirits’): Kakhuri Traditional Winery Ltd and Sarajishvili JSC. Sarajishvili is also listed as amongst the biggest 100 Georgian exporters of spirits to the EU, along with Tiflis distillery Ltd. International Trading Co Ltd & K & Georgian Spirits LLC are also in the list of 100 biggest exporters, but are listed as spirit wholesalers, rather than producers.

The Georgian wine market’s dependence on the Russia market is widely seen as a big issue. Georgia has actually suffered twice from this dependence. Once in 2005, because of the embargo and also in 2015, when the sudden devaluation of oil precipitated a depreciation of the ruble and a collapse in exports and profits.<sup>68</sup>

For that reason, government policy is to diversify and the Georgian Wine Agency’s recent statement of objectives focuses its marketing attention on developing ‘old world’ (the EU and the US) and new world (Asia). This is both a strategic objective and is also a practical necessity of the marketing, since Russia does not allow alcohol advertising.<sup>69</sup>

For the purpose of this project, one can ask why does Georgia not export more wine to the EU and is it a desirable market?

The Galt and Taggart review of the sector highlights two main challenges to EU exports, the ‘Main headwinds to exporting to new markets are low awareness and high competition’<sup>70</sup>. Alternatively, one can say that in a highly competitive sector globally, Georgian wine has a long history in CIS countries and so it has a high level of awareness and long-standing relationships exist between Georgian producers and Russian buyers. Therefore, Georgia is able to sell to CIS countries fairly easily.

This is understood differently in different quarters. On the one side, big producers who export predominantly to Russia will point out that the margins are good and Russia remains the one large market for Georgian wine.

A representative of Bolero and company, one of the biggest exporters of wines and spirits, with around 20 million bottles of wine and brandy exported annually, points out that not only is Russia the only true large-scale market that Georgia has right now, but also that Georgia produces mostly semi-sweet wine and that this is what is demanded by Russia and also the growing Asian market. Sweet wines, he said, require particular (and more expensive) equipment than dry wines, and Georgia’s wine sector mostly uses this equipment. On the other hand,

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<sup>66</sup> Galt and Taggart Research, ‘Georgia’s Wine and Spirits Sector: In Vino Veritas’, p5

<sup>67</sup> Galt and Taggart Research, ‘Georgia’s Wine and Spirits Sector: In Vino Veritas’, p5

<sup>68</sup> Galt and Taggart Research, ‘Georgia’s Wine and Spirits Sector: In Vino Veritas’, p5

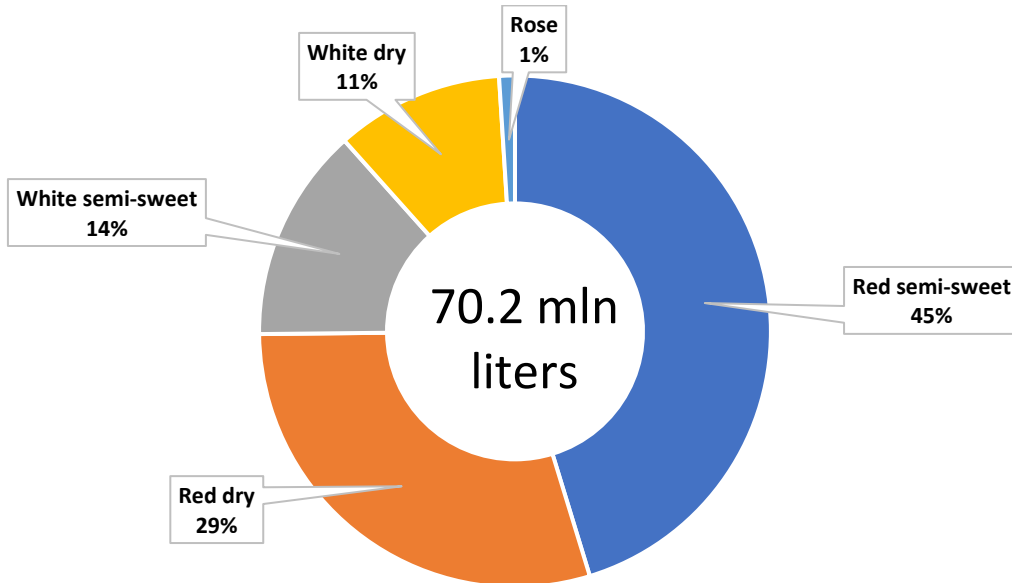
<sup>69</sup> Georgian Wine Agency (2020), Wine Sector Objectives, p10

<sup>70</sup> Galt and Taggart Research, ‘Georgia’s Wine and Spirits Sector: In Vino Veritas’, p4

Europe and America generally want dry wines. Therefore, a major shift to Western markets would require a significant shift in the nature of Georgian wine production.<sup>71</sup>

This fact about the kind of wine produced is an important consideration and supported by Georgian Wine Agency figures.

Figure 42. Georgian wine production by type of wine 2019



Reference: National Wine Agency of Georgia (provided on request, July 2020)

On the other hand, wine producers and exporters that sell or aspire to sell to Europe or the US will often claim that conventional wine companies are simply lazy, and sell to Russia and Ukraine because they are comfortable with the markets that they know.

In addition, Western-oriented producers often see the marketing of wine as a significant element of the marketing of the country, with considerable synergies between wine production, tourism and food and agriculture (and potentially exportables in that area too).

A representative of a recent European entrant to the Georgian wine production market, small wine company Mosmieri, argues that tourism, gastronomy and wine production are mutually reinforcing, where tourists to Georgia from the West are connected with higher quality Georgian wines. Mosmieri sells at about double the national average by focusing on the premium market AND avoiding distributors, building direct-sale relationships with end-clients and retail outlets.<sup>72</sup> A review of wine prices certainly reinforces that Russia is a more price sensitive market.

<sup>71</sup> Interview with a representative of Bolero and Co, 5<sup>th</sup> May 2020, Bolero and Company

<sup>72</sup> Interview with a representative of Mosmieri, April 2020

Figure 43. Average unit export price of wine for top export countries, 2019 (USD)

#	Country	N of bottles (mln)	Average bottle price (USD)
1	Russia	58	2.80
2	Ukraine	10	2.99
3	China	7	3.53
4	Poland	4	2.74
5	Kazakhstan	4	3.10
6	Belarus	2.8	2.98
7	Latvia	1.5	3.31
8	Lithuania	0.7	2.83
9	Estonia	0.7	2.75
10	USA	0.7	6.32
11	Germany	0.7	4.73
12	Moldova	0.6	2.42

Reference: National Wine Agency of Georgia (provided on request, July 2020)

Of course, just because Russia has very price sensitive segments does not mean that it is entirely price sensitive. Talking to hoteliers in Georgia, one often hears about the preparedness of middle-class Russians to be high-spenders on wine and food and there is no doubt that wine sales to Russia include higher-end wines as well. Also, wine sold in smaller quantities to Russia is also more costly to produce and to ship. And the current structure of wine production remains highly profitable, with a 26% net profit according to Galt and Taggart.

#### Ideas for enhancing Western exports

Strategically, the Georgian Government has set diversification of wine exports as a key objective. They divide this into the encouragement of exports to the 'old world' (by which they seem to mean, the EU but also the US) and the new world (meaning Asia and particularly China). For the purpose of the EU, potential markets are assumed to be Northern Europe, including Northern Germany, the Scandinavian countries and the UK, as more southerly wine producing countries like France, Italy and Spain mostly drink their own wine.

The support offered by the Georgian Wine agency in their objectives is particularly focused on grape growers, and small wine producers (who together vastly outnumber those employed in wine production). This includes the updating of technology in grape growing, a vineyard cadastral system and better environmental standards.

This is incredibly important for wine producers as well, because wine producers do not generally grow most of their own grapes, and for foreign investors, now that there are restrictions on owning agricultural land, this may be even more restrained. Therefore, producers need to have relationships with growers and need to be able to rely on the quality of the inputs, particularly for the higher-cost wines.

Of particular interest to those oriented to the EU market is also the support and promotion of Qvevri wine, which was granted the status of an intangible cultural asset by UNESCO in 2013 and the development, registration and management of both geographic and grape-specific PDO and PGI standards.<sup>73</sup>

<sup>73</sup> Georgian Wine Agency (2020), Wine Sector Objectives, p9

Also, a focus of the government strategy is support in marketing. As they point out, this will inevitably connect the sale of the country as a whole,

‘One of the key buying arguments is the “country of origin effect” and a positive image-transfer for each export market. Beside the geographical diversification a further key buying argument is a diversified product in terms of grape varieties, tradition, knowledge and production. Georgia with its numerous indigenous grapevine varieties, the “orange wine” movement and the Qvevri tradition should act as a market leader in this sector’.<sup>74</sup>

Naturally, as suggested in the introduction, it seems like this would suggest that Georgia’s tourism, gastronomy/food export, hospitality and similar sectors will naturally benefit from cross-fertilising marketing and investments and these things should be more tightly coordinated in national marketing campaigns.

One thing that is not considered in the marketing strategy are transport and logistic concerns. At the current time Georgia’s aspirational European/US export companies tend to be smaller, offering ‘niche’ high value products.

Direct sales in smaller quantities to more customers seems to be the most likely option for expanding this sector. However, this quickly becomes expensive. One idea, being explored by a local retailer, is a bonded warehouse in the EU, where wines could be sent in large quantities for sale. However, as is often the case with these ideas, this may not be viable as an entirely commercial idea and may need risk sharing.

In general, this sector, therefore does look like one with some potential and where existing and modest additional supports could move growth quite quickly. Due to the reinforcing ‘country effect’ wine/tourism/culture could be mutually reinforcing in a range of ways, so that selling more wine internationally could continue to serve the role of introducing many people to the country, which could in turn help other sectors.

## Other beverages

‘Other beverages’ are considered here because they involve some fairly large-scale exports.

Figure 44. Breakdown of domestic exports for water by top export countries (4-digit level) 2009-2019 (million USD)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Mineral water</b>	<b>25</b>	<b>37</b>	<b>48</b>	<b>59</b>	<b>107</b>	<b>137</b>	<b>82</b>	<b>80</b>	<b>96</b>	<b>118</b>	<b>133</b>
Russia	0.0	-	-	0.1	34	66	33	35	46	50	61
Ukraine	12	18	22	29	30	28	14	14	17	18	23
Lithuania	3	4	6	7	8	11	10	12	13	16	15
Kazakhstan	2.4	5	8	10	15	13	10	6	6	10	14
Belarus	1.0	2.3	2.7	5	11	9	5	5	7	9	10
Uzbekistan	0.0	0.1	0.2	0.3	0.8	1.0	1.1	1.0	1.2	0.6	2.7
USA	0.8	0.9	0.8	1.1	1.0	1.2	1.3	1.0	1.4	1.3	1.4
Azerbaijan	3.2	2.9	2.7	2.3	2.5	2.3	1.8	0.8	0.6	1.0	1.2
Israel	0.3	0.4	0.4	0.6	0.6	0.7	0.6	0.7	0.8	0.9	1.0
<b>Soft drinks</b>	<b>11</b>	<b>15</b>	<b>15</b>	<b>21</b>	<b>17</b>	<b>28</b>	<b>18</b>	<b>12</b>	<b>17</b>	<b>27</b>	<b>27</b>

<sup>74</sup> Georgian Wine Agency (2020), Wine Sector Objectives, p10

Russia	-	-	0.2	1.4	2.5	4	2.8	2.8	6	8	11
Azerbaijan	4	5	5	7	8	10	8	4	6	11	6
Armenia	2.1	3	2.3	2.3	2.8	4	3	2.2	1.6	2.2	4
Kazakhstan	0.3	0.6	1.2	1.9	1.3	8	1.6	0.7	1.2	2.0	1.6
Ukraine	0.1	0.3	0.7	1.2	1.1	0.7	0.1	0.1	0.3	0.6	0.9
<b>Beer</b>	<b>0.1</b>	<b>0.4</b>	<b>1.5</b>	<b>2.6</b>	<b>2.2</b>	<b>1.0</b>	<b>0.5</b>	<b>0.6</b>	<b>1.3</b>	<b>1.4</b>	<b>1.8</b>
Russia	-	-	-	-	0.0	0.2	0.3	0.3	0.5	0.8	1.0
China	-	-	-	-	0.0	-	0.0	-	0.0	0.0	0.2
Azerbaijan	0.0	0.4	1.5	2.4	1.9	0.6	0.1	0.1	0.0	0.0	0.1

Reference: Geostat (provided on request, July 2020)

Mineral water is a huge export category that, like wine, surged in its scale of exports when the ban on exports to Russia was lifted in 2013 (a year later than wine). It is dominated by Borjomi mineral water.

Borjomi is the only mineral water producer in Georgia's top 100 export companies. Though Borjomi and Nabeglavi are in the list of top 100 largest exporters to the EU, they are based entirely on the fairly large exports to Lithuania which, presumably like Ukraine, leverages a former-Soviet brand recognition.

Mineral water does not seem like a likely export category that will expand significantly in the EU because it is a relatively low value and high weight product with high transportation costs, and because mineral water is a highly developed market in the EU with countries generally consuming water produced in-country or by a neighbour.

The only large export of beer was to Azerbaijan in 2012 and 2013 which imported \$2.4m and \$1.9m worth beer in respective years.

We interviewed one of the representatives of Anadolu Efes, the owner of JSC Lomisi, which is probably Georgia's biggest beer and soft drink producers, and one of Georgia's 100 biggest companies. He explained that Anadolu Efes made their investment in Georgia in 2005, and only intended to produce and sell beer locally, but they were convinced to continue soft-drink production because it had a long cultural history with the company and the region.

Now, he says, the company is a large producer for the Georgian market and has effectively helped to substitute beer imports. When they entered the market, he said that imports accounted for 60% of local consumption, and this is now 8%. However, they now also export 27 million liters of beverages, which includes 2 million liters of beer and 25 million liters of lemonade. This leverages an attachment to a range of lemonades that Georgia is famous for in the region. About half of the lemonade goes to Russia and the rest to other former CIS countries, with small amounts being exported to the EU to be sold in CIS-oriented markets, which particularly target diasporas from the region.

Georgia is also a regional bottler for Coke and Pepsi, and this, along with significant growth in beer producers, has generated a fair amount of expertise in soft drink production. This has created market opportunities in associated products. For example, we talked to 'Boom' which has become a fairly large producer of energy-drinks for the local market and for export. This was started by the same management and technical group that started the Pepsi bottling plant, and they are currently looking for financing for a new venture.

## Nuts

Nuts are the second biggest category of agricultural exports and by far the biggest value-added export to the EU.

Figure 45: Breakdown of domestic exports for nuts by top export countries (4-digit level) 2009-2019 (million USD)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Total</b>	<b>70</b>	<b>75</b>	<b>127</b>	<b>82</b>	<b>166</b>	<b>183</b>	<b>175</b>	<b>178</b>	<b>80</b>	<b>54</b>	<b>65</b>
Italy	8	7	21	11	19	36	45	48	19	14	14
Germany	12	15	28	9	47	34	48	48	13	5	11
Russia	1.4	-	-	-	-	4	10	9	11	6	4
Czech Republic	7	7	9	6	9	10	10	8	5	2.8	4
China	1.4	6	0.5	0.7	0.9	-	-	-	0.3	1.0	3
Lithuania	2.0	3	4	2.2	3	5	2.7	3	2.7	2.9	3
France	1.9	1.8	4	2.4	6	4	5	9	2.9	1.9	3
Spain	6	1.8	5	4	6	13	12	9	2.2	2.0	2.9
Poland	1.6	2.5	3	1.8	2.7	2.3	2.3	1.6	1.6	1.2	2.5

Reference: Geostat (provided on request, July 2020)

The numbers above show a breakdown for ‘nuts’. Until 2018 this was more or less 100% hazelnuts, but in 2019 there was the beginnings of other nut exports with about USD 1.2 million in walnuts and \$250k in chestnuts. This is slightly over 2% of the total. There are also two large hazelnut investments that will be producing pistachios and almonds in the near future.

