



**German Economic Team Georgia**

in cooperation with



**ISET Policy Institute**

Policy Paper Series [PP/03/2015]

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

Stephan von Cramon-Taubadel, David Saha

Berlin/Tbilisi, May 2015

## **About the German Economic Team Georgia**

---

The German Economic Team Georgia (GET Georgia) advises the Georgian government and other Georgian state authorities such as the National Bank on a wide range of economic policy issues. Our analytical work is presented and discussed during regular meetings with high-level decision makers. GET Georgia is financed by the German Federal Ministry for Economic Affairs and Energy. Our publications are publicly available at our website ([www.get-georgia.de](http://www.get-georgia.de)).

### **German Economic Team Georgia**

c/o Berlin Economics

Schillerstr. 59

D-10627 Berlin

Tel: +49 30 / 20 61 34 64 0

Fax: +49 30 / 20 61 34 64 9

E-Mail: [info@get-georgia.de](mailto:info@get-georgia.de)

<http://www.get-georgia.de>

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

### Executive Summary

Georgia's wine industry is heavily dependent on export to CIS countries and especially Russia. Two main short-run risks associated with the Russian market prevail for Georgian wine exports at present:

1. Russia might cancel its free trade agreement with Georgia. This would reduce the demand for Georgian wine in Russia by 18%, or USD 20 m based on 2014 exports.
2. The economic slowdown in Russia could lead to reduced demand for wine. We estimate that this could reduce demand for Georgian wine by 5%, and at most 10%, or USD 5.5 to 11 m.

These short run risks are substantial but manageable. Reduced demand due to the economic slowdown combined with a cancellation of free trade with Russia would reduce total Georgian wine exports by USD 28.5 m or 17%, but still leave them much higher than their average level in recent years.

In the long run, the Russian wine market is likely to stagnate or even decline as the Russian population shrinks and ages. Hence, steps should be taken to reduce the dependence on this market and diversify exports. A corresponding strategy needs to take into account several factors that reinforce the current dependence on Russian and other CIS markets. These include the brand premium currently enjoyed by Georgian wines on CIS markets, the quality challenges arising from the production structure of grapes with hundreds of thousands of small farmers, and the high up-front costs of switching to new grape varieties and of introducing new winemaking technologies and quality certification systems

We recommend several measures to expand exports to non-CIS markets:

1. A strict quality control and certification system should be established that targets selected wines destined for new export markets and does not create high compliance costs for wines aimed at traditional domestic and CIS export markets.
2. To increase the brand recognition of Georgian wines in new export markets, the National Wine Agency's international marketing activities should be continued. In addition, much more attention should be given to education and research, also in cooperation with international partners.
3. Georgian wine production is characterised by a lack of vertical integration and a pre-eminence of small-scale grape production. Internationally, the fully vertically integrated model in which the winemaker also owns the vines is most common. Vertical integration through delivery contracts with grape producers and cooperation between grape growers are alternative models for Georgia while a gradual process of consolidation of vineyards takes place.

### Authors

Prof. Dr. Stephan von Cramon-Taubadel

scramon@gwdg.de

David Saha

saha@berlin-economics.com

+49 30 / 20 61 34 64 0

### Acknowledgements

The authors would like to thank Ia Katsia for excellent research assistance and are highly grateful to Hilarius Pütz and Patrick Honnef for comments and suggestions.

## Contents

1	Background.....	5
2	Short-run risks.....	7
3	Long-run challenges .....	9
4	Expanding exports to non-CIS countries .....	14
4.1	Ensuring strict quality control for wines destined for non-CIS markets .....	14
4.2	Assisting producers through public research and training institutions .....	15
4.3	Dealing with small vineyards in a competitive wine sector .....	16
5	Conclusions.....	17

## 1 Background

Grape and wine production are important economic activities in Georgia. Fruits and vegetables are a mainstay of Georgian agriculture, and grapes account for roughly 40% of the country's fruit production. Between 2008 and 2013, Georgia produced an average of roughly 162 thousand tons of grapes annually, of which 88% were consumed domestically, mostly in the form of wine (Table 1).

**Table 1**

Official data on grape production and use in Georgia (2008-2013, in thousand tons)

Year	2008	2009	2010	2011	2012	2013	Avg.	Share of supply/use (%)
Production**	176	150	121	160	144	223	162	99
Imports*	2	1	2	1	1	1	1	1
<b>Total supply</b>	<b>178</b>	<b>151</b>	<b>123</b>	<b>161</b>	<b>145</b>	<b>224</b>	<b>163</b>	<b>100</b>
Domestic consumption	153	145	138	143	147	132	143	88
<i>as grapes</i>	13	7	9	8	9	10	9	6
<i>as wine*</i>	140	138	129	135	138	122	134	82
Exports*	28	25	32	37	32	52	34	21
Waste	5	5	4	5	4	7	5	3
Change in stocks*	-8	-24	-51	-24	-38	33	-19	-12
<b>Total use</b>	<b>178</b>	<b>151</b>	<b>123</b>	<b>161</b>	<b>145</b>	<b>224</b>	<b>163</b>	<b>100</b>

\* These items refer to wine converted into grape equivalents.

\*\*According to preliminary data grape production was 226 thousand tons in 2014.

Wine is also vital social and cultural factor in Georgia. Almost one-half of the Georgian population is employed in agriculture. Over 90% of Georgia's grapes are produced by family farms that have an average size of less than 1.5 hectares. Essentially all of these households grow grapes and produce wine for own consumption, family and friends, which explains the dominant share of domestic consumption in total supply displayed in Table 1. Furthermore, Georgians are proud of their country's history as the cradle of wine, looking back on eight millennia of wine production and cultivating as many as 500 indigenous varieties of grape.

