

# Short-run risks and long-run challenges for wine production in Georgia

## - Summary of results -

German Economic Team Georgia



in cooperation with ISET Policy Institute

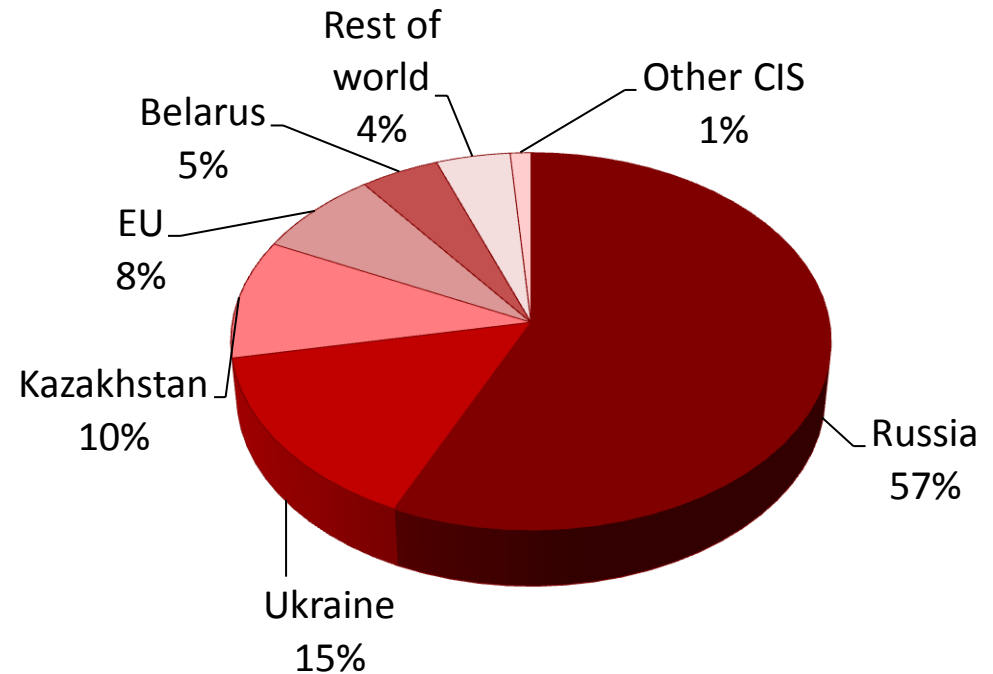
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Berlin/Tbilisi, May 2015

## Grape and wine production and exports

- Grapes account for 40% of fruit production
- 162 mt, 88% consumed domestically, mainly as wine (2008-2013)
- Wine 16% of agricultural exports, and over 4% of total exports (2013)
- Exports concentrated on CIS (88%) and especially Russia (57%)