Georgia has a long history of nut production. However, the recent dramatic growth can largely be connected to the arrival of the Italian confectionary producer Ferrero. In 2007 Ferrero brought land in Samegrelo region and planted new hazelnut trees with the intention of diversifying their global supply chain, which is heavily dominated by Turkey. They started with 5,500 hectares and currently have 2,500, as they are gradually shifting to a model where they buy more local nuts under contract rather than growing everything themselves.

After setting up their facility they also have worked with local farmers, both within development projects like USAID’s G-HIP and outside of it, to develop the sector. Prior to their arrival in 2006, Georgia’s nut exports were around \$56m. At its peak, a decade later, this had reached 183 million, though this peak is generally considered to be a pretty exceptional year, with higher than usual nut prices due to a poor Turkish harvest.

More recently, however, the sector has been decimated by the arrival of the brown marmorated stink bug (hereafter ‘stink bug’). This insect first emerged as a major problem in the 2016/2017 growing year and was reflected in the 2017 harvest and exports. In 2017 exports were reduced by 55%. The following year was worse and exports declined to less than one-third of their previous highs.

The government has responded to this with support for disease management, and there seems to be consensus that the situation is gradually being brought under control, though this year’s harvest will be the key test. A large multi-year USAID project called G-HIP has been working with the hazelnut sector, particularly through the



Georgian Hazelnut Growers Association, and has extensive knowledge of the growers. They conducted a survey of farmers in 2017 and another in 2019 that gives a view of the sector from the side of producers.

They estimate that there are around 40,000 hazelnut farmers in Georgia.<sup>75</sup> The hazelnut harvest is then the main source of income for families that include 160,000 people. Most production is small scale, with land-plots for hazelnuts averaging 0.8 hectares. The collapse in productivity created by the stink bug is huge, with farmers reporting a 25% decline in 2017 and then a 50% decline in each of the following two years, so that by 2019, at 0.27 tons per hectare, productivity was around 20% its 2016 levels.<sup>76</sup>

The impact on hazelnut production comes from the nuts that the bugs destroy, and other diseases, like fungus, that the bugs make worse. There has been a large effort on the part of the government to help farmers manager this disease. This survey does highlight that the number of farmers that protect themselves against disease has increased from 30% to 60%, though it is too soon to say if this is enough to bring about a dramatic recovery. Since protection is a fairly high additional cost (making up 40% of total farming costs, according to G-HIP) and only one-third of farmers reporting that they have received government help, it seems likely that this disease will have a long-term impact on productivity.<sup>77</sup>

While producers are generally small-scale, there are a reasonable number of large producers as well. CNFA suggested that at one Ferrero-led event, there had been more than 50 producers with 10 hectares or more, and many with a lot more.<sup>78</sup>

The largest companies in the sector, however, tend to be collectors and processors. In the list of 100 top exporters in Georgia, there are three nut processing/exporting companies. In the list of top 100 EU-exporters, there are 25 nut exporters. We spoke to seven companies from that list, all of which turned out to be nut consolidators, traders and processors, exporting all or almost all of the processed product. None of the listed large companies in the sector were large producers (except Ferrero, whom we have been unable to talk to). However, on top of those seven we also talked to two companies, Adjara Group and Aric, both of whom are making considerable investments into nut production. In the course of our other interviews, we also found that the Georgian Co-investment Fund also has a land plot which they have recently turned to hazelnut production.

*Figure 46. Nut companies interviewed for this project*

Company name	Description	Exports
Ajara Group	New facility will produce almonds, fruit and vegetables	No exports yet
Aric	New facility based on pistachios	No exports yet
Edelling Ltd	Mainly hazelnut processing	EU via German partner
Euro-Nuts-2009 Ltd	Nut processing	Mainly EU
GeoNuts	Grinded and toasted hazelnut in different calibers – flour and granulated	EU, mainly Germany and Italy

<sup>75</sup> USAID (2017), BSMB Economic Impact Survey, REAP Project/CNFA, p4

<sup>76</sup> USAID (2019), Hazelnut Grower and Processor Survey, Georgian Hazelnut Improvement Project/CNFA

<sup>77</sup> USAID (2019), Hazelnut Grower and Processor Survey, Georgian Hazelnut Improvement Project/CNFA

<sup>78</sup> Discussions with CNFA Team, Managing the USAID Georgian Agricultural Development Project and the GHIP project (July and August 2020).

Georgian Hazelnut Corporation	Hazelnut oil	Mainly EU, also USA, Asia, North Africa and Middle East
NutsGe	Nut processing, full/uncracked walnut, walnut “heart”, powder, pasta – wholesale	Mainly EU, also Africa, Russia, Mexico, China
NutsGood	Importing various kinds of nuts (from EU, China, US, Thailand), packaging and exporting, also selling on Georgian market	CIS and Eastern Europe
Olam Georgia Ltd	Nuts, almond paste	Has not had export since they entered Georgian market when stinkbug hit and they decided to leave the market

The exporters whom we spoke to generally do not rely upon their own production, but collect from farmers across the country and sort, crack, roast and pack to varying degrees. They were all mainly exporters and most were 100% export-oriented, with between 40 and 150 workers, though the number of workers varies considerably.

In terms of tariffs, some producers we spoke with, acknowledged that the Association Agreement had given them relief on a 3.2% tariff that applies to non-EU importers. When asked about problems, neither labor, standards/certification nor finding clients were generally suggested as problems.

Apart from the stink bug, which had almost universally decimated their businesses, the only long-standing problem that was often highlighted was transportation and, even this was only mentioned in a few of the interviews. Most of the exporters we spoke to exported through Turkey and Bulgaria and several highlighted challenges with truck availability, transport time and small-scale corruption on the Bulgarian border.

Several of the producers we spoke to were relatively new entrants to the market though many had a long-standing business in the sector. One producer, called Edeling, supported with partners from Germany and Israel has installed modern sorting and packing equipment and are currently ratcheting up to their current 2,000 tonnes capacity (currently producing at 450 tons, but with 100% YoY growth).

Generally, there seems to be no lack of companies who will be able to expand and gradually add processing capacity to the expanding production of nuts, when growing gets back on track. One small silver lining to the stink bug catastrophe is that the bugs do not damage the trees, but only damage the nuts, so trees do not have to ‘recover’ from the bugs. However, no-one expects the stink bug problem to go away, and it has now become an endemic problem that has be managed, and will, inevitably continue to hit productivity levels in the medium term.

There are two signals, however, that regardless of expressed difficulties in production, this sector will soon be booming and is likely to be a big driver of Georgian export expansion. The first is the scale of newly planted trees in the years before the stink bug. There is widespread consensus that as export numbers and prices increased prior to the stink bug, many producers, both large and small, have expanded their production and there have also

been new market entrants. We are told that at the current time, there are no reliable figures on the scale of this expansion.<sup>79</sup>

The second positive signal is that we are seeing a few instances of major investments in the sector that are also experimenting with different variations. If these are successful, it could stimulate considerable copy-cat investments. We spoke to two companies with large nut investments Aric and Adjara Group, and we also briefly discussed the Georgian Co-Investment Fund's nut investment.

Aric and Adjara Group are both large companies that have made investments into commercial farming. Aric has been established for several more years and has bred its own pistachio trees, which are now having their first modest harvest. Their land for cultivation is planned to be 1,800 hectares in the context of the project, with 1,000 hectares for pistachios.

In a similar vein, Adjara Group, who have mostly made their name in tourism investments, particularly the Georgian brand of Rooms, has bought a 5,000-hectare land-plot in Kakheti, and are in the process of planting 2,600 hectares with almonds, with the ultimate goal of having 4,000 hectares planted with almonds, berries and vegetables. This investment, which currently stands at 20 million USD, will start producing some nuts this year, with an estimation that they will hit full production in 2026, producing almost \$35 million USD in overall production. They also plan to have a local processing facility to produce almond milk.

The Co-investment fund also just moved into nut production. They have a 600-hectare land-plot, which was purchased with another agricultural product in mind, but which they have now decided to turn over to hazelnuts. They have an agreement with Ferrero who will buy the nuts that they will produce.

Between them, these investments are not only considerable in themselves, but will clearly gain attention from the rest of the investor community. Aric says that there are already 'copy-cats' looking to duplicate what they are doing, and it is clear that Adjara Group is being watched closely as well. There are also several international investors who are waiting to invest in nuts but who have been waiting to see how the new provisions to allow foreign ownership of agricultural land develop.

### [Fruit, vegetables, processed fruit and vegetables and other agricultural products](#)

Apart from the big export categories of wine, nuts and mineral water, exports of agricultural products are fairly modest, but have been the focus of quite a lot of attention. The German Economic Team's analysis of Georgia's lack-luster exports to the EU, as mentioned before, was mostly looking at this sector.

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<sup>79</sup> Discussions with CNFA Team, Managing the USAID Georgian Agricultural Development Project and the GHIP project (July and August 2020).

Figure 47. Breakdown of domestic exports for fruits and vegetables (4- and 6-digit levels) 2009-2019 (million USD)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Fruits and vegetables</b>											
<b>Total</b>	<b>21</b>	<b>23</b>	<b>14</b>	<b>19</b>	<b>35</b>	<b>28</b>	<b>25</b>	<b>27</b>	<b>36</b>	<b>43</b>	<b>54</b>
Mandarins	16	12	5	7	18	13	12	10	11	14	16
Peaches	0.6	0.2	0.1	0.6	1.1	2.5	1.5	2.8	4	8	12
Apples	0.1	0.6	0.1	0.2	0.2	0.5	0.6	0.2	0.9	1.0	5
Persimmons	1.4	3	2.6	2.8	4	1.9	2.3	1.8	1.4	1.9	4
Dried fruit	0.2	0.4	0.4	0.6	0.7	1.0	0.6	0.8	0.9	1.3	1.2
Tomatoes	0.1	0.1	0.0	0.1	0.0	0.1	0.3	2.1	4	4	2.1
Mushrooms	-	-	-	-	0.0	0.1	0.1	0.3	-	0.2	1.1
Cucumbers	-	-	-	0.0	-	0.0	0.1	0.5	0.8	0.6	1.1
Potatoes	0.1	1.3	0.2	0.1	3	0.9	0.3	2.0	5	5	1.0
Other fruits and vegetables	2.8	5	6	7	8	8	8	7	8	8	10
<b>Processed fruits and vegetables</b>											
<b>Total</b>	<b>4</b>	<b>8</b>	<b>9</b>	<b>15</b>	<b>11</b>	<b>18</b>	<b>18</b>	<b>16</b>	<b>23</b>	<b>25</b>	<b>19</b>
Fruits and nuts, preserved	0.4	1.0	2.2	2.3	3	7	10	10	7	9	8
Juices	3	6	6	13	7	11	7	6	9	9	7
Jams	0.4	0.4	0.6	0.4	0.6	0.5	0.3	0.4	7	6	4
Other processed fruits and vegetables	0.2	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.3	0.4	0.5

Reference: Geostat (provided on request, July 2020)

As one can see, the range of exported products is fairly large, though the volumes continue to be modest. Citrus has varied a lot over the last 10 years, with high export levels in 2009 and 2013. Peaches/apricots/cherries have grown fairly fast, particularly in recent years. Apples saw a huge jump in 2019, though in previous years had been exported as processed juice by Hipp and others. Persimmons have also grown steadily. More or less everyone (except nuts) seems to have had a good year in 2019.

Figure 48. Breakdown of domestic exports for fruits and vegetables by top export countries (4- and 6-digit levels) 2019 (million USD)

<b>Fruits and vegetables</b>	
Mandarins	Russia (\$12m), Ukraine (\$2m), Armenia (\$1m)
Peaches	Russia (\$11m), Armenia (\$1m)
Apples	Russia (\$4m)
Persimmons	Armenia (\$2m), Ukraine and Russia (\$1m each)
Dried fruit	Germany (\$1m)
Tomatoes	Russia (\$2m)

Mushrooms	Russia (\$1m)
Cucumbers	Russia (\$1m)
Potatoes	Azerbaijan (\$1m)
Other fruits and vegetables	Russia (\$5m), Armenia (\$2m), Ukraine and Romania (\$1m each)
<b>Processed fruits and vegetables</b>	
Fruits and nuts, preserved	Germany (\$3m), Russia (\$2m)
Juices	Germany and USA (\$2m each), Australia, Israel and Greece (\$1m each)
Jams	Germany (\$2m), Belgium (\$1m)
Other processed fruits and vegetables	No country value over 0.2m

Reference: Geostat (provided on request, July 2020)

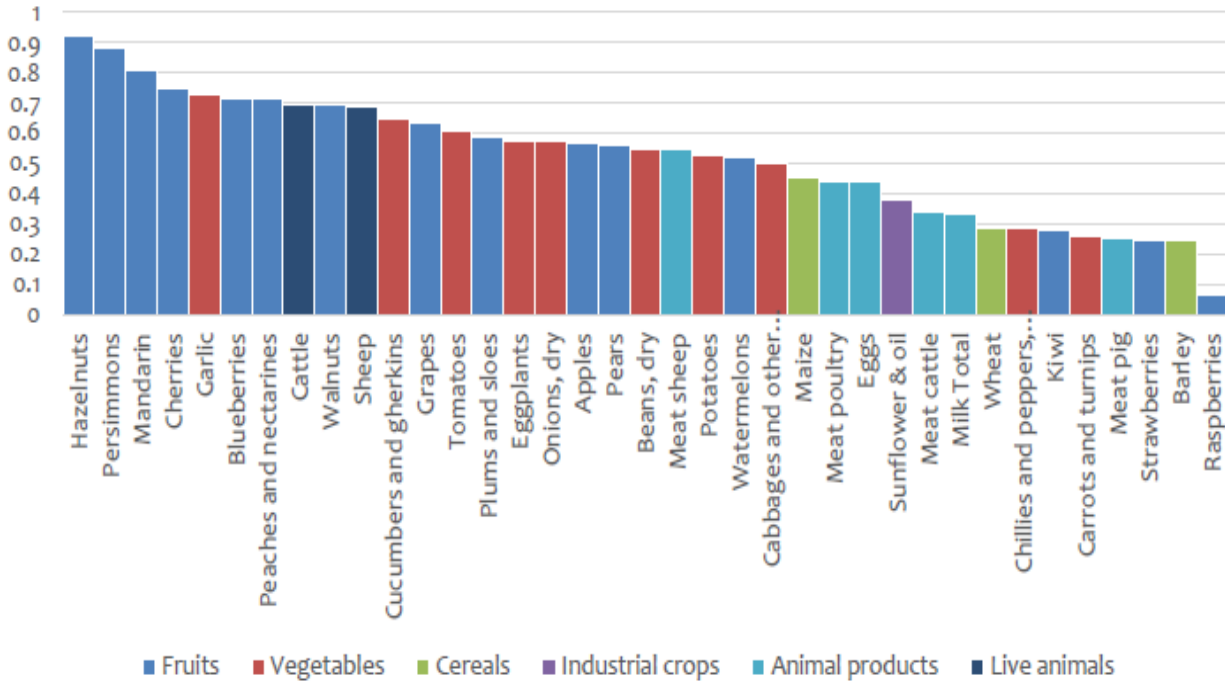
A breakdown of fresh fruit production and exports shows that the bulk of produce goes to the CIS region, mostly to Russia. The exception to this is processed products, of which about 7 million USD go to the Germany. For fresh fruits and vegetables, we also heard several experts mention a range of other countries. Japan has imports of \$300k in 2019, Afghanistan \$200k, UAE, Turkey, Israel and Qatar (\$100k each) and Pakistan, Iraq and Lebanon (around \$10k each). These are obviously very small right now, but it does highlight that the Gulf states are a potential export markets, taking advantage of price differences at certain times of the year, relative geographic proximity and a high density of air-traffic, and other places may also be possible in refrigerated ship containers.

As in the other agricultural sectors, most of the farmers are very small, so the larger companies are usually connected to wholesalers or to processors rather than primary producers. This will change when Aric and Adjara hit full capacity. There also seem to be other producers in Georgia, like Nergeta who produce kiwis for export to Japan and who are gradually scaling-up and could be significant producers/exporters in the next few years. In Georgia's top 100 exporters, Frustar and Best Fruit were listed, and are wholesalers generally selling to Russia.