Even though most of the grape production in Georgia ends up being consumed domestically as wine, the roughly 20% that ends up being exported plays an important role.<sup>1</sup> Wine accounted for 17% of Georgia's total agricultural exports between 2008 and 2013; in 2013 Georgia exported roughly USD 122 m of wine, which accounted for 16 % of the country's agricultural exports and slightly over 4% of its total exports. Hence, wine exports represent an important source of foreign currency revenues for agriculture and for the Georgian economy as a whole. Furthermore, since much of the grape harvest is processed into wine for own use and not marketed commercially, demand for export wines, and the corresponding

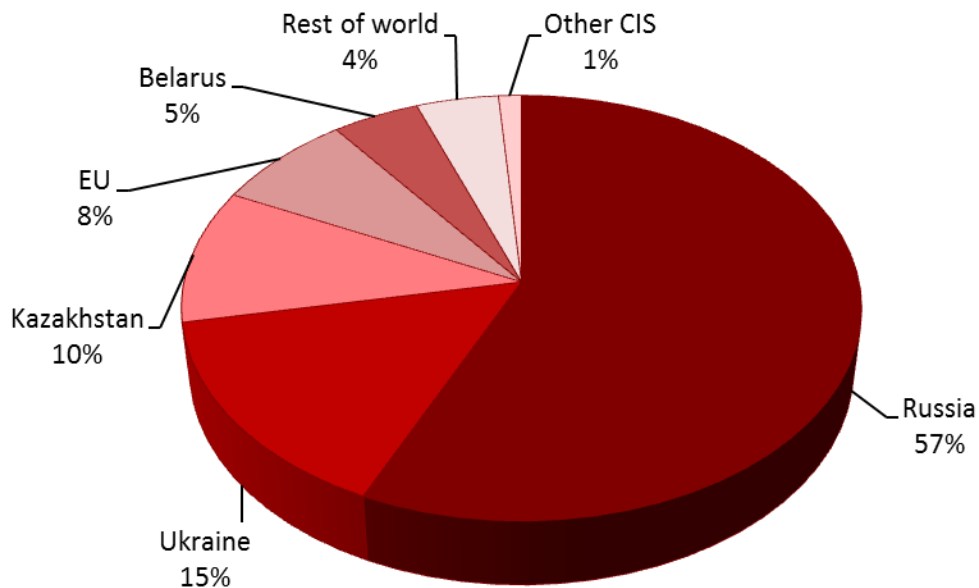
<sup>1</sup> Note that in Table 1 domestic consumption plus exports add up to more than total supply. This is because Georgia's stocks of wine have been drawn down considerably between 2008 and 2013. 2013 was the first year in that period in which stocks grew again.

derived demand for grapes that are processed into export wine, has an important influence on domestic grape prices.

Georgia's wine exports depend heavily on markets in the Commonwealth of Independent States (CIS) and specially Russia. On average in 2013 and 2014, 88% of Georgia's wine exports went to CIS countries, with Russia alone accounting for 57%, and the EU and the rest of the world for only 8% and 4%, respectively (Figure 1).

**Figure 1**

Georgian wine exports by destination (average of 2013 and 2014)

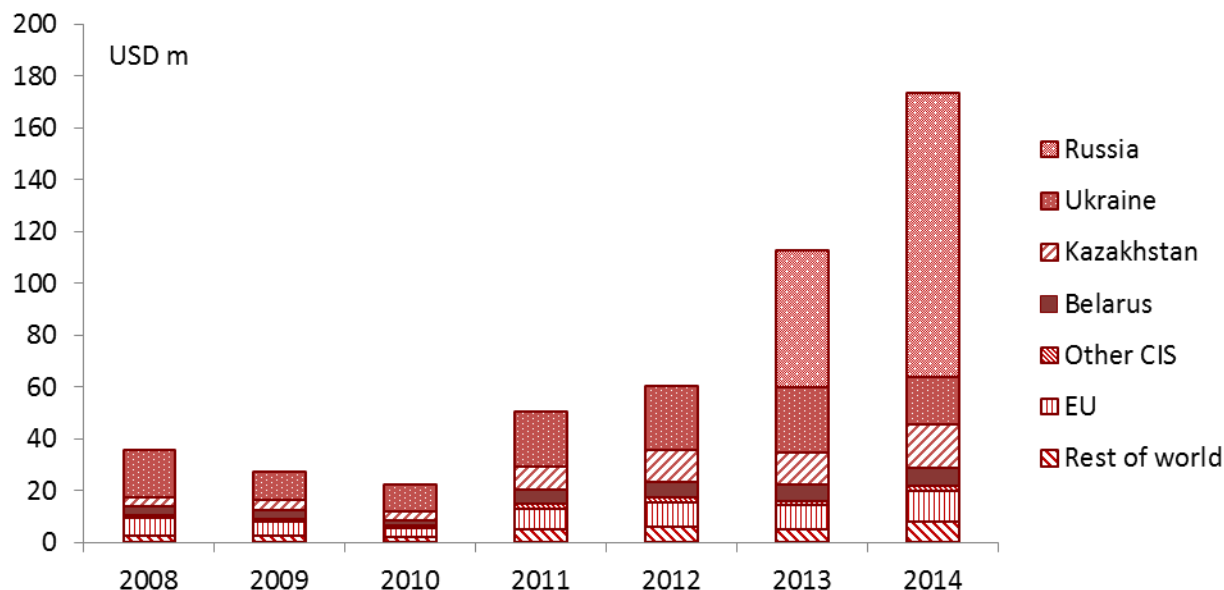


*Source: Own calculations, Ministry of Finance of Georgia*

Dependence on a small number of export destinations makes the Georgian wine industry vulnerable to trade disruptions. This vulnerability was acutely felt when Russia imposed a ban on Georgian exports of alcoholic beverages and bottled water in March 2006. Wine's share of Georgia's total exports fell from over 5% in 2005 to less than 1.5% by 2010. The value of wine exports averaged roughly USD 39 m per year between 2008 and 2012, but when the Russian ban was lifted in 2013, wine exports rebounded to over 4% of total exports and an average value of USD 143 m in 2013 and 2014 (Figure 2).

