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Reform assistance to Georgia

საქართველოში რეფორმების განხორციელებაში დახმარება

PRIORITY INVESTMENT SECTORS IN GEORGIA

Appendix to the Final Report

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Contents

Abbreviations used in the report

Abbreviation	Definition
AA	Association Agreement
APMA	Agricultural Projects Management Agency
B2B	Business to business
BEEPS	Business and Enterprise Performance Survey
BGN	Bulgarian lev(s).
BSEC	Black Sea Economic Cooperation
BTC	Baku-Tbilisi-Ceyhan
CBCC	Cross-Border Cinema Culture
CEE	Central Eastern Europe
CIS	Commonwealth of Independent Sates
DCFTA	Deep and Comprehensive Free Trade Area
EBRD	European Bank for Reconstruction and Development
ECI	Economic complexity index
ECO	Economic Cooperation Organization
EORI	Economic Operators Registration and Identification
EU	European Union
EWHCIP	East-West Highway Corridor Improvement Project
FDI	Foreign Direct Investment
FOB	Free on board
FTA	Federation of Tax Administration
Gap analysis	Project management tool for determining what you need to do to meet a project's objectives
GATT	General Agreement on Tariffs and Trade
GCAA	Georgian Civil Aviation Agency
GDP	Gross Domestic Product
GEL	Georgia Lari (ISO currency code)
GMP	Good manufacturing practice
GNTA	Georgian National Tourism Administration
GR	Georgian Railway
GSP+	Generalized scheme of preferences
HHP	High hydrostatic pressure
HMIS	National Health Management Information System
HSN	Harmonized System of Nomenclature
HVDC	High voltage direct current
ICPC-2-R	International Classification of Primary Care
ICTSI	International Container Terminal Services INC
IMF	International Monetary Fund
ISO	International Standardization Organization
IT	Information Technology
JSC	Joint Stock Company
LLC	Limited Liability Company
MFN	Most-Favored Nation
MFO	Micro-finance organization
MoESD	Ministry of Education and Skills Development
NATO	North Atlantic Treaty Organization
NBG	National Bank of Georgia
NCSP	Nordic Classification of Surgical Procedures

NGB	National Bank of Georgia
NGO	nongovernmental organization
NPL	Non-Performing Loan
NSMGP	North South Main Gas Pipeline
OECD	Organization for Economic Cooperation and Development
OHSAS	Occupational Health and Safety Management System
PEST index	Political, Economic, Social & Technological index
PPP	Purchasing Power Parity
PwC	PricewaterhouseCoopers
R&D	Research and development
SAD	Single administrative document
SCP	South Caucasus Pipeline
SECI	Southern Europe Cooperative Initiative
SME	Small to medium-sized enterprise, a company with no more than 500 employees
SOCAR	State Oil Company of Azerbaijan Republic
SSR	Soviet Socialist Republic
TAM	Tbilisi Aircraft Manufacturing
TARIC	Tariff of the European Union
TEIAS	The Turkish Electricity Transmission Company
TEU	Treaty of European Union
USA	United States of America
USAID	United States Agency for International Development
USD	US Dollars
VAT	Value Added Tax
WREP	Western Route Export Pipeline
WTO	World Trade Organization

Appendix 1: Methodology

The goal of this chapter is to present the main methodological techniques used throughout the study. The present study will use different tools and techniques in order to gather information and provide an analysis of market failures in order to quantify, where possible, the market gaps, and propose a suitable investment strategy. More detailed methodological subsections will also be included in later sections of the report.

1.1 Rationale behind the Methodology

The present report follows the specific methodology taking into account the specifics of Georgia - the market conditions of Georgia and the experience with Exports and FDI in the country. However, it has to be noted that this methodology will be used as a road map in order to achieve the expected result.

The methodology follows the Porter's Competitive Advantage of Nations – Determinants of National Advantage. The analysis of the sectors with the potential competitive advantage is analyzed through four elements[1]:

1. *Current sector conditions.* Georgia's current position in the sector and the availability of key factors, such as skilled labor or infrastructure, necessary to compete in the sector.
2. *Existing market Demand.* Domestic and international demand for the sector's product or services and expected growth trends.
3. *Related or supporting industries.* The presence or absence in Georgia's of supplier industries and related sectors that are internally competitive or complementary.
4. *Existing competition and competitiveness.* The competitive conditions in individual sectors.

The determinants create the context in which a nation's firms are born and compete through the availability of resources and skills necessary for competitive advantage in an industry, the information that shapes what opportunities are perceived and the directions in which resources and skills are deployed, the goals of the owners, managers, and employees that are involved in or carry out competitions and most importantly, the pressures on firms to invest and innovate.

Export and FDI potential were defined through Georgia's sectors that possess a competitive advantage in target export markets relative to their main regional and global competitors. It has to be noted that neither the size of the sector, existence of exports or domestic profitability can be used as a completely reliable indicator of sectors export and FDI competitiveness. Measuring the competitiveness of these two dimensions is a statistically challenging proposition, therefore the report not only relies on quantitative sector and sub-sector assessments but also on qualitative assessments.

The research conducted was founded on best measures of current and future sector competitiveness and has shown the presence of substantial and sustainable exports (rather one-offs) to a wide array of trade partners from different regions and/ or significant inbound investments in Georgia that are based on skills and assets that are being created in Georgia.

1.2 Tools applied to gather data and information

For the purpose of research we had to apply the following tools:

- Desktop research

In order to perform a proper quantitative analysis, we had to analyze the data that we extracted from publicly available, international and Georgian statistical data bases. To better understand the output from statistical analysis, we conducted additional research through supplementary published sources (Bibliography), which gave this study an additional qualitative perspective.

- Interviews

In order to analyze certain sectors, such as services, creative industries and statistical data availability we have conducted 35 interviews to get a clear stakeholders. Please find attached the list of executed interviews in

[1] Please note that for certain sectors some data was not available.

Executed interviews.

1.3 Data Analysis

The basic unit of analysis was the industry sector or sub-sector as defined by the HS classification using levels 2,4 and 6 where applicable. The different levels of details were applied to different industries as the national advantage is becoming increasingly concentrated in particular sectors and sub-sectors, reflecting their specific and differing sources of competitive advantage.

Appendix 2: Georgian business and investment environment

In this section information were gathered from the in-depth interviews with businesses, as well as official data provided by Geostat; reports published by leading international organization (World Bank, IMF, IFC); reports, publications and yet unpublished research conducted by ISET Policy Institute, other leading think tanks in Georgia.

2.1 Macroeconomic environment

The macroeconomic environment in Georgia has been remarkably stable and even favorable, compared to other countries in Europe and Central Asia (ECA) region. In the recent years (2011-2014) the average real GDP growth was 5.6%, while in the corresponding growth rate in the ECA developing countries was 3.7%. In 2015, a particularly difficult year for the entire region, Georgia's real GDP growth slowed down to 2.8%. This, however, was higher than the 2% projected by the IMF and other leading international organizations.

The year of 2015 was clearly a test of resilience for the Georgian economy. The shocks, which **originated largely on the outside dented the economy, affected real growth, but did not result in a banking crisis or a recession.** To summarize:

- The sharp drop in metals and commodity prices worldwide which affected not only Georgian exports, but the financial situation in the tightly linked economies of Azerbaijan and Russia. Both factors contributed to the drop in demand for Georgian goods, and a sharp depreciation of Lari against the USD. Depreciation, however, helped export competitiveness and, more importantly, did not lead to high inflation.
- The country's banking system stayed sound, displaying remarkable resilience. Despite the high rates of loan dollarization the ratio of non-performing loans to total loans did not exceed 2%. The banks offered restructuring of loans to clients, but indicated that few clients took advantage of the opportunity.
- The inflation rate stayed within the 5% target in 2015. The sovereign external debt/GDP ratio increased to over 40%, as a result of lari devaluation, but stayed within the sustainable range. Government spending deficit did not increase substantially.

Sources of strength for the Georgian economy:

- **Flexibility in trade:** despite a sharp drop in exports in 2015, especially to the traditional CIS countries' markets, the exports were re-oriented to new markets – the economy witnessed a marked increase in exports to Europe and China.
- **Sound financial system** with a strong and independent central bank: Georgian financial system showed remarkable resilience in the face of devaluation shock. The National Bank of Georgia withstood the political pressures and kept the lari exchange rate flexible, intervening only to smooth the sharp fluctuations on the market. As a result, NBG managed to keep foreign exchange reserves at an acceptable level. Commercial banks offered loan restructuring terms, but according to surveys, few customers took the opportunity to restructure dollarized loans. One of the reasons behind this is the fact that Georgian financial system has quite conservative lending policies. On the one hand, conservative lending practices preclude financial meltdown in tough times, but on the other hand, this system does little to promote financial inclusion, to the detriment of entrepreneurial development. Since financial stability is paramount to the credibility of the country's favorable business environment, the government has to find alternative ways to finance small and medium entrepreneurs and start-ups.
- **Low and stable inflation environment:** inflation was kept at target (5% in 2015) despite sharp depreciation of lari against the dollar and the euro. Low commodity prices (oil, food) put the downward pressure on CPI. In the same time, the prices of healthcare and medicine (typically imported from abroad) increased substantially. Nevertheless, low rate of inflation meant that the purchasing power of remittances inflows to Georgia were kept relatively stable (although remittances decreased in dollar terms, in lari terms adjusted for CPI inflation, the drop was very modest).
- **Consumption growth as a sign of economic resilience**: stronger than expected consumption growth in 2015. Despite low real growth in 2015, consumption growth was about 9%, of which close to 3%, according to estimates, was due to tourisms. Low inflation kept the purchasing power of international incomes from exports and remittances stable – this contributed to stronger consumption growth in 2015.
- **Functioning bureaucracy, lack of corruption:** The legacy of the Rose revolution was a modernized and functioning bureaucracy in Georgia. The system proved resilient, and remained stable and largely free of corruption even after the changes in the government after 2012.
- **Stable FDI trends:** the fact that the new government managed to maintain the functioning bureaucracy of the Rose revolution era contributed to investors' confidence, and created favorable FDI environment in Georgia. Despite the fact that FDI was down in 2015 relative to 2014, we observe that already in the first quarter of 2016 the FDI is higher than the same period in 2014, a record year for FDI inflows.

- **Favorable tax environment:** Tax environment has greatly improved in Georgia following a series of reforms to reduce the number of taxes and the complexity of the tax system. Big problems that remained had to do with the enforcement of tax regulations and compliance. The tax authorities has the power to freeze the operations of businesses while the investigations were still pending. This effectively paralyzed the affected businesses. Such a practice was a huge drag on the country's business environment and investors' perceptions. The planned reform of the tax system which precludes freezing of company's assets before the investigation is concluded will be a big boost to the country's investment attractiveness.

Vulnerabilities

- **Exports, Imports, high current account deficit and low domestic savings**: Current account balance in Georgia remains high and negative by international standards. High current account deficit implies that the country is borrowing heavily from abroad in order to finance consumption and investment, while domestic savings remain relatively low. In international experience, including the experience of transition economies, high CA deficit is a source of vulnerability for the country:
  - Heavy borrowing from abroad can make a country vulnerable to capital flows reversals. Although in Georgia much of the inflows comes in form of FDI, which is considered one of the most stable sources of capital, the exposure remains, nevertheless
  - High CA deficit leads to high external debt burden, which affects investors' sentiments. The worry is that unsustainable debt burden can lead to "debt overhang" - a phenomenon, where an increasing debt burden puts a strain on the development of companies and reduces economic growth.
  - Low domestic savings means that the country's economy is not yet mature enough to generate enough internal output.
  - High CA deficit means that exports are rather low, while imports are high. This can be signaling problems in the country's export sectors, such as lack of competitiveness.
- **Remittances. Dependency on Russia, Azerbaijan**: Georgian economy remains vulnerable to demand shocks coming from larger oil-exporting economies, Russia and Azerbaijan. For example, the change in the legislation in Azerbaijan essentially wiped out Georgia's second-hand car market. In retrospect, this sector was of course not "growth enhancing", but the abrupt disappearance of this type of cross-border trade put a strain on the economy in the short run. Recession in Russia has affected Georgia in a number of ways. Most importantly, though the reduction in remittances inflows (Russia remains by far the largest sources of remittances for thousands of Georgian households). Secondly, the reduction of demand from these countries and protectionist measures (import substitution policies in Azerbaijan), put a strain on Georgia's export industries. In the same time, Russia's strained relationship with Turkey helped boost Georgia's tourism. To summarize, the high dependence on the economic situation in Russia and Azerbaijan is not an ideal scenario for Georgia. DCFTA agreement could help reduce these dependencies and help further diversify Georgia's export base.
- **High country risk, small market size:** Judging by the high interest rate risk premium and the sustained high spread between lending and deposit rates in Georgia, the country remains a "high risk" investment. The risk comes not so much from macroeconomic environment (which is quite stable) or any serious internal structural deficiencies of the economy (e.g. corruption, graft, etc), but primarily from the small market size, and the fact that Georgia is in a challenging geopolitical neighborhood, which understandably makes investors nervous. Recently, the business confidence concerns subsided, as it was becoming increasingly clear to investors that Georgia's economic and policy environment did not suffer drastic changes after the 2012-2013 peaceful transition of power from the ruling party to the opposition. Yet, for much of the foreign investment in Georgia personal ties in the country remain the most important motivation.
- **High poverty and inequality, inadequate human capital:** One of the most important constraints facing Georgia's long-term development potential is the lack of adequate human capital, which is exacerbated by the very high poverty rates (even when compared with the developing countries in the region), and income inequality. Most businesses cite lack of human capital as one of the major constraints for business development. In the same time, the percentage of firms offering on-the-job training is quite low in Georgia (e.g. according to the WB data, 2008, 2009, only 14.5% of firms in Georgia offered such training, while in Ukraine and in Turkey 24.8% and 28.8% of firms did). This suggests that the kind of skills the firms are looking for are either difficult to train for, and require years of formal education (e.g. engineering), or that the kind of skills that are required are not readily trainable, if a person lacks some prerequisite soft skills (e.g. punctuality, responsibility, work ethics, that are particularly crucial in hospitality or other service industries). Arguably, industry-led VET programs in combination with a comprehensive primary education reform could offer a good solution to these kind of problems.

- **Low diversification of the industrial base:** One of the current key constraints facing Georgia is the lacks a well-diversified industrial base. Ores, Iron and steel products were among the top export commodities in 2015, accounting for about a third of Georgian total exports (not counting the re-exports of cars).
- **Dollarization; access to finance:** Access to finance remains a problem for many small and medium firms in Georgia. Bank financing is about the only outside financing options for Georgian businesses, including start-ups. However, bank financing is very expensive for these kinds of firms. Raising capital is a problem.
- **Infrastructure constraints:** Infrastructure remains a constraint in the regions, much less so in the capital and large towns, such as Batumi. According to business surveys, access to reliable electricity supply remains a concern and constitutes as much as 9% of revenue losses in business operations. The interviews with businesses revealed that internal electricity consumption will be increasingly important, and therefore focus on developing effective and reliable internal electricity supply network focused on domestic producers should be a priority.

2.2 Business environment

General overview of the business environment:

Strength:

Georgian tax system is simplified and tax rates capped. Since 2004 Georgia has undergone significant institutional reforms, not the least of which was the overhaul of the taxation structure. Fair and predictable taxation legislation and enforcement is one of the key drivers of business investment. Georgia retained 6 taxes out of 21 in 1997, simplified filing and payment of taxes. Moreover, tax rates are capped by Constitution (Organic Law of Georgia on Economic Freedom), and the cap can be removed only subject to a country-wide referendum.

Low tax rates. Tax rates in Georgia are competitively low, comparing to other countries in the region. For example, in Georgia VAT, Personal Income Tax and Corporate Income Tax are all 1.2-2.2 percentage points lower than in Eastern and Central European countries (World Bank data). In addition, Georgia does not collect a Social Contribution tax.

Capital flows: Unlike many countries in the region, Georgia managed to maintain freedom of capital movement even during the tough times – e.g. the 2014-2015 lari devaluation episode. The Organic Law of Georgia on Economic Freedom further codifies the freedom of capital movement.

Lack of corruption: Eliminating low-level corruption has been one of the greatest reform achievement in Georgia since 2004. The dual effort of trimming the state bureaucratic apparatus and making it more professional paid off, and propelled Georgia into the top improvers in Ease of Doing Business Index complied by the World Bank and the IFC.

Weaknesses:

Regulatory environment – certain regulations need adjustment to make sure that foreign inputs into production are not given unfair advantage over domestically produced inputs. The notable example was glass bottles produced in Georgia, which were subject to VAT (to be later reimbursed), while foreign-imported glass was exempt. This created an unfair tax timing advantage for foreign inputs. Another example of undue regulatory burden was the system of accounting for losses in production, which placed particular burden on domestic poultry producers (the producers had to produce physical evidence for each dead chicken in order to claim losses). The regulators instead need to rely on the established world practice of accounting for average losses in the industry.

The overall recommendation to the government is to establish direct lines of communications (e.g. a practice of regular consultations) with key industry leaders to make sure that key regulatory issues get proper attention and early resolution.