A number of various recent assessments have looked at this sector and tried to assess the relative merit of the different fruit categories. CNFA did a large value chain comparative assessment, to try and highlight the most viable value chains in 2019.<sup>80</sup> This suggested the following, in terms of competitiveness relative to the EU.

<sup>80</sup> CNFA (2019), The USAID Agricultural Program: Sector Selection and Value Chain Assessment, Tbilisi

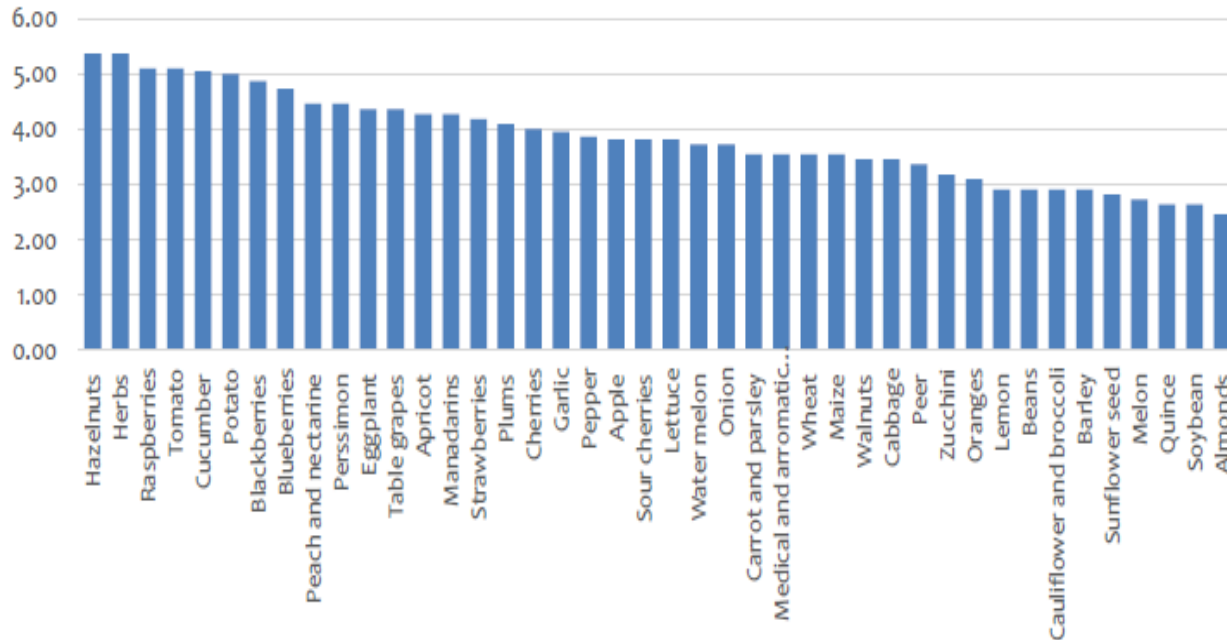
Figure 49: Competitiveness of Georgian Agricultural Crops relative to the EU



Reference: CNFA (2019), The USAID Agricultural Program: Sector Selection and Value Chain Assessment, Tbilisi, p. 9

This relative competitiveness should mostly just be seen as a reflection of the relative maturity of Georgian production and is not intended to suggest exportability, as it does not take into account the various practical export hurdles. Also, the goal of the CNFA research project was to decide on the sectors that need the most attention from their development project. Therefore, it does not just look at competitiveness, but also size of sector, potential (based on trend and size of export), job creation, importance for rural development, value addition and current government priority. And when all these factors are taken into account, they come up with a somewhat different ranking.

Figure 50: Product Rank by Scoring Methodology



Reference: CNFA (2019), The USAID Agricultural Program: Sector Selection and Value Chain Assessment, Tbilisi, p9

This gives the top ten fruits and vegetables as:

- Hazelnuts
- Culinary herbs
- Raspberries
- Tomatoes
- Cucumbers
- Potatoes
- Blackberries
- Blueberries
- Peaches and nectarines
- Persimmons

This is an interesting list, and mostly builds on export categories that are already prominent. The USAID project did have export-orientation in mind, including to the EU but, along with most others who have looked at this sector, they did not come out of the analysis believing that there were many opportunities in exports to the EU, as the combination of scale and quality is so difficult to reach. That said, of course, recovery of hazelnuts will certainly expand EU-involvement in Georgia, and culinary herbs and berries might just be high-enough value to be interesting for that market. Tomatoes, cucumbers and potatoes almost certainly will not be, as they are too heavy and of relatively low value.

We spoke to 12 companies in this space, who covered a wide range of different products (including Adjara and Aric who are both planning to produce fruits and vegetables too).

Figure 51: Agricultural companies interviewed for this project

Company name	Description	Exports
Adjara Group	Agricultural investors, as well as almonds, will produce fruit and vegetables	No exports so far
Aric	Agricultural investors, as well as almonds, will produce fruit and vegetables	No exports so far
Biojuce	Apple concentrate	Germany
Co-investment Fund	Greenhouse production of tomatoes and cucumbers	For local market with possible small exports to Russia.
Caucasus Organic Fruits	Bio forest fruits, organic fruits, natural dry fruit. Without additives and sugar	Germany, Russia Now entering Czech Republic, Lithuania, China
Frutex+ Ltd	Fruits and vegetables, many types. Fresh, unprocessed. Peach, nectarine, garlic, apple, persimmon, berries, fig, mandarin	Former CIS: Ukraine Belarus Azerbaijan Russia
Gemuani	Two directions: 1) Live fruit production, kiwi mainly and also walnut, and tea. 2) processing – freeze drying – sublimation – new technologies, fruit, vegetables and herbs.	Europe: Czech, Poland, Germany, Lithuania. Russia. Israel – new. USA – new. Nestle big buyer
Georgia's Natural & Aromaproduct	Semi-prepared foods, juice press, from stone of fruits	USA – 40%. Asia, EU - semi-prepared foods, Italy, Romania, Czech, Bulgaria, Greece a lot,
Georgian Herbs Ltd	Natural/wild medicinal herbs, roots, seeds and berries.	USA, France Germany Poland, Asia
Georgian Nektar	80% local pomegranate juice. sour cherry, combination of pomegranate and sour cherry. Bilberry, blackberry, cornel, etc. 10-12 types now. Single and mixed	USA, Europe - Greece, France, Germany. England, Norway. Bahrain, Kuwait, Dubai
Global Invest General td	Fruit and vegetables – wholesale	CIS countries: Russia and Ukraine (together 70%) Turkey Azerbaijan Armenia.
Kareli Fruits ltd (Chikori)	Dried fruits – around 10 and more coming	EU: Czech, Germany, Lithuania (LIDL), Austria. entering Ukraine and Japan, potential to Belarus
Nergeta	Kiwis	Japan
Nutrimax	Animal feed	Georgia 75%, Armenia and Azerbaijan 25%, one small test to Africa
Vako	Seasonal fruit	Former CIS



It is hard to generalise from this list of companies, but our interviews did confirm that in regular agriculture, almost no one is thinking about the EU market. For the export of fresh fruit and vegetables, as already suggested, distance and transportation challenges are compounded by the very specific constraints that the EU market places on producers, where not only does one need to produce extremely high quality and reliably at a low price, but the exact form of delivery, such that products need to be 'shelf ready' with more or less zero defects makes transport from Georgia incredibly hard.

Comparatively, for example, Nergeta, who exports to Japan, explained that it is easier to export to Japan than the EU because the Japanese buyer, knowing that everything arrives by ship, have a higher tolerance for repacking/sorting products in-country. This allows for modest rejection rates, in a way that EU supermarkets do not.

This does not rule out the possibility of exports to the EU in the future in a few, particularly high-value items, but none of the people we spoke to were doing that, or even seriously working on it.

The producers that we spoke to who export a fresh, highly perishable product – the Co-investment Fund (Greenhouses), Fruitex + and Global Investment General – are all exporting to the CIS and did not see the EU as a viable market. The one company that we spoke to that is gradually building up to exports of fresh fruits other than to the Russian market is Nergeta, who sells their kiwis to the 711 chain in Japan. We did hear about some companies exporting fresh berries to the markets in Gulf states, but the quantities are still modest. According to official statistics, no Gulf state receives more than \$1 million in fresh produce. However, we did not come across any examples of that happening for the EU.

Apart from nut sellers, all of the Georgian agricultural producers we spoke to who are exporting to the EU were processing their product in some way. This, of course, alleviates the transportation problem, since the processed goods are no longer as perishable, but it means that the product is a lot more commoditised and removes some of the comparative advantage generated by geography.

There seem to be two responses to this. Biojuice and Georgian Nektar are both pretty small companies that are selling a fairly commoditised juice at market prices and seem to have simply accepted that they will maintain modest businesses.

Kareli, Gemuani and Caucasus Organic Fruits dry their product, but again, this makes the product far more commoditised. Once dried, they are competing with global producers like China, Brazil and the US. They recognise that in order to be competitive, they will have to distinguish their product in some way and, in different ways, they say that they saw 'organic' certification as the solution to this. Four other investors who invest in the agricultural sector also said that they thought that given the scale issues, organic was the solution to Georgia ensuring niche markets.

However, one industry specialist we spoke to was more pessimistic and said that while 'organic' is a nice idea, in Georgia it is unrealistic. As they explained, Georgian farmers, even at the high-end, have enough difficulty trying to do regular agricultural development, but organic production is significantly more difficult.

Certification was also a common complaint, but not because they could not get it, but generally because of cost barriers. In terms of certification, all of the companies we spoke to apart from Global Investment General and

Fruitex, which concentrate on CIS countries, had some form of international certification, though not all gave the actual name of the certification. Several specified ISO standards, only Caucasus Organic Fruit mentioned HACCP, Georgia's Natural and Aromaproduct made reference to an 'organic certificate provided by a German company', Kareli and Caucasus Organic Fruit said that they have FFSC22000, which is an international standard for food safety management, and Biojuice said that they were applying for the same standard.

The other major complaints were transportation reliability and price, and Gemuani, who said that they were looking into direct sales online, said that storage in the EU would be a good idea.

## Manufacturing

It is surprising to many people that 'manufacturing' as a whole is one of Georgia's biggest sectors, worth around 10% of GDP in 2019, only beaten by trade' (mostly import/export or the activities of small shops) and 'real estate'. By official statistics, it is therefore, a greater contributor to national income than construction, agriculture or financial services.

This is surprising because if you ask most people in Georgia, they will say that Georgia does not really produce anything (except maybe wine) and that it has no history of production. Neither of these statements is true. Georgia has a strong tradition of manufacturing. For example, in the Soviet system Georgia had large steel smelting, manganese mining and processing, fertiliser, airplane, automotive, steel wire and railway plants. Most of these have some remnant of production to this day, leveraging large but dated Soviet infrastructure. However, what they produce is usually regionally oriented (auto, plane and railway) or highly commoditised (manganese and fertiliser).

More recently, Georgia has expanded its manufacturing, but many of these products are also regional, for different reasons to those of the former-Soviet companies. Pharmaceuticals, for example, export almost entirely to the CIS, because the pharmaceutical companies are mostly making pills out of imported chemicals and essentially re-exporting those chemicals to long-established clients in the region.

Some more recent regional production includes product categories where value addition is so low and weight is so high that production does not usually take place a long way from consumption. In Georgia, steel, concrete, some petrochemicals and glass bottles generally fit this category. As we have seen, fresh agricultural products face a similar challenge, as do low value beverages.

The idea of 'regional products' here is, of course, not fixed. Rebar may be a largely regional product, but when Rustavi Steel does some more value addition, then the seamless steel pipes they produce are certainly valuable enough to justify long-distance transportation. Similarly, many aspects of the Soviet legacy may have provided infrastructure and know-how such that an upgraded facility would change the business model. However, in almost none of the old-school businesses has this happened in the last 30-years.

Very different to the heavy manufacturing associated with the traditional Georgian economy is the manufacturing that Enterprise Georgia, amongst others, have set as a target to help introduce into Georgia, most obviously highlighted by the goal to set up electronics, automotive and aerospace-related factories. This whole area is in its infancy and represented by a handful of companies.

Light manufacturing is the other category that comes up most often in discussions of development. That is because outside of the traditional manufacturing companies, apparel production is the only new manufacturing sector that employs a lot of people, and exports considerable volumes of products. Other light manufacturing particularly worth noting is furniture production, and while this is a sizable local business sector, it does not export very much.

In the following sections, we will consider each of these in turn, again, specifically with a view to thinking whether these sectors constitute an opportunity, particularly in terms of access to the EU. This will consider some of the ‘regional’ products, precisely because of the opportunity that they might present for export, but the focus will be on products that already export or which are the targets of current export-oriented interventions.

### Traditional manufacturing – the Soviet legacy

The biggest categories of manufacturing in Georgia are heavy industry that date back to the Soviet system; this includes manganese, steel, fertiliser, trains, electrical wire and other metal products. These sectors gain their comparative advantage from different sources. In all of these cases, Georgia was a large industrial manufacturer during the Soviet Union, and enough of the previously existing infrastructure was left after the Soviet collapse to allow the continuation of very much paired-back production.

*Figure 52. Breakdown of domestic exports for traditional manufacturing (2- and 4-digit levels) 2009-2019 (million USD)*

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Manganese (Ferro-alloys)	132	270	260	266	238	292	200	175	312	360	313
Steel and steel pipe (excl. ferro-alloys)	71	159	195	127	165	131	51	40	71	78	65
Fertilisers	60	84	144	137	131	138	110	66	77	93	96
Trains	15	16	19	13	29	22	15	4	1.9	6	13
Electrical wire	0.5	1.2	0.7	1.2	0.4	0.2	0.8	0.8	1.5	1.7	3
Vehicles and parts	17	26	38	13	3	2.6	11	1.5	0.9	5	5

Reference: Geostat (provided on request, July 2020)

As already mentioned, this project is not considering these sectors in much detail, as they are generally regional or connected to one company with a particular story. Nonetheless, below we will briefly describe the companies that export these products and look at the country breakdown of those exports.

Figure 53. Country breakdown of domestic exports for Manganese 2009-2019 (million USD)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Manganese (Ferro-alloys)</b>	<b>132</b>	<b>270</b>	<b>260</b>	<b>266</b>	<b>238</b>	<b>292</b>	<b>200</b>	<b>175</b>	<b>312</b>	<b>360</b>	<b>313</b>
USA	18	164	94	127	102	155	86	57	104	144	117
Russia	3	6	6	6	14	18	23	40	129	131	116
Turkey	82	25	51	18	5	11	5	12	25	33	19
Iran	0.0	1.3	0.0	0.9	10	1.1	1.4	9	8	5	14
Brazil	-	-	-	-	0.3	5	13	-	-	0.4	7
Azerbaijan	1.7	4	5	6	5	4	4	4	5	8	5
Chile	-	-	-	-	3	2.9	2.6	2.2	0.5	4	4
UK	0.9	0.7	0.8	1.8	5	2.8	3	1.6	1.7	0.9	4
Spain	0.1	0.5	0.3	0.6	10	16	11	7	7	8	4
Peru	-	-	-	0.9	5	3	2.6	2.2	0.8	5	4
Colombia	-	-	0.6	2.7	1.9	3	1.0	1.8	0.6	5	3
France	-	-	5	-	0.3	4	4	2.1	2.9	3	3
Kazakhstan	-	-	-	-	-	-	-	-	-	1.1	2.5
Netherlands	2.2	8	5	1.8	2.5	1.2	0.9	1.2	1.1	2.4	1.7
Italy	-	3	0.1	0.0	2.9	0.0	0.2	1.1	1.5	3	1.3

Reference: Geostat (provided on request, July 2020)

The biggest Georgian production category is manganese. This is largely controlled by Georgian Manganese, LLC whose holdings includes the Chiatura manganese mine, the Zestafoni ferro-alloy plant, and the Vartzikha hydropower.