**Figure 2**

Georgian wine exports by destination (2008-2014)



Source: Own calculations, Ministry of Finance of Georgia

Georgia's dependence on the CIS and in particular the Russian wine market creates short-run risks and long-run challenges for its wine industry. In the short run there is concern about two possible threats: the threat of new trade restrictions, and the threat of a possible reduction in Russia demand for Georgian wine due to the current economic slowdown in Russia and, possibly related, a devaluation of the Russian Rouble vis-à-vis the Georgian Lari. In the long run there is reason to be concerned that the Russian wine market will stagnate or even shrink, and that continued concentration on this market will distract attention from the opportunities presented by growing wine markets elsewhere in the world. In the following we discuss these short-run and long-run challenges in greater detail.

## 2 Short-run risks

Relations between Georgia and Russia remain strained, and the imposition of renewed restrictions on Georgian exports to Russia is a distinct possibility. Short of reintroducing a complete ban on imports of Georgian wine, one threat that has been discussed in recent months is that Russia could cancel or suspend its current free trade agreement with Georgia. If this were to happen, the Russian import tariff on wine from Georgia would increase from 0% to 20%. Russia imported USD 110 m of Georgian wine in 2014 (Figure 2), and simulations suggest that this volume would have been roughly USD 20 m or 18% lower, if a 20% tariff had been in place.<sup>2</sup> Therefore, cancellation of the free trade agreement with Georgia would certainly lead to a substantial reduction in Georgian wine export revenues. On the other

<sup>2</sup> These calculations are based on an assumed price elasticity of import demand for wine in Russia of -0.9. According to this assumption, if the price of imported wine increases by 10%, demand for this wine will fall by 9%. This estimate of the demand reaction in Russia is taken from the TRAINS/WITS database.

hand, however, Georgian exports to Russia grew by roughly USD 52 m in 2013 and by another USD 61 m in 2014. Cancellation of free trade would therefore cut into recent and possible future growth in wine trade with Russia, but by no means lead to a collapse of this trade.

Another short-run risk that concerns stakeholders in the Georgian wine industry is that Russian demand for imported wine could contract significantly due to the current economic crisis in Russia. At first glance the effects of such a contraction in Russian demand could be considerable. For example, Ukrainian imports of Georgian wine fell by 26% from USD 24.9 m to USD 18.4 m between 2013 and 2014 as the Ukrainian economy went into recession (Figure 2). There is concern that economic contraction in Russia could reduce Russian imports of Georgian wine by a similar proportion, but that this reduction would be much more important in absolute terms, as Russia imports much more wine from Georgia than Ukraine.

However, the prospects are perhaps not as dire as they first appear. In a meta-analysis of 141 published empirical studies of the demand for alcoholic beverages, Fogarty<sup>3</sup> finds that the average income elasticity of demand for wine equals 1.1, meaning that if income falls by 1%, demand for wine will fall by 1.1%. The World Bank<sup>4</sup> is projecting a contraction of Russian GDP of between 2.9 and 4.6% in 2015, which would therefore lead to a reduction in demand for wine of between 3.2 and 5%. Since most of the estimates that Fogarty uses to calculate the average elasticity of 1.1 were calculated for high-income countries, this is likely an underestimate of the effect that an income contraction would have on demand for wine in Russia, where the income elasticity of demand for wine is likely larger. But even if this elasticity in Russia were twice as high as the average reported by Fogarty (i.e. 2.2 rather than 1.1), wine demand in Russia would fall by no more than 10%, and not 26% as was the case in Ukraine.

A key difference is that the Ukrainian economy contracted more than 8% in 2014, which is considerably more decline than is projected for Russia in 2015. Furthermore, the demand for Georgian wine is not determined by income alone. Exchange rates also play an important role. Throughout 2013, the exchange rate between the Ukrainian Hryvnia (UAH) and the Georgian Lari (GEL) was stable at roughly 5 UAH/GEL. In the course of 2014 the Hryvnia devalued sharply, however, falling to over 8 UAH/GEL in the fourth quarter. This devaluation of the Hryvnia made Georgian wine considerably more expensive in Ukraine and compounded the effect of falling incomes in Ukraine on the demand for Georgian wine. Hence, the observed 26% reduction in Ukrainian demand for Georgian wine resulted from a combination of income and exchange rate effects.

The exchange rate between the Russian Rouble (RUB) and the Georgian Lari has developed differently, however. From 2011 to mid-2014 this exchange rate was relatively stable at 18-20 RUB/GEL. But in mid-2014 it began to increase, peaking at roughly 33 RUB/GEL in January and February 2015. The combination of a weak Russian economy and a strong Lari vis-à-vis the Rouble would have doubly burdened Georgian exports of wine to Russia, perhaps leading to a contraction as large as that experienced in the case of Ukraine. But since the beginning of this year the exchange rate has fallen again to currently roughly 21 RUB/GEL, thus restoring the competitiveness of Georgian wine on the Russian market. Indeed, if the Lari

---

<sup>3</sup> Fogarty, J. (2008): The demand for beer, wine and spirits: Insights from a meta-analysis approach. American Association of Wine Economists Working Paper No. 31. [www.wine-economics.org](http://www.wine-economics.org).

<sup>4</sup> The World Bank (2015): Russia Economic Report No. 33, The World Bank, Washington, D.C.



remains weaker vis-à-vis the Rouble than the currencies of other wine exporting countries (e.g. Spanish, Portuguese, French, Italian and German wines are priced in Euro), then wine imports from Georgia might fall less than Russian wine imports overall, or even increase slightly, as Russian consumers switch from other imported wines to Georgian wines.

In summary, barring the reintroduction of a complete ban on wine imports from Georgia by the Russia, the short-run risks to the Georgian wine industry that stem, first, from possible cancellation of the current free trade agreement and, second, from the economic slowdown in Russia, are significant but not devastating. The combination of an increase in the Russian tariff on imports of wine from Georgia and a contraction in Russian demand for wine due to the economic crisis could reduce exports of wine to Russia by around 26% (18% due to the tariff combined with 10% due to lower incomes in Russia). Based on 2014 export data, this would be equivalent to a reduction in exports of USD 28.5 m, or roughly 17% of total wine exports in 2014. This would be a painful loss, but even with this loss, Georgia's wine exports in 2014 would still have been by far the highest in recent years (see Figure 2).