Tax collection and enforcement of tax regime – Businesses' perception was that while tax collection improved, it was far from an ideal system, in which the burden of proof rested on the tax-paying business, not on the tax regulating authority. One of the major issues was the disruption of business (imposing fines and freezing business accounts, etc.) while tax investigation was still pending. This problem is already being addressed in a new tax legislation and it will go a long way towards improving business environment in Georgia.

Protection of vulnerable industries – While the liberal economic environment with few regulatory burdens generally helps businesses, certain key international practices need to be considered an adapted to the Georgian case. One of the big issues for Georgia is the lack of protection to vulnerable industries. This issue has been quite sensitive for policymakers in Georgia who tend to frown upon any kind of protective market measures. Nevertheless, in 2015 the country went through a very sharp (nearly 40%) national currency depreciation against the USD. However, regional partners and competitors (e.g. Ukraine, Russia) suffered even deeper devaluations, which directly hurt the competitiveness of Georgian industries.

One such example was the steel industry. Georgian steel products (e.g. high-quality re-bars) have long been competitive on the internal market, due to advantages in the cost of transportation. However, temporary deep devaluation of the Russian ruble and Ukrainian hryvna all but wiped out this competitive advantage. The temporary shock threatened the survival of the industry, while government intervention (invoking the temporary safeguard measures available to WTO members under GATT article 19) would have been appropriate. The mechanism for reviewing the cases and implementing such measures needs to be put in place, so that industries which require substantial capital investments feel protected from unanticipated temporary shocks and currency fluctuations.

2.3 AA and DCFTA impact on the Georgian Economy

On 27 June 2014 the EU and Georgia signed an Association Agreement (AA) and have applied it provisionally since 1 September 2014. The Agreement introduces a preferential trade regime – the Deep and Comprehensive Free Trade Area (DCFTA)[2].

DCFTA implementation showed to be an important step for Georgian exports to the European Union. While EU exports to Georgia did not increase too much and mainly remained stable, the Georgian exports to EU rose by 12 % in the first six months of the free trade agreement. During the first 12 months of DCFTA, the export of hazelnuts increased by 20%, wine by 5% and mineral and still water by 13%.There was a slight increase in export of ferro-alloys as well. In the first six months of free trade agreement, Georgia exported 285 thousand tons of petroleum oils to the EU, arise of nearly a quarter compared to the same period the year before. In the first six months of the free trade agreement Georgian exports of fruit juices to the EU more than tripled. Furthermore, under the free trade agreement Georgia has started exporting some products to the EU that it did not export to it before, such as acyclic alcohols and synthetic filament yarns. The Georgian market has also opened to European know-how and technology in services. Companies may offer services by going to the country or across the border (e.g. online). Georgian companies can now already open subsidiaries or offices in the EU and benefit from direct presence and access to customers in the EU, in almost any manufacturing or services sector. The EU companies can do the same in Georgia. They can send their staff for training, exchange know-how, or search for a business partner. Georgia and the EU are creating domestic advisory groups composed of civil society and business representatives. Thus, one can safely conclude that DCFTA had numerous positive impacts on Georgian economy so far[3].

Nevertheless, there are still several points in question:

- **New opportunities for existing industries**

Existing industries may see new opportunities related to the DCFTA, but no major breakthroughs are expected as there are no clear “locomotive” industries.

The ones with the greatest potential are animal products, prepared foodstuffs, vegetable products, animal/vegetable fats and oils, and chemicals industries.

- **Two sets of sectors to benefit from the DCFTA**

Two basic groups have tariff structure with the highest differential against MFN (Most-Favored Nation) countries, hence provide incentives for FDI from non-FTA countries. :

– Agriculture and food, particularly animal products; prepared foodstuffs: Highest tariffs

– Industrial goods, particularly textiles, footwear, chemical products, also selected engineering goods: Lower tariffs, but with some tariff peaks

In agriculture sectors, Georgia will have to improve food safety and hygiene standards to maximize advantages offered in the DCFTA. To give farmers time to adjust to the EU’s regulations, the Georgian government and EU are developing an implementation timeline spread over eight years. It also grants small farmers facilitated access to finance, subsidized insurance policies and various support for start-up agri-businesses[4].

- **There are tradeoffs connected with the implementation of the DCFTA**

Jobs vs. exports. From the jobs and local production costs/product prices perspective, Georgia should push back food and environment safety measures as much as possible. From the export point of view, such measures should be accelerated.

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[2] http://ec.europa.eu/trade/policy/countries-and-regions/countries/georgia/

[3] http://trade.ec.europa.eu/doclib/docs/2015/may/tradoc_153435.pdf

[4] http://www.eurasianet.org/node/74041

Another tradeoff concerning differential treatment of small and large enterprises. Small companies may not able to afford certain DCFTA measures. Exempting them may harm the big guys (e.g. because of competition for raw materials). There is a need to understand sector-specific tradeoffs before committing to any timetable and concrete measures.

- **Import substitution**

DCFTA will also affect Georgia's ability to substitute for imports. The production costs will go up, particularly in the food industry, mostly because of environmental regulations and some sectors are likely to be on the losing side (meat).

- **Lack of clear understanding**

There is a lack of proper understanding – in government and industry – as to the precise DCFTA requirements (for each subsector) and the optimal timetable for their implementation.

Based on the analysis of the Georgian industrial landscape, as well as the interviews with industry leaders, it becomes clear that existing industries may see new opportunities related to DCFTA implementation, but we should not expect any major breakthroughs. DCFTA could bring about many small developments in niche products across different industries, but no clear "locomotive" industries will emerge from the DCFTA agreement.

Because of global competition, no small scale activity is likely to be successful (because of issues with market access and cost). Hence, need for intra-sectoral coordination of investment decisions: in provision of inputs and skills, actual production, downstream services, product certification and quality control, export facilitation, transport. and logistics, international branding and marketing

2.4 Structural characteristics of FDI and trends[5]

Georgia received the highest amount of FDI in 2007 (2.01 billion USD), but due to global economic crisis the level of investments dropped. However, since 2010the amount of FDI in Georgia has again been rapidly growing, from 0.81 billion USD in 2010 to 1.35 billion USD in 2015, but it has yet to reach its pre-2008 levels.

FDI by sector

Table 1: FDI in Georgia by Economic Sectors (1000 USD)

Sectors	2010	2011	2012	2013	2014	2015*	Total 11-15
Total	814,497	1,117,244	911,564	941,903	1,758,423	1,351,054	6,080,188
Transports and communications	215,116	126,517	72,829	140,104	433,655	593,973	1,367,078
Energy sector	21,878	203,952	179,403	244,745	189,945	89,881	907,926
Financial sector2	107,406	167,702	162,552	166,386	115,323	191,208	803,171
Manufacturing	175,335	120,340	167,906	99,765	205,417	90,709	684,137
Other sectors3	90,431	131,185	178,045	155,837	188,424	9,596	663,088
Construction	4,706	48,112	41,839	49,847	316,588	129,059	585,446
Real Estate1	119,253	224,776	52,806	42,295	138,655	47,840	506,371
Hotels and restaurants	17,122	22,706	17,652	-13,360	124,852	60,982	212,832
Mining	53,436	40,220	4,862	43,705	42,782	42,665	174,233
Health and social work	1,182	16,827	17,551	720	-9,508	66,366	91,956
Agriculture, fishing	8,632	14,908	16,119	11,857	12,290	28,774	83,949

[1]Real estate, renting and business activities;

[5] http://www.geostat.ge/index.php?action=page&p_id=140&lang=eng

[2] Since 2009 data for the financial sector besides banks include FDI data in insurance and microfinancial companies.

[3] Trade; Education; Research and experimental development; Other community, social and personal service activities.

Source:

1. National Statistics Office of Georgia (Statistical survey on external economic activities);
2. National Bank of Georgia;
3. Ministry of Economy and Sustainable Development of Georgia.
4. Ministry of Finance and Economy of Adjarian A/R.

Sectoral FDI shows some volatility in the past 5 years. Clearly, big projects in transportation and communications sector, in construction and energy sector are driving the ups and downs in sectoral FDI from year to year. However, one may still observe **that transport and communications, energy and the financial sectors** dominate the FDI landscape, accounting for half of all FDI in 2011-2015.

FDI by countries

Table 2: FDI in Georgia by Countries (1000 USD)

Countries	2011	2012	2013	2014	2015*	2011-2015
Total	**1,117,244**	**911,564**	**941,903**	**1,758,423**	**1,351,054**	**6,080,188**
Azerbaijan	138,016	59,007	81,940	341,401	541,758	1,162,122
Netherlands	241,819	35,368	153,185	373,741	111,014	915,127
United Kingdom	54,977	93,603	55,171	107,581	198,437	509,769
Luxembourg	43,284	42,032	142,545	109,633	86,642	424,135
China	9,643	36,126	89,874	217,944	57,616	411,204
Turkey	75,524	81,060	42,758	63,110	77,294	339,745
United States	28,106	20,254	44,813	181,867	35,173	310,213
Russia	55,435	20,486	2,047	82,242	48,646	208,856
Germany	25,513	138,813	21,828	3,993	5,945	196,092
Czech Republic	46,598	8,031	43,578	51,962	5,473	155,643
Denmark	97,170	6,558	9,572	12,730	21,135	147,166
International Organizations	94,897	63,455	54,681	-105,962	39,143	146,213

Source: Geostat

Among the 12 top FDI sources are 6 EU countries – Netherlands, UK, Luxembourg, Germany, Czech Republic and Denmark. Georgia's immediate neighbors, Azerbaijan, Turkey and Russia, are also in top 12, with Azerbaijan accounting for as much as 20% of total FDI between 2011-205. China emerged the 5th top FDI country (by the total volume of FDI in 2011-2015).

FDI from Russia has been uneven, while German FDI dwindled significantly in 2014 and 2015.

2.5 Structural characteristics of Exports and trends

International trade is explained by the fact that each country imports the goods that are not available at home. This unavailability may be due to the lack of natural resources (oil, gold, etc.: this is absolute unavailability) or the fact that the goods cannot be produced domestically, or could only be produced at prohibitive costs (for technological or other reasons): this is relative unavailability. On the other hand, each country exports the goods that are available at home.

Georgia's value of total exports have been rising rapidly until 2013 (from 865 million USD in 2005 to 2.9 billion USD in 2013), but the value has now dropped to 2.2 billion in 2015 (this is mostly due to lower value of exports to countries in the CIS region).

Export by sector

Table 3: Georgian Exports by BEC (1000 USD)

Commodity	2011	2012	2013	2014	2015
Food and beverages	422,059	485,600	728,029	781,184	573,009
Industrial supplies, not elsewhere specified	978,929	909,912	1,033,088	1,083,077	886,644
Fuels and lubricants	72,364	50,035	66,220	74,804	136,754
Capital goods (except transport equipment), and parts and accessories therefore	44,934	62,862	74,713	43,901	61,696
Transport equipment, and parts and accessories therefore	548,781	670,802	819,194	616,526	252,191
Consumption goods	115,189	160,362	183,318	253,963	287,999
Goods	4,459	36,581	4,954	7,216	5,982

Source: Geostat

Industrial supplies (such as steel, iron and ores, fertilizers) have formed the largest share of Georgian exports for many years. However, these sectors, while still having the largest contribution to total exports, were severely hit by the drop by the global commodity prices. In contrast, consumption goods have been gaining importance as exports in 2015.

In general, export structure has been changing and will continue to change in the future. For example, iron and steel products had a negative compound average growth rate over five years (- 14%), while pharmaceuticals grew at a fast past of 30% per year over 5 year period. Among the products that had the largest compound average growth rate were textiles; rubber; plastics, nuts and vegetables. Among the products with negative growth rates were iron and steel, copper, cement, live animals.

Export by country

Table 4: Georgian Exports by Countries (1000 USD)

	2011	2012	2013	2014	2015*	2011-2015
Total	**2,186,715**	**2,376,155**	**2,909,516**	**2,860,671**	**2,204,273**	**12,537,329**
Azerbaijan	425,964	626,836	709,965	544,505	240,430	2,547,700
Armenia	223,118	258,349	315,441	288,085	180,086	1,265,079
Turkey	226,388	140,089	183,796	239,296	186,684	976,252
United States	143,466	226,219	137,539	207,333	104,181	818,738
Russia	36,610	46,800	190,390	274,675	162,835	711,310
Ukraine	141,200	167,011	192,772	139,921	59,874	700,777
Bulgaria	93,699	69,655	150,754	167,105	214,247	695,460
Kazakhstan	156,867	62,236	103,598	88,589	44,967	456,258
Canada	114,794	108,220	81,359	48,754	70,170	423,297
Italy	75,517	53,270	81,100	86,095	74,407	370,389
Germany	49,079	38,600	73,128	69,192	75,811	305,809
China	28,970	25,676	33,956	90,393	125,800	304,796

Source: Geostat

Georgia's immediate neighbors, such as Azerbaijan, Armenia and Turkey continue to be the top export destinations by volume of exports in 2011-2015. However, trade patterns began to change in 2015, affected by devaluation of national currencies and drop in demand for Georgian goods in the region's economies (in particular Russia, Ukraine, Azerbaijan). Azerbaijan exports dropped due to the change in regulations on the re-exports of cars.

Bulgaria became of the the tope export destinations in 2015, and there was a notable increase in exports to China.

Generally, Georgian economy managed to re-orient its trade towards Europe and Asia, following the drop of exports to the former CIS destinations.

The table below presents the changes in total exports share by country and product category between 2014 and 2015. One can observe that EU countries became more prominent in Georgia's total exports, by share. This is especially true for vegetable products, which saw a 4% growth to EU destinations, chemical industry products, such as fertilizers (61% growth to EU destinations), and some others.

Table 5: Total Trade flows by HS section 2015

Product Category	% of total in 2014	% of total in 2015	Product Category	% of total in 2014	% of total in 2015
I Live animals; animal products	**2.15%**	**2.41%**	**XII Footwear, hats and other headgear**	**0.15%**	**0.10%**
CIS countries	1.77%	1.37%	CIS countries	0.07%	0.07%
EU countries	0.00%	0.01%	EU countries	0.05%	0.00%
Other countries	0.37%	1.02%	Other countries	0.02%	0.03%
II Vegetable products	**8.92%**	**10.59%**	**XIII Articles of stone, glass and ceramics**	0.47%	0.56%
CIS countries	2.99%	2.39%	CIS countries	0.44%	0.32%
EU countries	5.30%	7.14%	EU countries	0.02%	0.13%
Other countries	0.62%	1.06%	Other countries	0.01%	0.11%
III Animal or vegetable fats and oils	**0.29%**	**0.36%**	**XIV Pearls, precious metals and articles thereof**	**1.74%**	**3.34%**
CIS countries	0.04%	0.04%	CIS countries	0.01%	0.01%
EU countries	0.02%	0.03%	EU countries	0.35%	0.42%
Other countries	0.23%	0.29%	Other countries	1.38%	2.91%
IV Foodstuffs, beverages, tobacco	**17.51%**	**14.40%**	**XV Base metals and articles thereof**	**17.09%**	**13.58%**
CIS countries	13.90%	10.11%	CIS countries	5.05%	3.03%
EU countries	2.25%	2.26%	EU countries	1.18%	1.38%
Other countries	1.35%	2.03%	Other countries	10.62%	8.91%
V Mineral products	**12.05%**	**18.75%**	**XVI Machinery and appliances**	**2.50%**	**2.97%**
CIS countries	0.82%	0.38%	CIS countries	1.36%	1.45%
EU countries	7.51%	10.59%	EU countries	0.39%	0.56%
Other countries	2.68%	5.77%	Other countries	0.75%	0.95%
VI Products of the chemical or allied industries	**10.18%**	**14.16%**	**XVII Transport equipment**	**20.57%**	**10.40%**
CIS countries	4.87%	8.33%	CIS countries	17.34%	6.88%
EU countries	1.70%	3.55%	EU countries	1.31%	1.11%
Other countries	3.62%	2.28%	Other countries	1.92%	2.41%
VII Plastics, rubber and articles thereof	**1.24%**	**1.50%**	**XVIII Optical and photographic instruments, etc.**	**0.39%**	**0.96%**

CIS countries	0.66%	0.83%	CIS countries	0.13%	0.35%
EU countries	0.43%	0.52%	EU countries	0.12%	0.29%
Other countries	0.15%	0.15%	Other countries	0.14%	0.31%
VIII Raw hides and skins, and saddlery	**0.26%**	**0.26%**	**XIX Arms and ammunition**	**0.00%**	**0.00%**
CIS countries	0.05%	0.05%	CIS countries	0.00%	0.00%
EU countries	0.16%	0.14%	EU countries	0.00%	0.00%
Other countries	0.05%	0.06%	Other countries	0.00%	0.00%
IX Wood, charcoal and cork and articles thereof	**0.77%**	**0.83%**	**XX Miscellaneous manufactured articles**	**0.38%**	**0.41%**
CIS countries	0.38%	0.28%	CIS countries	0.30%	0.27%
EU countries	0.16%	0.19%	EU countries	0.05%	0.08%
Other countries	0.23%	0.36%	Other countries	0.03%	0.06%
X Pulp of wood, paper and paperboard	**0.18%**	**0.26%**	**XXI Works of art and antiques**	**0.01%**	**0.01%**
CIS countries	0.10%	0.20%	CIS countries	0.00%	0.00%
EU countries	0.03%	0.01%	EU countries	0.01%	0.00%
Other countries	0.05%	0.06%	Other countries	0.00%	0.01%
XI Textiles and textile articles	**3.18%**	**4.15%**			
CIS countries	0.48%	0.48%			
EU countries	0.56%	0.68%			
Other countries	2.15%	2.99%			

Source: Geostat

2.6 Role of the financial sector and capital markets

Georgia's financial sector is dominated by the banking sector, which accounts for 95% of financial sector assets.[6]

The only allowable legal status of banks is a joint stock company. Capital requirements for commercial banks are in line with the standards of the Basel Committee on Banking Supervision and corresponding EU directives. The level of minimum capital for commercial banks is set by the NBG (National Bank of Georgia) at GEL 12 million for newly founded commercial banks and foreign bank branches and should be fully paid in cash. By the end of 2014 there were 21 banks operating with a market capitalization (by total assets) of GEL 20.6 billion (GEL 0.88 billion in 2001). However, it is worth noting that only two banks account for more than 55 % of total assets (Bank of Georgia-31,65% and TBC Bank-24,12%).

