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GEORGIAN ECONOMY – NEED FOR A NEW ECONOMIC MODEL IN THE CONTEXT OF GLOBAL CHANGE

JUNE 2020

Key Findings

Covid-19 pandemic has highlighted the importance of local production and the need to diversify supply chains, as companies were paralyzed by the disruptions of their supply chains after China's lockdown. According to analysts, this pandemic will significantly change the world economic model for the next decade - economies will become more autonomous, focusing on the regional concentration of supply chains and meeting regional demand.

In recent years, Georgia's economic growth was driven by services, with tourism being a catalyst and boosting also trade, construction, and other services sectors.

The share of services in the Georgia's economy increased from 60% to 78% over 2009-2019. However, most of the revenue generated from these sectors were driving imports, as production base was low – we estimate that out of US\$ 3.3bn revenues from tourism in 2019, only US\$ 1.3bn was retained in the economy.

Georgia's new economic growth model should focus on enhancing production potential. In this regard, both the stimulation of local companies and the attraction of foreign investments are crucial.

We see production potential in agriculture in the following areas: meat and dairy products, grains, vegetables and fruits, food processing. In this regard, Georgia has the potential to substitute imports worth of US\$ 400mn and also to diversify exports. Land fragmentation and low productivity remain the main challenges in this sector.

Construction sector is very import-intensive, and we estimate that by encouraging local production in certain areas, it will be possible to substitute imports worth of US\$ 450mn. According to preliminary estimates, production of the following products is feasible: wires and cables, re-bars, plastic materials, paints, furniture, electric water heaters, articles of iron and steel, wood materials, ceramic products, cement clinker.

Georgia needs new strategy to attract FDI, especially considering increased competition globally. We see potential for attracting foreign investments in the following sectors: textile, apparel and leather manufacturing, manufacturing of automobiles & auto parts, pharmaceuticals and other chemical production, manufacturing of home electronics, transport and logistics, business process outsourcing. At the same time, the qualification of the labor force and the shortcomings in infrastructure are one of the main obstacles for FDI attraction along with the judiciary system.



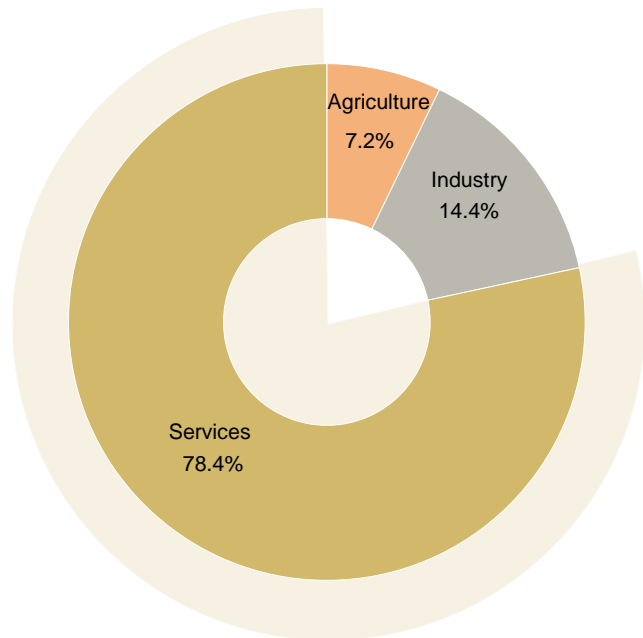
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- 2 Production potential in agriculture & food processing
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- 4 In which sectors and how to attract FDI?



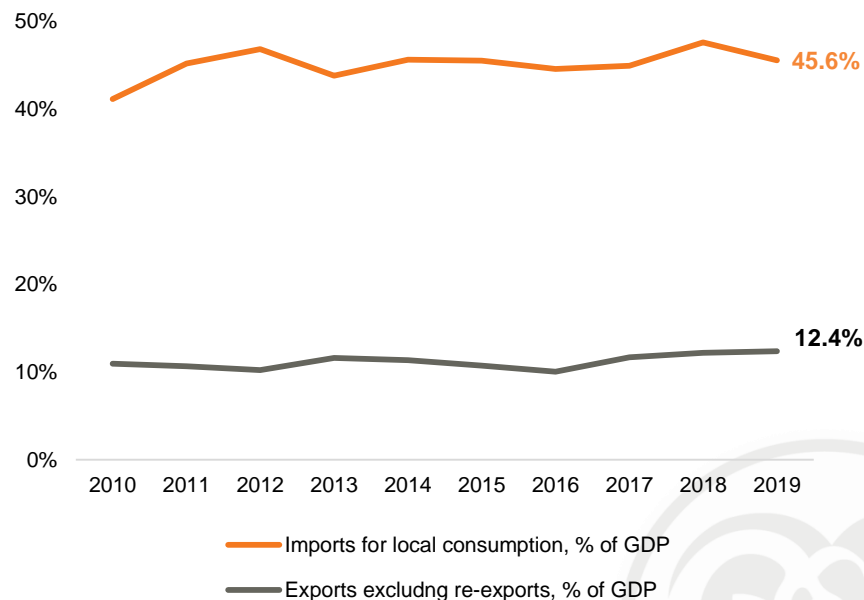
Georgia's economic growth is driven by services and goods exports base is very low