The company extracts ferroalloy manganese as well as manganese ore-concentrates and manganese oxide, they then process some of the manganese in the Zestafoni plant. Chiatura manganese mine includes four mines and three open quarries. To give an indication of the scale of the resource, a reference to Chiatura mine from 1974 suggested that it contained 239 million tonnes of manganese, which is more than 100 years of supply at recent levels.

Georgian Manganese has shifted corporate structure of the years, but is generally accepted to have Ukrainian owners.

Figure 54: County breakdown of fertilizer exports 2009-2019

Fertilisers	60	84	144	137	131	138	110	66	77	93	96
Ukraine	-	-	-	0.0	-	-	-	0.0	7	21	36
Lithuania	1.4	-	2.7	1.9	-	-	6	-	6	15	11
Romania	6	5	15	3	2.2	1.0	10	3	10	6	10
Turkmenistan	-	-	-	-	-	-	-	-	-	-	7
Peru	-	-	-	-	-	-	-	-	-	-	6
Bulgaria	16	11	16	18	32	10	13	15	12	11	5
Azerbaijan	0.2	-	3	0.6	1.3	1.8	0.6	0.3	0.0	0.8	5
UK	0.0	0.8	1.4	2.9	1.4	1.3	2.9	-	-	2.9	5
Armenia	5	2.7	5	4	12	13	12	10	7	5	4
Italy	6	3	7	1.0	1.0	2.8	2.9	1.3	1.9	4	3
Spain	6	8	8	2.4	4	3	2.2	2.3	4	2.5	2.3
Greece	7	4	2.1	-	5	9	4	2.7	0.6	1.0	1.2

Reference: Geostat (provided on request, July 2020)

Fertiliser is largely supplied by Azot LLC which is the only major producer of fertilisers in the South Caucasus. The company is situated in Rustavi and is a fully owned subsidiary of Agrochim S.A, which is in turn owned by the ethnically Georgian, but Russia-based Roman Pipia. The company employs more than 2,000 workers. The technology used for the production of the fertiliser is heavy capital equipment built during the Soviet period. This equipment fixes natural gas to produce a range of products, including ammonia, nitric acid, ammonium nitrate, ammonium sulfate, sodium cyanide, oxygen, dry ice and carbon dioxide.

Figure 55: County breakdown of steel and steel pipe exports 2009-2019

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Steel and steel pipe (excl. ferro-alloys)</b>	<b>71</b>	<b>159</b>	<b>195</b>	<b>127</b>	<b>165</b>	<b>131</b>	<b>51</b>	<b>40</b>	<b>71</b>	<b>78</b>	<b>65</b>
Turkey	55	89	84	31	53	37	30	27	43	35	34
Azerbaijan	4	21	38	38	48	62	9	7	13	17	12
Armenia	2.3	11	12	5	8	4	1.2	2.7	4	6	4
Turkmenistan	0.0	-	0.0	0.1	0.1	0.6	5	1.3	1.1	2.4	2.6
Germany	0.3	1.0	0.9	0.4	0.2	0.1	0.0	0.2	0.9	4	1.9
USA	0.0	0.6	0.9	0.8	0.0	0.0	0.0	0.0	0.6	1.6	1.4
Ukraine	0.0	0.3	1.1	2.3	7	1.7	1.7	0.4	0.2	0.6	1.3
Iran	1.4	6	10	8	0.3	0.3	0.1	0.2	0.1	0.0	1.2
Italy	0.3	0.1	1.7	2.0	4	0.0	0.0	0.1	1.5	4	1.1
Kenya	-	-	-	5	14	-	0.0	-	1.4	-	1.0

Reference: Geostat (provided on request, July 2020)

Until 2005, steel exports used to be one of Georgia's biggest export sectors, with much of the iron coming from scrapped industrial equipment as well as the reprocessing of a large slag pile from the old Soviet smelter that is no longer in operation. It is dominated by Rustavi based steel producers, which mainly consists of the large Rustavi

Metallurgical Plant, owned by Hunnewell Partners, a local investment fund owned by the ethnically Georgian but London resident Patarkhatashvili Estate. Other significant but far smaller players include the Indian/British owned GeoSteel, and a smelter in Kutaisi, owned by the Turkish, Eurasian Steel Ltd. In addition, there are several dozen small smelters across the country, mostly in the old industrial cities. It is hard to be sure how many people are employed in the sector at the current time, but local experts estimate somewhere around 3,000.

GeoSteel, in explaining the market structure for rebar, explained that they are extremely geographically constrained by shipping costs and that steel production the world over tends to be located in the markets that use it. There can be some export to further market for higher value-added products, or for products that require larger capital investment, but other than that, this tends to be modest. They mentioned that a significant part of Georgia’s steel export to Turkey is driven by Eurasia Steel, which is a Turkish company plugging-into a Turkish supply-chain.

Rustavi Steel has, over the years, tried to figure out a deal to start the smelting of iron ore again. This would require hundreds of millions of dollars of investment and, since Georgia does not have its own native iron-ore, it would have to enter into a joint partnership with a neighboring country, most likely Azerbaijan or Turkey. However, after many years of trying, this has not developed.

However, they have invested in industrial equipment to produce ‘seamless metal pipe’ and this is a significantly higher value-added product than the rebar that they have mostly sold to date. Next, we will review the export of trains.

Figure 56: County breakdown of trains 2009-2019

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Trains</b>	<b>18</b>	<b>17</b>	<b>21</b>	<b>14</b>	<b>30</b>	<b>24</b>	<b>16</b>	<b>4</b>	<b>2.6</b>	<b>8</b>	<b>15</b>
Kazakhstan	-	0.7	-	-	0.0	-	0.1	-	0.4	2.5	9
Russia	0.6	0.3	0.2	0.2	0.1	0.0	0.0	-	-	0.1	2.9
Ukraine	4	-	7	13	29	22	0.0	4	0.7	2.6	0.5
Armenia	10	15	9	0.1	0.0	-	0.1	0.0	0.0	0.0	0.2
Switzerland	-	-	-	-	0.0	0.0	0.0	0.0	0.0	0.0	0.1
Azerbaijan	1.2	0.0	2.8	0.1	0.4	0.1	15	0.1	0.1	0.2	0.1

Reference: Geostat (provided on request, July 2020)

All of the production and export of trains and train equipment is undertaken by JSC Locomotive Maintenance Factory. The existence of train and carriage production in Georgia is largely a hang-over of industrial organisation in the Soviet system as the Soviets used particular countries to produce and maintain the railway capital materials needed for an entire region. As these businesses provided support for the huge rail system of the region, they were inherently large support-businesses.

Georgia provided this support for Armenia and Azerbaijan. However, since the train standards are the same across the region, following the collapse of the Soviet Union, they have produced for a number of CIS countries. In particular, they had a large order with Ukraine in 2012-2014, with Azerbaijan in 2015 and with Kazakhstan in 2019.

This is a highly variable business which seems to be demand driven and has, so far, made no impact outside the region.

Another rather smaller industrial product is electrical wire.

*Figure 57: Country Breakdown of electrical wire*

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Electrical wire</b>	<b>0.5</b>	<b>1.2</b>	<b>0.7</b>	<b>1.2</b>	<b>0.4</b>	<b>0.2</b>	<b>0.8</b>	<b>0.8</b>	<b>1.5</b>	<b>1.7</b>	<b>3</b>
Azerbaijan	0.1	0.1	0.1	0.2	0.1	0.0	0.1	0.2	0.1	0.2	1.6
Armenia	0.0	0.0	0.4	0.2	0.2	0.2	0.6	0.4	1.1	1.5	1.0
Russia	0.0	0.0	0.0	0.4	0.0	0.0	0.0	0.0	-	-	0.6

Reference: Geostat (provided on request, July 2020)

This production has, until recently, been driven by Sakcable, based in Zestafoni, which uses Soviet-era cable-winding equipment (of course supplemented by recent investments) to make cable for the electricity transmission sector.

A former employee of Sakcable has also leveraged Georgia's experience and expertise in that area to start a new company with a Turkish investor to produce electrical cable. They are also trying to develop a joint partnership with a Japanese company which would also come and produce cable in Georgia. As an exporter to the EU, it would also be able to bring with it all the standards and accreditation for the EU market.

On top of these, Georgia also had two other major facilities, though their current export levels are minimal. This included both airplanes and automotive that are somewhat mixed in the export statistics

Figure 58. vehicles and parts part exports (4-digit level) 2009-2019 (million USD)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Vehicles and parts total</b>	<b>17</b>	<b>26</b>	<b>38</b>	<b>13</b>	<b>3</b>	<b>2.6</b>	<b>11</b>	<b>1.5</b>	<b>0.9</b>	<b>5</b>	<b>5</b>
<b>Plane parts</b>	<b>7</b>	<b>26</b>	<b>36</b>	<b>10</b>	<b>2.1</b>	<b>1.1</b>	<b>0.9</b>	<b>1.1</b>	<b>0.1</b>	<b>0.1</b>	<b>2.0</b>
Israel	-	-	-	-	-	-	-	-	-	-	1.8
USA	-	-	0.0	-	-	-	-	-	-	0.0	0.2
Sudan	-	-	-	-	-	-	-	-	-	-	0.0
Germany	0.0	-	-	0.0	0.0	-	0.0	0.0	0.0	0.0	0.0
Poland	-	-	-	-	-	-	-	-	0.1	0.0	0.0
Azerbaijan	6	25	36	10	2.1	0.3	-	1.0	0.0	-	0.0
<b>Car parts</b>	<b>0.1</b>	<b>0.1</b>	<b>0.1</b>	<b>0.6</b>	<b>0.4</b>	<b>1.2</b>	<b>0.2</b>	<b>0.2</b>	<b>0.3</b>	<b>1.2</b>	<b>1.1</b>
Saudi Arabia	-	-	-	-	-	-	-	0.0	-	0.1	0.3
Armenia	0.1	0.0	0.0	0.3	0.1	0.1	0.0	0.0	0.0	0.2	0.3
Azerbaijan	0.0	0.0	0.0	0.2	0.1	0.5	0.1	0.1	0.1	0.9	0.2
Russia	-	0.0	-	-	-	0.1	-	0.0	0.0	0.0	0.1
Germany	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.1
<b>Other<sup>81</sup> vehicles and parts</b>	<b>10</b>	<b>0.4</b>	<b>1.4</b>	<b>2.3</b>	<b>0.5</b>	<b>0.3</b>	<b>10</b>	<b>0.2</b>	<b>0.4</b>	<b>4</b>	<b>1.8</b>
Mali	-	-	-	-	-	-	-	-	-	0.0	0.8
Azerbaijan	9	0.1	0.5	0.1	0.2	0.2	0.2	0.0	0.1	0.6	0.2
Germany	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.0	-	2.1	0.2
Netherlands	-	-	-	0.0	-	0.0	10	0.0	0.0	0.1	0.1
Armenia	0.9	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.1	0.1
Canada	-	0.0	-	2.1	-	-	-	-	-	-	-
Poland	-	-	0.6	-	0.0	-	-	-	0.0	0.1	0.0

Reference: Geostat (provided on request, July 2020)

Exports of airplane parts before 2019 were generated by Tbilisi Airplane Manufacturers (TAM).<sup>82</sup> Under the Soviet system, Georgia built several different categories of aircraft, particularly the SU25 “frogger” fighter-bomber. Following the collapse of the Soviet system, TAM ceased to produce completed planes but continued to maintain and upgrade the fleet of former Soviet aircraft. This was one of Georgia’s only foreign currency producing businesses during the early 1990s, and in that time provided Georgia with the currency necessary to import gas from Turkmenistan.

In 2004 airplane parts were Georgia’s second largest export category, with a value of 84 million USD. This number seems to fluctuate fairly dramatically year-to-year, but as one can see, 2009-2012 were significant years. Since 2008, it has also shifted its work and is now focused on developing armoured personnel carriers and in April 2012

<sup>81</sup> Most of these exports are either attributable to TAM or Kutaisi Automotive Plant. The bigger categories are generally listed as aviation, while the smaller exports are generally related to trucks and trailers.

<sup>82</sup> This also explains the exports under ‘other vehicles and parts’ of \$9m in 2009 to Azerbaijan, (probably) \$2.1 million to Canada in 2012 and \$10m to the Netherlands in 2015 and Germany in 2018, as these are all listed as airplane parts.



it unveiled the production of Unmanned Aerial Vehicles, though these do not seem to be produced for export at the current time. The plane parts listed in 2019 have nothing to do with TAM and are exports from the cyclone factory described below.

The other large machinery production in the soviet system was the Kutaisi Automechanical Plant that produced heavy trucks since 1945. There does not seem to be much written about this plant following the Soviet collapse, but it was bought by Georgian Industrial Group in 2006 and now produces a wide range of automotive industry parts.

Each of these companies have their own particular dynamics, and it is impossible to judge what opportunities they might represent. If any one of the companies was able to leverage their local infrastructure connections and physical infrastructure to get the financing necessary to upgrade or upscale their facilities, then maybe there would be opportunity for rapid and large growth. But the scale and nature of the very capital-intensive industries does seem to make that unlikely without significant government support.

## Regional manufacturing

As mentioned in the introduction, many of the manufactured products listed above are largely excluded from detailed consideration in this study, as they are commodities or regional in nature. A range of other Georgian manufacturing sectors seem to be similarly regional.

## Pharmaceuticals

Pharmaceuticals is another area that is largely included in this study simply to confirm that it is probably not much interest as a western-oriented export category.

*Figure 59. Breakdown of domestic and national exports for pharmaceutical products (2-digit level) 2009-2019 (million USD)*

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
National	25	37	44	55	59	105	154	119	152	160	182
Domestic	18	16	19	26	21	22	13	14	18	22	19

Reference: Geostat (provided on request, July 2020)

Before looking at the international composition of the exports of this sector, it is worth taking a second to consider its size and value addition. As one can see here, the export of pharmaceuticals appears to be huge if one looks at total exports, and that is often how it is commonly presented. For the same reason, in the list of Georgia's 100 biggest exporting companies, there are eight pharmaceutical exporters, since this list counts size of export, and does not consider re-export.

However, Geostat's classification of 'domestic export' (which excludes the element of the product that was imported) shows a very much less developed sector because most of Georgian pharmaceuticals is just the production of tablets or caps, with imported chemicals.

Figure 60. Breakdown of domestic exports for pharmaceutical products by top export countries (2-digit level) 2009-2019 (million USD)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Domestic Total</b>	<b>18</b>	<b>16</b>	<b>19</b>	<b>26</b>	<b>21</b>	<b>22</b>	<b>13</b>	<b>14</b>	<b>18</b>	<b>22</b>	<b>19</b>
Uzbekistan	4	2.1	1.9	3	7	10	5	6	5	8	6
Azerbaijan	6	2.9	3	12	4	3	2.1	1.8	2.7	2.6	2.5
Tajikistan	1.0	0.8	2.3	2.0	1.0	1.3	0.2	0.2	0.6	1.2	1.8
Armenia	5	6	6	1.6	2.4	1.4	0.8	0.7	2.0	1.2	1.4
Kazakhstan	0.3	0.5	0.9	1.2	1.6	1.8	0.7	0.7	1.1	1.2	1.0
Latvia	0.2	0.5	0.6	0.2	0.4	0.1	0.4	0.4	1.3	0.7	0.9
Ukraine	0.5	0.3	0.6	0.8	0.2	0.6	0.0	0.0	0.2	0.7	0.9
Saudi Arabia	-	-	-	-	-	-	-	-	-	-	0.9
Iraq	-	-	-	-	-	0.2	1.5	0.8	0.4	0.8	0.7
Turkmenistan	1.1	0.8	0.4	0.9	1.2	0.8	1.1	0.4	0.9	0.7	0.5
Kenya	-	-	-	-	-	-	-	0.2	0.2	0.5	0.5

Reference: Geostat (provided on request, July 2020)

That said, some conversations have suggested that while some companies in this sector are beginning to move up the value chain, and the scale of production and regional export may make this a sector where increased value addition could occur in the future.