The Georgian banking sector is stable, but according to the International Monetary Fund (IMF) the sector faces key risks. Risks related to dollarization and reliance on nonresident deposits should be closely monitored. Dollarization increases credit and liquidity risks. There are two major dollarization-related problems: First, most of the borrowers in USD are unhedged, as their income and expenditures are in national currency (this is especially evident in case of households). The problem became obvious in the period of GEL depreciation against USD, in the end of 2014, when the borrowers having the loan in USD were in difficulties in respect to paying the payment amount.

Georgian banks offer a wide range of products to customers. They are innovative in terms of new product development and are trying to be in line with global trends in the industry. In terms of technology development, most of the banks are offering remote banking channels to customers, such as internet banking, mobile banking, telephone banking, online consultancy, online payments, etc. However, these services are not developed sufficiently and many customers are more or less illiterate in terms of the efficient usage of these resources.

[6] http://www.eib.org/attachments/efs/econ_report_psf_and_the_role_of_rbi_georgia_en.pdf

For investors, deposit rates still remain high, e.g. term deposits range from 4% to 8.75 % in GEL, and from 3% to 5.25% in foreign currencies; Child deposits range from 7% to 8.75% in GEL and from 5.25% to 5.5% in foreign currencies; other products, such as saving accounts, on-call deposits, investment deposits, convertible deposits and others also exist for the savers. Few banks in Georgia have brokerage services, which gives the opportunity to the customers to invest in stocks on local and international financial markets, however this type of service is not well developed in Georgia, as the Georgian customers are not used to this type of investments yet.

Regarding loans, the main interest rates offered to retail customers for loans differ according to their purpose, for instance the interest rate for a mortgage loan is approximately 9 %; on consumer loans from 11% to 12.5%, on student loans from 19% to 20%, and for auto loans from 0% to 15%. Georgian banks are offering different debit/credit cards to their customers: visa (electron, classic, gold, platinum); maestro/cirrus; American express, which helps Georgian customers to easily handle all local and international monetary transactions.

In terms of wholesale banking, the banks have special terms for deposits and loans for corporate clients, which are dependent on the agreement between the parties.

Financial constraint has been one of the most cited obstacles for firm growth for small and medium enterprises (BEEPS surveys, Business Confidence Index). In the high risk environment of the Georgian market banks remain very conservative in their lending, and interest rates on national currency loans are rather high even when the company qualifies for such a loan. The interest rates have gone down quite significantly since 2011, but the problem of access to loans remains.

The capital markets in Georgia are still in the rudimentary stage. Hence, bank financing remains the only outside financing options for Georgian businesses, including start-ups. Bank financing is both costly and often inaccessible for small and medium enterprises. Raising capital for start-ups is a problem. In this environment, government programs which help export-oriented small and medium businesses with financing and training would help solve the problem. The long-term solution lies in developing intra-industry clusters which will be large enough to raise capital outside of the banks. Already now in Georgia large health-care groups, such as Evex, are raising funds on the London stock exchange.

2.7 Lending by Georgian commercial banks

Loans Granted in **Foreign Currency** to Resident Legal Entities by Type of Activity	2011		2012		2013		2014		2015	
	thous. Lari	%	thous. Lari	%	thous. Lari	%	thous. Lari	%	thous. Lari	%
Total	4,079,264	13.6	3,628,474	13.7	4,359,982	12.5	5,138,440	10.8	5,680,000	10.4
Agriculture, Forestry, Fishing	58,739	13.7	39,500	14.1	104,759	11.0	166,847	11.2	189,023	9.6
Industry	754,333	13.2	818,847	13.8	915,538	12.7	1,392,976	10.5	1,183,001	10.1
Construction	317,206	14.6	286,289	14.7	387,841	13.1	356,248	11.4	397,743	10.5
Trade	2,285,963	13.7	1,868,239	13.6	2,157,600	12.6	2,082,563	10.9	1,974,370	10.3
Hotels and Restaurants	25,998	14.2	57,073	14.2	156,320	11.9	225,302	10.2	256,690	9.2
Transport and Communication	131,224	14.5	112,511	13.0	216,450	13.1	149,202	11.7	549,305	12.2
Financial Intermediation	5,208	16.3	22,202	15.8	43,818	12.8	155,264	12.6	345,133	10.9
Real Estate, Researches	108,659	13.1	85,719	12.7	108,257	11.9	178,183	10.2	317,009	10.5
State Administration, Defense	22,689	9.0	0	0.0	5	20.1	0	24.0	0	24.0
Education	31,425	13.4	20,568	13.5	25,878	11.4	42,501	10.2	27,962	9.6

Health Care and Social Services	143,657	11.9	130,515	13.5	64,149	11.1	121,991	9.5	109,525	9.7
Other Services	194,162	13.5	187,012	13.0	179,367	12.0	267,364	10.3	330,238	10.6

Loans Granted in **National Currency** to Resident Legal Entities by Type of Activity	2011		2012		2013		2014		2015	
	thous. Lari	%	thous. Lari	%	thous. Lari	%	thous. Lari	%	thous. Lari	%
Total	2,145,611	14.9	2,329,902	14.7	2,628,308	13.4	4,102,939	10.2	7,432,846	9.1
Agriculture, Forestry, Fishing	22,257	14.9	20,378	15.3	49,122	12.2	116,903	10.6	109,023	11.0
Industry	590,869	14.2	826,238	13.5	570,444	13.4	633,044	10.8	684,187	11.6
Construction	283,192	15.4	302,382	14.9	225,485	14.7	251,918	12.7	283,233	13.5
Trade	840,359	15.6	871,641	15.8	1,165,128	13.7	1,459,320	12.3	1,718,654	12.9
Hotels and Restaurants	3,258	15.8	3,417	17.3	22,864	12.1	13,697	12.5	46,490	13.1
Transport and Communication	56,548	16.2	60,028	15.5	78,766	14.8	50,446	13.6	67,261	13.6
Financial Intermediation	24,751	13.6	20,086	15.3	89,137	10.4	1,058,306	5.2	4,117,862	6.2
Real Estate, Researches	47,820	12.9	17,111	14.2	55,547	13.0	86,995	12.3	24,665	12.3
State Administration, Defense	0	0.0	0	0.0	36	21.1	107	16.0	54	16.0
Education	17,868	15.5	15,882	13.1	14,250	12.9	22,652	11.9	18,008	13.2
Health Care and Social Services	29,178	14.4	40,485	15.1	70,641	12.4	228,334	11.6	110,123	13.2
Other Services	229,512	13.2	152,253	14.1	286,887	12.3	181,218	12.8	253,286	13.0

Among Georgian industries (excluding financial intermediation), trade remains the leading sector which attracts bank lending. This is driven primarily by the fact that trade is a relatively high-return type of activity which in the same time does not require long-term investment. Unfortunately, agriculture, the industry which stands to benefit most from DCFTA, attracts very little bank lending. This is driven both by the maturity of investments, low productivity in this sector and the uncertainty associated with agricultural production (crops, wine depend heavily on weather conditions from year to year).

Appendix 3: Regulatory and legal environment for investments in Georgia (DCFTA impact, Policy review and Legal Environment)

3.1 General trends in regulatory and legal environment

Georgia greatly desires integration of their economy with the global economy. Because of this, Georgian Parliament has been working since 1995 to liberalize the business environment.

Following the Rose Revolution in 2003, the Georgian government increased efforts to reduce corruption in public and private sectors and sought to meet international standards. These efforts have resulted in significant improvements in Georgia's ranking in various categories:

In 2015, according to World Bank's survey Georgia ranks **15th in the Ease of doing business category** (it was ranked 112th in 2005)

In 2015, The Heritage Foundation has ranked Georgia as the **22nd** among 178 countries **in the Economic Freedom Index**.[7]

Furthermore, among transitional economies, Georgia reportedly has seen the **largest reduction in corruption** in the years 2002-2005, according to the Business Environment and Enterprise Performance Survey (BEEPS), an EBRD/World Bank initiative.

The Georgian **tax system was also simplified**, customs duties were reduced and procedures for granting licenses. Moreover, the permits were simplified and now the country enjoys competitive trade regimes with many countries.

3.1.1 Current policy reforms

In 2016, Georgia has already introduced two new business reform that will make doing business easier both for domestic and international investors[8]:

- **Dealing with Construction Permits:** Georgia made dealing with construction permits easier by reducing the time needed for issuing building permits
- **Enforcing Contracts:** Georgia made enforcing contracts easier by introducing an electronic filing system for court users

3.1.2 Future/expected policy reforms

According to various report, it is expected that Georgia will continue to make reforms with the aim to attract more international investors.

3.2 Importing and Exporting

3.2.1 Developments & trends in customs policy

At the end of 2010, the Customs Code was repealed and customs provisions are now incorporated into the tax code. The consolidation of tax and customs rules into a single code did not involve any significant change in customs policies.

3.2.2 Import restrictions

There are no restrictions on imports into Georgia. Georgia has no quantitative restrictions (quotas) on trade.

3.2.3 Customs duties

For the **tariff classification** purposes Georgia uses the Harmonized Commodity Description and Coding System, in compliance with the 1984 International Convention on Harmonized Commodity Description and Coding System.

[7] http://investingeorgia.org/en/ajax/downloadFile/528/Investment_Climate_and_Opportunities_in_Georgia

[8] http://www.doingbusiness.org/reforms/overview/economy/georgia

Georgian **customs valuation rules** comply with the Agreement on Implementation of Article VII of the GATT 1994. This means that:

- The declared customs value should generally be used as the basis for determining customs duties
- The customs value should be determined in accordance with the six WTO valuation methods
- The customs authority is entitled to assess duties on a higher value in certain circumstances

There are also some goods that are **exempt from custom duties** such as:

- Export of goods
- Transit of goods
- Goods intended for official use of diplomatic representatives in Georgia
- Import of goods intended for oil and gas operations under the Law on Oil and Gas
- Goods produced in a "Free Industrial Zone" are free of customs duties when imported to an area outside the zone

Also, **goods originating in WTO member states are taxed at lower rates**. Oil products, including oil products from CIS countries, are taxed at a 0% rate. Except for construction materials and agricultural products, all kinds of raw materials and equipment delivered to Georgia are exempt from custom fees.

Excise tax is payable on alcoholic drinks, condensed natural gas (except for pipeline), oil distillates, goods produced from crude oil, tobacco products, automobiles and ferrous and non-ferrous metal scrap.

Unless expressly exempted under the law, imported goods are subject to **18% VAT** during customs clearance. The taxable base is the customs value of the goods, plus the amount of any import duties and excise duties (if any). In most cases, VAT is required to be paid within the period from 5 to 30 days after importing goods, depending on the conditions of the import. However, a taxpayer who carries out exclusively taxable transactions may later offset the import VAT against its output VAT liability, meaning import VAT may not be a cost. In addition, a taxpayer that has declared and paid VAT (output tax less input tax) for any continuous 12-month period in an amount exceeding GEL 200,000 is entitled to relief from VAT upon importation of goods.

3.2.4 Customs procedures and fees

All goods crossing the border are subject to customs control, which includes specific procedures aimed at ensuring compliance with customs rules. Other types of border control may also be conducted. The customs authorities may conduct post-entry audits to verify compliance with customs and tax legislation. An entity is subject to a fee of GEL 400 per customs declaration if the value of goods exceeds GEL 15,000, GEL 300 per declaration if the value of goods is between GEL 3,000 and 15,000, and GEL 150 if the value of goods is less than GEL 3,000. Customs fees for temporarily imported goods vary with respect to the weight of goods.

3.2.5 Export policies and procedures

Georgia has no export duties and exported goods are zero rated for VAT purposes.

3.3 Corporate environment

3.3.1 Legal framework

The Law on Entrepreneurship of 1994 outlines the procedures for establishing a presence in Georgia. Establishing an entity in Georgia is straightforward. Under the one-stop shop principle established in 2005, registration is conducted only with National Agency of Public Registry, and can be completed on the day that the required documentation is submitted if the higher fee for one-day processing is paid. Otherwise, registration will take 2-3 days.

Documents prepared overseas must be apostilled by the appropriate government body (or legalized through a Georgian embassy, if the head office or parent company is not in a state recognizing the Hague Convention on Abolishment of Legalization for Foreign Public Documents). In addition, documents prepared in a foreign language will need to be translated into Georgian once they are sent to Georgia and that translation should then be authenticated by a notary.

3.3.2 Legal forms

Individuals may operate business as sole proprietors. In addition, the Law on Entrepreneurs recognizes:

- Limited liability companies (LLCs)
- Joint stock companies (JSCs)
- General partnerships, which are limited to participation by individuals
- Limited partnerships, where some partners have limited liability and the other partners (who must be individuals) have unlimited liability
- Cooperatives, which aim to serving the common interests of their members rather than receiving profits

From a foreign investor's perspective, the choice will tend to be between a LLC, a JSC, a branch or a representative office.

3.3.3 Policies for foreign owned companies

Georgia is one of the most open countries to foreign equity ownership and policies are very business friendly. All sectors are fully open to foreign investment and establishing a foreign-owned limited liability company (LLC) in Georgia is fast (only 4 days), efficient (only 4 procedures, application is available online) and inexpensive (registration is at a low cost), no minimum capital requirement for foreign or domestic companies).

3.4.Labor relations and labor code

A new labor code came into effect in July 2006, and applies to all types of enterprises performing activities in Georgia and having local employees. The code is considered to be rather progressive in nature, and includes the following features:

- Salaries and wages – subject to agreement between the parties.
- Labor Contract – can be concluded for definite or indefinite period.
- Probation period – should not exceed six months.
- Vacation – each employee is entitled to not less than 24 working days annually.
- Maternity leave – employees are entitled to be paid maternity leave of 126 days. Maternity leave is partially paid from the sources of the Social Security Fund.
- Termination of a Labor Contract – employer should be informed 30 days prior about termination of a labor contract.
- Severance payment – amount of severance payment is equal to one month’s salary of an employee

The Heritage Foundation ranks Georgia first in the world in the Labor Freedom category of the Index of Economic Freedom, and the World Bank ranks Georgia fifth in the world on the Employing Workers indicator of Doing Business 2010.

3.4.1 Social security system

Georgia eliminated separate employer and employee contributions to social security at the start of 2008. Social security is now funded through the tax system.

3.4.2 Policies for foreign nationals

Nationals of Armenia, Azerbaijan, Belarus, Kazakhstan, Kyrgyzstan, Moldova, Tajikistan, Turkey, Ukraine and Uzbekistan have **visa-free** movement in Georgia.

Nationals of many other countries, including all countries of the European Union, Argentina, Australia, Bahrain, Brazil, Brunei, Canada, Chile, Croatia, Iceland, Israel, Japan, Kuwait, Malaysia, Mexico, New Zealand, Norway, Oman, Qatar, Saudi Arabia, Singapore, South Africa, South Korea, Switzerland, Thailand, United Arab Emirates, United States and Uruguay, may enter Georgia for **360 days without a visa**.

For those needing a visa, it is generally possible to obtain a visa/entry permit for 360 days at border crossing points at a cost of USD 30. Foreigners do not have to obtain special work permits to work in Georgia.

3.5 Taxation

3.5.1 Tax system and administration

Georgia is a country with low tax rates and transparent tax system. In 2005, Georgia introduced a new tax code that made radical changes to the tax system. Low tax rates were introduced and the 21 taxes that applied in 2004 were reduced to six in 2005. In 2010, another new tax code was enacted to take effect from 1 January 2011. The new code consolidated the tax and customs rules into a **single code**. In addition, the new code implemented further initiatives under three main objectives:

- **Taxes should be simplified**

Special rules for individual entrepreneurs should encourage small businesses to legalize their operations. Registered micro businesses (annual turnover below GEL 30,000) will be completely exempt from tax. Registered small businesses (annual turnover below GEL 100,000) will pay a turnover tax of 3% or 5%. For other taxpayers, withholding tax reporting and VAT and excise tax payments and reporting shift from a monthly to a quarterly basis.

- **Trust in the tax system should be increased**

This will be done through the formation of a stable and sustainable tax environment, simplifying the language of the code to remove ambiguities, and making tax administration more reasonable. A new chapter was introduced on taxpayer rights Taxpayers who believe their rights have been violated may make a complaint to the newly established Tax Ombudsman. Efforts were also made in the new code to improve the integrity of the administrative appeals process.