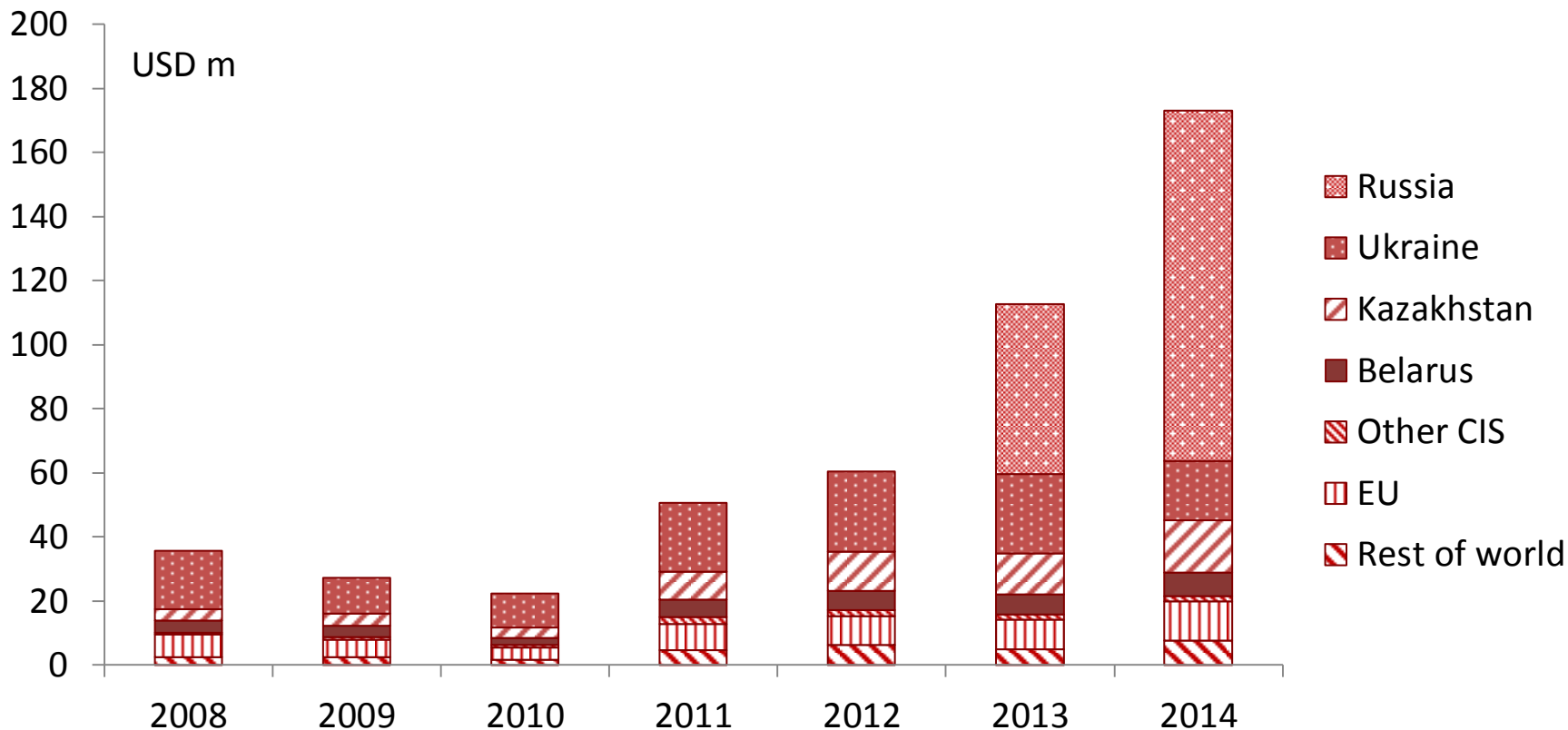
### Wine exports by destination (average of 2013 and 2014)



Source: Own calculations, Ministry of Finance of Georgia

## Exports to Russia are important but volatile

### Wine exports by destination, 2008-2014



Source: Own calculations, Ministry of Finance of Georgia

## Short-run risks facing Georgia's wine industry

Risk	Mechanism	Estimated reduction of wine exports to Russia (baseline 2014 exports)
1) Russia cancels free trade with Georgia	Wine import tariffs increase from 0% to 20% → prices in Russia increase → wine demand falls	18% (USD 20 m)
2) Economic contraction in Russia	Incomes in Russia fall by 2.9% to 4.6% (World Bank) → wine demand falls	5-10% (USD 5.5-11 m)
1) and 2) together	Tariff increases combines with lower incomes in Russia → wine demand falls	26% (USD 28.5 m, = 17% of total Georgian wine exports)