GDP by sectors, 2019



Source: Geostat

Goods exports excluding re-exports and imports for local use



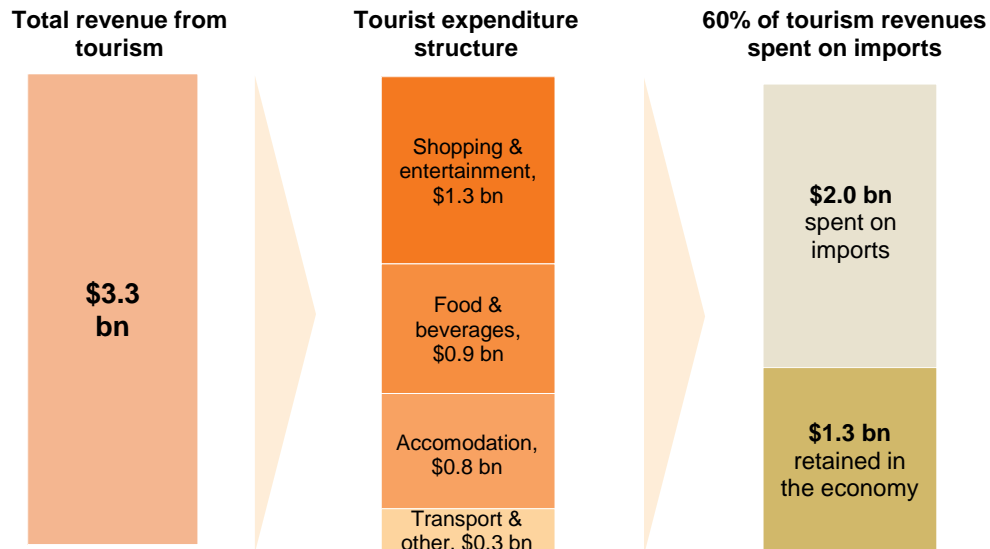
Source: Geostat, Galt & Taggart

Note: Imports are valued only for local consumption (re-exported categories are reduced - copper, cars, pharmaceuticals, tobacco); Exports also exclude these re-export products



Revenues from tourism largely spent on imports

Revenues from tourism and expenditure structure in 2019



Source: Geostat, NBG, GNTA, Galt & Taggart

Note: According to our estimates, out of \$1 spent by tourist c. 40-45 cents is spent on imported goods (primary effect). The NBG estimate is 35-40 cents. Furthermore, based on the links between tourism-related sectors (construction, trade, real estate, etc.) and their demand for imports, the \$1 spent by tourist generates an additional demand of c. 18-20 cents on imported goods and services (secondary effect). Considering these two effects, c. 60 cents is spent on imports from \$1 spent by a tourist