- **Georgian tax legislation should be better aligned with international best practice and EU directives**

New transfer pricing rules were introduced, and the VAT rules were amended to adopt several measures from the EU VAT Directive.

This tax initiative seems to be working well as World Economic Forum's Global Competitiveness Report named Georgia **#9** among low tax rate economies, which emphasizes the simplicity and reliability of Georgian tax system.[9]

Currently, there are only **6 flat taxes** in Georgia:

- Corporate Profit Tax (15% rate)
- Personal Income Tax (20% rate)
- Value Added Tax (18% rate)
- Import Tax (rates of 0%, 5% or 12%)
- Excise Tax (only on few selected goods)
- Property Tax (rate up to 1%)

Only property tax is a local tax, all other taxes are national. All taxes are administered by the **Tax Department of the Ministry of Finance of Georgia** and since 1 January 2010, all taxpayers have been required to file tax returns electronically. Furthermore, to avoid double taxation, Georgia has **Double Taxation Avoidance Treaties** with **52** countries and under current rules, taxpayers are required to obtain confirmation of treaty relief from the authorities for most payments, which involve filing an application form, along with a certificate of tax residence that has been apostilled or legalized in the investor's home country.

3.5.2 Taxation of corporations

Georgian entities and foreign entities doing business in Georgia through a permanent establishment are liable for corporate income tax with the standard **rate of 15%.** There is no system of group taxation in Georgia. Members of a group must file separate tax returns as there are no provisions to allow losses to be offset against the profits of another group member. From 1 January 2017, the corporate income tax will only be payable when profits are distributed or when certain events happen, such as the payment of non-business related expenses or the provision of free-of-charge services. As

[9] http://www.investingeorgia.org/en/georgia/taxation

such retained earnings will not be taxed and the tax base will be accounting profits from financial statement, removing the time consuming need to carry out separate tax accounting.

In terms of **dividend payments** companies must deduct withholding tax from dividends paid to individuals and foreign entities not having a permanent establishment in Georgia at a **rate of 5%.** It is also worth noting that dividends paid between resident companies are exempt from income tax.

Furthermore, the Tax Code of Georgia gives an opportunity to the companies to use **accelerated depreciation on capital assets** (including full deduction during first year) and loss carry forward for corporate profit tax purposes (10 years).

3.5.3 Taxation of individuals

At the start of 2009, Georgia shifted from taxing residents on worldwide income to a territorial system of taxation. Both resident (an individual is treated as a resident if he or she is present in Georgia for more than 183 days in any continuous 12-month period, including the time he or she spent outside the country for purposes of medical treatment, vacation, business trip or study) and non-resident individuals are subject to **tax only on income that has a Georgian source**. Georgian source rules generally follow international norms. An important exception, however, is that **salary has a Georgian source if it is paid through a Georgian payroll, regardless of where the employment is exercised.**

In terms of taxation rates, a flat **tax of 20% applies to most forms of income**, whereas dividends and interest are subject to **5%** tax rate.

It is also important to note that for individuals who do not operate their businesses as micro or small businesses, documented expenses incurred directly and exclusively for the purpose of generating business income are deductible.

3.5.4 VAT

Georgia operates the **input-output model of VAT**. Persons subject to VAT deduct the VAT paid on their inputs from the VAT charged on their sales and account for the difference to the tax authorities. **The standard rate** of VAT on domestic sales of goods and services and the importation of goods **is 18%.** Exported goods and related services are VAT exempt with the right to credit input tax. Unless there is an express exemption in the law, VAT applies to:

- Supply of goods and services where the place of supply is in Georgia (including when supply is made to employees without consideration or goods are used for non-business purposes)
- Importation of goods into Georgia

In most cases, the amount of VAT will be determined based on the transaction price for the supply of goods or services. If the tax authorities can demonstrate that the market price is different from the transaction price, the authorities may substitute the market price for VAT purposes. When goods and services are provided to employees free of charge or goods or services are used for noncommercial purposes, the supplier is required to account for VAT based on the market value of the goods or services.

Furthermore, a taxpayer is required to register for VAT if their sales for the 12 preceding calendar months exceeded **GEL 100,000**, or if they produce or import excisable goods. A taxpayer must also register if they will make a one-off taxable transaction in the course of economic activity in an amount exceeding GEL 100,000. Taxpayers whose revenues are below the GEL 100,000 threshold may voluntarily register as VAT payers.

3.6 DCFTA impact on Regulatory and legal environment

The DCFTA services provisions include a commitment from Georgia to align its legislation on financial, electronic commerce, postal and courier, and international maritime services with current and future EU legislation. This may trigger further access to the EU services market for Georgian service providers. It will also mean that EU investors in those sectors will find the same regulatory environment in Georgia as in the EU.

Appendix 4: Case studies and lessons learned for Georgia from CEE countries

Chapter summary

In order to enhance the export activities, Georgia should

- encourage and educate existing and potential exporters and implement export strategies, analysis and policies to **identify target sectors and countries for export activities,**
- Attract FDI through **stable macro-economic environment** as well as through **flexibility and openness,**
- Take advantage of the fact that country's **FDI is dependent on exports and exports are highly dependent on FDI** (some foreign companies that are registered in the home country also account for certain percentage of exports),
- Provide **government incentives** for investing in less developed sectors and areas of the home country as well as guarantees and insurances to encourage export activities,
- Provide the **same playing field** for foreign investors as the local firms have.

4.1 Bulgaria

Bulgaria's export

Bulgaria's exports have been rapidly growing since the beginning of the 1990s and the country is acknowledged as one of the **most open economic in Europe.** From entering in the EU, Bulgaria has made a significant progress in **shifting its economic policy from domestic demand-led to export-led growth**[10].

Bulgaria is the **66th largest export economy** in the world. It exported 41.0 billion BGN from January – November 2015, a 5.3% increase compared to the same period in 2014, but the country's **total foreign trade balance remains negative**. The export to EU countries only, accounted for 29.1 billion BGN in 2015, showing an increase of 7.9% compared to 2014. The foreign trade balance was also negative and added up to 4,175 million BGN[11]. Top export destinations are **Germany, Italy, Romania, Greece, France and Belgium** which accounted to 69.2% of the exports to the EU Member States.

In order to enhance the export of small and medium enterprises (SMEs) in Bulgaria, the Bulgarian Small and Medium Enterprise promotion Agency has implemented the project *"Promotion of internationalization of the Bulgarian companies"* with a budget of 14 mil EUR (funds from the Operational Programme "Competitiveness") that was carried out in order to **strengthen and expand the presence of the Bulgarian companies at European and world markets** and effectively use the advantages of the Single European market. The programme included **the development of a National Export Internet portal** that provided specialized services and eased the access of the Bulgarian companies to business information for export promotion and provided supporting Data Base of Bulgarian companies with export potential. Furthermore, **export strategies, analysis and policies** for the **prioritisation of economical sectors** have been executed where 18 priority export sectors and target international markets have been identified. The programme provided seminars and training courses for SMEs, information/consultancy services and advertising and publishing activities. Moreover, it organized trade missions and B2B Forums in Bulgaria as well as abroad[12].

Agriculture is one of the **core sectors** of the Bulgarian economy. It has passed through a rapid transformation since the last decade of the 20th century when the abolishment of state cooperatives and land restitution reforms were launched; as a result, all operations in the sector were liberalized and the sector was left to self-organize according to the

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[10] http://library.fes.de/pdf-files/bueros/sofia/10070.pdf

[11] http://www.focus-fen.net/news/2016/03/11/400236/bulgarian-exports-to-eu-in-2015-79-up-yy-preliminary-data.html

[12] http://export.government.bg/ianmsp/en/promoting-the-internationalization-of-smes

mechanisms of the free market economy[13]. Land reforms in Bulgaria also resulted in land use fragmentation as excessive as where land was distributed in physical parcels.

In 2014, around 50% of the territory of Bulgaria was utilised with agricultural land[14]. The agricultural export increased **3.13x** in the period 2006 - 2011[15]. The shares of the agricultural export and import up to 2007 remained relatively stable; however, after the accession to the EU, the export share has risen to 16.3% and the share imports reached 9.7% of overall trade. In the last several years there has been a gradual shift in the trade significance of the EU markets as more and more Bulgarian exports are **redirected to the markets of the third countries**, which can offer better sales conditions for the Bulgarian commodities[16]. However, **EU is still a major partner for Bulgaria's trade in agriculture commodities** – in 2012 almost 72% of export value was realized in the EU and 75% of the imports into Bulgaria were generated by Member States. Trade turnover has decreased, mainly due to decrease in exports to the Member states, while imports from the EU kept at the same level. Major trade partners from the EU are: Greece (18.8%), Romania (17.9%), Germany (9.2%), Spain (8.5%) and Italy (7.0%). The **productivity** of Bulgaria's agriculture sector is **among the lowest of the EU countries** (in 2011 it was around EUR 5000/AU which is equal to 35% of the average agriculture productivity in the EU) and has the **highest share of agricultural employment**. Agriculture sector employed 23.9% of the workforce in 2001 and declined to 19.2 percent in 2012. At the same time, the productivity has been trending downwards. The lower productivity in crop production can be explained by inefficient usage of inputs, worse production management, less productivity of seedlings and plants, and worse natural conditions (Republic of Bulgaria, 2014). Nevertheless, Bulgaria's land productivity has **improved significantly** for several crops since EU accession, though a major drought in 2012 constituted a major setback (World Bank, 2015).

The changes in the **structure of farm holdings** and the **use of the agriculture lands** were particularly dynamic. Number of agricultural producers have been falling constantly in the last 15-20 years. In 2003 there had been over 650.000 registered producers and in 2013 the number fell to about 250.000. Cooperative farms have been in constant decline, too. Between 2003 and 2010 both their number and the land they use fell by about 50%, but, at the same time, private agricultural investors have enjoyed high growth levels. Despite that there are still many small producers, they have very **limited access to land**[17]. Moreover, between 2005 and 2010, **Bulgaria's average farm size doubled** from 6 ha to 12 ha, which contributed to a significant decline in agricultural full-time employment (World Bank, 2015). Bulgaria has experience with land consolidation, but not yet a programme, but it may be expected to have operational programmes within the next few years if the preparation continues to go well. Biggest remaining challenges are to build up technical and administrative capacity to implement land consolidation projects in the field and to manage the programmes as well as to secure funding for the programme[18].

The 87% of the employed in the agriculture sector were reported in the holdings of **physical persons,** which rely mainly on family labour inputs and 29% of the employed were elderly people above 65 years of age. Above 96% of the holders have only practical qualifications in agriculture and **barely 1.3% of the managers have higher education** and this is the economic sector with the lowest share of employed with higher education. **Policies that boost labour demand outside of agriculture** combined with **continued investments in farm modernization and improvements of agricultural products**, for example, by developing strategies for voluntary land consolidation and investments in hydro-amelioration, could help accelerate Bulgaria's structural change (World Bank, 2015). Through the organisation AKIS (The Agricultural Knowledge and Information System) there have already been efforts to improve internal and external communication,

[13] http://library.fes.de/pdf-files/bueros/belgrad/10399-20131211.pdf

[14] https://www.gov.uk/government/publications/exporting-to-bulgaria/doing-business-in-bulgaria-bulgaria-trade-and-export-guide

[15] http://appsso.eurostat.ec.europa.eu/nui/submitViewTableAction.do

[16] http://library.fes.de/pdf-files/bueros/belgrad/10399-20131211.pdf

[17] http://www.criticatac.ro/lefteast/landgrabs-and-the-eu/

[18] Annual World Bank Conference on Land and Poverty (2016). Land consolidation in Central and Eastern Europe – Integration with local rural development needs.

technology development (innovative IT use), to upgrade the human resource development and to provide various training courses to farmers. Moreover, **the farm advisory services** in Bulgaria are currently delivered by the National Agricultural Advisory Services and private advisory organisations. The NAAS has been established since 1999 to provide farmers with information, specialized extension and consultancy services to ensure **effective and competitive agriculture**[19].

Bulgaria still exports a relatively **high share of primary exports and relatively few medium-high tech goods**[20]. But in recent years, Bulgaria has started to export some more-sophisticated export goods – for example, it started to gain a comparative advantage in the export of copper alloys. Top exports of Bulgaria are **Refined Petrolum, Refined Copper, Raw Copper, Wheat, chemicals and manufactured items such as footwear, clothing, machinery and medical equipment**[21].

During the first two years of full EU membership, Bulgaria's exports have registered significant increase showing that the **accession process had a positive effect** on the performance of Bulgarian exports firms. Furthermore, dynamics of Bulgaria's exports to third countries followed the dynamics of exports to the EU, implying that there has been **no "trade diversion" effect**. The heavy drop of Bulgaria's exports mainly attributed to **the decreased demand in main trading partners due to the effects of the global financial and economic crisis.** Bulgarian export markets were low diversified. The top six major partners (Greece, Germany, Turkey, Italy, Romania and Belgium) accounted for 49% in 2008 and in 2009 already 51.7% which indicated a high dependence on the economic situation in those countries[22].

The period between 2007 and 2011 show **shift of Bulgarian exports towards the EU**, mainly driven by exports to Romania and partly to Germany. The share of other major EU markets was either declining (Italy, Greece, Belgium), or stagnating. Also the share of Bulgarian exports to the new member countries (joined to EU in 2004) and as well as to the Western Balkan region was falling. The growing share of Germany may point to **growing orientation** to one of the **most competitive and largest EU markets** and the rapidly growing share of Romania can be explained by Bulgarian successful use of the trade-creating effects of free trade with its Northern neighbour.

Since 2009, exports of goods and services grow at an annual rate of 9.5% and were driven by merchandise exports. **Total exports reached 68 percent of GDP in 2013,** which was much higher as the EU average at 44%. Moreover, summed exports and imports added up to 140% of GDP in 2013, compared to 77% in 2000. But the **exports per capita remain low**, reflecting the **low value added of exports** and its output.

In several countries, the technological progress has been supported by the export sectors, but that was not the case in Bulgaria. Bulgaria has been exporting **medium-to-high technology manufacturing products for decades,** the companies were not **able to expand on these exports** and the productivity growth of exporters has been limited.

Export-oriented sectors of the economy have recovered faster from the crisis. Bulgaria's gains in word market shares was sustained in 2013 and are projected to continue through 2016. Geographical and product specialisation of the country have shown that the country expanded its share on export as well as on import side in the 2008-13 period. Furthermore, **positive market dynamics** (markets growing faster than the world average) is shown by the main trading partners[23].

Bulgaria's FDI

The Bulgarian Constitution defines that foreign persons (legal entities, individuals or civil partnerships registered in a foreign country should enjoy **equal rights with local persons when conducting economic activities in Bulgaria** except where "national treatment" law is applicable. Equal treatment of local and foreign investors is also provided by **the**

[19] http://library.fes.de/pdf-files/bueros/belgrad/10399-20131211.pdf

[20] http://www.worldbank.org/content/dam/Worldbank/document/eca/Bulgaria/Bulgaria-Productivity-6-26-15-eng-web.pdf

[21] http://atlas.media.mit.edu/en/profile/country/bgr/

[22] https://www.u-picardie.fr/eastwest/fichiers/art110.pdf

[23] http://ec.europa.eu/europe2020/pdf/csr2015/cr2015_bulgaria_en.pdf

Investment Promotion Act (IPA). Bulgaria is also a party of 63 bilateral agreements for mutual protection and encouragement of foreign investment where more favourable investment terms and conditions for the investors of the contracting country will enjoy preferential investor treatment. Under IPA, certain state financing incentives are available for local and foreign investors that invest in certain economic activities in Bulgaria[24]. The investment has to be in the area of **manufacturing industry, high-tech services, R&D, education, healthcare, warehousing and logistics**. Further **benefits that are available to the investor** are shortened administrative procedures, preferential acquisition of state or municipal land, financial support for professional training/education, infrastructure and labour cost subsidies and individual administrative services[25].

In the early 2000s, many countries in the region became attractive FDI countries, but the crisis in 2008 slowed down FDI inflows. **Benefits of Bulgaria for FDI in early 2000 were market potential, low labour costs, well-trained and motivated workforce, and possible membership in the EU and improvements in the economic and business environment**. In recent years, the lack of educational improvement of the labour force and of efficient institutions has presented a constraint to FDI. Nevertheless, Bulgaria was part of the **group of 15 countries with the highest number of new jobs, related with the FDI in 2013**.

On the **attractive side**, Bulgaria offers a **stable macro-economic environment** and **an investor - friendly tax system** with a flat rate of 10 percent on corporate income, as well as reduced corporate tax for investors investing in less industrialized regions or regions with higher unemployment, **low cost of living**, **member of the EU** and a **good strategic geographical position**. On the negative side, Bulgaria is **lagging behind in terms of infrastructure**, **higher education, business sophistication, innovation**, has **inefficient bureaucracy**, **high level of corruption**, non implementation of the intellectual property and copyright law and significant amount of the population having limited revenue[26].

After the crisis, the FDI flows have been balanced in their industry composition. The sectors that attracted foreign investors have been **energy sector, including renewable energy sources, manufacturing, transportation & telecom and trade & repairs**[27]. Furthermore, FDI has a **positive influence in improving innovation** in Bulgaria. One in four innovating firms that are exporting goods from Bulgaria have received significant FDI, compared to one in 15 in the non-exporting innovative group.