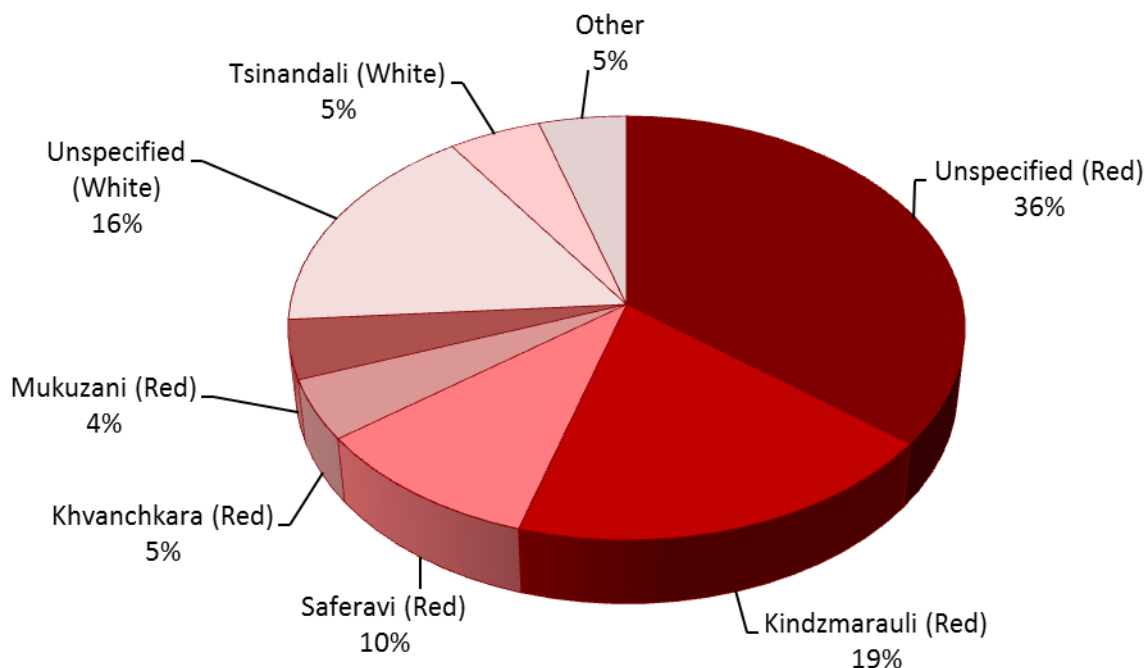
### **3 Long-run challenges**

Regardless of the magnitude of the short-run risks discussed above, they draw attention to the fact that Georgian wine exports are highly dependent on Russia and other CIS markets. This dependence is primarily a result of two “home market biases” (Anderson<sup>5</sup>). First, there is a strong tradition of drinking unlabelled wines with meals in Georgia, and this wine accounts for the majority of all grapes produced in the country (see Table 1). Second, the labelled wines that Georgia does produce are not widely known outside of the CIS, and they satisfy a demand for varieties of semi-sweet wine that is quite unique to the CIS region. Over 50% of the wine that Georgia exports is recorded in trade statistics as “unspecified”, and the rest is composed of varieties such as Kindzmarauli, Saferavi and Tsinandali that most consumers outside the CIS would not recognise (Figure 3). Indeed, while definitive data are not available, it is safe to assume that a significant share of Georgia's modest wine exports to the EU (see Figures 1 and 2) are consumed by members of the Georgian and CIS diaspora in these countries, who share a taste for these varieties.

---

<sup>5</sup> Anderson, K. (2013): Is Georgia the next ‘new’ wine-exporting country? Robert Mondavi Institute Center for Wine Economics, Working Paper No. 1301, University of California at Davis.

**Figure 3**  
Georgian wine exports by variety (2014)



Source: Own calculations, Ministry of Finance of Georgia

Georgia's manifest competitiveness on the unique CIS wine market has one important advantage: Georgia receives comparatively high prices for its wine exports to this region. The average price (unit value) of exported Georgian red wine was roughly 4 USD/litre in 2014 (Figure 4). According to Anderson, Georgia wines receive prices that are "among the highest in the world and well above those of other New World exporters and transition economies".<sup>6</sup> This might surprise those who associate Georgian wines with lower quality, but it only goes to show that quality is ultimately defined by the consumer, and that preferences for food and beverages are complex, heterogeneous cultural constructs. The preferences for Georgian wines in the CIS region are strong, and the willingness to pay for these wines is correspondingly high.