New growth model for Georgian economy – enhanced production capacity

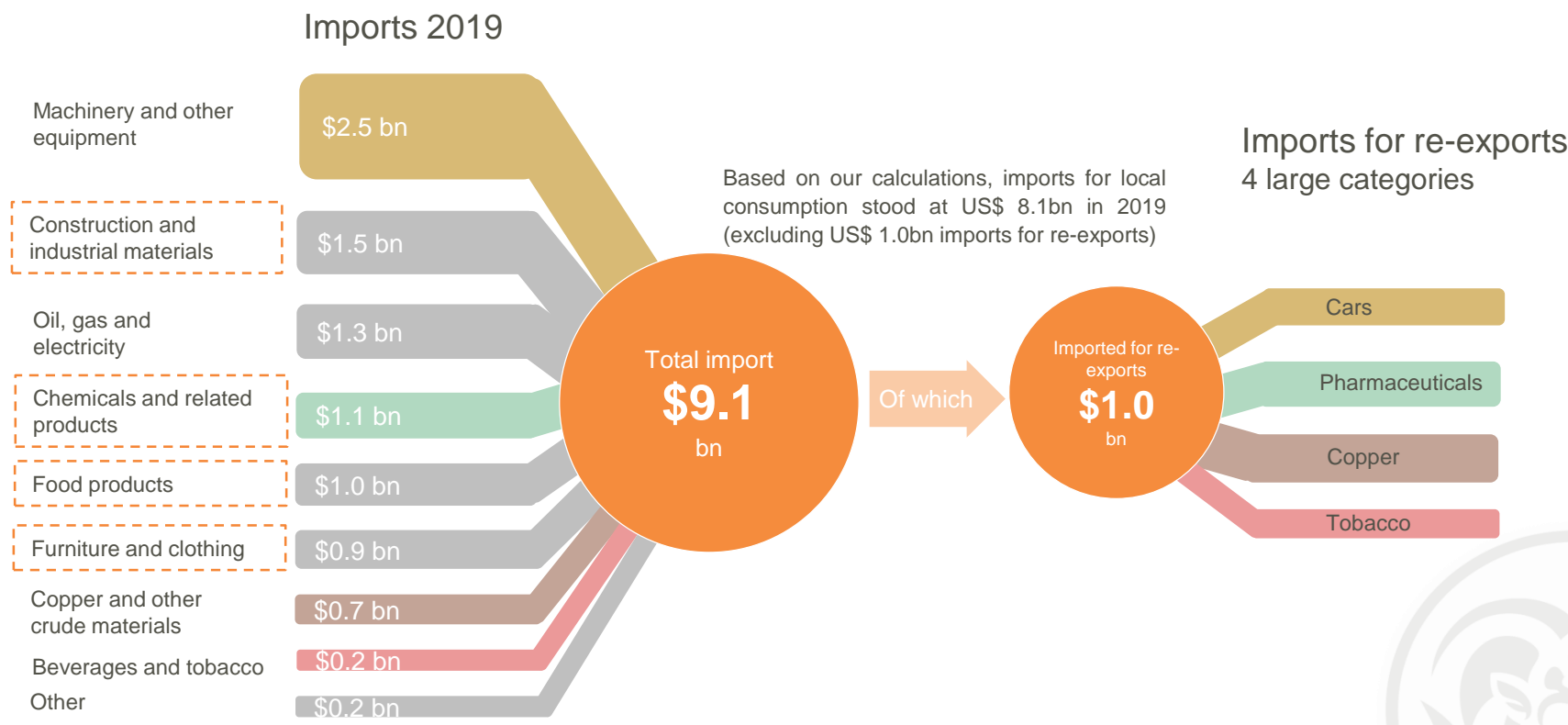
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Which sectors exhibit
production capacity?

In which sectors
and how to attract
FDI?



We see production capacity in agriculture products, construction materials, furniture and apparel considering economic structure