## Summary of short-run risks

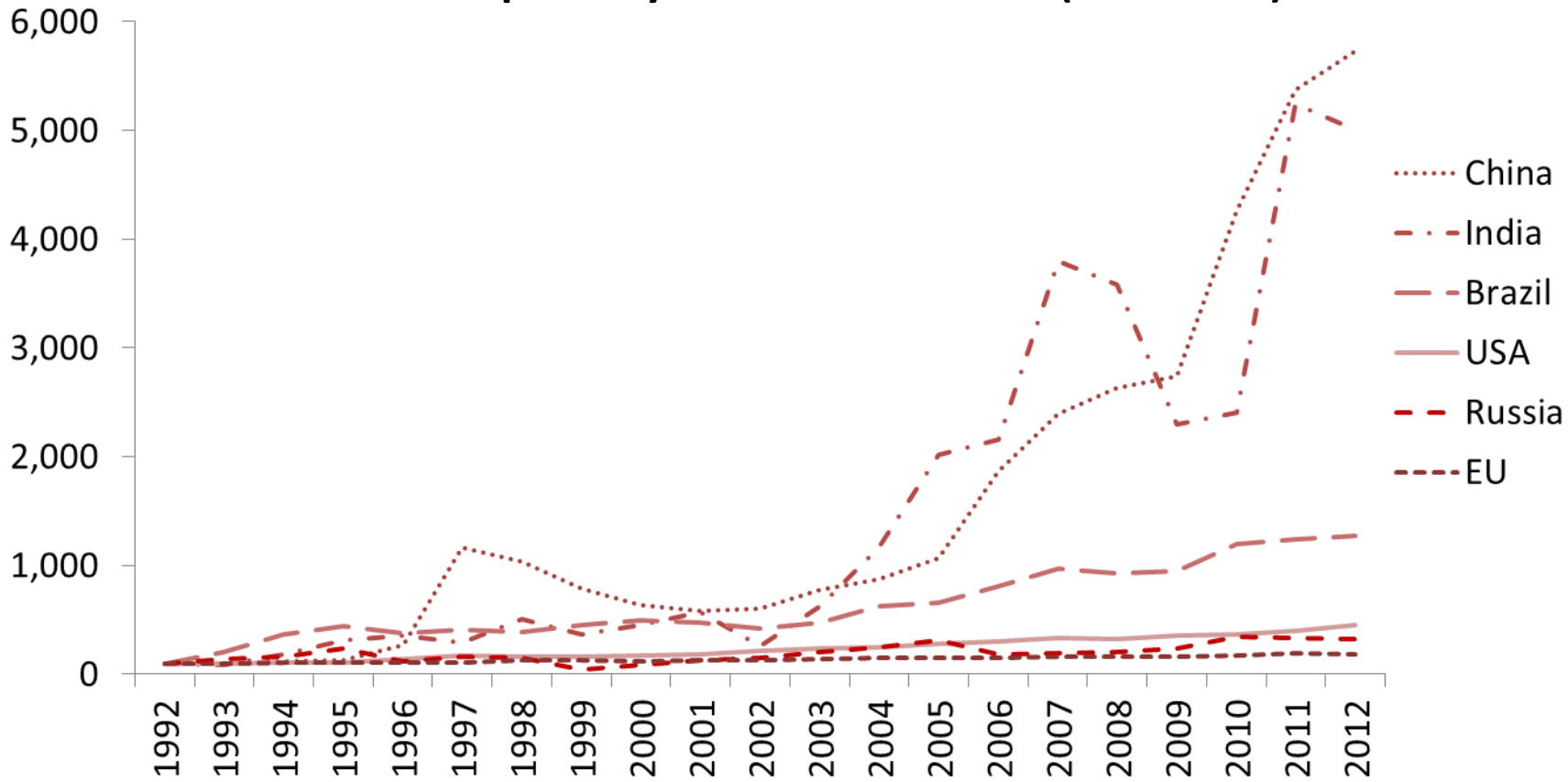
- 17% reduction in total wine exports would be a substantial loss
- Not devastating – would cut into but not reverse 2013 and 2014 growth in Georgian wine exports
- Exchange rate developments are an important unknown
  - Lari strengthened vis-à-vis Rouble in late 2014, but has recently weakened, restoring competitiveness
  - Georgian exports might even gain due to strengthening of the Euro vis-à-vis the Rouble
- Short-run risks largely uncontrollable