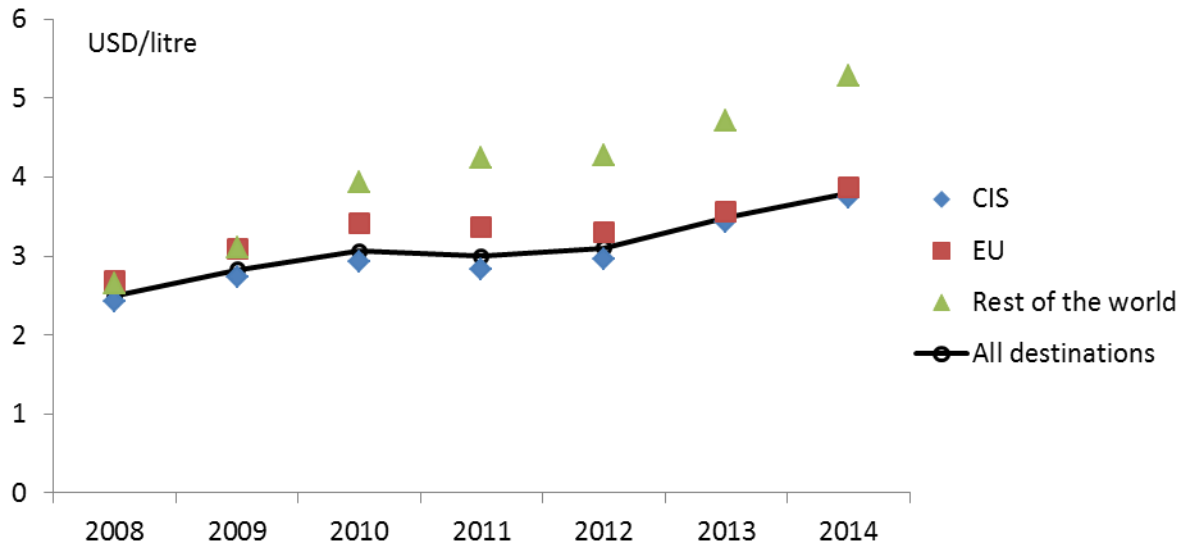
Georgia's dependence on the CIS and in particular the Russian wine market is, however, also associated with disadvantages. The Russian market in particular is vulnerable to disruption, as evidenced by the history of past trade interventions and current concerns over the possible renewal of these interventions. Hence, the Russian wine market is lucrative, but volatile. Furthermore, the prospects for the long-run development of the Russian market are not encouraging. The FAO projects that the population of the Russian Federation will fall from roughly 142 million individuals in 2015 to 134 million in 2030 and 121 million in 2050. A shrinking and ageing population implies a declining market for wine. Imports of wine by Russia have already grown less rapidly than imports by many other countries and regions in recent decades; Figure 5 shows that wine imports by other BRIC countries have grown faster

<sup>6</sup> Anderson (2013) p. 9.

since 1992 than Russian wine imports. Some of these markets (e.g. India) are still very small in absolute terms, but they nevertheless offer more growth potential than the Russian market.

**Figure 4**

Average unit values of Georgian wine exports by destination (red and white wines, 2008-2014)

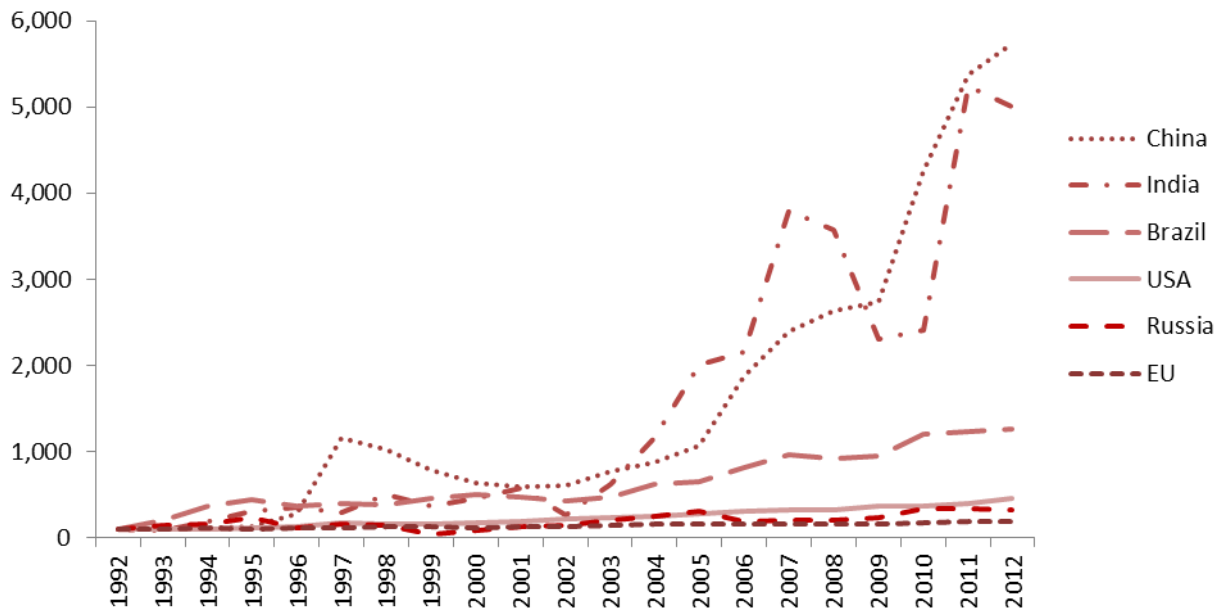


Source: Own calculations, Ministry of Finance of Georgia

Finally, while it was stated above that Georgia receives high average prices for its wine exports overall, the export price data displayed in Figure 4 indicates that it receives higher prices in the EU and especially in the rest of the world than it does in Russia. A more detailed breakdown of these data for 2014 reveal that wines exported to Russia are largely concentrated in the 3-4 and 4-5 USD/litre mid-range prices (Figure 6). Most Georgian exports to the EU are in the 3-4 USD/litre range, but the EU imports considerably more Georgian wines that fall into the 5-6 and 6-7 USD/litre ranges than Russia does. The rest of the world imports a disproportionately little wine in the 3-4 and 4-5 USD/litre ranges from Georgia; instead, almost 50% of the wine that the rest of the world imports from Georgia is priced at 5 USD/litre and higher. This suggests that sub-markets for higher-priced premium wines are better developed outside of Russia, or that Georgia has been more successful in tapping these markets in the EU and in the rest of the world than in Russia. While these higher-priced wines currently account for only small shares of Georgia's total wine exports, they represent markets with considerably more growth potential than the Russian market for mid-range wines.