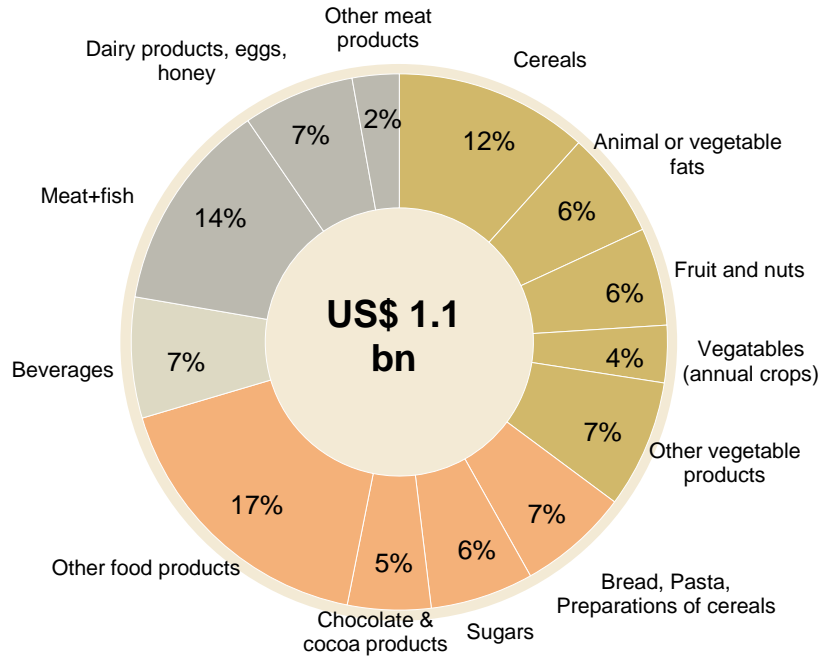
Source: Geostat, Galt & Taggart

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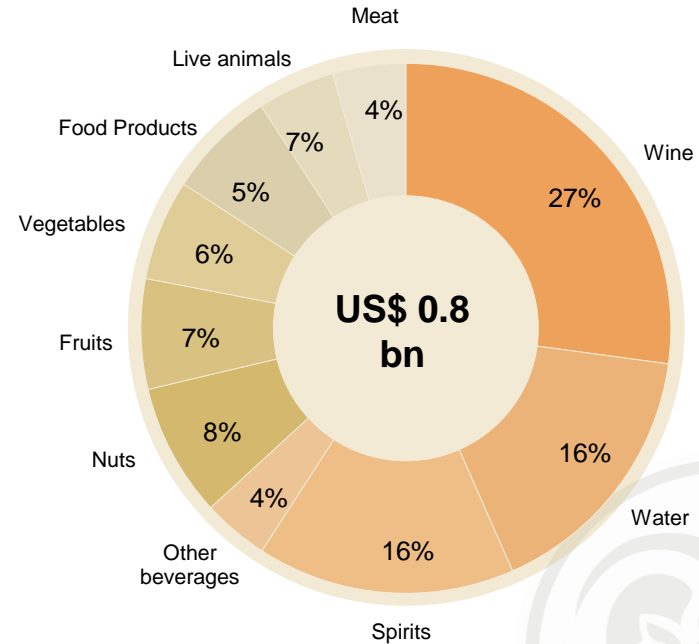


Food and agricultural products imports stood at US\$ 1.1bn in 2019, while exports reached US\$ 0.8bn. Beverages and nuts accounted for 73.3% of total exports

Imports of food and agricultural products, 2019



Exports of food and agricultural products, 2019



Source: Geostat, Galt & Taggart



We estimate that additional \$400mn worth of food products can be produced locally and further diversify exports

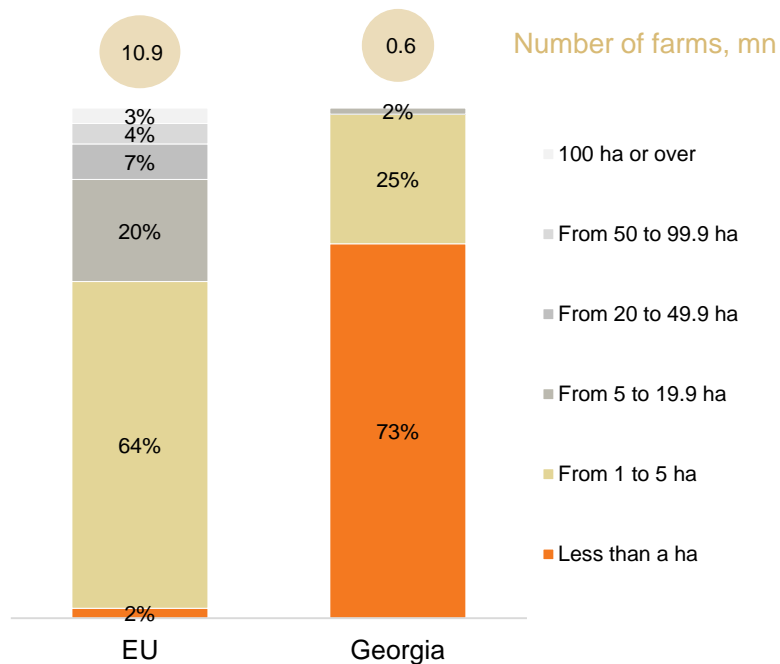
Sector	Imports, 2019	
Meat and dairy products	US\$ 229mn	Georgia has the potential to increase production of chicken and pork, fish and frozen meat products. In dairy products direction, we see potential to replace the import of milk powder and produce dairy products with local resources.
Cereals, fruits and vegetables	US\$ 236mn	Partial replacement of wheat imports and full replacement of corn imports are possible. Georgia also has the potential to increase vegetable production. Additionally, development of storage facilities is essential to reduce imports seasonality.
Processed food		With processing local raw materials, the food production can be developed in: flour confectionery, meat products, vegetable canned food, vegetable fats, etc.