Recent measures to promote FDI include Programme "**Promoting the advantages for investing in Bulgaria**", executed by the InvestBulgaria Agency (funded 85% by Operational Programme – Development of the Competitiveness of Bulgarian Economy 2007-2013, 15% by the national budget) that followed general objectives **to increase volume of attracted FDI** and positive economic effect of them and well as **improving business environment and the investment climate** in Bulgaria. Main components include providing analytical information on current investment processes and **identifying target sectors for investment promotion in Bulgaria,** based on its **competitive advantages**, conducting marketing and advertising program for investment promotion in the target sectors and countries and diversification of the package of services and developing an integrated information system[28].

To further strengthen its FDI, Bulgaria' strategic focus should be on **export-oriented sectors** with **higher-value added** and with long-term positive employment benefits. Furthermore, it should focus on sectors that **allow sustainable growth through attractive industry clusters.** High priority sectors where Bulgaria has certain competitive advantages are

[24] https://www.kpmg.com/BG/en/IssuesAndInsights/ArticlesPublications/Investment-in-Bulgaria-2015/Documents/2015-Investment-in-Bulgaria-web.pdf

[25] Invest Bulgaria Agency. Bulgaria – investment climate and business opportunities.

[26] https://en.santandertrade.com/establish-overseas/bulgaria/investing

[27] http://ec.europa.eu/europe2020/pdf/csr2015/cr2015_bulgaria_en.pdf

[28] http://www.investbg.government.bg/files/useruploads/files/iba-project_presentation-eng.pdf

transport equipment and machine building, electronics and electrical, chemical & plastics, food & agriculture, logistics, IT, outsourcing. These sectors have significant export, employment and regional development potential[29].

Bulgaria should also start to put emphasis on building capabilities in **a selected number of emerging global industries that have 5-10 year perspective** and put a focus on it where it could establish itself as **an innovation leader in the next 10 years**: IT & outsourcing – focus on attracting additional investments in IT/software and in parallel, attract R&D investment in latest IT technology; CleanTech – Bulgaria's renewable energy legislation should be used as a marketing base for attracting manufacturing and R&D capabilities in the sector; Food and agriculture-related biotechnology – attracting FDI in the food and agri-sector as well as investments related to bio-foods, nutraceuticals…; healthcare and wellness related industries – taking advantage on natural endowments in order to build an infrastructure in the healthcare, pharmaceuticals and medical device industries.

4.2. Estonia

Estonia's export

Estonia is **a small and very open economy** what makes it flexible, but consequently **volatile and vulnerable to foreign trade developments**. The goal of the government for the economic policy has been to create conditions for **sustainable economic growth** which would result in increased welfare and real convergence with developed countries[30].

After gaining its independence from the collapsing Soviet Union in late 1991, Estonia introduced in 1992 its **own national currency the kroon** and **pegged its value** at eight kroons to the Deutsche mark. It switched to fixing to the Euro after its introduction. The peg to the Euro was upheld until January 2011 with Estonia's adoption of the Euro.

As Estonia established the currency board, its current account became **strongly positive as the trade direction** shifted sharply from Russia to other CIS countries to Western Europe and beyond. Furthermore, the citizens converted their hard currency hoards into local currency, enterprises repatriated deposits that were deposited in foreign banks and foreign **private investments began to flow into Estonia**. On the other hand, the currency board system has caused the kroon monetary base to grow, consequently **increasing the domestic inflation.** Nominally fixed exchange rate resulted in real appreciation of the kroon against the Deutsche mark as well as other western convertible currencies. The trade and current accounts turned negative in the last quarter of 1993 and until 1994 which negatively affected exporters[31]. Nevertheless, the kroon has become hard currency that has **attracted capital inflows** which have **expanded the money supply, reduced interest rates and stimulated a revival of the real economy.** Compared to the other two Baltic countries (Latvia and Lithuania), the performance of Estonia was by far the best[32].

Later was Estonia also the **quickest among new European Union members** to meet the EU's financial convergence criteria. Nevertheless, the last decade of remarkable growth influenced increase in wages, which resulted in worsening labour cost competitiveness and increasing inflation which postponed the plans to join in the Euro Zone[33].

Export market performance has been **properly evolving over in the last 10 years.** Estonian export market shares have grown in line with Central Eastern European economies. Furthermore, the domestic **value-added content of exports** rose significantly between 2005 and 2009. But export competitiveness has been **weakened due to strong wage and subdued productivity growth** that pushed up unit labour costs greatly since 2011. Business surveys show that firms

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29 http://www.investbg.government.bg/files/useruploads/files/statichni_stranici/statistics_and_analyses/fdi_strategic_analysis_results_eng_final.pdf

30 http://estonia.eu/about-estonia/economy-a-it/a-dynamic-economy.html

31 http://www.ecofuente.freeservers.com/eco/eco27.htm

32 https://piie.com/publications/chapters_preview/20/1iie2229.pdf

33 http://unctad.org/en/Docs/diaepcb2010d4_en.pdf

reported growing worsening competitiveness, although a majority of firms are still reporting improving its competitiveness[34].

Country experienced a **serious contraction of output in the course of financial crisis**. In the following years, the **economy recovered quickly, led by exports**. Also a very **strong fiscal positions** helped to restore financial market confidence. Nevertheless, the economic growth started slowing again in 2012 on the account of weaker exports. Declining activity in Finland and Russia, together with the slow recovery in the euro area contributed to lower exports.

In Estonia, the export accounts **approximately for 85% of national GDP**. The share of the European Union countries accounted for 75% of Estonia's total export and 83% of Estonia's total import. The main export countries of destination have been **Sweden** (19%), **Finland** (16%), **Latvia** (10%) **and Russia.** The major exports in 2015 were **electrical machinery and equipment and parts** (21%), **wood and articles of wood** (10%) and **different mineral products,** including gasoline, shale oil and electricity (10%)[35]. Estonia exports also services, which represent about third of all exports. Among the most popular services are transportation, travel, business, IT and communication goods[36].

The **growth of exports has been moving slowly** in the recent years as Estonia's exports are quite dependent on a few markets and sectors. Among the most relevant markets, the **import demand in Latvia and Finland** has been **stagnant** in the last two to three years and **demand in Russia has declined** due to economic crisis and economic sanctions[37]. In 2015, export to Russia declined by 35% in 2015.

Even though that the **costs of wages are rapidly increasing** and there has also been a **small decrease in competitiveness,** Estonia' position in export markets does not seem under threat as market shares seem to **have further expanded**[38]. The growth of exports should strengthen in 2016 and should be supported by more robust growth among Estonia's trade partners[39].

The **number of Estonian exporters has been constantly growing** which shows the increasing **international competitiveness** of Estonian enterprises. Especially the number of Estonian exporters in foreign ownership has increased significantly. In 2015, exports from Estonia amounted to 11.6 billion EUR.

In 2014, relative to the world, Estonia was relatively specialized in **more labour-intensive areas**, such as metals, stones, textiles, wood pulp, paper and furniture. But in 2013 and 2014, the number of exports contracted and at the same time, the exports in **less labour-intensive subsectors expanded by 5%** (e.g. in computer electronics, pharmaceuticals, printing, machinery and vehicles). Generally, Estonia has become **a net exporter of semi-finished goods** and has largely reduced its dependence on capital goods. It also simultaneously expanded its large market share in the labour-intensive wood sector which is shifting toward higher value-added products such as prefabricated wooden houses. Based on the latest recommendations of the European Commission from 2016 report, the country should provide **higher investments in technological development** to strengthen productivity growth, **foster higher value added exports of goods** and **raise potential output**[40].

Based on the information provided in *the Estonian Entrepreneurship Growth Strategy 2014-2020*, there **are too many operators with not enough ambition** in the area of product development and aspiration toward foreign markets. The active participants in the export market also **lack cooperation**, which is in case of small volume of export often essential for success. Other main challenges included the fact that the **export capacity** of Estonian companies **is very strongly polarised** – 100 larger exporting enterprises account for approximately 1/3 of the total export turnover. There are also

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[34] http://www.oecd.org/eco/surveys/Estonia-Overview-2015.pdf

[35] http://www.tradewithestonia.com/estonian/economy-facts

[36] http://www.companyincorporationestonia.com/imports-and-exports-in-estonia

[37] Swedbanks. Macro Research. The Estonian Economy (2015)

[38] EBRD. Strategy for Estonia (2016)

[39] Swedbanks. Mcro Research. The Estonian Economy (2015)

[40] http://ec.europa.eu/europe2020/pdf/csr2016/cr2016_estonia_en.pdf

limited exporting territories as 60% of Estonian exports of products and services go to neighbours in Scandinavia and the Baltic region, as well as to Russia. Only approximately 20% of export is sold to more distant target markets.

Following actions have been planned to encourage and enhance the Estonia exports:

- **Improving the export capacity** of Estonian companies by target-country specific trainings and pilot programmes
- **Offering a funding scheme** to support medium and long-term export transactions and state-guaranteed insurance of export credit
- **Mitigating the risks** of Estonian exporters by offering export credit insurance and decreasing financial risks related to purchasers[41].

Furthermore, besides *Estonian Entrepreneurship Growth Strategy 2014-2020*, the Ministry of Economic Development and Communication has also prepared an action plan *"Made in Estonia 3.0*", being a continuation of action plans of the same name in 2009-2011 and 2012-2014 and which presents The Estonian foreign investments and export action plan for the years 2014-2017 for **increasing the export capacity of Estonian companies and involving foreign investments** where the objectives are to increase Estonian export turnover, export value added and number of exporters[42].

Estonia's FDI

Foreign investors have played a decisive role in building Estonian economy. The country has not based its attraction of FDI on specially-designed support schemes but on **its favourable business environment that attracts and strives to make a difference**[43].

Estonia is one of the **leaders in Central and Eastern Europe** in terms of **FDI per capita**. The country seized the opportunity during considerable uncertainty and volatility when embarking on policy reforms in 1993 after declaring its independence in 1991 and consequently achieved almost **complete investment and trade liberalization** really soon[44].

Since the early 1990s and especially as of the 2000s, Estonia had a **significant rise in inward FDI**. Between 1994 and 2008, the Nordic countries accounted for 76% of Estonia's inflows. The most important FDI inflows in the early 2000s were in **wholesale and retail trade, as well as in real estate activities**. As of 2005, there have been massive inflows of **financial FDI,** mostly due to **expansion of foreign banks** that entered into market in the late 1990s. As of the same year, more than two thirds of FDI has been in financial services, real estate and business services sectors. Additionally, there have also been several major investments in **transport, storage and communication**[45].

The Estonian international trading has been established by the **EU Common Commercial Policy** starting from May 2004, after entering the EU and in obligations stated by the World Trade Organisation (WTO). In 2010, Estonia became the 34th member country of the Organization for Economic Cooperation and Development (OECD).

Estonia presents an **attractive country for foreign investors** as its business environment is based on the principles of **flexibility and openness**. It can be treated as a country with a friendly economic climate, favourable to business growth and cost advantage. **Government programmes cover several priority areas:** R&D projects, technology development centres, support for Export Marketing, science and technology parks and incubators, start-up assistance… Estonia also ranked **16th** in the World Bank's **ease of doing business index**, placing right after Germany and before Ireland.

The **corporate tax** has had a **downward slope** in recent years as the Estonian Parliament decided to cut the corporate tax rate in 2005 from 26% to 24%. In 2006 the tax rate was reduced to 23% and in 2007 the corporate tax reached to 20%.

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[41] http://kasvustrateegia.mkm.ee/index_eng.html

[42] https://www.mkm.ee/sites/default/files/mie_3.0_english_version.pdf

[43] http://estonianexport.ee/?page=c51&lang=eng

[44] http://unctad.org/en/Docs/diaepcb2010d4_en.pdf

[45] http://unctad.org/en/Docs/diaepcb2010d4_en.pdf

Furthermore, since 2000, Estonia has a **zero corporate tax rate on reinvested profits**, which means that only the distributed profit is subject to taxation. The first effect were decreasing incomes in the consolidated budget which were at half value from the previous year from introduction. However, the revenues recovered within few years. The positive effects of this measure include **increasing of investments, production and taxable income** what suggests that lower taxes contribute to economic growth while increasing budgetary of the state. In 1999-2004, FDI almost tripled, including net investments. Within 2000-2007, reinvested profits increased more than 12 times, from 46.1 to 673 mil EUR[46].

Moreover, government has developed a **platform e-Residency** which can be used for digital signing, for a smooth and simple business from wherever you physically are in the world. With this platform, Estonia was the first country in the world to offer **state-issued secure digital identity for non-residents**[47].

Foreign investors are guaranteed a **level playing field with local firms**, including unrestricted repatriation of profits and capital along with the right to own land. Besides rapidly expanding offering of high-quality commercial and office property, there is also a growing number of industrial parks. Establishment of **free zones** has further enhances Estonia's attractiveness to foreign investors. There are four free trade zones in Estonia where goods are considered as being outside of the customs territory. **Several costs** (labour costs, transport, services, telecommunications…) are considerably **lower than in other parts of the Baltic Sea region**. Nevertheless, Estonia has gained a reputation for the high quality of its products[48].

To sum up, rapid privatisations and organisational restructuring, flexible labour market policies, balanced budgetary policies, flat tax system, with no taxation of reinvested profits, e-government public services and other free-market reforms have contributed to these **Estonian success**, besides other factors. These measures attracted foreign investments and economic growth[49].

4.3. Slovakia

Slovakia's export

Slovakia is a relatively small, but a **well-integrated export-oriented** country. The country is placed as a first-class world exporter and as **third most open economy** in the European Union. It has Germany and the Czech Republic as its largest trading partner[50]. It is currently the **45th largest exporter** in the world. The country is highly dependent on its exports and the export is highly dependent on FDI[51].

Slovakia has become one of the **strongest economic performers among new member states**. Growth was driven by **productivity gains and resilient export**. During the past decade, Slovakia has executed a very a successful **restructuring strategy** and export industries received special attention. The **automobile industry** has become the most important exporting industry. It doubled between 1997 and 2007, but it was also subject to severe cyclical fluctuations. Improvements of export were also **significant in building fixtures and telecom equipment**. Performance of traditional export industries like iron & steel and footwear were performing less well.

The crisis lowered Slovak exports by almost 20% in 2009, but the growth quickly returned and reached pre-crisis levels in the second quarter of 2011[52]. Currently, **exports as well as strong domestic demand keep propelling the Slovak**

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[46] http://www.companyincorporationestonia.com/taxes-on-reinvested-profit-in-estonia

[47] http://www.estonianexport.ee/

[48] http://estonia.eu/about-estonia/economy-a-it/a-dynamic-economy.html

[49] http://www.cea-policy.hr/flat-tax-reforms-in-estonia-and-slovakia/

[50] http://www.euro-challenge.org/wordpress/wp-content/uploads/2016/01/Slovakia-2016.pdf

[51] http://www.iz.poznan.pl/news/1150_Slovakia.pdf

[52] https://dgap.org/de/article/getFullPDF/25437

economy, which is predicted to grow by more than 3% during each of the next three years[53]. A total of 84% of exports are to EU members.

Due to export development, certain vulnerabilities were exposed. The Slovak economy has become **strongly dependent on foreign demand**, especially from Germany and the Euro area. Moreover, the export industries that have expanded have been mainly capital intensive and production growth on the account of increased exports only partially resulted in employment increase. Furthermore, **large regional imbalances** were exposed due to focus on large companies that imbalanced the Slovak labour market[54].

In Slovakia, domestic demand is depending on income that **is generated by the foreign-owned export** sector. **Unfavourable external shocks** are consequently not mitigated, but rather encouraged by the positive correlation of private consumption and residential investment with income growth in the export sector[55].

SMEs are lagging behind the large companies as in 2012 the number of SME that were exporting reached the number 27.474 which accounted for **97% of all Slovak exporters**, but it represented only **27,8% of the overall value of Slovak export**. Nonetheless, Slovak state institutions take internationalisation as a priority[56].

A dynamic export sector made Slovakia one of the **fastest growing economies in Europe** after the crisis and domestic demand has also picked up. But strong export **has left some regions behind** and Slovakia experienced rapid economic convergence, regional disparities in terms of income and employment remain among the largest in the EU[57].

Top exports in Slovakia (2013) were **cars** (18%), **video displays** (7.9%), **vehicle parts** (5.7%), **refined petroleum and vehicle bodies**. Besides Germany and Czech Republic mentioned above, the top export destinations are also Poland, Hungary and Austria[58]. In 2015, total exports grew 4.9% year-on-year and accounted for 67.87 billion EUR.

Slovakia's FDI

Slovakia is an **attractive country for foreign investors** and has been in recent years pursuing a policy of encouraging foreign investments[59].

"Tatra Tiger" refers to the massive growth of the Slovakian economy in the early 2000s. The growth was the positive consequence of the **economic liberalization**, which included government decisions to **lower taxes and barriers to foreign investment**. Moreover, privatization and semi-privatization that included health care, social security systems and tax reforms, made the economy very attractive to foreign investors at that time[60].