**Figure 5**

The development of wine imports in selected countries (1992-2012, 1992=100)



Source: Own calculations, FAOSTAT

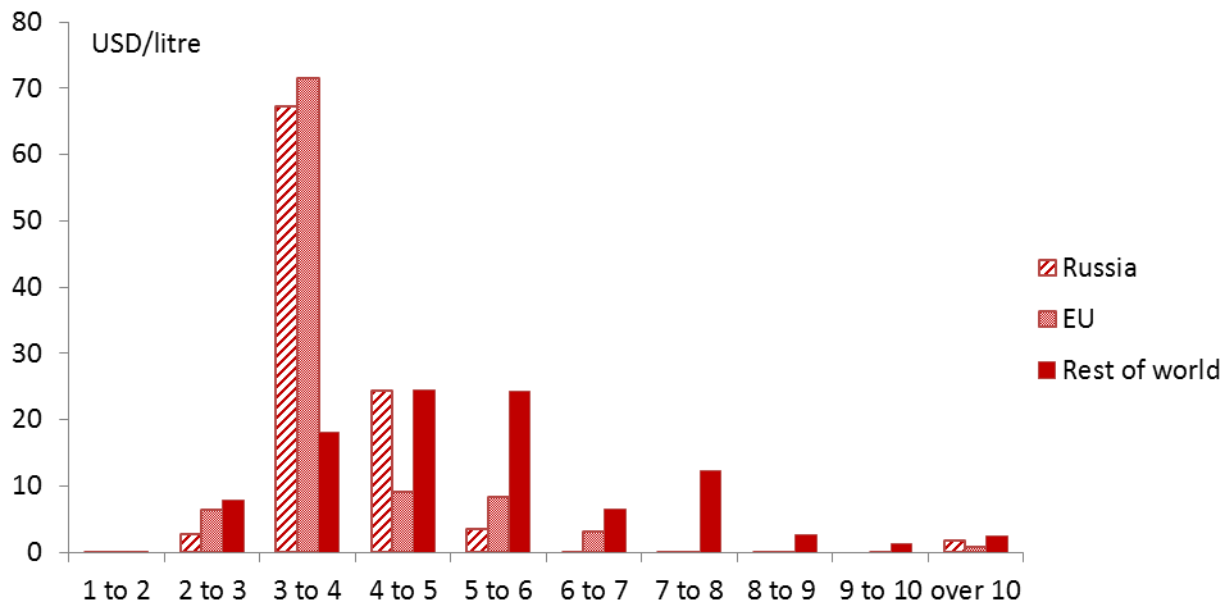
The home market biases described above, and the resulting Georgian dependence on Russian and other CIS wine export markets, are path-dependent outcomes of history. Sometimes the path of history leads to an outcome that is both difficult to change (“locked in”) and sub-optimal. One example that is often cited is the QWERTY-keyboard. There is evidence that the QWERTY-keyboard is sub-optimal because there are alternative keyboard configurations that would enable people to type more rapidly and with fewer errors.<sup>7</sup> However, by historical chance the QWERTY-keyboard became dominant, and the fact that essentially all users are accustomed to it creates a powerful lock-in effect.

In the case of the Georgian wine industry, dependence on the Russian and CIS markets is associated with the short-run risks and long-run challenges discussed above; exports to these markets are volatile and vulnerable, and it is likely that these markets will stagnate or even shrink in the future. Hence, dependence on Russian and CIS markets is sub-optimal, and threatens to become increasingly so in the future. For this reason, steps should be taken to reduce this dependence and diversify Georgian wine exports. However, several factors lock in the current dependence on the Russian and CIS markets. One such factor is the structure of the Georgian wine industry which is based on traditional varieties and hundreds of thousands of small grape producers who produce largely for own consumption. This makes it difficult for winemakers to secure dependable supplies of homogeneous, traceable, high-quality grapes. Other factors that lock in the current dependence on Russia and the CIS are the high up-front costs of switching to new grape varieties, of introducing new wine production technologies and quality certification systems, and of penetrating new markets outside of the CIS region.

<sup>7</sup> This evidence is, however, mixed. See Liebowitz, S. and Margolis, S.E. (1990): The Fable of the Keys, *Journal of Law and Economics*, Vol. 33(19), pp. 1-26.

**Figure 6**

Unit values of Georgian wine exports by destination (2014)



Source: Own calculations, FAOSTAT

There may be another important source of lock-in that reinforces these factors. When Russia reopened its market for Georgian wine in 2013, Georgia's exports increased from USD 60 million US\$ in 2012 to USD 113 m and USD 173 m in 2013 and 2014, respectively (Figure 2).<sup>8</sup> This expansion was almost entirely due to renewed exports to Russia. How was the Georgian wine industry able to expand exports so dramatically in the space of two years? Where did all the wine that was exported to Russia in 2013 and 2014 come from? One possibility is that the re-emergence of Russia as a destination for Georgian wine exports in 2013 and 2014 was less dramatic than it appears because some exports to Russia took place prior to 2013 despite the 'ban' on Georgian imports. There is anecdotal evidence that smuggling did and does take place. There are also reports of wines being produced in Russia with grape juice concentrate imported from Georgia, as a means of circumventing the ban. There are also reports of counterfeiting taking place in Georgia today to produce wines with imported grape juice concentrate. These reports are impossible to substantiate because smuggling and counterfeiting naturally take place in obscurity. Even the official data on grape and wine production in Georgia, such as those presented in Table 1, must be treated with caution because this production takes place on many hundred thousand small agricultural holdings where it cannot be measured reliably. However, to the extent that smuggling and counterfeiting do take place it is clear that the individuals and enterprises involved will have little interest in a reform of the wine industry that imposes quality control, certification and traceability systems for grape and wine production.

In summary, diversifying exports and tapping lucrative alternative wine markets outside the CIS would reduce short-run risks and mitigate long-run threats. It would provide major benefits to the economy as

<sup>8</sup> In volume terms, Georgia's wine exports increased from 27 m litres in 2012 to 45 and 66 m in 2013 and 2014.

a whole and especially to rural areas in Georgia. However the current system of grape and wine production has displayed considerable momentum. Even the major shock of Russia's 2006 ban on imports of Georgian wine, which dramatically highlighted the vulnerability of the current situation, was not able to disrupt this momentum. In the following we discuss a series of measures designed to establish a new path for the future development of the Georgian wine industry. The aim is not to break the old system; exports to Russia and other CIS countries will continue to be a mainstay in the foreseeable future. The aim is to foster an alternative system that produces wines that in style, quality and price are competitive on the non-CIS market. The new system can co-exist with the old system and will likely increasingly supplant it over time, thus reducing the risks and threats associated with dependence on CIS markets.