## Long-run challenges

- Regardless of their magnitude, short-run risks highlight the fundamental vulnerability of Georgian wine exports
  - Russian wine market is lucrative, but unreliable due to threat of trade restrictions
- Russia's population is ageing and shrinking (projected to fall from 142 million in 2015 to 121 million in 2050)
  - Russian wine market will stagnate and perhaps even decline in coming decades
- Strong incentives to diversify export markets for Georgian wine

# The most dynamic markets are outside Russia and CIS

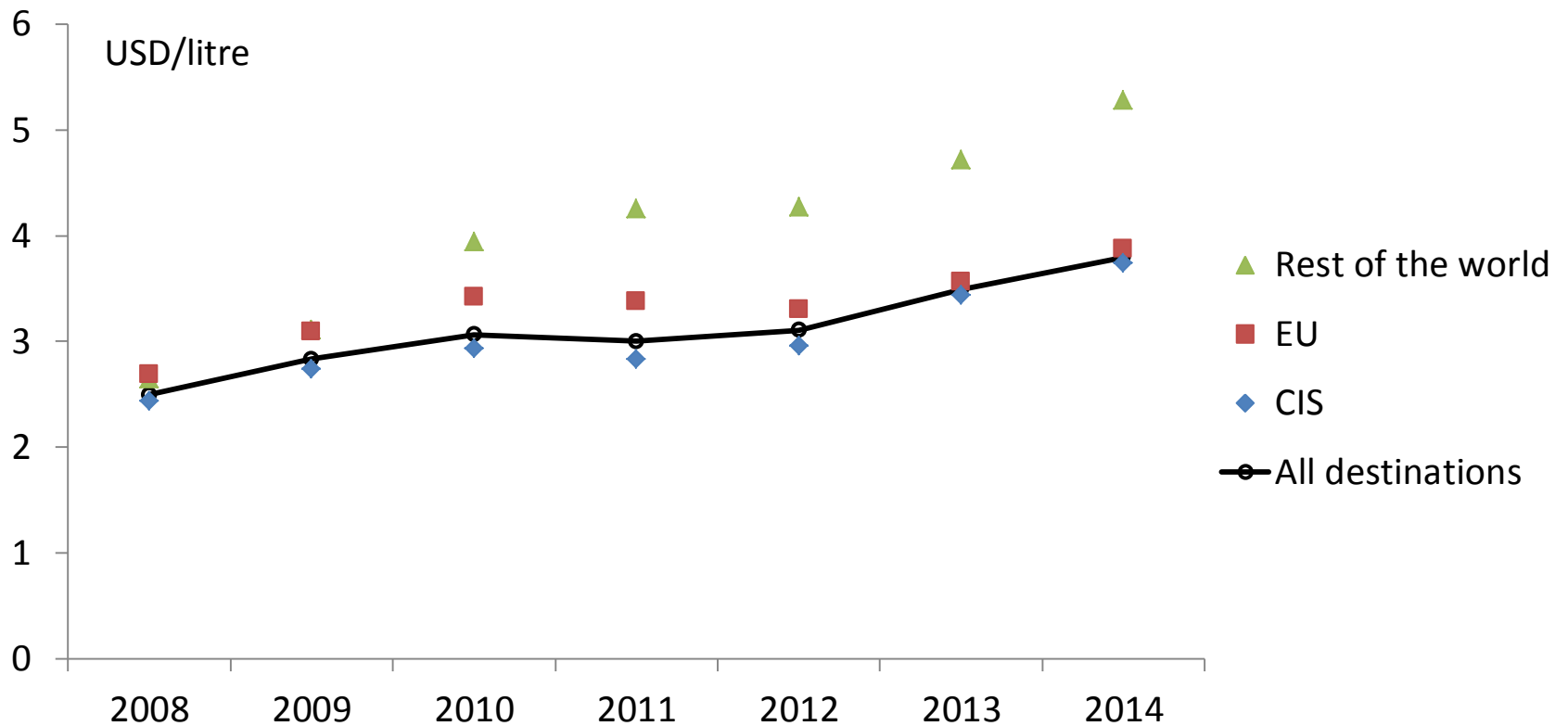
## Wine imports by selected countries (1992=100)