In the early 2000s, Slovakia successfully created an image of a **business-friendly and fiscally prudent country** that also has **lean state.** This was possible on the account of **austerity measures** that were passed in 1999 and included also a **reform of public finances to restrains in fiscal spending** and **privatization of state-owned banks**. Measurements in the banking sector (removing bad loans from the portfolio and recapitalization) directly **costed around 11% of GDP**. Moreover, the largest banks were then sold to new foreign owners. Consequently, the Slovak banking sector is now in much better shape compared to most EU countries[61].

The corporate **tax rate fell from 40% in 1999 to 19% in 2014**, foreign investment regulations were liberalized, labour laws were loosened and restrictions on starting new business and acquisitions were mostly eliminated. According to the

[53] http://spectator.sme.sk/c/20057936/slovakias-economy-continues-growth.html
[54] http://ftp.iza.org/pp55.pdf
[55] http://ftp.iza.org/pp55.pdf
[56] http://www.iz.poznan.pl/news/1150_Slovakia.pdf
[57] https://www.imf.org/external/pubs/ft/scr/2016/cr1613.pdf
[58] http://atlas.media.mit.edu/en/profile/country/svk/
[59] http://exportbritain.org.uk/market-snapshots/slovakia.html
[60] http://intpolicydigest.org/2015/09/14/slovakia-is-open-for-business/
[61] https://dgap.org/de/article/getFullPDF/25437

World Bank's publication "Doing Business in 2005", Slovakia was named world's top reformer in liberalizing the investment climate. Furthermore, foreign and domestic investors were also persuade by the low cost and wage environment, country's geographic central location and educated labour force. Additional stimulation was also full membership in the EU (2004) and adoption of the euro (2009)[62].

Nevertheless, **the frequent legislation changes** that were imposed by new governments and an associated risk of regulatory uncertainty **diverted investors** from Slovakia. FDI significantly **fell in 2010** (the remaining inflows were mostly in connection with equity investment in the financial sector) and remained negligible afterwards. Therefore, **FDI did not contribute to the recovery from the financial crisis**[63].

FDI inflows averaged 7.8% of GDP between 2004 and 2008 but fell to 2.1% of GDP between 2009 and 2014. The vast majority of investments **originated from the Eurozone,** with Netherlands[64] (29%), Germany (15%) and Austria (14%) as top three. Foreign investments have mainly been in manufacturing and financial services[65].

The **nature of FDI** inflows has **changed. Large greenfield FDI** were dominating before the crisis, but since the crisis the **investments in existing plants** have become more important. These investment created fewer additional employment opportunities and have attempted to defend the viability of existing operations in the face of the strong real appreciation before euro adoption, new competitors in the region and the worse outlook for Slovakia's main export goods (cars and flat screens)[66].

FDI is unevenly distributed within the country as Bratislava and Western Slovakia are attracting by far the largest share of investment inflows. Furthermore, **lack of sufficient interconnections** and **low quality of transport infrastructure** exacerbate the regional divide which is also evidenced by regional income differences.

The investment incentives (or state aid) represent one of the tools for motivating investors to execute their projects also in **less developed regions.** In Slovakia, there are four categories of projects that can be supported by investment incentives, if meeting certain criteria: **industrial production, technological centres, shared services centres and tourism**. Tax incentives are provided in different forms, i.e. as **subsidy** for the acquisition of material and immaterial assets, as **income tax relief**, as **contribution for created new jobs** and for **transfer or exchange** of immovable property at a **lower price**[67].

Some of the **main advantages** for the **foreign investors** are the **well qualified and inexpensive workforce, advantageous tax system** (single tax rate of 19%) and **existence of several financial aids favouring foreign investments**, whereas the **weak points** are important **technical and administrative barriers** such as requirement of import licences especially for raw materials, energy and some agricultural products, **high energy costs and insufficient infrastructure** and small domestic market with low purchasing power[68].

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[62] http://www.aabri.com/SC2015Manuscripts/SC15050.pdf

[63] http://ftp.iza.org/pp55.pdf

[64] The high proportion of investments from the Netherlands is likely due to companies that are formally registered there for tax purposes but have headquarters elsewhere (including the USA).

[65] https://dgap.org/de/article/getFullPDF/25437

[66] http://ftp.iza.org/pp55.pdf

[67] http://www.sario.sk/en/invest/investment-incentives

[68] https://en.santandertrade.com/establish-overseas/slovakia/investing

Appendix 5: Building Block 1: Gap analysis, Assessment of investment environment and opportunities

5.1 Identification of potential gaps on a sector level

In our research, we did the analysis and performed interviews with the relevant stakeholders from the following sectors:

- Aerospace and Defense
- Agriculture
- Creative (music, fashion, art)
- Energy and utilities
- Fertilizers/ Chemicals
- Financial services
- Food processing
- Healthcare
- Industrial manufacturing
- Infrastructure
- Light manufacturing
- Livestock (i.e. animal breeding)
- Mining
- Pharmaceuticals
- Services
- Start-ups
- Textiles & apparel
- Tourism
- Transportation & Logistics

The scoring for the individual sectors has been performed for four topics: *sector, demand, industry and competition* based on the below categorization system:

★★★★★	Excellent
★★★★	Good
★★★	Fair
★★	Poor
★	Very poor

In the following we will provide you with a short summary of each sector before short listing the sectors that were selected for action plans and where existing or potential competitive advantage has been identified.

Agriculture

Category	*Grade*	*Comment*
▪ Sector	★★★★	*Agriculture is one of the most important sectors in Georgia. It has several different microclimates that offer possibilities for diverse agricultural activities. It is also one of the few industries that does not have any human capital issues in Georgia.*
▪ Demand	★★★★★	*Agricultural products are in constant demand, therefore there is sufficient demand both locally and internationally for agricultural produce from Georgia.*
▪ Industry	★★★★	*There are established supplier industries and value chain elements that enable the future development of agriculture, such as; food processing, retail, fertilizers, transportation and logistics*
▪ Competition	★★★★	*sector is competitive and this competitiveness will also drive future development and growth in the sector as the fragmented competitors will start consolidating and creating stronger market players with larger economies of scale and competitive reach*

Factor conditions

Georgia is traditionally an agricultural country as agriculture and agribusiness account for 9.2% of the GDP and 17.5% of trade volume and approximately 53% of all labor force works in this industry. The country was renowned as a quality food supplier during the Soviet times and the Georgian food & beverage products are still well-recognized as healthy and supreme quality brands in CIS region. Georgia has good climate conditions and fertile land (soils are of volcanic origin located in the river valleys) as there are over 21 micro-climates in Georgia allowing a wide range of grain, vegetables, hard and soft fruits, meat and dairy, to be farmed.

Labor costs are very low, as employees in agricultural sector, although very experienced, receive 30%-40 % less wage than the national average. The average gross monthly salary in the agricultural sector in Georgia is USD 206 and wages can be expected to remain competitively low given the high level of unemployment in Georgia. Furthermore, as Georgia has big amount of water resources, the access on water is easy and cheap. Also, other utility prices such as energy and gas are generally low. But it is important to note that productivity level is generally lower than in most regional economies and the root-causes for underperformance lie in fragmented industry structure, lack of investments and obsolete machinery.

Furthermore, in recent years the Georgian government has become very supportive concerning the investments in the agriculture business. Land ownership and farming is highly fragmented with a low level of membership in cooperatives. This offers a great opportunity for the investor to enter and consolidate the market, as there are no restrictions on foreigner ownership. The government has created an environment that promotes the entry of foreign companies to help develop agricultural businesses in Georgia. The projects of building new agricultural products processing plants can get a grant from the government with a total value of up to 250 000 USD (maximum 40% of the value of project). Additionally, investor can buy state owned immovable nonagricultural property for 1 GEL (symbolic price) if the investment made on processing plant is 4 times more than its market value.[69] There are also many untapped business opportunities in most of the areas in the value chain. There are business opportunities not only in farming but also in supplying equipment and services (storage, deep-freeze facilities, processing, packaging and other).

Demand conditions

Domestic demand in Georgia is currently on the rise and it equals, if not exceeds, the export opportunity. Goods currently principally imported are:

- Wheat
- Feed and seeds
- Meat and poultry
- Specific types of pesticides
- And others

Export business is nonetheless also important and nuts and wine are considered the most important exports as they represent nearly half of all agro-related exports, while other products such as water, spirits, live animals and citruses represent the rest.

DCFTA effect[70]

Overall, enhancement of trade and investment relations with European countries should have sizeable positive effects on Georgian small-holder farmers, but given the obvious competitive disadvantages related to lack of land and capital resources, the room for big positive effects is rather limited in the foreseeable future.

It is expected that the Agreement will positively influence not only the wine and spirit exporters directly, but also have a promising effect indirectly on the entire value chain, including the primary producers of grapes. However, CIS markets will remain much more important for Georgian wine exports than EU in the foreseeable future. The major burden of requirements to upgrade production standards largely lies on the wine producing companies with the intent to increase EU shipments.

Georgia is emerging as an exporter of some niche products, such as greens, which first attained solid positions in FSU markets and now have a good chance to access EU markets; Georgia can concentrate on niche, high quality greens production with good prospects in the EU markets.

Investments in nuts industry can benefit and support local nut producers by increasing demand and stimulating small farmers to growing nut plantations. Likewise, establishment of fruit processing and olive plants, increases demand on primary production.

Vegetables exports for the Georgian smallholders should not be overestimated since the EU market is very competitive itself and joining the DCFTA does not introduce extra benefits on top of those existing within the GSP+ agreement.

Enhancement of trade relationships between EU and Georgia cannot bring any benefits to Georgia farmers involved in exporting of live animals.

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[69] http://www.investingeorgia.org/en/ajax/downloadFile/521/Investment_Opportunities_in_Agriculture

[70] http://www.eprc.ge/admin/editor/uploads/files/ENG_Oxfam.pdf

Healthcare

Category	*Grade*	*Comment*
▪ Sector	★★	*The healthcare infrastructure is developing and consolidating fast. There are still some issues with certain specialties, that have to be performed outside Georgia due to lack of experienced doctors but situation is improving*
▪ Demand	★★★★	*Due to demographic shifts the demand for healthcare services will remain high, however Georgian healthcare system must first meet local demand before it can become an attractive destination for Medical tourism and other similar services.*
▪ Industry	★★	*There are relatively few supporting industries in the Healthcare ecosystem, the Pharmaceutical sector is developing rapidly and could be a supporting backbone to healthcare in the future.*
▪ Competition	★★	*The sector is privatized with one player consolidating the market. There is some competition but the level is not very high.*

Factor conditions

Overall, the quality of healthcare in Georgia is improving. Despite, it is still considered to be poor.

Medical infrastructure, which fell into disrepair after the county gained its independence is undergoing a gradual upgrade and rehabilitation. Public and private investments have been mobilized for construction and/or the refurbishment of medical facilities. Consequently, towards the end of 2011, fifty hospitals had been completely remodeled or constructed. Improving the quality of health infrastructure is an essential precondition for improving quality of medical services and enhancing access. Therefore, renovating and constructing new health care facilities and equipping them with modern medical equipment, as well as spatial and functional planning of a provider network must be adequately addressed in the new strategy.[71]

The country is facing major challenges in health human resources. In Georgia, the number of physicians is higher than the European average, where there are 462 doctors per 100,000 people, compared to 327 in European countries. At the same time, the country faces an acute shortage of nurses, both in urban and rural areas. The country's educational institutions produce far more doctors than needed. Approximately 1200 doctors (excluding dentists) enter the labor market every year, whereas only about 100 nurses graduate every year from nursing schools. Therefore, Georgia's annual physician production count per 1,000 inhabitants is three times higher than the European average, while the number of nurses produced by educational system is more than ten times less than observed in Europe. The excessive number of doctors in the sector contributes to a low productivity. On average, a hospital physician in Georgia treats only 2.6 patients a month while a physician at an outpatient setting sees roughly three patients a day. Moreover, the current system for undergraduate and postgraduate medical education does not prepare students with adequate theoretical knowledge and clinical skills, which further aggravates the human resource problems. State qualification and certification examinations (market entry barrier) place a greater emphasis on knowledge assessment than on the evaluation of professional and clinical skills of recent graduates. Furthermore, the system of continuous professional education is also weak. Consequently, the quality of human resources poses significant challenges to the sector.

Furthermore, existing health information systems are also outdated. It is absolutely vital to improve Health Management Information Systems (HMIS). This must be built on new information technologies and must offer new approaches for data collection and analysis. In response to these challenges, the government has developed a new strategy for National Health Management Information System development. Furthermore, on March 1st 2011, the International Classification of Primary Care (ICPC-2-R), Nordic Classification of Surgical Procedures (NCSP), and the International Statistical Classification of Diseases and Related Health Problems (ICD-10) came into force. The project was supported by USAID. Georgia has additionally introduced the practice of annually producing and disseminating the National Health Report, National Health Accounts and Health System Performance Assessment reports. [72]

Demand conditions

The quality and the infrastructure for healthcare services is better developed in the urban areas and as consequence the demand can relatively be satisfied, the same cannot be said for the rural areas, where the demand severely outweighs the supply.

[71] http://www.nationalplanningcycles.org/sites/default/files/country_docs/Georgia/nhp_georgian.pdf

[72] http://www.nationalplanningcycles.org/sites/default/files/country_docs/Georgia/nhp_georgian.pdf

In terms of external/foreign demand for healthcare services in Georgia, there has been some improvement. This can be contributed to the fact that while in other many European countries surrogacy is still banned, it is completely legal in Georgia. Georgia is well-renowned for its fertility treatments centers, thus the country is considered as a good option for couples having problems with conceiving children because these centers provide modern infertility treatments at affordable prices. For example, surrogacy, including all stages of preparation, payment for services of medical personnel, control of pregnancy and childbirth, as well as payment of the fee a surrogate mother, is approximately about twenty thousand dollars. Similar services in Europe or America will cost several times more expensive.

Besides increasing demand for fertility treatments, dental services and hair transplants are also popular among foreigners. Furthermore, development of Spa centers is also a plan for the Georgian government. The Department of Tourism claims that the government is looking into the country's potential for medical tourism, although their priority is to recapture the country's Soviet-era legacy as a regional spa destination. In the Soviet era, Georgia was famous for medical treatment at spas, as there are 100 spa resorts in Georgia today with a potential of double that. Experts suggest that there is a potential demand for Spa treatments, but in order to utilize this demand more investments into Spa infrastructure and marketing is needed for Georgia to successfully compete with other regional Spa destinations such as Turkey.[73]

Related and supporting industries

Medical staff education and IT technology are an important factors in Georgian health care system and both of them need to be improved significantly. Furthermore, in order to utilize the potential for medical tourism, more direct flights to Georgia are needed, as medical tourists tend to choose destination, which are easily accessible.

Firm strategy, structure and rivalry

The Governmental Commission for Health and Social Reforms introduced market-based principles to health care management; about 80% of the hospitals were sold to the private sector for redevelopment as modern and most of them as multi-profile hospitals. Nearly all health care providers are private actors, independent of the state.[74]

Light manufacturing

Category	*Grade*	*Comment*
▪ Sector	★★★	*Nature of light manufacturing (less capital intensive) makes Georgia an attractive location for light manufacturing. Competitive advantage comes from availability of human capital, taxes and existing free trade regimes that make it an attractive location for Light manufacturing.*
▪ Demand	★★★★	*Demand is being driven by development of other sectors locally, that is creating specific needs and by opportunities for producing more cost effectively from international players (developing lodging industry, agriculture and food processing)*
▪ Industry	★★★	*Supporting industries in terms of raw materials and semi-finished products are available, future development of light manufacturing is highly dependent on development and demand driven from other sectors.*
▪ Competition	★★★	*As set-up of operations in light manufacturing in not as capital intensive as in other sectors, the establishment of competition is faster than in other sectors*

While Georgia's trade balance of processed goods is vastly negative, there has been some growth in light manufacturing industry throughout the last 5-7 years, although it is poorly diversified and most of its sectors lack scale. There are sub-sectors with export-ready products, intermediary export products and products with developing export potential.

Factor conditions

Sectors like apparel (HS: 61, 62) and pharma (HS: 30) have significantly stood out as export oriented and generated about 10% of total exports in 2015. Production of glass bottles, PET bottles and accessories, cardboard packaging and wood processing has grown significantly and these products are mostly consumed locally, but represent significant input for Georgia's export products (beverages, agri-products, furniture) and contribute additional value to exports. Certain other sectors like furniture production (HS: 94) have resurfaced throughout the last several years and started to actively

[73] http://www.imtj.com/news/georgia-seeks-attract-surrogacy-tourism/

[74] http://www.ncbi.nlm.nih.gov/pmc/articles/PMC3621519/

substitute imports. Some of the subsectors of the above industries will soon reach full capacity at local market and are expected to start exporting, as well as serving Georgia's growing hospitality industry (hotels) and increasing value-added of service exports (tourism).

Furthermore, as light manufacturing is less capital-intensive than heavy industry and there is an increasing trend by famous brands to outsource manufacturing to developing countries, because they generate largest share of their profit margin through markups for branding. The main cost drivers in manufacturing are semi-processed raw materials, labor, power, taxes, logistics and transportation. Georgia has competitive advantage in terms of labor, power, taxes (including free trade regimes) and location

Georgia's location also offers number of competitive advantages that precondition development of export of goods:

- Georgia is the nearest EU-free-trade zone for number of Far-Eastern and South-Eastern countries, including Russia and all Eastern CIS.
- It is also the nearest CIS-free-trade zone for Europe and rest of the western world.