#### **4 Expanding exports to non-CIS countries**

In order to foster the development of markets for Georgian wines in non-CIS countries, two challenges must be addressed:

1. A comprehensive system of quality control and certification is a prerequisite for entering most non-CIS markets. It is not only a formal prerequisite: importers in these markets, for example supermarket chains, insist that such a system be in place and often demand certification according to additional, private standards that go beyond the formal requirements. Much of the wine that is currently exported to CIS countries would not pass such a quality control system.
2. Given strict quality control requirements and intense competition on many non-CIS wine markets, exporting to these markets may not be commercially attractive compared with exporting to CIS markets. Only on some EU and other non-CIS markets do Georgian wines fetch prices that are significantly higher than on CIS markets and that might therefore justify the higher costs of producing certified quality.

Hence, efforts to establish and enforce the quality control infrastructure that is needed to increase exports to non-CIS markets may face resistance from wine exporters who traditionally supply the CIS market. These stakeholders might worry that compliance will increase their costs without providing matching benefits. This leads to two conclusions on how non-CIS exports should be supported by the Georgian government, one on quality control systems and one on assisting producers through available means of the state.

##### **4.1 Ensuring strict quality control for wines destined for non-CIS markets**

The Georgian government, through the Ministry of Agriculture and the National Wine Agency and with the help of international partners is already undertaking significant efforts towards establishing a strict and comprehensive quality control system. The two main components of such a system are traceability of wines to geographic origins and quality assurance regarding the methods of producing and vinifying the grapes. These ongoing efforts should be strengthened to expand non-CIS wine exports. However, the possibility of conflict with some traditional exports to CIS countries, which may not be able to meet higher standards, deserves attention. If stricter standards are introduced for the entire wine industry,

many market players who supply the domestic market or export to CIS countries may feel that this threatens their traditional business by imposing unnecessary compliance costs. They might therefore try to undermine efforts to implement stricter standards and lobby for weaker enforcement. However, this could seriously impair the development of new non-CIS markets, which will react very sensitively to any indication of lax or uneven enforcement.

We therefore recommend establishing a strict, government run, quality control system that is targeted on selected wines destined for new export markets and not mandatory for traditional domestic and CIS export markets. There is no immediate economic reason why traditional exports to the CIS markets should conform to additional quality control standards that are not required on these markets. A separate, parallel quality control system could help increase exports to non-CIS markets without imposing costs and generating opposition on the part of exporters who supply traditional markets.

Targeting could, for example, be achieved by concentrating quality control efforts on certain regions or types of wines as “quality exports”. This seems feasible, as the semi-sweet varieties of wine sold on traditional CIS markets differ from the drier styles that are required for expanded into non-CIS markets. Hence, introducing different levels of quality control standards (similar to the Italian system that incorporates three standards: DO – designation of origin, seldom used; DOC – controlled designation of origin; and DOCG – controlled designation of origin, guaranteed) could be an option that reconciles the development of new markets with retention of existing markets. However, strict internal checks and balances are required to ensure that there is no leakage between the different levels of the system. Only wines that have undergone the controls that correspond to a quality designation should carry the corresponding label, and strict compliance is required to ensure that individual stakeholders do not undermine the reputation of Georgian wines for short-run individual gain.

#### 4.2 Assisting producers through public research and training institutions

Competition is fierce on non-CIS wine markets. Not only is there a requirement for high quality control standards, but there is also intense competition on price and the subjective quality of the wines. Furthermore, Georgian wines are still largely unknown to customers in these markets. The brand recognition that Georgian wines enjoy on CIS markets is much weaker elsewhere and will have to be carefully cultivated over time. Government policy can help in several ways. First, in terms of marketing the National Wine Agency has already initiated generic marketing programs directed particularly at less entrenched, but growing wine markets such as China and India. These programs should be continued.

Second, much more attention and support should be given to education and research on grape growing and winemaking. Inadequate training of workers at all levels is a frequent complaint particularly of foreign investors in the Georgian wine industry. Although Georgia has an ancient tradition of winemaking, an almost exclusive focus on quantity over quality during the Soviet years has led to a knowledge gap. Public education, both in agricultural universities and in vocational education institutions, can contribute to closing this gap. Thanks to the tradition of family winemaking, valuable knowledge on grape growing and traditional winemaking has been preserved, but this knowledge needs to be complemented with education on modern grape production, winemaking methods and required quality standards.

Existing cooperation with international partners is aimed at improving the national agricultural university's winemaking course. This cooperation could be expanded. Together with modernising the syllabus in tune with international examples, including a practical element into the curriculum which gives candidates the opportunity to train and work in selected European winemaking companies would help build up a pool of highly qualified Georgian graduates who can act as multipliers in the Georgian wine industry.

The research component should also be strengthened. Public research institutions should not only conduct research on ideal methods for growing grapes in Georgia but should furthermore undertake market-orientated research on which kinds of wines Georgia should produce for new markets. With hundreds of indigenous grape varieties as well as the tradition of Qvevri winemaking, Georgia has a massive potential for creating innovative products. At the moment, only a few indigenous grape varieties – most prominently Saferavi and Rkatsiteli – are used for making wines that are exported to non-CIS markets. The concentration on these varieties is to some extent a legacy of Soviet era planning, which focused on the varieties with the highest yields per hectare. Whether there is a significant potential for these varieties on non-CIS markets is not clear at present. Some winemakers are, for example, very optimistic about the market potential of Saferavi-based wines that are made with care and adherence to quality standards (such as not exceeding certain limits on yield per hectare). However, other experts recommend looking at other varieties or assemblages such as Saferavi with Cabernet. Anderson (2013) argues that an internationally recognised variety name together with an indigenous name on a label (e.g. Cabernet-Saferavi) might make non-CIS consumers more likely to try a new wine once, and to remember the label (and perhaps even try an unblended Saferavi) when they next shop for wines. Exploring the potential of the other indigenous varieties as well as assemblages of indigenous and international grape varieties should therefore be actively supported by the state. The success of one winemaker in producing and exporting a “new” or “rediscovered” wine could be a signal for many others to attempt the production of such a wine. Chile's success with the Carmenere variety demonstrates the potential that could be tapped.