Source: Geostat, FAO, Galt & Taggart



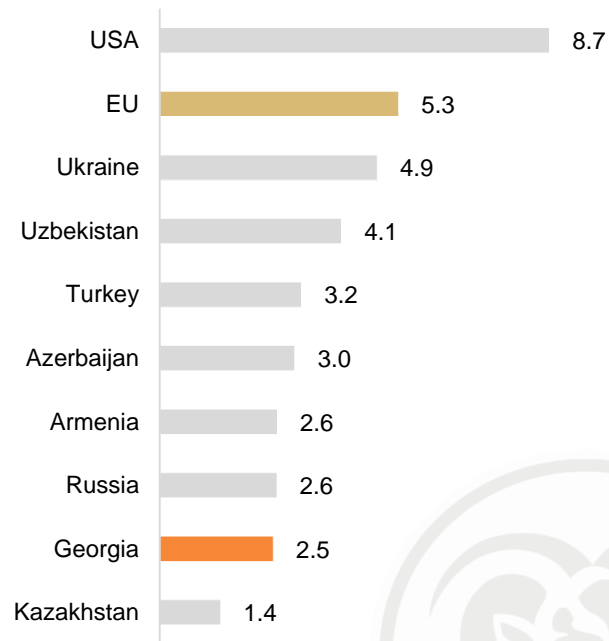
Land fragmentation and low productivity remain key challenges for the sector

Distribution of farms by land size, 2013-2014



Source: FAO, Eurostat, Geostat

Cereal yields, Ton/ha, 2018



Source: FAO, Eurostat, Geostat



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Pipeline of public and private projects in construction sector estimated at **\$20-25bn** over 2020-25



Residential real estate

\$ 8-10bn



Government infrastructure projects

\$ 4-5bn



Large private infrastructure projects

Including **\$ 2.5bn - Anaklia**



HPPs

\$ 4.0bn



Hotels

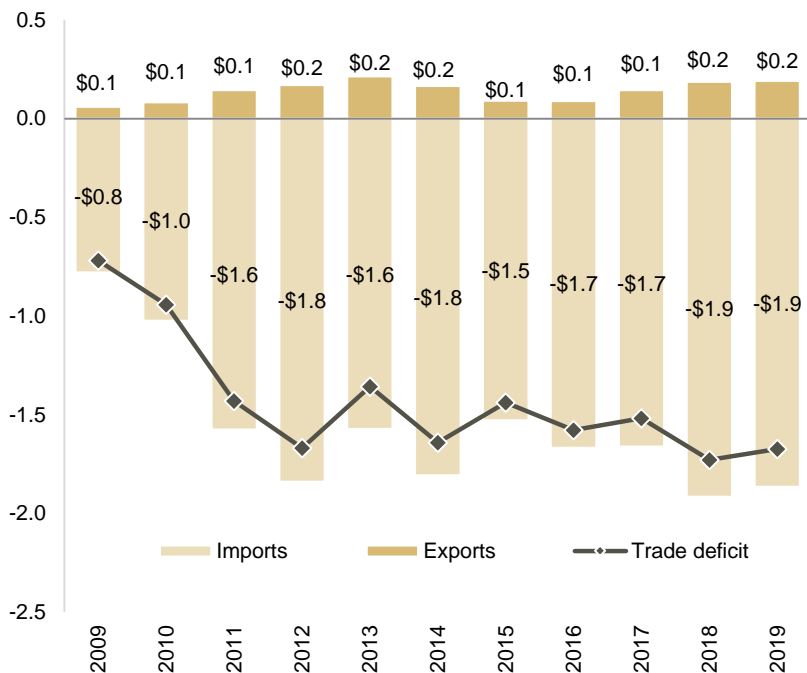
\$ 1.5-1.7bn

Source: GNTA, Ministry of Finance, Ministry of Economy and Sustainable Development, Galt & Taggart