Georgia's location has also been logistically advantageous due to regional restrictions in trade between the conflicting countries in the region. The country has become increasingly attractive in this context after recent Russia-Ukraine conflict, resulting in trade restrictions between Russia and the EU. While Ukraine also enjoys DCFTA with EU, the country's PEST index falls far behind that of Georgia's. Georgia is the sole West-East transit route for Armenia due to closed borders with Turkey and Azerbaijan. Because of Azerbaijan-Armenia conflict, Georgia also serves as regional representation location for many retailers entering South-Caucasus region. It is also a platform for Iran to access Europe more cost-effectively. While Iran is not a member of WTO and has certain restrictions on trade from developed countries, its imports in WTO members' territories are taxed heavily. It is also one of the largest raw material producers (plastics, chemicals) for manufacturing industries. The raw materials could be processed to final goods in Georgia and exported to EU duty free. There are already several successful cases of Iranian investments in export-oriented agriculture. Furthermore, Georgia also offers advantageous location and business environment for China, especially until its favorable trade negotiations with EU (underway) enter into force. Recent launching of Chinese cargo rail route through Georgia, high interest in construction of Anaklia deep-sea port and initiation of China-Georgia free trade negotiations put Georgia on China's strategic map. Due to Georgia's free trade regimes across the West-East route (EU, CIS, Turkey), it has the potential of becoming a strong link in the supply chain of manufacturing industries of these regions. The main advantages are the proximity to the both, the low-cost raw material trader countries (CIS, Iran, South-Eastern Asia) and highest value-adders (Europe). This means that investing in manufacturing of export products in Georgia can be attractive for both parties: Eastern producers willing cost-effective access to EU markets and EU producers and retailers targeting Eastern part of the world.

While the location is considered as advantage, the costs of transport and logistics are relatively high due to lack of infrastructure and traffic. Most of the necessary semi-processed raw materials are not produced locally and jeopardize the benefit of free trade (difficult to comply with rules of origin). Georgia's Deep and Comprehensive Free Trade Agreement (DCFTA) with EU strictly regulates the level of allowance of imported raw materials in manufacturing of Georgian products. The cost of imported materials in Made-in-Georgia products shall not exceed 40%-50% to qualify for import duty exemption. For GSP+ beneficiaries (Georgia's competitors) the allowance is usually higher - up to 70%.

Therefore, the short-term strategy for competitiveness lies in prioritizing sectors with high labor intensiveness, generous use of electricity and ability of satisfying rules of origin, resolve policy issues and attract brands that work on contract manufacturing.

In medium term, the goal will be to develop high quality raw material base (wherever possible) with the purpose of driving costs down further, improve vocational education system for timely supply of skilled and productive labor force, improve quality of power supply.

The long-term strategy will aim at developing professional technical and creative staff with higher education to take over an engineering, design and branding of locally manufactured product lines and creating maximum value-added locally.

The appealing sectors with potential of benefiting from duty free trade include:

- Apparel, including cheap labor, power usage intensity and rules of origin that are 40%-47.5%, but qualify in case of using Turkish materials (due to cumulation agreement). High demand for contract manufacturing from European brands.
- Wooden furniture, toys and accessories require intensive labor and power usage and easily qualify for rules of origin if manufacturers use local timber in production. Otherwise, the maximum allowance of imported materials in production is 40% of the ex-works price, while it is 70% for GSP+ beneficiaries (competitors). For handmade (e.g. braided) furniture, labor cost share is high. Therefore, this type of furniture may qualify for free trade in certain cases, although difficult to achieve the scale. Furniture for niche segments (e.g. pet furniture, mus. Instruments, wine accessories, etc.) leave better margins for producers and Georgia may have competitive advantage using wood imported from Asia, or even Europe (Scandinavia).
- Essential Oils for cosmetics industry qualify due to existing rich raw material base allowing for up to 50% imported materials, which in this case, could be just packaging. The processing is not labor intensive, but has strong

impact on rural incomes (plant suppliers). The target products are oils derived from laurel, citruses, roses and grapeseed.

- Ceramic products qualify due to existing raw material (clay), labor intensiveness and power usage. Contract manufacturing for EU beverage and food producers available.
- Glass products now serve as input material for export (bottles), although due to local raw material, the industry can create additional value by producing high quality glassware for other purposes (e.g. tableware).

Furniture (HS: 94)

Georgia's furniture exports are very low, around $3M (2015), but the production has relatively large scale (to compare across manufacturing industry) and stands at $100M (2015). The growth of the sector is driven by expansion of construction and hospitality industries (new hotels, restaurants, amusement centers). Successful example is furnishing of Batumi Kempinski hotel fully with Georgian-made outdoor furniture.

Labor and electricity have significant share in furniture production costs, although there is a lack of cheap raw or semi-processed material. Furniture production requires diversified base of semi-processed wood, plastic, glass, chemically derived foam, textile and metal.

Certain average-priced wood is available locally, through largest licensee – a Chinese company Hualing. The wood is cut and exported raw by the company. Drying and initial processing is done by local companies, despite the processing quality is low due to lack of skills and equipment.

Plastic parts are fully imported from China, Iran and Turkey.

Foam for soft furniture is produced locally since the last year (substituted imports by 90%) and has capacity of significant growth. Key problems identified by the sole producer is lack of qualified chemists and damping prices of imports from Russia.

Glass for windows is not produced locally, although there is special sand obtained by the sole producer of glass Ksani. The company produces bottles and can't satisfy beverage industry fully.

Textiles are imported from China and Turkey, no local production exists. There is certain coarse wool available for use in rugs, but no processing facility exists.

Metal parts are mostly obtained and forged locally, via Georgia's metallurgical plants.

For Georgia made furniture to qualify for duty free imports in EU, raw materials shall not exceed 40%-50% of the ex-works prices. For developing countries under GSP+ scheme, the allowance is higher, at 70%.

Due to potential scale and cost of raw materials, Georgia cannot compete with main furniture supplier to EU – China, although certain higher end furniture elements can be competitive in case of good price/quality correlation. The success case is contract manufacturing of pet furniture by a European investor in Georgia.

In the medium term, the strategy is to develop domestic market for furniture producers to increase the industry scale, improve skills and experience and create demand for local semi-processing of inputs. The strategy would be: a) attracting retail brands (Success case is Domino hypermarket), b) attracting experienced furniture manufacturing brands (Success case is Embawood who is purchasing some semi-processed inputs locally); b) linking local producers with local official representatives of international furniture brands (e.g. Belux, Furniture Laboratory) as well as attracting foreign manufacturing brands (e.g. IKEA type) attempting contract manufacturing; c) Encouraging development of local brands, engaging young interior designers to add value to existing production.

The long-term sector strategy lies in the production of the most expensive input - the high quality wood, which is highly demanded and ensures highest profit margins. Modern technologies allow for harvesting of such lumber in 5-7 years. Georgia's climate and soil are very favorable for all types of nuts, including black walnuts, which originate in North America. Black walnut (or similar expensive wood) cultivation could significantly boost the price tag of locally produced furniture and accessories if processed by skilled labor and modern equipment. Development of such raw material industry can also have a strong spillover effect if mountainous farmers (e.g. Racha, Svaneti) are engaged in farming. The trees also generate income through edible yield for income, before logging.

Glass Industry (HS:7010)

Georgia has $235M (2015) worth beverage export industry (HS:2200; Beverages, spirits and vinegar), which reached its record high value of 0.45bn in 2014, just before the crisis at its major export markets of Russia and Ukraine. Of these figures, $125M and $100M were the share of non-alcoholic beverages (min. waters and soft drinks) in 2014 and 2015 respectively.

Georgia has been consuming 1 glass bottle per every 0.44$ of export of non-alc. beverages for the last two years. The average price of 1 glass bottle produced in Georgia was about 0.26$ (0.6GEL).

There is only one glass producer and exporter JSC Mina. The company has substituted import of glass bottles by about 50% since 2013, due to re-investment in equipment. Currently, the import of glass bottles is valued at $14.5M, while exports (only to Azerbaijan) stand at $3M. The imports are made for wine bottles as Mina is not specialized to produce these.

With an assumption of growth of beverage exports (not counting fruit juices, jams and other food preparations requiring glass containers), the glass industry has the potential to initially, absorb at least 60% of wine bottle imports (substitute main competitors: Armenia and Russia) and consequentially grow along with growth of beverage industry.

The current industry stands at about $50M (192M bottles x $0.26). In case of growth of exports to the 2014 ceiling of $125M (306M bottles at $79M value), and substitution of 60% of current imports ($8M), there is a clear potential of industry expansion to about $87M value.

The glass is viewed as intermediary export product. The strategy towards growth of glass industry is to reduce cost of production and increase the value-added of the beverage industry, including alc. And non-alc sectors. As part of this strategy, it is necessary to reduce cost of production of non-alc. beverage bottles already produced locally and start production of wine bottles to aim at substitution of at least 60% of current imports from Armenia, Russia and Ukraine. On the longer run, the objective is to approximate quality standards of wine bottles to those required by the EU. Currently, the major share of glass bottle imports are made by wine companies, whereas wine has the highest chance among Georgian beverages to grow in EU market and is one of the most advantage takers of DCFTA, quality wine bottle production locally remains high priority.

- Local raw material is non-efficient for production of certain quality bottles and it needs to be imported. Lowering of import tariff would make final price more competitive;
- Encouraging more production capacity by providing low-cost capital to producer and/or resolving issue of Khashuri glass plant investment the 40% share of which belongs to Energy Ministry owned Ltd.
- Encouraging high quality wine bottle production through closer coordination with wine and glass industry;

Tourism

Category	*Grade*	*Comment*
▪ Sector	★★★	*The tourism sector is developing fast with a lot of investments in new lodging capacities, the challenge in the future will be to fill these capacities with high utilization rates to make the investments sustainable in the long term*
▪ Demand	★★★★	*Along with rising disposable incomes of the domestic population, the foreign tourists will be redirected to countries that exhibit stability and good service offering. Georgia has a lot of potential along both of these dimensions.*
▪ Industry	★	*The modern accommodation capacities that are being built across Georgia will have to be complemented by accompanying service offering (recreational, gastronomical, MICE…) and transportation infrastructure (airports, rail, road connections…) which will make the destination more competitive and attractive for foreign tourists*
▪ Competition	★★★	*Competition in the sector is growing both in urban city areas as well as main Georgian tourist destinations and resorts.*

Domestic and international tourism are important factors in the Georgian economy. The expenditures of foreign visitors to Georgia has a significant effect on the balance of payments. Approximately 59% of Georgia's service export revenue comes from tourism. Revenues from international tourism receipts demonstrated an increasing trend and reached 1.79 bln USD in 2014. The share of tourism in total GDP was 6%. The outlook for the tourism industry is highly optimistic. National Geographic Traveler magazine included Georgia in its list featuring 50 of the world's best guided trips. The Georgian tour was selected due to offering an authentic travel experience connected with food, wine and culture. The list placed Georgia amongst a number of top tourist destinations: France, Italy, Portugal, Scotland, Sweden, Switzerland and Denmark. It is forecast that the sector will create more jobs and generate more income in the years to come if the right measures from the Georgian government will be taken. To facilitate on opportunities that are arising from tourism GNTA intends to take several actions, which will increase the number of travelers: the development of tourism infrastructure; the facilitation of international travel; the improvement of service; increasing awareness of Georgia; implementation of marketing activities on domestic and international markets; and the development of tourist products.[75]

Factor conditions

[75] http://gnta.ge/wp-content/uploads/2014/08/eng-4print10.pdf

The infrastructure for tourism activities is developing. In 2014, there were a total of 1,332 accommodation units registered in the GNTA database, comprising 19,910 rooms with 47,012 beds. The classification of accommodation units by number of rooms showed that accommodation with five and fewer rooms was the largest category–with 447 such units (representing 34% of the total).

Transport infrastructure can be considered as an important part of the tourism industry. The largest share of visitors, 86% (4,757,264), arrived in Georgia by land transport, followed by 643,088 (12%) by air transport, making air transportation a significant bottleneck to the further development of tourism. Arrivals by sea and railway had almost the same share of 43,692 (1%) and 71,515 (1%) respectively. In 2014, the most visited regions for holiday, leisure and recreation purposes were the Ajara region (29,2 %), Samtske-Javakheti region (16,2 %) and Mtskheta-Mtianeti region (13,2 %).

Furthermore, tourism represent a vital source of employment for Georgia. In the fourth quarter of 2014, the total number of tourism-related jobs amounted to 195,100. The largest share is employed in the transport sector, which accounts for 60% of all tourism jobs. Other significant contributors are hotels and restaurants, accounting for 13% of tourism employment. In 2014, the total contribution of tourism to employment was 11%.

Demand conditions

With rising disposable income of Georgian citizens and with the recent tendency to open Georgia's market to foreign investors, there has been increasing demand for tourism & leisure activities from both domestic and international clients. In 2014, the number of international arrivals reached its historical peak of 5,515,559 and for the second time in history the five million mark was surpassed. The majority of all arrivals, 88% (4,863,165), were from neighboring countries. Only 12% arrived from other countries. Turkey was the annual leader in terms of the number of international arrivals with 1,442,695 arrivals (an annual decrease of 10%). Azerbaijan occupies first place in terms of the growth of international arrivals (+207,357), with the highest growth rates registered in July (+38,581) and August (+39,800). There was also a significant growth of international arrivals from Russia (+44,225), Armenia (+33,797) and Ukraine (+16,724). This growth was primarily a result of new direct flights, press trips and marketing campaigns administered by Georgian National Tourism Administration. In 2014, there were 232,558 international arrivals from EU countries, representing a 4% share of total arrivals and an increase of 11% over last year.

Related and supporting industries

Many industries are indirectly connected to Georgia's tourism activities. Agriculture, mostly wine production indirectly attracts tourists as Georgia is one of the most well-known wine producers in the world and the development of this industry definitely helps Georgia's tourism boost. But, probably the most important industry that affects tourism activities in the transportation, mainly air, industry. This can be considered as a bottleneck as Georgia lacks good, direct connections to other countries, which express interest in Georgia (see transport section below).

Food processing

Category	***Grade***	***Comment***
▪ Sector	★★★★	*The sector is well developed, with a sizable number of smaller and larger companies in the sector. The sector is highly dependent on agriculture and forms one value chain with the available agricultural produce*
▪ Demand	★★★★★	*Local demand is driven by consumer preferences for products of Georgian origin, there is also strong international demand for some specific processed food segments where Georgia has a good fit with international demand patterns*
▪ Industry	★★★	*Supporting industries are present (eg. Agriculture), however some parts of the value chain need to be upgraded (eg. Packaging) in order to enable higher levels of industry competitiveness. Both large and small scale operations are present in the sector that enables production of different batches based on type of demand.*
▪ Competition	★★★★	*Besides the local producers there are also international players entering Georgia with the ambition to export products, this creates a lot of competitive pressure on resource availability and prices.*

The importance of agricultural business is already highlighted in the Agriculture paragraph and food processing, as a part of the agricultural business, is also an important part of Georgia's economy.

Factor conditions

Fruit and vegetables are grown all over Georgia by highly skilled, small to medium sized farmers. The goods with the highest opportunity for processing are tomatoes, apples, cucumbers, potatoes, stone fruits, citrus, olive oils, etc. The value of exported goods reached USD 18,3 million, while the value of imported goods reached 41 million USD in 2014. Nowadays there are some international food producer brands in Georgia such as Hipp, Wimm Bill Dann, Ferrero etc. Recently, Georgian government (as a part of supporting agriculture development plan) has acknowledged the food processing field as one of its top priorities and it nowadays subsidizes this field through Agricultural Projects Management Agency (APMA). APMA offers grants for agro processing companies – new agriculture processing factories (minimum value of project 200,000 USD) can get a grant (maximum 500,000 GEL and 40% of total project). However grant should be used only for purchasing of capital assets (excluding land and buildings) and/or training & technology implementation. Additionally factory should use local raw materials and labor and the project supports only specific sectors and specific regions (production of wheat flour, wine and other alcohol beverages aren't covered by this scheme).[76]

Demand conditions

Georgian retail market of processed fruits and vegetables is characterized by:

- Strong preference of consumers towards ''Georgian'' products
- Availability of few large and many small scale local producers
- Home preparation of processed fruit and vegetables is taking significant share of retail consumption, especially in rural areas

Related and supporting industries

Transportation and logistics may be considered as negative factor for the food processing business, because even though Georgia has excellent climate conditions and highly skilled labor, the country still has not reached the potentially large export value and this might be attributed to Country's poor connections to other countries.