Another group that have not been the target for this research are heavily geographically constrained products. These might be interesting export categories, but are extremely unlikely to be oriented to Europe. Most are actually only producing for the local market. In the course of our research, we spoke to Mina, a bottle producing company; GeoSteel, a local steel producer, and; Henkel, which produces adhesives. Each of these are foreign investments into Georgia, but in each case the primary objective is really serving the local market and maybe the Caucasus.

None of these are necessarily local producers, but most accepted that they are practically constrained and either designed their projects to suit the local market, or had accepted that they would not sell much beyond it. Mina, for example, is a modest scale Turkish bottle producer that at certain points in its evolution has exported to the region, but generally relies extremely heavily on its one big customer, Borjomi. Since energy costs are a large part of the business, Russia is a far cheaper production location, but since bottles are a critical part of its manufacturing, where significant disruption would destroy their ability to produce, Borjomi prefers to source locally. However, cost patterns in surrounding countries make significant exports unlikely.

Henkel, which produces adhesives that are heavy and thus do not ship easily or cheaply, had set up a small production facility in Georgia to serve the Georgian and Armenian markets and since they have plants in other neighboring markets, exports would be extremely unlikely.

Similarly, cement and most bulk construction materials are aimed at the local market primarily.

This does not exclude the possibility of exports. Heidelberg and GeoSteel, as well as Rustavi Steel have often complained that if the Azerbaijani market were truly open to Georgian goods, then they would be very cost competitive in those markets. Mina originally hoped that relatively lower energy costs in Georgia would make

them price competitive to export to some markets, but changes in relative currency prices in the region undermined some of that logic.

## New industrial manufacturing

The other set of production sectors which Enterprise Georgia and the Georgian Government have been more broadly interested in bringing to Georgia is industrial manufacturing. Enterprise Georgia does not provide very many examples in some of these newer industrial categories. However, a review of these example companies and their sectors can be useful.

### Electrical/electronic

Figure 61. Breakdown of domestic exports for electrical machinery (2-digit level) 2009-2019 (million USD)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Total</b>	<b>8</b>	<b>8</b>	<b>9</b>	<b>13</b>	<b>13</b>	<b>7</b>	<b>19</b>	<b>11</b>	<b>14</b>	<b>16</b>	<b>14</b>
Azerbaijan	2.7	1.0	1.6	3	3	0.9	2.7	2.1	1.2	3	4
Armenia	0.3	0.7	1.1	1.1	2.4	1.7	2.3	1.5	2.8	5	4
Israel	0.1	0.1	0.0	0.4	0.2	0.1	0.6	0.7	0.9	1.2	1.1
UAE	0.2	1.1	0.3	0.9	0.2	0.2	0.9	1.4	1.0	0.5	0.8
Russia	0.1	0.5	1.9	1.6	0.3	0.1	0.1	0.2	0.3	0.6	0.8

Reference: Geostat (provided on request, July 2020)

In ‘electrical and electronic’ there are four companies that come up often to justify the possibility that this sector may be an opportunity for Georgian exports: Atlantic Group, AE Solar, Kockablo and MyGPS. None of these companies export to the EU.

Atlantic Group is an example of one of the business models that many people originally thought would make sense for Georgian industrial development – producing products for the region. Atlantic Groups produces water heaters for the region and decided to do so from Georgia because of the business environment, labour costs and tariff free access to the region, particularly Russia.

They were fairly positive about their experience, highlighting that they had more or less matched expectations in terms of product, but they focused on how industrially under-developed Georgia is and the challenges this has created for them. They say that they know of other companies who have come to Georgia, interested to start-up production, but who have been put off by the limited facilities and the amount of basic work that they need to do (preparing ground, installing plumbing and gas, etc). For them, they said that one of the biggest problems has been local sourcing. In other places they would be able to source many inputs locally – but in Georgia they have had to import or make them themselves, pipes for water heater, water heating elements, packaging and plastic injections.

Ironically the representative says that this has actually made them MORE competitive. Their inability to source inputs locally means that they had to figured out how to produce for themselves. They have also had fairly severe challenges finding people with basic math and engineering education.

On top of that, they point out that the relationship with Russia is obviously problematic for regional producers. This has not been critical for Atlantic Group in the time that they have been in Georgia, but routine long delays at

the Upper Lars Georgia/Russia crossing does mean that their Moscow warehouse has to keep three weeks of stock. Also, they worry about what might happen if the relationship with Russia were to deteriorate and the border closed.

AE Solar is probably the most referenced of the new export-oriented companies in Georgia and, along with Georgian Products, it is referenced continuously by people interested in Georgia's export potential. However, the details of its case are worth consideration both for the successes and the challenges that it represents.

AE Solar started manufacturing in Sept 2019. The main company, AE Invest, had up until then been producing solar cells for use on domestic residences in China. However, the EU had a trade restriction which put a price floor on domestic solar cells coming from China. AE Solar, therefore, wanted to use Georgia as a cheap labor, low bureaucracy, production facility with access to the EU market.

Unfortunately for AE Solar, the EU changed its regulations while the factory was being built, and by the time the company entered production, it had lost its tariff related comparative advantage. However, the company realised that the US does have restrictions on Chinese manufacturing and therefore the company shifted its sales focus to the US.

They had no major complaints about doing business in Georgia. The German owners had recruited plant managers from Uzbekistan and so they are comfortable with the general environment. Also, they have enlisted ethnic-Georgian line managers from Poland and Germany. They also acknowledge that local staff don't have the skills and it costs 90,000 euros per person to train them

They say that Georgia is not price competitive with China on the more price-sensitive parts of the market, but has been able to distinguish itself for a slightly higher quality product, and to that extent, not being China helps because internationally China is associated with low-quality products (even if that is not always true). Also, they say that occasionally the distributors, who are their clients, want to visit the production facility and clients are always keen to visit Georgia. They say that 50 or 60 clients have visited Georgia since production started. This never happened in China.

Another new industrial investment we spoke to is Kockablo, which is a Turkish investment that is starting to produce electrical cable. This investment clearly builds on the back of Georgia's long-term experience producing cable, as the new GM of Kockablo is a former director of Sakcable, the company described above, that is a continuation of the Soviet production facility.

Kockablo see the value in a Georgian investment from lower labour costs, lower taxes and government support, and they are happy to find ways to diversify their production away from Turkey. Georgia was also an interesting place to do manufacture because they wanted to produce aluminium cable and Georgia has experience of making this. Turkish law requires the use of copper cable so Turkish companies have less experience in this sector.

They expect their markets to be Israel and Ghana, though client management is usually done by the Turkish holding company. They had looked at the EU, but the EU already has many small cable producers and certifications requirements are prohibitively expensive. Certification for one cable costs 3,000 euros per cable every two years. They did look into getting certificates for six products but realised that they need to have a large number of

products for any client, and so would have to get certification for far more cables at the same time. They have 70 products that they offer to each client.

One way around this is that they are trying to develop a joint project with a Japanese manufacturer who may start producing with them in Georgia under a joint venture. They already have EU certification. However, the partnership has been slow in developing.

The final company that fits into this category is MyGPS, which produces lighting fixtures. They are the only fully Georgian company and a good example of how hard it is to build up companies in these kind of sectors from scratch. Over the last decade or so they have been producing for local clients and trying to get into the EU market. They have been to a range of lighting exhibitions and have focused on trying to build relationships with municipalities in the EU, who might use their lighting fixtures in different cities.

But they have found the EU to be incredibly difficult from a procurement point of view. They say that many of the EU public procurements that were supposed to be open were incredibly hard to break into. They also found it difficult to develop a track record in projects with Georgian government municipality tenders, because the Georgian Government was usually price-determinative on contracting. Polish partners said that they could partner with them if they moved to Poland. In France, they said that you had to be part of some kind of French Association to access procurement and in Sweden, government procurement was done through agents with pre-approved networks, which were hard to access. They also said that Georgia has not signed-on to a WTO government procurement agreement, which has precluded them from some clients.

They said that they needed help navigating the EU bureaucracy and figuring out the rules in different markets. They also want the Georgian government to be more demanding in terms of standards in terms of its own procurements in Georgia. They argue that if the Georgian Government could adopt EU standards ahead of wider national market adoption, this could be a big spur for companies to adopt these standards, and would help Georgian companies develop the profile needed to be plausible in EU procurements.

### Plane parts and automotive

As we have seen, airplane-part and automotive-part production has some history in Georgia, but it is included here under 'new industrial manufacturing' because there is almost no connection between the historic sector and the newly imagined sector. Most of the discussion under these two categories relates to efforts to attract foreign producers to locate some part of their supply chain in Georgia.

KPMG conducted an analysis of automotive parts in 2018 for Enterprise Georgia. The document mostly describes the global situation and the comparative advantage that Georgia could offer in this area, mostly highlighting the generally good business environment, free trade agreements, free industrial zones, cheap labour, cheap energy, etc. There is very little that suggests that these industrial sub-sectors would benefit relative to any others.

At the current time Georgia does have a couple of new and interesting companies in these sectors. For Aerospace, the Georgian Partnership Fund and Israeli Defence manufacturer Elbit systems have created Aero-structure Technologies Cyclone (ATC), a factory in Georgia producing carbon composite parts for the Boeing 787 Dreamliner.

The factory was located in Georgia because of relatively low labour costs and for a highly technical labour force. These composite parts, though capital intensive, are also sensitive to labour costs, since the exact products made

in Georgia are the more bespoke carbon composite parts, which are made in smaller numbers and so need to be produced significantly by hand, with skilled labour. Almost all of the staff had to be sent to Israel to be trained for three months to a year. They were also able to attract some Georgians back who were working in the sector abroad.

In discussion with Elbit, they also said that it was extremely important that business was made very easy. Having the Partnership Fund was extremely valuable. Given that the Partnership Fund took a 66% stake of the \$93 million initial investment of the project, the government was really a partner. This partnership built on Elbit's experience working with the Georgian Government in the defence sector several years earlier.

The combination of their experience in this area and their partnership with the Georgian Government, meant that it took them only a year and half to build their factory and another six months to gain the necessary accreditation. This is particularly impressive because the quality standards on airline composite parts are very high.

The only new automotive facility in Georgia is a company called SDT that makes automotive parts, particularly windscreen wipers and housings. SDT is owned by an Italian entrepreneur who has R+D in Madrid and factories in China. The owner started thinking about Georgia as a location for his business when he came on holiday.

SDT has currently not even started building the factory, and has faced considerable challenges in dealing with government bureaucracy. Some of this seems to arise from the Georgian government's limited understanding of certain production methods, but other problems have related to obtaining visas and dealing with some parts of local officialdom.

This experience is troubling. The difference between the experience of these two companies do strongly highlight the difference that exist between companies, if they are strongly supported by the government (as in the case of Elbit) versus those that are not (like SDT). This certainly seems to suggest that particularly in key manufacturing sectors where facility set-up, standards evaluation and government approvals are necessary, there needs to be strong supports from the government, at least in the first few cases.

## Light manufacturing

While Georgia may have a long track-record in industrial manufacturing and aspirations to attract new industrial manufacturing by connecting to existing supply chains, its experience in the latter is extremely limited. On the other hand, Georgia has considerable track record in local production, connection to international supply chains and considerable exports in light manufacturing. This is most obvious in the case of apparel production, but can also be seen in new categories like furniture and toys.

### Apparel

Apparel is one of the most interesting potential areas for Georgian export growth, particularly oriented to the EU.

Figure 62. Breakdown of domestic exports for apparel (2-digit level) 2009-2019 (million USD)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Total</b>	<b>26</b>	<b>29</b>	<b>27</b>	<b>40</b>	<b>53</b>	<b>78</b>	<b>81</b>	<b>76</b>	<b>85</b>	<b>85</b>	<b>105</b>
Apparel	24	28	26	39	53	77	78	72	81	80	98
Footwear	1.1	0.2	0.2	0.1	0.3	0.4	0.6	0.9	0.4	0.6	2.9
Other textiles	0.6	0.4	1.1	0.7	0.3	0.6	2.1	2.7	4	4	4

Reference: Geostat (provided on request, July 2020)

Figure 63. Breakdown of domestic exports for articles of apparel by top export countries (2-digit level) 2009-2019 (million USD)<sup>83</sup>

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Total</b>	24	28	26	39	53	77	78	72	81	80	98
Turkey	21	23	20	35	42	60	61	56	65	67	75
Italy	-	0.0	0.0	0.9	6	12	11	11	12	8	13
Poland	0.0	0.0	0.0	-	0.0	0.0	0.0	0.0	0.0	0.0	3
Germany	2.5	2.9	4	2.9	3	3	3	2.8	2.9	3	3
Russia	0.0	0.0	0.0	0.0	0.0	0.1	0.0	0.2	0.5	0.6	1.0

Reference: Geostat (provided on request, July 2020)

As one can see, apparel has seen huge and consistent growth in the last 10 years, with exports increasing by a factor of four. Turkey is worth about 75% of this market (though goods collected in Turkey may be reshipped to the EU), but exports to the EU have increased in size even faster, going from a market share of about 10% to about 25% in 10 years, particularly with large growth in exports to Italy.

The size and importance of the sector is reinforced by the fact that there are five companies from the apparel sector in Georgia's list of top 100 companies, and four textile exporters in the list of Georgia's biggest exporters. Also, based on our interviews with some of these companies, it is possible that the numbers are significantly underestimated, as many companies are currently just charging for sewing services in order to avoid rule-of-origin based trade restrictions (more on this below).

Apparel has been a focal point for discussion of export growth for a long time. Invest in Georgia suggests that the market started growing in 2004 when Turkish investors started to move into the country to take advantage of the improved business environment, inexpensive labour, low inputs and transportation costs.<sup>84</sup> This sector has been supplemented by locally developed fast fashion producers in recent years, as well as boutique and high fashion.

Enterprise Georgia has, for a long time, targeted the sector as a potential source for exports and growth. Enterprise Georgia has also done several 'Investment Proposals' on footwear, accessories and bag production, though current export numbers in these areas are very small.<sup>85</sup>

<sup>83</sup> Multi-year country-breakdown figures for Footwear and Other apparel are given in the 'Other apparel' section below.

<sup>84</sup> Enterprise Georgia (2016), Investment opportunities in the Apparel and Textile Industry of Georgia, Tbilisi, p10.

<sup>85</sup> KPMG (2018), Georgia's potential for footwear, bags and accessories manufacturing, Produced for Enterprise Georgia. KPMG (2018), Investment proposal for leather footwear manufacturing, Produced for Enterprise Georgia.



This has been supported by other extensive analysis. In 2016, GIZ and EU4Business released a study of the sector that highlighted the importance of standards development as a necessary step for developing the sector’s EU-export potential. Also, this year, EPRC, identified three sub-sectors in the apparel sector as particular sectors to targets. This included general apparel, footwear and also the production of leather and leather articles.<sup>86</sup>

These different analyses identify different sub-categories, but they are usually supported by the same arguments to claim that Georgia has a high comparative advantage. These arguments focus on highlighting Georgia’s long-term strong export growth, cheap labour, easy supply chain connections to Turkey and the EU, some training facilities for people in the sector, and some modest evidence that there is an opportunity to move up the value chain.

There are around 200 companies in the apparel sector, most very small, though Enterprise Georgia highlights four big Turkish investors with between 500 and 5,000 employees each. The Georgian apparel sector is almost entirely in the cut-make-trim component of the apparel sector. Georgia does not produce any of the textiles with which its final clothes are produced, so the textiles with which the cut-make-trim is done are imported.

Below is the list of clothing/design companies that we spoke to for this project.

Figure 64: List of clothing and jewelry producers

Name of company	Category	Their main product
Fast Track Textile ltd	Turkish contractor CMT	Finishing textile/clothes
Geoline 7777 ltd	Turkish contractor CMT	Sewing bras
Georgian Textile Ltd	Turkish contractor CMT	Women’s clothes and uniforms
Tuana Textile ltd	Turkish contractor CMT	Bras and underwear
Elselema ltd	Georgian CMT	Clothes and accessories for men, women and children. Mainly uniforms for defence security.
MGM tex	Georgian CMT	Fashion
MOVI	Georgian CMT	Textile finishing/processing of coats, horse-riding pants, recently face masks
MPT Textiles	Georgian CMT	Fast fashion
MATERIA TBILISI	Fashion	Fashion clothes/brand; uniforms for government. During Covid - overalls, slip-on shoe covers, masks, white coats (Lugar Lab cleared as safe)
Liya	Fashion	Knitwear jewelry shoes

KPMG (2018), Investment proposal for manufacturing sports footwear with upper of textile, Produced for Enterprise Georgia.