Source: Own calculations, FAOSTAT

## Georgia's wines fetch high prices...

### Average prices received for Georgian wine in different export markets

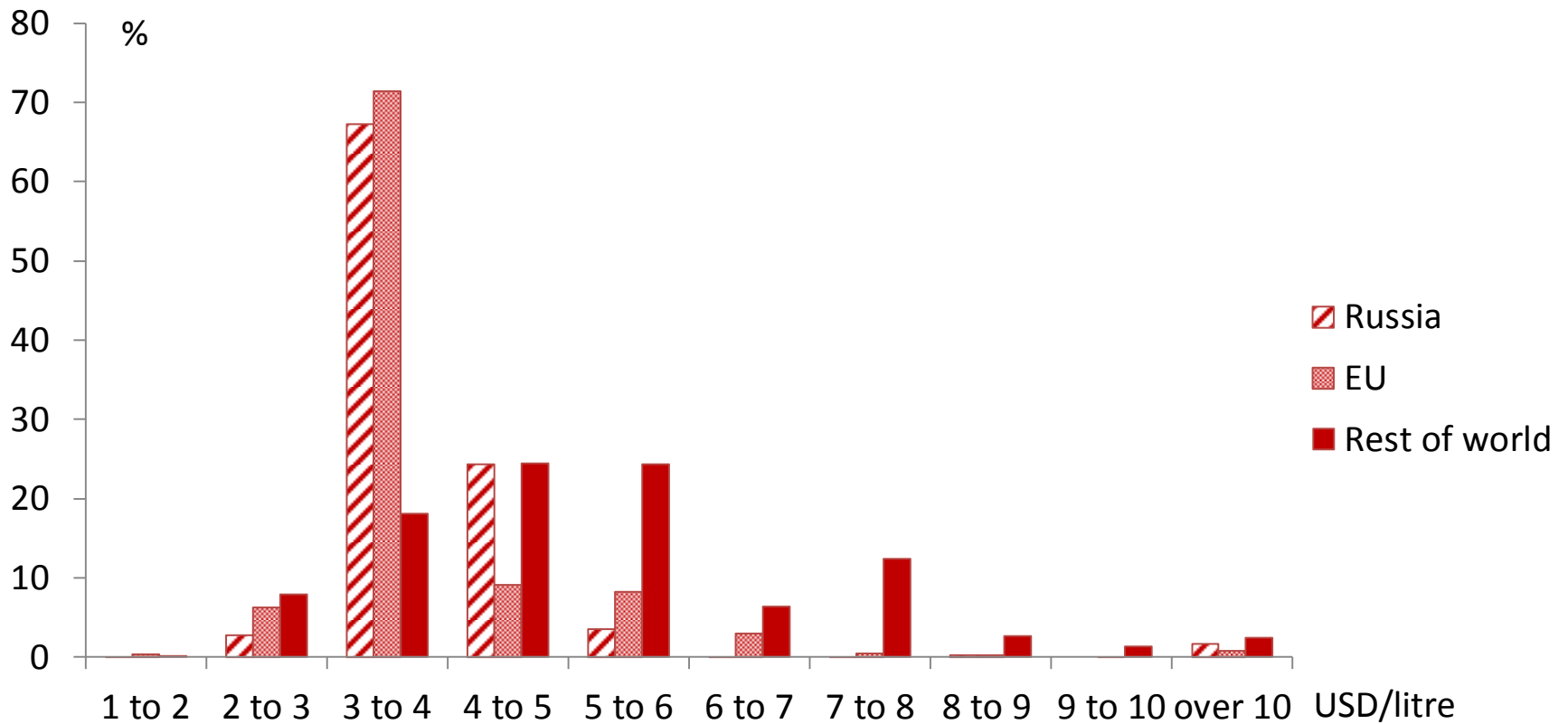


Source: Own calculations, Ministry of Finance of Georgia



## ... especially on non-CIS markets

### Shares of wine exports in different price ranges (2014)

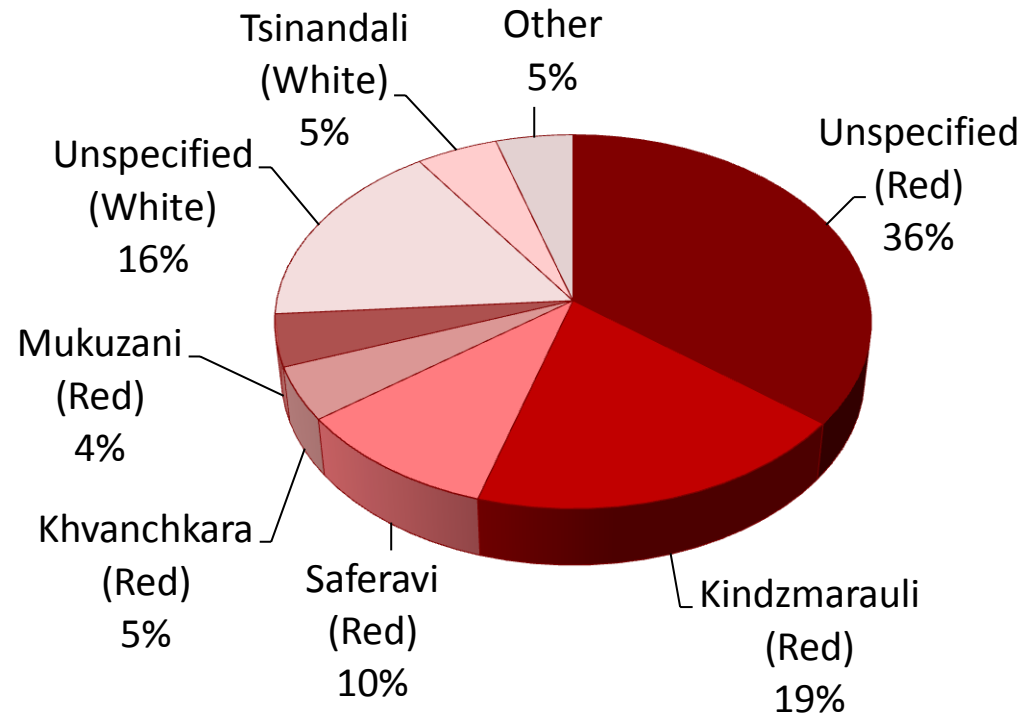


Source: Own calculations, FAOSTAT

## Georgia is locked-in to Russian and CIS markets

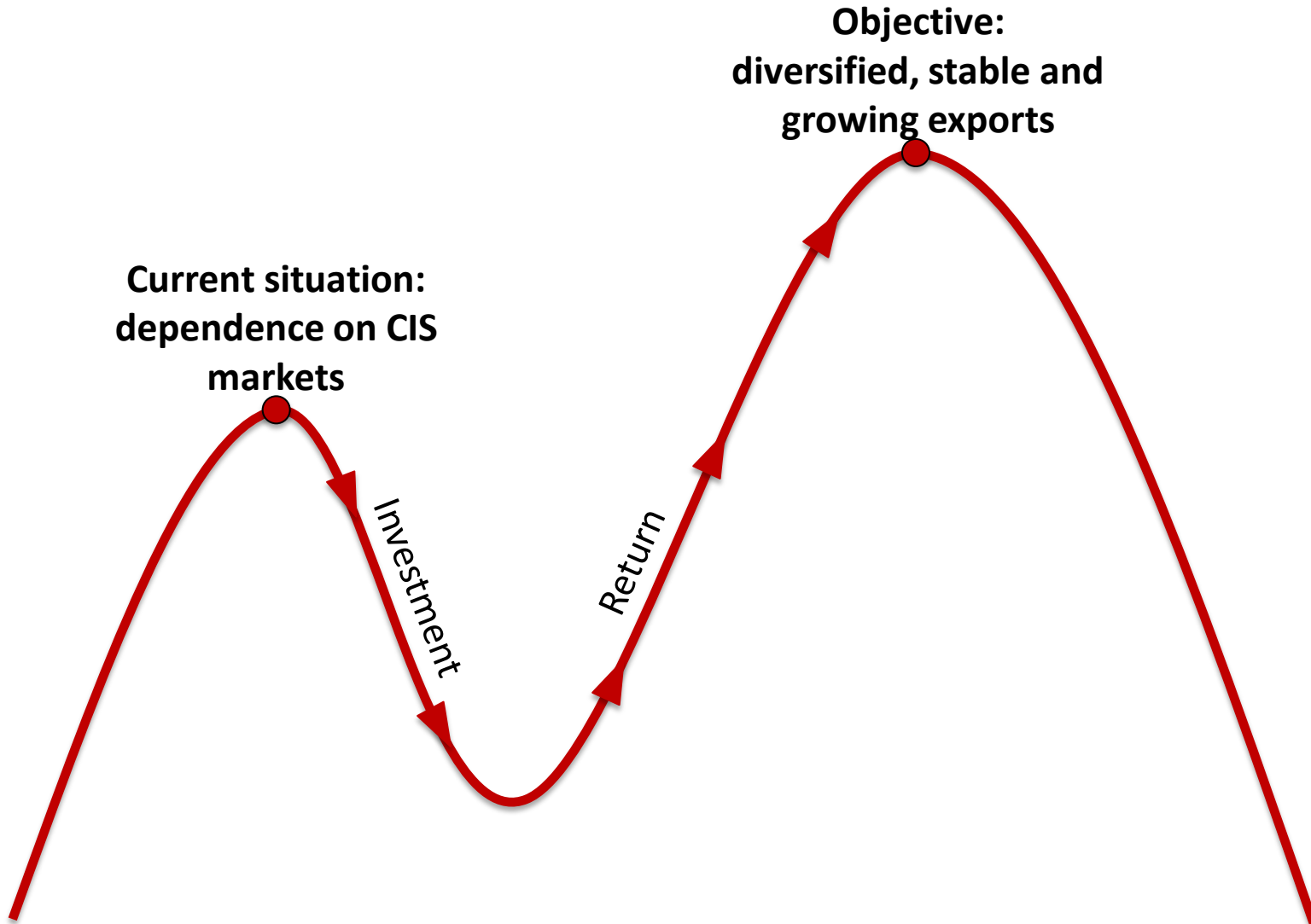
- Grape production fragmented in many small operations
- Dominance of unlabelled wines for own consumption
- Winemakers cannot secure reliable supplies of grapes
- Most indigenous varieties little known outside CIS
- Costs of adopting new grape varieties and winemaking technologies are high

### Wine exports by variety (2013-14)



Source: Own calculations, Ministry of Finance of Georgia

# The challenge of lock-in



## Recommendations

- Implementation of a quality control system that targets selected wines destined for new export markets
  - No unnecessary compliance costs for those who supply traditional markets
  - Strict observance, no leakage!
- Continuation of the National Wine Agency's international marketing activities
- Strengthen investments in education and research on grape growing and winemaking (international partners)
- Foster vertical integration in the wine supply chain
  - Cooperation between grape growers, and delivery contracts between grape producers and winemakers
  - Ultimately winemakers will own vineyards

## Summary

- Short-run risks are substantial, not devastating, uncontrollable
- Long-run challenges of dependence on a volatile and stagnant market can be addressed
- Need to diversify export destinations
  - Take advantage of growing non-CIS markets
  - Fetch higher prices
- Recommendations
  - Establish separate and strict quality control system
  - Foster development of wine varieties suited to non-CIS markets
  - Invest in education and research on grape growing and winemaking
  - Provide incentives for increased vertical integration between grape growers and winemakers

## Contact

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