#### 4.3 Dealing with small vineyards in a competitive wine sector

An important characteristic of the Georgian wine sector is the relative lack of vertical integration and the pre-eminence of small-scale grape production. The largest share of grapes used by winemakers is bought from independent, small farmers on the market at the time of harvest. This gives rise to a range of problems: First, as long-term delivery contracts are still highly infrequent, grape prices are quite volatile. This can reinforce the lock-in on the current market, particularly as grape prices are significantly higher when wines can be sold in Russia – to the detriment of those winemakers attempting to enter the more price-competitive markets of the future. Second, small farmers are often unable to invest in more modern production methods, leading to outdated, inefficient and labour intensive cultivation techniques and grape prices that are relatively high for a country with low wages and good natural conditions for wine growing. Third, quality control over the grapes is very hard to establish in market with hundreds of thousands of producers and little vertical integration. Small grape producers are very reluctant to allow a winemaker to influence the varieties that they grow, their production techniques and harvest times, etc. While some small farmers do produce excellent homemade, usually Qvevri, wines, the resulting quantities are too small for commercial export.



A consolidation of vineyards is unrealistic in the short run and would lead to difficult social considerations, although some larger winemakers are gradually attempting to increase their own grape production and should be encouraged to do so. Internationally, the fully vertically integrated model, in which the winemaker also owns the vines, is most common. It allows the highest degree of quality control by the winemaker, who has the strongest interest in high-quality grapes, and it also makes traceability from the vine to the bottle comparatively easy, which is an important component of quality control. In the medium- to long-run, consolidation of vineyards is inevitable in Georgia. While this process is taking place, other models are also possible and should be supported:

- Vertical integration through advance delivery contracts and long-term relations between grape farmers and winemakers will allow winemakers to exert pressure for higher quality and support farmers in increasing quality of the grapes.
- Cooperatives of grape growers – as for example in the French “caves cooperatives” – allow growers to share more expensive equipment, from farming equipment to actual winemaking and marketing of own products. This might be a model for aiding the exportability of Qvevri wines, for instance.

## **5 Conclusions**

The Russian market for Georgian wine is lucrative but volatile. Steps to reduce the dependence on this and other CIS markets would reduce these short-run risks associated with trade restrictions, and address the long-run threats of dependence on markets that are likely to decline as a results of demographic developments in the coming decades.

However, diversifying Georgia’s wine export destinations is a challenging task. Many of the unique characteristics and strengths of Georgia’s winemaking legacy also make it difficult to produce the types of wine that are needed to penetrate new, non-CIS markets.

We recommend steps that will enable a separate wine supply chain for non-CIS exports to evolve and grow parallel to the existing system. These steps include the implementation of a strict quality control and certification system that is targeted on selected wines destined for new export markets, continued generic marketing on these markets, and increased investments in education and research in grape growing, winemaking and marketing. In the medium- to long-run, consolidation of vineyards in Georgia is inevitable and will make it possible for winemakers to own vines and produce the grapes that they require themselves. In the meantime, vertical integration through delivery contracts and cooperation between grape growers are alternative models for improving coordination in the wine supply chain.

### **List of recent Policy Papers**

- Can low electricity prices be a comparative advantage of Georgia?, by Georg Zachmann, Policy Paper PP/02/2015
- Georgia's economic specialisation: Present and future, by Georg Zachmann, David Saha and Michele Peruzzi, Policy Paper PP/01/2015
- Financing road maintenance in Georgia, by Jürgen Ehrke and David Saha, Policy Paper PP/03/2014
- Georgia's agricultural exports, by Stephan von Cramon-Taubadel, Policy Paper PP/02/2014
- Energy Security of Georgia, by Georg Zachmann, Policy Paper PP/01/2014

### **List of recent Policy Briefings**

- Can low electricity prices be a comparative advantage of Georgia? - Summary of findings - by Georg Zachmann, Policy Briefing PB/03/2015
- Georgia's economic specialisation: Present and future – Summary of findings – by Georg Zachmann, David Saha, Ricardo Giucci and Michele Peruzzi, Policy Briefing PB/02/2015
- Macroeconomic effects of the global oil price decline on Georgia, by David Saha, Ricardo Giucci and Woldemar Walter, Policy Briefings PB/01/2015
- Green Growth – What could be in it for Georgia?, by Georg Zachmann, Policy Briefings PB/07/2014
- German energy efficiency policies – Lessons learned and relevance for Georgia, by Jörg Radeke, Policy Briefings PB/06/2014
- Financing road maintenance in Georgia: Summary of Results, by Jürgen Ehrke and David Saha, Policy Briefings PB/05/2014
- Georgia's agricultural exports: Structures and challenges, by Stephan von Cramon Taubadel, Policy Briefings PB/04/2014
- Economic impact of a possible change in Russia's trade regime vis-à-vis Georgia, by Woldemar Walter and Ricardo Giucci, Policy Briefings PB/03/2014
- Ex-ante evaluation of investment projects at local government level Policy, by Jürgen Ehrke and Ricardo Giucci, Policy Briefings PB/02/2014

---

All papers and briefings can be downloaded free of charge under <http://www.get-georgia.de/publikationen/policy-papers/>. For more information please contact the German Economic Team Georgia on [info@get-georgien.de](mailto:info@get-georgien.de).