KPMG (2018), Investment proposal for travelling bags manufacturing, Produced for Enterprise Georgia.

<sup>86</sup> EPRC (2020) Assessing prospects of Export of Separate Products and Services from Georgia to the EU.



Gepherrini Manufacturing Company	Fashion	Bags
Eshvi Kids	Kids	Organic material clothes are for kids from 6 months to 2 years of age. Unisex clothes. 2 collections a year – winter and summer, 25 items per collection
RKO	Kids	Hand knitted kids' stuff
Zarapxana	Design	Jewelry
Georgian Heritage Craft Association	Craft	A range of clothes and jewelry, artisanal producers

The importance of 'cut-make-trim', and the separation from the fabric inputs (coming from Turkey or China) and customers (coming from Turkey or Europe) does make Georgia dependent on supply chains outside of the country. This is clearly a disadvantage.

One way to look at the different business models offered by different businesses is the extent to which they outsource different parts of the business to their international partners. The simplest business model is when Georgia provides only a sewing element in the value chain. This is what happens with Turkish apparel producers. The biggest example of this in Georgia is Ajara textile, which is the biggest company in the sector, employing 5000 workers across three different factories.

The companies we spoke to that connected with Turkish supply chains were Fast Track Textile Ltd, Geoline 777 Ltd, Georgian textile limited and Tuana Textile Ltd. Of these, Fast Track Textile and Tuana Textile are Turkish owned, but the rest are Georgian owned, contracting to Turkish companies. In all of these companies, however, the logic is the same: unlike in other textile companies, they don't have to worry about prototyping, finding clients or transport and logistics. Their main concern is managing workers and their main reason for wanting to operate in Georgia is low wages and low taxes.

The next level of complexity are the apparel businesses that are heavily tied to international partnerships, where the partner's companies do the client development, but the Georgian side is involve in patterning and sample development (which is usually done in Turkey with the Turkish firms already mentioned). Elselema, MGM Tex, Movi and MPT Textiles all have partnerships with European companies or business people and do both prototype development and patterning as well as the sewing.<sup>87</sup>

MGM Tex, MPT and Movi have similar stories, working in 'fast fashion' with partners who are either buyers of the products or well-established intermediaries. 'Fast fashion' is a sub-sector of the apparel business that focuses on particularly fast production and delivery of finished products, usually requiring prototyping, production and delivery (usually to a retail warehouse) in 40-100 days. Due to the short timeline for production, proximity to producers is important, so that a lot of European fast-fashion takes place in Bulgaria, Romania and Turkey.

MGM Tex was started in 2018 through a relationship with an international partner who had worked for many years in fast fashion. They started the company in 2018 and in two years got to 10 million euros of exports, but

<sup>87</sup> Since original writing in mid-2020, MGM Tex closed.

are now finding it hard to grow due to staffing constraints. MPT started working with Danish partners, DK, in 2007. They worked exclusively with DK, who were the owners, but DK sold the local Georgian production entity to the local managers in 2016. Since that time, the Georgian company have diversified in clients since then. Movi provides a stitching service for an Italian client.

Materia, in addition to fast fashion, produces its own clothes and sells them in 35 countries, producing a turnover of 2.5 million euros. Liya and Gepherrini are fashion oriented and smaller, with Liya making designer collections for small shops in Europe and Asia, and Gepherrini making bags for the Asian market. Eshvi kids is a virtual start-up, producing high-end boutique kids' clothes and RKO are also very new, producing hand-knitted kid's clothes for sale locally and for export.

The problems that these companies highlight generally connect to their place in the value chain. Probably the most common complaint for most of the producers whose focus is the provision of sewing services is the availability of trained sewers. For many of the companies, relatively inexpensive labour is one of the biggest benefits of producing in Georgia.

In fact, almost all of the Turkish contractors highlighted cheap labour and low taxes as the two biggest strengths of the Georgian economic situation. The Estonian tax model had been seen as particularly valuable, as it presented Georgia as having no corporation tax (if profits are reinvested) compared to Turkish 40% corporation tax.

Labour was also highlighted by almost all of the producers. It was most commonly stated that labour costs in Georgia are less than half that of Turkey, with Turkish producers paying \$500 per month compared to \$250 in Georgia. However, some producers did point out that Georgian sewers are a lot less productive than Turkish sewers and this significantly reduced the advantage. Several producers said that they had tried to work with VET centers to get more staff, but we did not find a company that had done so successfully.

The Ministry of Education developed the new short-term vocational training project starting from September 2019. Under this project, any private company can initiate a new customized training program (as a sole implementer or together with already authorized VET), present necessary documents to the special authorization board (members are from business associations, state and private agencies, including Enterprise Georgia) and ask for the training course authorization. If it gets authorized, the company can issue officially recognized certificates for trainees who will complete this program as well as apply for financial support from the Ministry of Education. None of the companies we spoke to were aware of this program, but Enterprise Georgia pointed out that Ajara Textile has received the authorization for the customized two months training course at the end of 2020.

For producers in the fast fashion sector, even more important than the lack of sewers is the lack of pattern makers and technologists, who can translate a design provided by a client into a workable pattern for production.

In addition to complaints about finding staff, the fast fashion clients with well-defined international partners complained about rules of origin and transportation generally.

EU Rules of Origin require that to count as 'made in Georgia' goods need to have no more than 40% of their product made up of non-EU inputs. In its absence, Georgian clothes are subject to a 12% tax when sold into the EU. Turkish producers aren't troubled by this, because the cloth comes from Turkey and the partially finished clothes go back to Turkey where they are marked 'made in Turkey'. Other companies get around it in similar ways.

For Movi and MPT, they just get paid for the stitching, which undercuts their margins, and also means that textile exports are almost certainly understated.

This is not supposed to be a problem. Under an agreement between Georgia, the EU and Turkey, goods in Georgia which use Turkish inputs should be able to include those materials as contributing to Georgian added value. CIS countries allow this classification. The EU and Georgia have ratified this agreement but, in spite of high-level bilateral efforts, Turkey has not signed the agreement.

Transportation costs were also a complaint for everyone except the Turkish subcontractors. This complaint took several, interestingly different forms. Most obviously, many companies complained about the high cost and travel time for shipping of clothes, the lack of appropriate trucks (with wracks in them) and the lack of shipping that would allow multi-company consolidation to make smaller orders viable. This was another sector where several companies suggested the need for an EU reshipping hub and other strategies to allow companies to share shipping and split costs.

Interestingly, this was not a problem for everyone and the higher value producers like Liya said that they were OK with Express Post. RKO said that they just used Georgian post.

However, worse than the general shipping costs were the costs and timing of express shipping. In fast fashion, in particular, the companies complained that both speed and price were really big problems, when developing a new product might mean sending 30-40 prototypes back-and-forth. MGT pointed out that shipping from Turkey takes two days, while from Georgia it takes a week.

However, MGM Tex, did not consider this a big problem, since their client DK had a global agreement with DHL, reducing their shipping costs by about 70%. This suggested that there could be an opportunity whereby the Georgian government would make an agreement with one of the express parcel delivery companies so that selected companies could access cheaper services for certain kinds of transport. Alternatively, maybe Georgian Post could develop a state-subsidised service.

Standards were also occasionally highlighted as a problem, but most of the companies that we spoke to said that they the standards that they needed – because most of the standards required related to material testing and since materials were imported – could be provided by the supplier. One company did mention that productions facility standards and labour standards were increasingly required by clients, but this was not mentioned by others.

On top of regular apparel, Enterprise Georgia have produced multiple investment proposals for footwear, and this was also a priority identified by EPRC. Explaining the selection, EPRC argues that footwear has grown significantly over the last 10 years or so as an exporter, as an employer and in terms of income growth. They also see benefit in the fact that there is a production cluster in Kutaisi, which may make supporting the sector easier.<sup>88</sup> At 2.9 million USD of exports and fairly rapid growth in recent years, it is worth brief consideration. At the current time, the majority of Georgia's footwear exports have gone to Azerbaijan and Kazakhstan.

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<sup>88</sup> EPRC (2020) Assessing prospects of Export of Separate Products and Services from Georgia to the EU, p26-28

Looking at the composition of Georgian apparel production, one reason why it might be interesting in the medium term is that the country has the appropriate design skills to potentially move up the apparel value chain. One way this might happen is by leveraging Georgia’s vibrant international fashion scene.

Georgia’s international fashion scene counts at least a dozen Georgian designer names, some of whom have worked for such iconic brands as Maison Mugler, Saint Laurent, Alexander McQueen, but mostly Georgia has won-over international celebrities, fashion photographers and store buyers.<sup>89</sup> In particular, re-imagining Soviet history through fashion seems to be giving Georgian fashion design a specific edge.

Georgia has been becoming a point of attraction in the sector for almost a decade now. This has also been promoted through multiple ‘Fashion Week’s including Georgia’s Mercedes Benz Fashion Week, and the press exposure caused by Georgian Demna Gvasalia’s move to Balenciaga as a Creative Director and his Vetements collections. Some big Georgian fashion designers present their collections at international showrooms, including Paris, which has also helped contribute to Georgia’s international name and interest in it. On the back of this, one hope is that Georgia could duplicate Turkey and move from CMT to a producer of its own label, keeping more of the value addition in Georgia

## Furniture

Furniture production is highlighted as a potential investment sector by Invest in Georgia, mainly because of high local demand and low labour costs. Up until now it has not been a large exporting sector, showing significant fluctuation, and Georgian Products Ltd, which makes pet furniture, is the only ‘furniture’ manufacturer listed in Georgia’s list of top 100 exporting companies.

Export numbers are fairly modest and have shown dramatic fluctuation in recent years.

Figure 65: Breakdown of domestic exports for furniture (2-digit level) 2009-2019 (million USD)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Total</b>	<b>5</b>	<b>6</b>	<b>10</b>	<b>11</b>	<b>11</b>	<b>6</b>	<b>3</b>	<b>1.4</b>	<b>3</b>	<b>5</b>	<b>5</b>
Azerbaijan	0.3	0.2	0.5	1.1	1.4	0.3	0.5	0.6	0.6	2.3	1.9
Germany	0.2	0.0	0.0	0.0	0.1	0.3	0.3	0.0	0.1	0.4	0.6
Poland	-	0.0	-	-	0.0	0.0	0.2	0.0	0.0	0.3	0.5
USA	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.5
Netherlands	0.0	-	0.0	0.0	0.0	-	0.0	0.0	0.1	0.4	0.4

Reference: Geostat (provided on request, July 2020)

Enterprise Georgia on its website highlights a that the opportunity for furniture investment in Georgia comes from a large local production gap, with 177 million USD of consumption and only 65 million USD of local production low salaries, and a local ‘furniture cluster’ which has been supported by GIZ, with 121 producers.

<sup>89</sup> Observer (2016), Georgia Just Might Be the Fashion Capital of Eastern Europe <https://observer.com/2016/12/georgia-just-might-be-the-fashion-capital-of-eastern-europe/> (Reviewed August 2020); Forbes (2018), How These Emerging Designers Are Putting Tbilisi, Georgia On The Fashion Map <https://forbes.ge/news/3895/How-These-Emerging-Designers-Are-Putting-Tbilisi> (Reviewed August 2020); Forbes (2020), Why Georgian Fashion Is One of the New Global Trendsetters <https://www.forbes.com/sites/stephanrabimov/2020/04/15/why-georgian-fashion-is-one-of-the-new-global-trendsetters/#76bc84d527cc> (Reviewed August 2020).

The EU4Georgia project, through GIZ and Enterprise Georgia, produced an analysis of the sector and the potential export from Georgia. This makes out the case that the EU has considerable demand for furniture and, in its SWOT analysis, highlights low energy costs and low labour costs as Georgia's greatest comparative advantage in the sector.<sup>90</sup>

However, they also point out that raw material costs are more than 57% of the cost composition of furniture production, and Georgia has to import almost all of its inputs, with labour costs only counting for 20% and electricity 6%.<sup>91</sup> Therefore, the benefit of savings on labour and energy will be fairly modest.

It also seems unlikely that, if this cost structure is generally true, Georgia will ever be able to gain benefit from the Association Agreement in relation to furniture, since they can only have 40% imported inputs, but most of Georgian furniture inputs are imported and this is around 60% of the costs.

This cost structure might explain why, unlike in textiles, there has not been in Georgia any production service or outsourcing developed. It might also explain why there has been little or no export to the EU market.

That said, there has been one great success story in this area, that is constantly referenced. Georgian Products and Geo Provision are companies that respectively produce pet furniture and pet food. The pet furniture company is the strongest example that this project came across that attributed its success to the Association Agreement. Founded in 2014 and conceived of precisely because of the Association Agreement, they have said 'we are babies of the association agreement'.

The people who started the company conceived of it because of a connection with an EU-buyer. They now hire 425 people and export mainly to the EU 'Zoo Plus' retail chain, but are currently opening-up trading with the US.

As one might expect, they highlight low labour costs as a competitive advantage and said that the safety and certification requirements for pet furniture are not too demanding. They import many of their inputs, but they say that this does not take up more than 30% of their costs, so it is acceptable from a rules-of-origin point of view. This saves them from a 12% customs tax benefit over Chinese firms. They say that this benefit is useful but not critical.

The important fact to note from this category is that if the company is able to get sufficient local value addition, utilise low labour costs and develop good relations with European buyers, then there are clear opportunities. It is also helpful if, as with the two children's clothes manufacturers, there is a design component, so that product is more valuable and prices are not entirely sensitive to tax fluctuations and Georgia's higher transport costs.

## Medical

The last light manufacturing category highlighted by multiple conversations is medical. This seems to be based on the success of a single company. However, before reviewing the company it is worth considering the export profile of the category.

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<sup>90</sup> Natia Arsenishvili and Elene Chkhaidze (2017), Georgian Furniture Potential in the EU Market, Enterprise Georgia/EU, Tbilisi.

<sup>91</sup> Natia Arsenishvili and Elene Chkhaidze (2017), Georgian Furniture Potential in the EU Market, Enterprise Georgia/EU, Tbilisi, p21.

Figure 66. Domestic exports for medical and surgical apparatus (2-digit level) 2009-2019 (million USD)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Total</b>	<b>2.6</b>	<b>4</b>	<b>3</b>	<b>5</b>	<b>6</b>	<b>5</b>	<b>9</b>	<b>7</b>	<b>9</b>	<b>11</b>	<b>10</b>
Russia	0.0	0.0	0.0	0.1	0.4	0.5	1.2	1.8	2.8	2.9	3
Poland	-	0.0	0.1	-	0.0	0.0	0.0	0.0	0.0	0.0	1.6
Turkey	0.1	0.1	0.2	0.1	0.1	2.0	2.4	2.0	1.3	1.7	1.0
Azerbaijan	1.4	0.9	0.9	2.3	2.8	0.4	3.0	0.3	0.5	0.9	0.5
France	0.0	0.0	0.0	0.0	0.1	0.0	0.2	0.3	0.4	0.1	0.4
Turkmenistan	0.0	0.0	0.0	-	0.2	0.3	0.0	0.0	0.2	-	0.4
Singapore	-	0.0	-	-	-	-	-	-	0.1	0.0	0.4
Uzbekistan	-	0.1	0.0	-	-	0.6	0.3	0.2	0.3	1.2	0.4
Germany	0.3	1.2	0.5	0.4	0.6	0.6	0.5	0.6	0.7	0.7	0.3
Israel	0.0	0.2	0.1	0.0	-	0.0	0.0	0.1	0.1	0.4	0.3

Reference: Geostat (provided on request, July 2020)

The only production company that we could find in this category, was Aptos. Aptos is a medical product invented by a Georgian plastic surgeon, given a patent in 1996, which is a barbed thread that lifts the skin, essentially providing a non-surgical facelift. They sell 30 different kinds of thread across 73 countries and have factories in Germany and Russia.