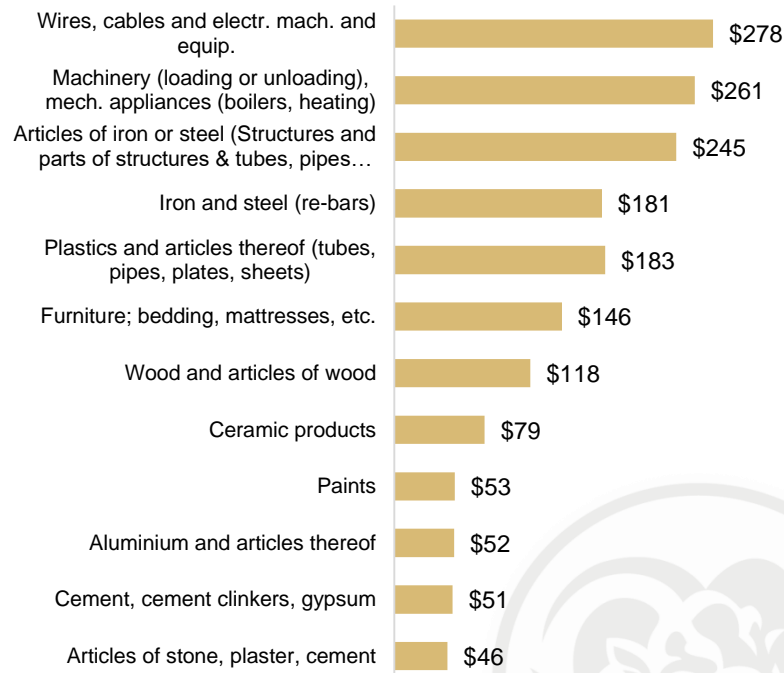
Construction sector is import-intensive with trade deficit at \$1.7bn or 32% of total trade deficit

Foreign trade with construction materials, US\$ bn



Source: Geostat, Galt & Taggart

Import structure, 2019, US\$ mn

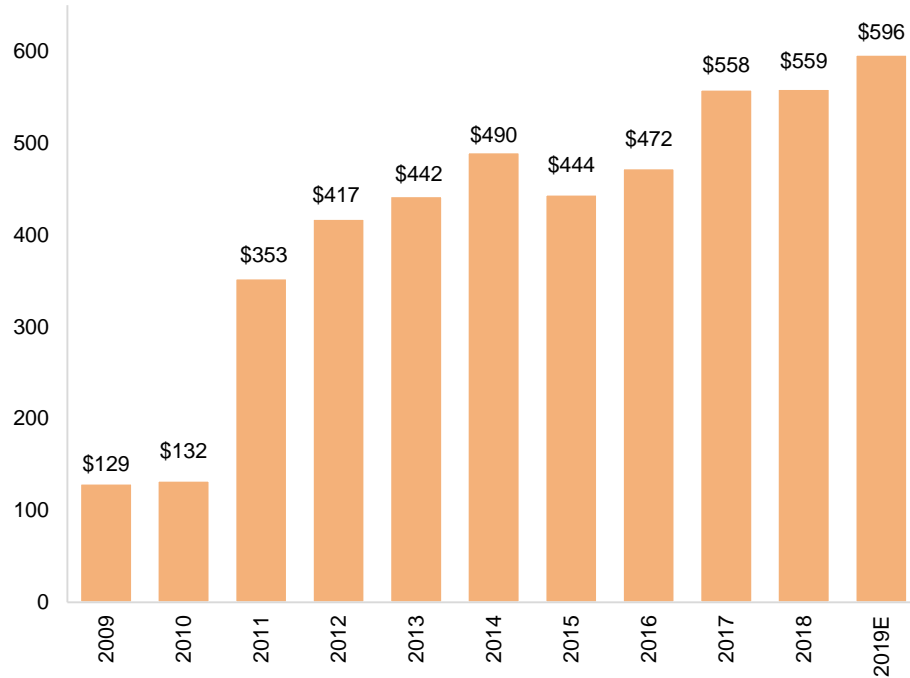


Of which:



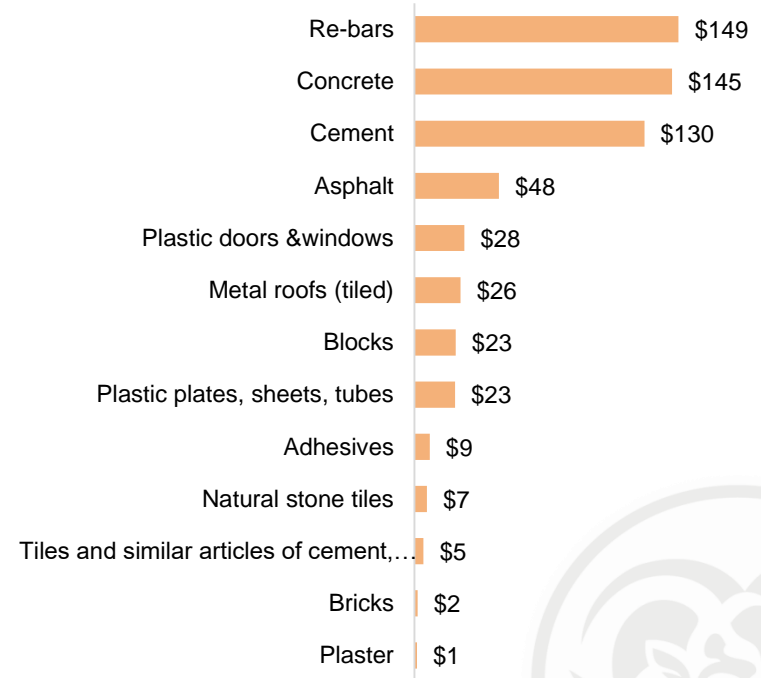
Local production of construction materials meets only 25% of total demand

Production of major construction materials, US\$ mn



Source: Geostat, Galt & Taggart

Detailed production 2019, US\$ mn



Of which:



Production potential in construction materials sector

- The pipeline of public and private investment projects in construction sector is estimated at US\$ 20-25bn for 2020-25, making enhancement of local production of construction materials feasible. Boosted local production will also facilitate exports
- We identified the following products with production potential :

Wires and cables	Re-bars	Plastic materials	Paints	Furniture
Electric water heaters	Articles of iron and steel	Wood materials	Ceramic products	Cement clinker

- **Circa US\$ 450mn of imports can be replaced by local production**

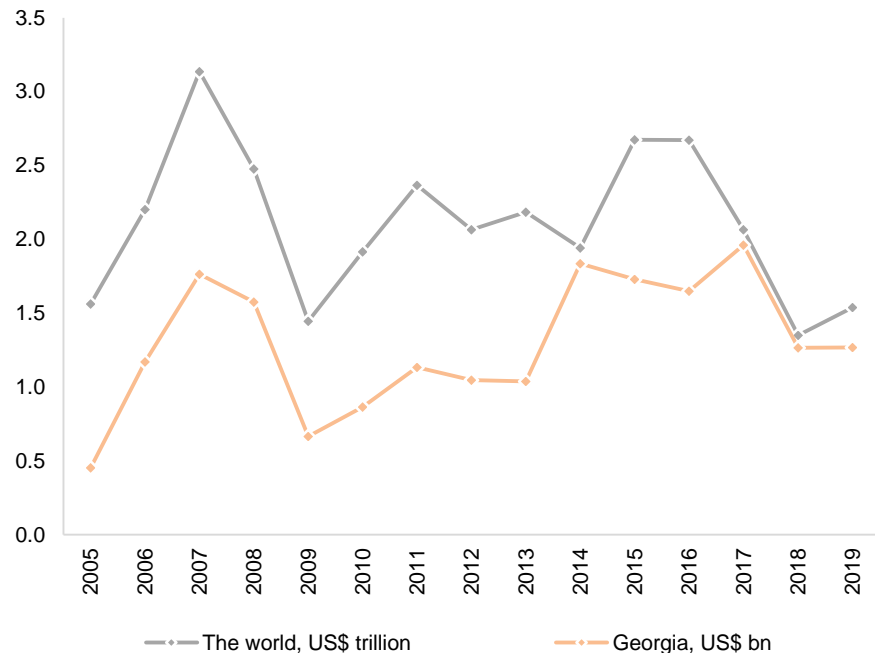


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FDI expected to decline significantly in 2020, particularly to developing countries

FDI dynamics globally and in Georgia



Source: Geostat, UNCTAD

Georgia can benefit from supply chain regionalization trends

- According to UNCTAD, FDI is expected to fall by 40% in 2020 globally and for the first time in 15 years, FDI will fall below US\$ 1 trillion
- The largest decline in FDI will be observed in developing countries
- In the context of Covid-19, rearrangement of supply chains is a hot topic
- According to Enodoconomics Reshoring Index, some sectors are more likely to diversify their supply chains (e.g. auto, electrical machinery, wood processing & products, etc.)