The business operation in Georgia, until recently, has been very small. However, they are now building a complex for medical devices, near to Tbilisi, which will be the first of its kind in the region. The new factory will produce their product, but will also provide facilities for sterilising other medical equipment. Up until now, any production then had to be sent to another place for sterilisation.

They are currently finalizing approval for the Brazilian market and hope within a few years to have eight million euros worth of exports to Brazil. They received FDA approval in September. They sell in Europe but from their German factory, which will carry on working.

Another area of interest are phages, which are a bacteria-eating virus that can be used to treat infections, and can work as an alternative to antibiotics. The world's biggest and one of the oldest laboratories of phage science is housed at the Eliava Institute in Tbilisi. The institute has the world's largest library of known phages, and their

staff have been producing commercially available phage drugs for the countries of the former USSR for decades.<sup>92</sup> They supply German farms with phage preparations for poultry and veterinary applications, as well as aquaculture.

Mzia Kutateladze, the current director, says the Eliava Institute cooperates with two big companies in Switzerland and the US and participates in Horizon 2020 project with six other countries. The Phage Therapy Centre, an American-owned subsidiary, brings foreign patients to Tbilisi for phage treatments on ailments relating to diabetes burns, ulcers, osteomyelitis, and drug-resistant infections such as MRSA.<sup>93</sup> Additionally, BioChimPharm, a Georgian private company offers products to treat various bacterial infections (Streptococcus, Staphylococcus, E. Coli and others)<sup>94</sup>, but it does not have the infrastructure to develop, test and manufacture phage drugs on a large scale.

### Other light manufacturing

A similar category to textiles and furniture in which this combination of relatively low capital investment, high labour contribution, good design and an ability to build closer relations with EU buyers is present, is toy manufacturing.

EPRC highlights the connected sub-sectors of wooden toys and children's clothing.<sup>95</sup> They say that there are 10 child's apparel producers and 40 toy manufactures in Georgia, but their optimism about its prospects (which our analysis supports) is largely based on a few specific companies that have emerged in recent years. EPRC sites the examples of Spilow and Riko (who produce children's clothing), who were able to get international contracts from one (Enterprise Georgia supported) trip to a trade fair. Eshvi kids also showed considerable success in this area.<sup>96</sup>

In our discussions, we came across similar examples. Kodala Social Enterprise and Chikatai Toys both produce traditional wooden toys, with the addition that the Chikatai toys includes Georgian folk music in the toys that they produce. Both entities are very small. Chikatai has six employees and Kodala Social Enterprises has 25, but both say that when attending toy trade fairs, they have no problem getting customers for their relatively high-value goods, particularly in German and British markets where there is a strong demand for authentic hand-made toys.

For these companies the biggest complaint is definitely certification, and particularly its cost, as toys exported to the EU need a range of safety checks and these are very expensive.

## Services

Assessing the role of services in export profile is extremely difficult. Unlike goods, since services often don't involve anything physical crossing a border, there is no necessary mechanism for registering it. Services are currently not included in Georgia trade data, though Geostat is developing a methodology to include them. The Harvard Atlas

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<sup>92</sup> Eliava Institute, Bacterial Strain and Phage collection. <http://eliava-institute.org/bacterial-strain-and-phage-collection/> (Reviewed August 2020).

<sup>93</sup> Investor.ge (2020), How Georgian phage science might pave the future of biotech, [http://www.investor.ge/wp-content/uploads/2020/02/2019\\_6.pdf](http://www.investor.ge/wp-content/uploads/2020/02/2019_6.pdf) (Reviewed August 2020).

<sup>94</sup> Biochimpharm, About us. <http://biochimpharm.ge/en/about-us/> (Reviewed August 2020).

<sup>95</sup> EPRC (2020) Assessing prospects of Export of Separate Products and Services from Georgia to the EU.

<sup>96</sup> EPRC (2020) Assessing prospects of Export of Separate Products and Services from Georgia to the EU, p41.



of Economic Complexity suggests that Georgian service exports could be valued at more than 60% of Georgia's total exports, with travel and tourism 45% of the total, transport 14% and ICT 2%.<sup>97</sup>

The importance of tourism certainly aligns with the public perception of the importance of the sector. It also helps to explain why Georgia has been disproportionately impacted by the covid crisis, and the cessation of travel that it has caused, even though the country as a whole is judged to have dealt extremely well with the pandemic. This Harvard data is surprising, however, as it suggests that ICT exports are a similar order of magnitude to wine. The Atlas values ICT exports at \$132 million or 1.8% of exports, while wine is listed as \$183m or 2.2% of total exports.<sup>98</sup>

Regardless of the agreed importance of tourism, this project is not considering it, as there has never been any suggestion that the market accessibility provided by the Association Agreement would have any impact on that sector. Having reviewed the operation of the Association Agreement, it may be that the agreement has more of an impact than we originally imagined, as overall improvements in standards in the country may have a positive impact on tourism from Western countries as well. Also, EU support to rural development generally, sometimes explicitly supports the tourism sector and often indirectly helps the sector (through vocational training, waste management, environmental standards, general business environment reform, agricultural development and much more). Nonetheless, this sector will not be considered here.

Initial assessment would also suggest that the Association Agreement did not have much of an effect on services generally. An EPRC analysis of different sectors gives an overview of how much the AA has increased the access of services to the EU. They reference a numerical approximation of the 'Services Trade Restrictiveness Index'. This index has a range of 1 (an entirely closed market) and 0 (an entirely open market) for potential service spheres between the EU and Georgia.

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<sup>97</sup> Atlas of Economic Complexity (Reviewed July 2020), What did Georgia export in 2018?, <https://atlas.cid.harvard.edu/explore?country=82&product=undefined&year=2018&productClass=HS&target=Product&partner=undefined&startYear=undefined>

It is unclear how this data is derived, but it is presumably deduced based on Geostat data.

<sup>98</sup> Atlas of Economic Complexity (Reviewed July 2020), What did Georgia export in 2018?, <https://atlas.cid.harvard.edu/explore?country=82&product=undefined&year=2018&productClass=HS&target=Product&partner=undefined&startYear=undefined>

It is unclear how this data is derived, but it is presumably deduced based on Geostat data.



Figure 67. Services Trade Restrictiveness Index of Potential Service Spheres in EU countries, 2018

Service sphere	Average Services Trade Restrictiveness Index	Liberalization compared to 2014	Number of EU countries with less than average Services Trade Restrictiveness Index	Largest importer	Most liberal importer
Computer services	0.24	Insignificant	16	Germany	Latvia
Accounting services	0.33	Insignificant	19	Germany	Latvia
Architecture services	0.27	Insignificant	13	Germany	Latvia
Engineering services	0.25	Insignificant	16	Germany	Latvia
Sound recording services	0.22	Insignificant	19	Germany	Latvia
Motion pictures services	0.22	Insignificant	18	Germany	Latvia
Courier services	0.30	Insignificant	23	Germany	Latvia

Reference: EPRC (2020) Assessing prospects of Export of Separate Products and Services from Georgia to the EU, p12

As one can see, the level of trade restrictiveness has not really changed as a result of the Association Agreement. In other EPRC research on services and the Association Agreement, they point out that the main benefits to Georgian companies have been the creation of opportunities for Georgian companies to set up branch offices in the EU, gaining recognition of some qualifications and sending staff to the EU for training (thanks to visa-free travel).<sup>99</sup> However, from our discussion with businesses, these elements are fairly peripheral to their core business for a range of reasons.

Nonetheless, a range of different analysts, including the Georgian Government, have highlighted the opportunities presented by Business Process Outsourcing (BPO). The comparative advantage of Georgia for BPO is, again, the usual list of ease of doing business, low taxes, low salaries and an open economy. There have also been a number of success stories which seem to suggest that the low capital costs, strong cultural alignment, language skills and Georgian appreciation for the service sector all work to make the sector attractive.

Deloitte provides an assessment of Business Process Outsourcing, that includes all Finance and Accounting, Human Resources, Customer Relations Management, Architecture and Engineering and IT sector.<sup>100</sup>

The Deloitte reports gives brief reviews of the sub-sectors. Architecture Design and Engineering, they say is the biggest of all the sectors, which is not surprising since it includes local building contractors, though they are not clear about the scale of the export. However, they say that there are 15 companies providing rendering, 3D modelling and engineering services to international clients.

<sup>99</sup> EPRC (2020), Guide to trade in services between Georgia and the European Union, Tbilisi, p6

<sup>100</sup> Deloitte (2018), Business Process Outsourcing and Shared Service Centers investment potential research, Enterprise Georgia, Tbilisi, p55

In IT, they report big growth for the sector as a whole, which is again not surprising. What is surprising is that, by their assessment there are 25 firms that provide international outsourcing companies, which are only generating 4 million USD for outsourcing services, with main services including support functions, web-design and programming.

In finance and accounting. they claim that there are 40 companies providing international services, with financial analysis and transactional processes in the most demand amongst clients. HR, exists locally, but there is little current international outsourcing.

In CRM (call-centers) they claim that there are 40 companies, mostly providing customer support and telemarketing, producing a turnover of 6 million USD.

The Deloitte report offers the same positive reasons for investing in BPO in Georgia, as has already been mentioned. However, while they claim that Georgia is extremely competitive in terms of salaries, for skilled staff, they also agree that deficits in this area are also the biggest complaints.<sup>101</sup>

In finance and accounting 'The main problems in exporting F&A services are associated with technical knowledge'. In IT, due to recent fast demand 'IT companies may face rapid employee turnover due to intense competition for skilled IT professionals in the local market'. In architecture developing and engineering, they say workforce skills is the key challenge in this service area, as fresh graduates require training in modern architectural programmes.<sup>102</sup>

In our discussions, we interviewed 14 companies in these areas:

*Figure 68: Service oriented companies interviewed for this project*

Name of the company	Sector
Majorel	Customer service provision/BPO
Base4	Architectural Services
Asseco	IT
Azry	IT
Dressler Consulting	IT
MaxinAI	IT
Qarva	IT
Wandio Software Development	IT
20Steps Production	Film
Alien Kid	Film
Highway VFX	Film
Parachute Films	Film
Postred Audio	Film
Studio Velocepede	Film

<sup>101</sup> Deloitte (2018), Business Process Outsourcing and Shared Service Centers investment potential research, Enterprise Georgia, Tbilisi, p55

<sup>102</sup> All of these sector components are taken from Deloitte (2018), Business Process Outsourcing and Shared Service Centers investment potential research, Enterprise Georgia, Tbilisi, p55

Service export can be an extremely appealing area for export growth and economic development. Most obviously, they benefit from the absence of transportation costs. For the company, they also usually involve limited start-up costs, since in modern times, service exports often simply need staff with the right skills, an office, computers, a good internet connection and the appropriate software.

The converse of the lack of physical barriers, of course, is that there is very little geographic comparative advantage conveyed by proximity to the EU. Proximity in terms of time zones, and proximity that allows for EU-based training can be useful, particularly with visa-free travel. However, as the world increasingly operates in the cloud and we all move our professional lives into Zoom, even these considerations seem less important. As a result, a call center in Georgia competes with every other country with high levels of English and lower salaries. An IT-service provider competes with every country where those skills exist. In some ways the sector can seem highly commoditised.

Certainly, in our discussions, we have found that services are one of the least restrictive of sectors for Georgia trade. The main hurdle for companies to sell services internationally is the availability of staff with skills that companies in other countries want to buy. As we will see, there can be accreditation and standards requirements, and there has been some effort within the Association Agreement to reduce these hurdles, but most of the companies that we spoke to were providing services to companies that would themselves provide quality assurance or accreditation of the final product. The sections below will consider CRM/call-centers, IT and architectural services, as these are the categories that came up during early discussions in the project.

### Customer relations management/call centers

CRM/call-centers, often called 'BPO' in Georgia, are one of the country's most highly promoted new export categories.<sup>103</sup> Evolution Gaming is the biggest of these, with around 3000 employees. This is an online gaming/call center facility that includes mock-ups of actual casino situations with croupiers, etc. We were unable to talk to Evolution Gaming for this project, as they have been struggling to shift their business model to one that allows for distance working.

The second company that is commonly referenced in this context is Majorel, who provide call-center services particularly to the German speaking world. They opened in 2016 because they needed German language operators and labour costs in Romania and Estonia, where they had been sourcing these services earlier, were going up significantly. The company started by providing call-center services to Lufthansa, but after two years had expanded the provision to include seven client companies, particularly large technology companies.

They have two sites in Tbilisi and one in Kutaisi and hire 1900 people. A representative of the company said that while it is a struggle to find enough German language speakers, he likes operating in Georgia because a call-centre job is considered a 'good-job' in Georgia and so he can attract motivated and enthusiastic staff. This is helped because people like the office environment and salaries are high, reaching about 2,000 GEL six months after people start and reaching 4,000 to 5,000 GEL for middle managers.

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<sup>103</sup> Enterprise Georgia usually uses the term BPO for this category, which can be confusing as internationally, BPO is usually used as a wider umbrella term.

Georgia's greatest strength for Majorel is the availability of foreign language speakers. They also cited the low-tax regime and particularly the Estonian model of corporate income tax as useful. German is the most highly demanded language by Majorel but they also demand other non-English languages. Majorel explained that they do not generally provide much in English since generally it is hard to compete with the Asian market for providing English speakers. Other than German, in Georgia they provide services in Russian, French, Italian, Dutch and Spanish. There is some space for English, a representative said, because a range of clients don't want to rely on Asia, and English is extremely valuable when combined with another language.

The principal bottleneck, therefore, is the number of language speakers, and they have worked with development programmes to try and help support German language instruction, but there is a limit on what they can do. They also say that German language acquisition is very much helped by visa-free travel to/from Europe, as this has both encouraged people to improve their language skills and facilitates language acquisition, some travel for work and education and much more.

## IT

One obvious area of skill provision export is IT. We talked to six companies in the sector. Three of these were pure service-export oriented. Asseco is a big Polish technology company that bought a local Georgian company with around 15 employees and a solid list of Georgian clients. Now they have over 50 employees in Georgia, and they still do 80% of their work in Georgia, because of high local demand, particularly from the banking sector. They have been offered significant other projects, out of country, but had to turn them down because of lack of technical staff. In one instance they said that they had to turn down a multi-million-dollar project because they could not find six key people.

The director is currently in discussion with Code School, a trainer in coding that is prominent in Poland, the Czech Republic and Lithuania. Asseco (the global firm, not the Georgian subsidiary) has 1.7 billion Euro of IT outsourcing in Europe, and the demand is practically limitless from a Georgian point of view.

Dressler consulting is a similar story, though Dressler is set up exclusively to export IT services to clients, mostly in the US but also in the EU. Dressler grew quickly in Georgia and at the time of talking to the representative had 40 technical staff. However, they also have bigger operations in other countries in the region, particularly Ukraine. They also faced challenges recruiting and have also investigated developing teaching facilities using a range of models, but have so far found the Georgian market to be too price sensitive to be able to finance IT instruction: even if this instruction is tied, or made conditional on employment.

MaxinAI is a pure IT coding service exporter that focuses on AI. They have 45 employees and have clients that are 50/50 Europe- and US-based. The company started when some coders in the data sector started to organize 'data-community' events in Tbilisi (including one last November with 1,000 participants) and through that recognized some talented people. They say that in addition to the company, people from the community work in big tech companies (in person or at a distance) all over the world.

Azry has a similar profile to Asseco, in that it started as an IT service provider for Georgian banks and developed several products to manage cash payments. They say that they have 70 employees and are constantly hiring, training people, usually looking for students or recent graduates with basic skills and good work ethic who they

train-up intensively over six months. Hiring in batches of 4-10 and training during an internship where they get 800 GEL, they keep about one-third of those who go through the internship.

However, the Azry owners have decided that given the limitations in coders in Georgia, IT outsourcing has limited scalability, and so, they are attempting to do product development for a range of markets. They are actually using the regular commercial Georgia-based client work, to finance their development of products.

They are working on a very disparate group of products, including developing products for niche consumer markets that can be sold on Amazon (their most recent is a product that can close a valve in a pipe if a leak is detected). They have also been trying to market a payment system for public transport that they developed in Georgia for the Georgian public-transport system. They have had several promising introductions in Central Asia where the similarity of the market means that products developed for Georgia can be transferred. Also, they have networks and can easily get introductions in the regional countries, in a way that they would find difficult in the EU. They say that in Europe the most difficult thing is meeting potential customers, in addition to the certification requirements, particularly for physical technology that transmits or receives signals of any kind.

Other companies we spoke to include Qarva, which has 100 employees working in IP TV just in Georgia and Wandio, which has 85 employees with very little export. But all the companies we spoke to suggested that they had huge problems finding skilled employees, with the main competition coming from banks and online gaming platforms. Some of the people we spoke to even talked about the banks (and their spin-offs) trying to turn themselves into IT companies, with most of the major banks having several hundred IT developers. Gaming companies also seem to pay above market.

In addition to all of these companies, there are a range of 'start-up' technology companies in Georgia. GITA, with World Bank funding, has financed a range of these, including companies working in AI, Fintech, Virtual Reality, ISP marketing and much more. These companies are extremely hard to assess in this context. They usually aspire to larger mass markets and the mythical 'unicorn' status (an IT start-up that reaches a \$1 billion valuation) but none have so far made a significant splash in Georgia or outside in terms of revenue generation. Also, unfortunately, in several instances, when companies have started to do well, or have been seen as having potential, they have often moved to other markets, where experience, capital and a deeper pool of experienced coders are available.

What seems clear in this market is that talent is everything and geography is largely irrelevant. Usually, one might expect that if neighbouring countries have a comparative advantage, this would disadvantage the local market, but that is not the case here.

The fact that Belarus, Ukraine, Russia and Armenia are known for IT outsourcing may actually be a benefit to Georgia, as Georgia may get discovered by other companies operating in the region in these areas. In fact, in a region with a deep bench of coders, there may be an opportunity for attracting more 'digital nomads' from the region, particularly Ukrainians, Belarussians and Russians who could be attracted by the better business environment, lower taxes and a nicer place to live. However, the key is to produce coders, and given the high salaries paid in this area and the almost guaranteed employment for anyone good, it seems clear that the emphasis should be on training. This is not something likely to happen in state VET, however, as minimal university level training in IT or math is a prerequisite for additional development.

As a result, at the very least, this would suggest that companies interested in training in this area should be provided some kind of government subsidy, and training courses at public and private universities should be supported. However, in this sector, as in other STEM fields, there is a high dependence on earlier education to give basic training – particularly in math and science and formal problem solving. The success of Slavic countries in IT seems to be largely built on the long history of math-schools and math-Olympiads. This used to be a tradition in Georgia but has lessened over the years, and should probably be resurrected.

### Architectural services

Architectural services are also listed by Enterprise Georgia as a focal area. We only found one company that matched this description, providing exportable services, but it is worth considering.

Base4 is US-based firm who, in 2016, were looking for a branch office. Enterprise Georgia gave them a good sales pitch about Georgia and offered to help in finding staff, in paperwork, and in set up. Following a test office of two people they scaled-up and just before Covid and had 25 staff (though in April they had 14). The representative said that an office of 100-500 people may be possible in Georgia.

They work providing architectural service support to a US company. The US company then provides all compliance. They generally hire BAs and MAs in architecture. They say that staff are not great when they start, but they are adequate and learn quickly. The US company is not worried about qualification-recognition, though they have provided training in specialist areas. Their US consultants are licensed for the services that the company provides, and they filter everything, so the US partner just cares about the quality of the final service. Georgia's service input is mostly in quality control and concept design.

They hire on the basis of potential and it takes a few months to train people up. Thanks to local construction boom, seven or eight universities now teach architecture and the students are generally amongst the brightest with about half scoring well enough on entrance exams to get a grant from the government. The representative said that maybe 30% of graduates are good enough for Base4 to consider hiring.

### Film and animation

Film and animation cover a wide range of activities, from BPO/design work to the advertising sector, to filming and other support services for local or international films, to producing films in their entirety. This sector gained the attention of this project because it has been supported by tailored large-scale co-financing support from the Georgian Government and continues to be a target group for Enterprise Georgia. It also was supported by GIZ under one of their early 'cluster' support programmes, and has also been targeted by the current USAID Economic Security project.

The Georgian film sector has been built-up over the last 15 years or so, first with Georgia developing a reputation for its own films, then providing production facilities for Bollywood films and more recently hosting the production of Hollywood films like 'The Fast and the Furious'.

Native produced films are a cultural export and generate revenue for the country through ticket sales and licensing, but Georgian films are still largely art-house films that are often made with grants from cultural organisations, so are lucky if they break a profit. However, a significant increase in the number and acclaim of Georgian films, has been one of the keys to unlocking the rest of the industry.

The developmental model of using film for export generation, was centered around the development of a local production hub, for film-makers from all over the world. Georgia's relatively small size and extremely varied nature and urban scenery were marketed through Enterprise Georgia, and the program 'Film in Georgia'. It was hoped that this could develop revenue for the country, at the same time as showcasing the country internationally and generating more tourism interest.

There were two types of companies that we spoke to in the film industry that are relevant for our project. First, those companies that provide production support to film makers.

20 Steps Production, which was established in 2010 for example, produces films and supports a range of clients in production and post-production services. They currently listing 15 completed works and up to 10 work-in-progress projects. They also run Caucasian Film Service which provides various production equipment rental.

Alien Kid is a production studio offering full production and post-production services, including animation, mainly to foreign clients. They were established in 2011 after the funder who had studied and worked in the USA was approached by an American colleague about production in Georgia. They have had clients from the US, Europe and India.

One of the crucial elements of the efforts to attract film companies to Georgia was the 'Film in Georgia' scheme, run by Enterprise Georgia. This offered a range of supports to film makers but, in particular, offered a 20-25% cash-back scheme for qualified expenses that occurred in-country, after filming had completed. According to Enterprise Georgia, this support has been used by 20 companies since the project was conceived.<sup>104</sup>

According to every film sector representative with whom we spoke, this cash-back strategy was critical to the growth of this sector, but is currently stalled. They also underlined the importance of including post-production in the cashback strategy.

The second category we talked to were firms involved in post-production. These companies may have emerged because of the development of the first group, but were not supported directly by the rebate scheme. They are really equivalent to the IT firms, architectural or finance and accounting firms, as they generally provide technical skills that do not need to be done for clients in the country.

One example of this is Highway VFX, which provides visual effects for commercials, animation and movies. They particularly focus on 3D post production and have been found by clients who saw and liked their work and found that they could do it less expensively than others. They now do about 30% of their work for the local market and about 70% is exported.

They say that there is no university training course in this area with much value, as this is something that starts with artists and gives them technical skills, rather than simply taking technical people and giving them specific training. However, they believe that there is an untapped talent pool in Georgia. They train their own people. But medium term the likely scale is still modest, with 20-50 people doing fairly large projects. They say that they were unaffected by the rebate scheme as it did not cover post-production anyway.

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<sup>104</sup> Enterprise Georgia – Film in Georgia (reviewed August 2019), Projects implemented within the Program, <http://www.enterprisegeorgia.gov.ge/en/business-development/filmingeorgia>



Another example is Postred - a production and post-production studio working on sound design, music production, video games, installations, educational and art projects. Their clients are various mostly international movie studios, mostly local advertisement agencies and video game companies. Postred was established in 2015 in Georgia, with five team members, now consists of 15 core employees and 15 freelancers. The founder was educated and worked in Canada and the USA, which is the main source of international clients and main reason for compatibility with their principles too. Since formal education in the film industry in Georgia is poor, Postred is thinking about creating a Postred Inspire Platform that will offer short courses, hopefully with scholarships as a result of negotiations with various foundations.



## Appendix 1: Information requested from Geostat

N of letters	Date requested	Information requested
1	23-Dec-19	Monthly breakdown of export and import by EU28 countries and 6-digit product codes for 1995-2019
2	06-Mar-20	Annual export breakdown by EU28 countries and 6-digit product codes for 2013, 2015, 2017 and 2019
		Annual export breakdown to 12 countries: Azerbaijan, Russia, Armenia, Turkey, China, Ukraine, USA, Kazakhstan, Uzbekistan, Switzerland, Iran, UAE, by 6-digit product codes for 2013, 2015, 2017 and 2019
		List of largest 50 exporter companies in 2019
		List of largest 200 companies in 2019
		List of largest 50 companies by size of FDI received for 2013-2019
3	06-Apr-20	List of largest 100 companies exporting to the EU in 2019, by economic activity
		List of largest 50 companies by size of FDI received for 2013-2019, by economic activity and investing country
4	10-Apr-20	List of 3 largest exporter companies for selected 39 4-digit product codes
5	07-Jul-20	List of 15 largest companies by received FDI for 2009-2019
		FDI by components and sectors for 2013-2019
6	28-Jul-20	Domestic export values and units for 2-, 4-, and 6-digit product codes for 2009-2019
7	30-Jul-20	Domestic export values and units for 2-, 4-, and 6-digit product codes for 2009-2019, by export country
8	30-Jul-20	List of 5 largest exporter companies for product code 95 – Furniture, in 2019
		List of 3 largest exporter companies for product code 8803 – parts of aircrafts, in 2019
9	03-Aug-20	Monthly breakdown of domestic exports values and units for 2-, 4-, and 6-digit product codes for 2019-2020, by export country
10	19-Aug-20	Domestic export values and units for 2-, 4-, and 6-digit product codes for 2009-2020, by EU country group
11	01-Sep-20	Domestic export values and units for 2-, 4-, and 6-digit product codes for 2009-2020, by EU country group
12	02-Sep-20	Updated domestic export values and units for 2-, 4-, and 6-digit product codes for 2009-2019, by export country
13	02-Oct-20	Import values and units for 2-, 4-, and 6-digit product codes for 2009-2020, by EU country group

## Appendix 2: List of interviews: businesses

#	Company	Sector	Interview date
1	Majorel	Services	April 11, 2020
2	TBC Capital	Investment	April 11, 2020
3	Mosmieri	Wine	April 22, 2020
4	GeoSteel	Steel	April 22, 2020
5	MyGPS	Electrical	April 23, 2020
6	Cross Country	Investment	April 24, 2020
7	Independent advisor	Investment	April 24, 2020
8	Kockablo	Electrical	April 27, 2020
9	Nergeta	Agriculture	April 28, 2020
10	Eshvi Kids	Apparel	April 29, 2020
11	Liya	Apparel	April 29, 2020
12	Zarapxana	Jewelry	April 29, 2020
13	Kodala Social Enterprise	Wood stuff	April 29, 2020
14	AE Solar	Electrical	April 29, 2020
15	Edelling Ltd	Agriculture	April 30, 2020
16	NutsGood	Agriculture	April 30, 2020
17	Elselema Ltd	Apparel	April 30, 2020
18	CBO	Oil and Gas	April 30, 2020
19	Gazelle Finance	Investment	April 30, 2020
20	Euro-Nuts-2009 Ltd	Agriculture	May 1, 2020
21	Caucasus Organic Fruits	Agriculture	May 1, 2020
22	Georgian Nektar	Agriculture	May 1, 2020
23	Gepherrini Manufacturing Company	Apparel	May 1, 2020
24	Chikatai Toys	Toys	May 1, 2020
25	Atlantic Group	Electrical	May 1, 2020
26	MnChemical Georgia Ltd	Chemicals	May 1, 2020
27	Silk Road Group	Investment	May 1, 2020
28	Natakhtari	Beverages	May 4, 2020
29	NutsGe	Agriculture	May 4, 2020
30	Biojuce	Agriculture	May 4, 2020
31	Nutrimax	Agriculture	May 4, 2020
32	Dressler Consulting	Services	May 4, 2020
33	Bolero and Co	Wine	May 5, 2020
34	Gemuani	Agriculture	May 5, 2020
35	Georgian Herbs Ltd	Agriculture	May 5, 2020
36	Fortuna Ltd	Construction materials	May 5, 2020

37	Silkinvest Ltd	Auto trade	May 5, 2020
38	Base4	Services	May 5, 2020
39	Georgian Hazelnut Corporation	Agriculture	May 7, 2020
40	Frutex+ Ltd	Agriculture	May 7, 2020
41	Global Invest General Ltd	Agriculture	May 7, 2020
42	Vako 2017 Ltd	Agriculture	May 7, 2020
43	SDT	Electrical	May 7, 2020
44	El Te Ni Gadamamushavebeli Ltd	Industrial	May 7, 2020
45	Georgia's Natural & Aromaproduct	Agriculture	May 8, 2020
46	Fast Track Textile Ltd	Apparel	May 8, 2020
47	MGMtex	Apparel	May 8, 2020
48	Aptos	Medical	May 8, 2020
49	Synergy Capital	Investment	May 8, 2020
50	Geoline 7777 Ltd	Apparel	May 11, 2020
51	MPT Textiles	Apparel	May 12, 2020
52	Olam Georgia Ltd	Agriculture	May 13, 2020
53	Georgian Textile Ltd	Apparel	May 13, 2020
54	Tuana Textile Ltd	Apparel	May 13, 2020
55	Transoperator JSC; Carriage Building Company Ltd	Rail	May 13, 2020
56	20Steps Production	Services	May 13, 2020
57	MOVI	Apparel	May 14, 2020
58	RKO	Apparel	May 14, 2020
59	Kareli Fruits Ltd (Chikori)	Agriculture	May 15, 2020
60	MATÈRIEL TBILISI	Apparel	May 15, 2020
61	Boom Group Ltd	Beverages	May 18, 2020
62	Geo-Nuts	Agriculture	May 18, 2020
63	Georgian Heritage Craft Association	Apparel	May 18, 2020
64	Highway VFX	Services	May 18, 2020
65	Postred	Services	May 19, 2020
66	Studio Velocepede (Giraffe Jose)	Services	May 19, 2020
67	Asseco	Services	May 19, 2020
68	Azry	Services	May 19, 2020
69	Qarva	Services	May 20, 2020
70	Homemade	Furniture	May 21, 2020
71	Alien Kid	Services	May 22, 2020
72	Parachute Films	Services	May 22, 2020
73	Georgian Products; Geo Provision	Wood stuff	May 25, 2020
74	Henkel	Chemicals	May 25, 2020

75	Mina	Glass maker	May 29, 2020
76	MaxinAI	Services	May 29, 2020
77	Forbes	Investment	June 1, 2020
78	Anaklia City	Investment	June 2, 2020
79	Wandio Software Development	Services	June 3, 2020
80	Aric	Agriculture	June 11, 2020
81	Funduki	Furniture	June 12, 2020
82	Hunnewell	Investment	June 12, 2020
83	Ajara Group	Agriculture	June 16, 2020
84	Fabrika 1900	Packaging	June 16, 2020
85	Georgia Capital	Investment	June 16, 2020
86	Georgian Co-investment fund	Investment	June 16, 2020
87	GIG	Investment	June 18, 2020
88	Wings and Freeman	Investment	June 18, 2020
89	8000 vintages	Wine	July 24, 2020

### Appendix 3: List of interviews: other

#	Organization	Interview date
1	EU	March 18, 2020
2	German Economic Team	March 13, 2020
3	German Economic Team	April 27, 2020
4	Gov	April 27, 2020
5	PMCG	March 10, 2020
6	European Business Association (DWV)	April 20, 2020
7	German Business Association	April 21, 2020
8	EPRC	April 25, 2020
9	IFC	April 27, 2020
10	Enterprise Georgia	April 25, 2020
11	GCCI	April 24, 2020
12	Economic Security Project	May 4, 2020
13	Economic Governance Project	May 6, 2020
14	CNFA	May 11, 2020
15	Economic Security Project	May 13, 2020
16	EBRD	May 7, 2020
17	GCCI	May 20, 2020
18	Turkish Business Association	June 1, 2020
19	British Embassy	June 3, 2020

20	GIZ	June 4, 2020
21	EUGBC	June 4, 2020
22	Zrda	June 2, 2020
23	Georgian Waste Management Association	June 11, 2020
24	Business Association of Georgia	June 11, 2020