Georgia needs a new strategy to attract FDI

Georgia's competitive advantages

- Access to 2.3bn markets without customs duty
- Low taxes
- Low energy and labor costs
- Low corruption level
- Favorable business environment
- Free industrial zones
- Strategic location

Considering global value chain relocation & competitive advantages of Georgia, we have identified the following sectors to be targeted for FDI:



Textile, apparel and leather manufacturing



Manufacturing of automobiles & auto parts



Production of pharmaceuticals and other chemical products



Manufacturing of home electronics



Transport and logistics

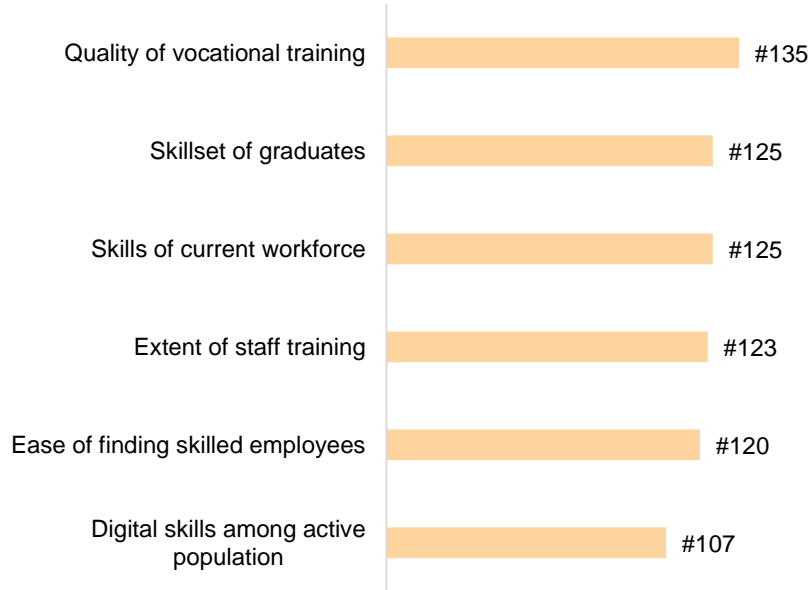


Business process outsourcing



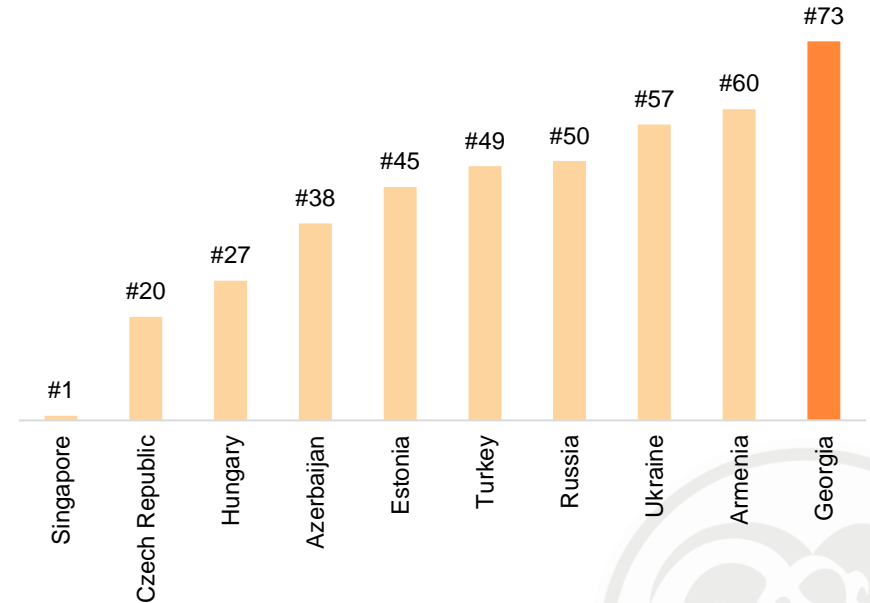
Improvement of workforce skillset and infrastructure is essential for enhancing Georgia's competitiveness globally

Georgia's workforce ranking in Global Competitiveness Index, out of 141 countries, 2019



Source: World Economic Forum
Note: 1st is the best, 141th is the worst

Georgia's infrastructure ranking in Global Competitiveness Index, out of 141 countries, 2019



Source: World Economic Forum
Note: 1st is the best, 141th is the worst
Includes air, land, sea and utility infrastructure



Roadmap to attract FDI – steps and investment proposal

Steps for attracting FDI

Identify international success stories

Identify sectors and potential investor countries

Identify list of target international companies

Prepare sector focused investment proposals

Launch ambitious and targeted communication strategy

Investment package is required to include incentives in the following areas:



Land / property



Tax benefits



Sectoral Industrial Zones /
Infrastructure



Target grants / financing of
employee trainings

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