Transportation & Logistics

Category	*Grade*	*Comment*
▪ Sector	★★★★	*Georgia has a strategic location as it serves as an entry gate to the Caucasus and Central Asia. Georgia is a reliable corridor for addressable flows between Caucasus and Europe and between Central Asia and Europe as this concept is being based on historical Silk Road that gives Georgia a significant geopolitical role.*
▪ Demand	★★★★★	*Georgian transport economy is transit oriented as 65% to 95% of cargo flow in Georgia is transit.*
▪ Industry	★★	*Rail and port handling costs are very high and air transport is currently a bottleneck not only for tourism but also agricultural exports.*
▪ Competition	★★★	*Currently competition is limited as there are monopoly or monopoly-type situations in most of the main areas of the sector that incur high costs and hinder faster development of the sector.*

Factor conditions

Georgian transport network comprises of:

- Seaports

Only access to the Black Sea for the Caucasus, Georgia's sea ports have been developing since 2000 and were privatized in 2008 (except for Supsa Terminal, which is 100 % nationalized by Azerbaijan)

Poti Sea Port is the largest port in Georgia handling liquid and dry bulk, ferries as well as containers. It was acquired by RAK Investment Authority (UAE), which resold 80% of its shares to APM Terminals (Netherlands) in 2011 to focus on the development of the 300-hectare free industrial zone adjacent to the port (49-year lease). The port currently serves as the European gateway for international trade in Georgia, Armenia and Azerbaijan, and has a good potential to become a future hub for Central Asia trade. It has 15 berths, with total berth length of 2900 meters and more than 20 quay cranes.

[76] http://www.investingeorgia.org/en/keysectors/access-to-finance/government-incentives/agriculture-projects-management-agency-apma.page

Poti Sea Port has experienced high growth over the last decade and the fundamentals for continued solid growth remain. A grain processing terminal with potential of 500,000 ton annual capacity was opened in May 2013, opening an alternate route for Central Asian wheat exports to the Black Sea and Mediterranean regions. In 2014, total container throughput of Georgian ports was approximately 480,000 TEUs, with Poti's container volume 80% of this total, or 385,000 TEUs. Furthermore, APM Terminals has already invested USD 65 million in upgrading and expanding the port and the next phase of the expansion plan, with projected completion in 2018, includes two new deep water berths able to accommodate vessels of 9,000 TEU capacity and an annual throughput capacity of one million TEUs. The planned new quay to be constructed in front of the existing Inland Container Terminal, will enable full integration of the terminal yard, road and rail infrastructure into the expanded deep-water Mega-Port facility. At completion, the fully built-out mega-port will have an annual cargo throughput capacity of 50 million tons and 2 million TEUs. With a water depth of up to 16 meters the port will be able to accommodate the largest vessels calling the Black Sea. An adjacent industrial and free trade zone complements the projected cargo throughput growth.[77]

Batumi Sea Port has four terminals: oil terminal, container and the railway ferry terminal, dry cargo terminal and marine passenger terminal.

Throughput efficiency of the oil terminal is – up to 15 million tons annually and it specializes in refining raw oil and almost all types of oil products: diesel fuel, petrol, reduced cruel and so on. The oil terminal has 3 berths with the length up to 200 meters and the depth up to 12 meters, and the given berths are leased to Ltd "Batumi Oil Terminal" until 2019.

Container and the railway ferry terminal has the throughput efficiency of 100 000 TEU annually. The container terminal has open storing areas and possesses transshipment equipment, which specializes in operating with containers in direct and storage ways. The ferry runs between Varna, Iliychevsk, Poti and Batumi and the operation of the ferry is totally automated. The nominal throughput efficiency of the terminal is approximately 700 000 tones. From November 2007, berths 4, 5, 6 and railway ferry terminal were leased to Batumi International Container Terminal LLC, which is the member of group of companies International Container Terminal Services INC (ICTSI).

Dry cargo terminal has four berths with the length up to 263 meters, which specialize in in bulk cargo, fluid cargo, general and packing and piece load with the weight of one piece no more than 20 tones. Maximum throughput of the dry cargo terminal is 2,0 million tons annually.

The marine passenger terminal is situated in the center of the city, in the seaside boulevard. The throughput efficiency is about 180 000 passengers annually. Terminal has 2 berth, which ensure handling passenger ships as well as small-capacity cargo and passenger ferries.[78]

The Kuhlevi Terminal began functioning in 2008 and from the first day of operations, all activities were aimed at the main goal – to increase of the output capacity. In 2008, the terminal was ISO 9001:2008 certified (Quality Management System), as well as ISO 14001 (Environmental Management System) and OHSAS 18001 (Occupational Health and Safety Management System), which means that all management system processes at the terminal fully meet the international standard requirements.[79] The terminal has a tank park with overall storage capacity of 320,000 cubic metres (11,000,000 cu ft) with the prospect of increase up to 380,000 cubic metres (13,000,000 cu ft). For loading operations there are two berths for receiving tankers with tonnage up to 100,000 tonnes. Loading performance is from 1,000 to 8,000 m3/h. The terminal has its own railway station, where 180 oil tank cars can be placed for discharging. The trestles make possible the simultaneous discharge of 168 oil tank cars, through four railway branches. The terminal has annual processing capacity of 10 million tonnes of crude oil and refined products. SOCAR plans to increase the capacity of the terminal to 20 million tonness per year. That would make Kulevi the largest oil terminal in South Caucasus.[80]

Supsa terminal, located on the Black Sea Coast of Georgia, in Lanchkhuti district, provides storage capacity for crude oil transported via the Western Route Export Pipeline (WREP) before loading to oil tankers via offshore loading facilities. The crude is further shipped via tankers through the Bosphorus Straits to global markets. İt has been in operation since January 1999 and Georgian Pipeline Company operates the pipeline on behalf of Azerbaijan İnternational Operating Company and its shareholders. The terminal has crude oil and petroleum capacity of 8 mln t/year. [81]

Furthermore, in 2016 Georgia's Ministry of Economy & Sustainable Development that the Anaklia Development Consortium LLC has been awarded the contract to build and develop a **Deep Sea Port in Anaklia**. Construction on the project is scheduled to launch by the end of 2016, subject to completion of environmental reviews. The Port will be operational three years after its groundbreaking. The project is expected to create as many as 3,400 jobs during the

[77] http://www.apmterminals.com/news/press-releases/2014/12/apm-terminals-reaffirms-poti-mega-port-plans

[78] http://batumiport.com/text/122/eng

[79] http://kulevioilterminal.com/en/view-page/114/History

[80] http://en.portnews.ru/news/10559/

[81] http://www.investingeorgia.org/en/ajax/downloadFile/522/Investment_Opportunities_in_Logistics

construction stage and 6,400 jobs to operate the Port upon completion. The Port will have the capacity to process 100 million tons of cargo and generate 0.5% of GDP annually by 2025.[82]

- Main road network

The road network in Georgia consists of 1,603 kilometers of main or international highways that are considered to be in solid condition and some 18,821 kilometers of secondary and local roads that are, generally, in poor condition, as only 7,854 km out of over 20,000 km of Georgian roads are paved. Some investments in improving the road transportation have already began, as The World Bank is approved a US$140 million equivalent financing for the Fifth East-West Highway Corridor Improvement Project (EWHCIP) for Georgia. The completion of the East-West Highway corridor is a central piece in the Government's strategy of transforming Georgia into a regional transport and logistics hub. The Project will directly contribute to economic development by reducing transportation costs and linking rural communities and their agricultural products to urban centers such as Tbilisi and once completed, the East-West Highway from Tbilisi to Batumi via Poti will provide direct access to 2.2 million people or more than half of the total population of Georgia.[83]

- Railway network

Georgia has 2100 km (95 % electrified) of railway infrastructure. Georgian Railway (GR) is mainly a transit railway as around 80 % of their revenue come from transit cargo, which is split roughly 50:50 between liquids and dry bulk.[84] Future developments for the Georgian railway system rely mostly on the development of the Baku-Tbilisi-Kars project, which intended to complete a transport corridor linking Azerbaijan to Turkey (and therefore Central Asia and China to Europe) by rail. The project envisages the rehabilitation, reconstruction and construction of 180 km length Marabda-Kartsakhi railway section consisting of: Marabda-Akhalkalaki reconstruction-rehabilitation section (useful length 153 km) and Akhalkalaki-Kartsakhi (Turkish border) new construction section (length 27 km).[85] The line is going to be functional in 2017 and is intended to transport an initial annual volume of 6.5 million tones, rising to a long-term target of 17 million tones.[86]

- Air transport

The aviation market in Georgia has demonstrated considerable growth in recent years. Three international and one domestic airport currently operate in Georgia, all of which fully comply with International Civil Aviation Organization standards. Georgia's aviation market is primarily international, with the majority of flights being served by Tbilisi International Airport. Tbilisi and Batumi International Airports are run by the Turkish TAV Airports Holding Company. They started operations in February and May 2007, respectively. Mestia (Queen Tamar) Airport officially opened in 2011. The construction of Kutaisi's King David the Builder International Airport was finished in September 2012. The capacity of Tbilisi International Airport is 2,000 passengers/hour; the capacity of Batumi and Kutaisi International Airports is both 500 passengers/hour; and Mestia Airport's capacity is 100 passengers/hour. The opening of Kutaisi airport was marked by the launch of flights by the low-cost carrier (LCC) Wizz Air. Wizz Air was the third LCC to enter the Georgian market, after Pegasus and Fly Dubai. In 2014, Air Arabia, a new LCC entered the Georgian aviation market. According to the Georgian Civil Aviation Agency (GCAA), Turkish Airlines is the dominant air company operating in Georgia and carries the largest number of passengers. In 2014, it served 415,867 passengers (22%). Ukraine International Airlines is the second most popular airline with 279,389 passengers (15%). This is followed by Georgian Airways with 218,536 passengers (11%); Pegasus with 145,931 (8%); Siberia Airlines with 93,579 (5%); Belavia with 92,549 (5%); and Lufthansa with 65,475 (3%). In total, 32 international and three domestic airlines operated in Georgia in 2014. The major airlines operating are: Turkish Airlines, Georgian Airways, Ukraine International Airlines, Pegasus, Siberia Airlines, Belavia, Lufthansa, Atlasjet International, Qatar Airways, Fly Dubai, Air Astana, Azerbaijan Airlines, Air Baltic, and Air Italy.[87]

Demand conditions

Georgian transport economy is transit oriented as 65% to 95% of cargo flow in Georgia is transit. There seems to be increasing interest from the Western part of China, which is in process of rapid development. In 2015 the first railway freight transportation from China in the direction of Georgia was carried out. Loading of the transported freight was carried out in China on January 29, 2015 and unloading – on February 6, 2015 in Georgia. The project was carried out by means of close cooperation with the railways of Georgia, Kazakhstan and Azerbaijan and the province of China - Xinjiang. Georgia remains the position of crucial transit corridor for the north and south countries in Caucasian Region

Firm strategy, structure and rivalry

[82] https://www.youtube.com/watch?v=3BwzP1laWkQ

[83] http://www.worldbank.org/en/news/press-release/2015/12/02/world-bank-continues-to-support-upgrading-georgias-major-transport-route

[84] http://www.railjournal.com/index.php/freight/georgia-pins-hopes-on-the-iron-silk-road.html

[85] http://www.investingeorgia.org/en/keysectors/regional-logistics-hub

[86] https://railturkey.org/2014/10/20/baku-tblisi-kars-railway/

[87] http://gnta.ge/wp-content/uploads/2014/08/eng-4print10.pdf

Georgia's government strategic plan is to develop the transportation system as quickly as possible. In order to speed up the process Georgia decided to engage private investor and now all sea ports (except for Supsa Terminal, which is 100 % nationalized by Azerbaijan) as well as Tbilisi and Batumi International Airports are privately owned, and Georgian Railway, while still 100% state owned, is managed by a British investment fund, Parkfield.[88] Several projects, which will improve Georgian transport routs have already began, as can be seen from the development of Deep Sea Port in Anaklia and Baku-Tbilisi-Kars railway project.

Textiles & apparel

Category	*Grade*	*Comment*
▪ Sector	★★★	*The sector has been growing rapidly mainly on the comparatively lower labor costs than in Turkey which is one of the main manufacturers in the world. The factor conditions are given for human capital but not for raw materials that would enable a sustainable development of the sector.*
▪ Demand	★★★★	*Industry demand both locally and globally are high, however Georgia is not highly involved in the global trade flows as it exports most of its manufacturing capacities to Turkey*
▪ Industry	★★	*Main deficiency of the textile sector in Georgia is the unavailability of raw materials (such as cotton) that have to be imported, thus making the value chain unsustainable long term. For the mid-term the sector will continue to be a contract manufacturing hub for global brands.*
▪ Competition	★★	*There are several textile manufacturing operations based in Georgia, they are however mostly based on low skilled labor that is cost advantageous in comparison to other countries.*

Factor conditions

Georgia has a history of wool and silk production. Revival of these sectors can give a slight boost to the cost-effectiveness, although Turkish and European textiles and their prices will remain key drivers of the margins. This means working on average to higher-end niches, to retain profitability. The raw materials have significant share in cost-structure of apparel (55%-65%). Costs for materials of non-Georgian origin shall not exceed 40%-47.5% of the ex-works price of the final product to enter EU market duty-free. This means that textile and accessories used in production shall be produced in Georgia, Europe or Turkey (allowed by special trilateral agreement). Because labor accounts for large share of the production costs (20%), the sector has current to mid-term development potential, until Georgia's labor force loses its competitiveness that is closely tied to GDP per capita growth. The short-term strategy is to further diminish the production cost via policy measures and to promote Georgia more actively for contract manufacturing to attract more higher-end brands' orders for existing factories, as well as attract more re-locators with active supply contracts.

Furthermore, Ajara region, due to proximity to Turkish border, has become a natural cluster for contract manufacturing of apparel by Turkish apparel companies that relocated from Turkey due to cheaper labor and energy and cheap land. Regardless of the favorable business environment, there are still policy issues to be resolved. The sector is requesting tax alleviation on product waste.

Related and supporting industries

The long-term potential of the apparel sector is tightly linked to development of creative industries. Several recent developments have put Georgia's fashion industry in the spotlight. These include:

a) International coverage of Georgian fashion industry in the world high fashion media (upon promotion by MoESD); b) Opening of online store (www.moreislove.com) which successfully retails Georgian brands at significant markup; c) High attention to Georgian designers' lines in international fashion weeks; d) And the most importantly, the appointment of Georgia-native designer Demna Gvasalia to lead one of the world's powerful fashion house of Balenciaga.

If these credentials are not used effectively at this right moment, Georgia's chances of positioning on the map will quickly diminish. The most important of the problems in the industry is the lack of its scale. Due to this, many of the designers couldn't satisfy orders received at the tradeshows or as a result of promotion.

[88] http://www.civil.ge/eng/article.php?id=15616

The key to the sector development strategy lies in linking apparel production with Georgian designers who shall start mass production. The key strategy hampers to overcome are:

- Few number of professional designers due to weak local higher education institutions for fashion design (all current successful Georgian designers are educated in Europe);
- Lack of skilled template cutters due to lack of specialized VET education;
- Limited choice of quality fabrics on local market, which limits creativity of designs. The designers have to adjust to existing raw material as there is no enough scale to administer wholesale imports;

Firm strategy, structure and rivalry

Georgia's apparel exports stand at $63M (2015 excluding reexport), to the EU and Turkey. The industry is driven by 5 large Turkish companies and 12 Georgian manufacturers who do contract manufacturing for famous brands like Moncler, Tommy Hilfiger, Zara, Marks & Spencer, Koton, Puma, Mexx, Next, Etam, Lotto, Per Una, Autograph, Lebek, Hawes & Curtis, Roberto Cavalli.

Creative industries

Category	*Grade*	*Comment*
▪ Sector	★★	*Sector is still developing but has high potential due to Georgia's creative potential in publishing, arts, gaming and music.*
▪ Demand	★★★★★	*Creative industry can generate global demand with its accessibility and reach through digital channels. Online demand for high quality affordable creative services is growing very rapidly.*
▪ Industry	★★	*Georgia has been developing the supporting environment for creative services, however further investments will be required to develop a platform that will be able to launch Georgian creative services into an international arena. Also other industries that would support the development of creative industries would need to be upgraded as well (eg. Cinema)*
▪ Competition	★★★	*There is competition in the creative services sector however it is very fragmented and niche oriented.*

Factor conditions

In Georgia, the creative industries are still in the process of development and have not yet been formally established. Publishing, however, is quite well developed in Georgia. Georgia is one of the leading countries in the world to produce the most books per capita, claims the International Publishers Association. Georgia made it into the top 5 book producing countries with 1 547 titles per million people, while big countries such as the United States and China ranked only 12th and 25th respectively. The establishment of the LEPL National Centre for Georgian Books in 2014 is important for the promotion of the publishing sector in Georgia. In 2014, the National Centre for Georgian Books, supported by the Ministry of Culture and Monument Protection of Georgia, announced three translation programmes that are intended for foreign and Georgian publishing houses:

- The programme "Georgian Literature in Translation" is intended for foreign publishers that wish to translate and publish Georgian literature into foreign languages.
- The programme "Foreign Literature in Georgian Translation" is intended for publishers that wish to translate and publish foreign literature into the Georgian language.
- The "Trial Translation Programme" is intended for translators, publishers and literary agents that wish to translate Georgian literature into German and English languages. These translations will then be offered to foreign publishers for publishing abroad.

The aim of these programmes is promote the translation of Georgian literature into foreign languages and foreign literature into Georgian and publishing of translated books.

Furthermore, professional seminars in international rights and publishing management for Georgian publishers were held in September 2014, under the initiative and support of the National Centre for Georgian Books, as well as the Goethe Institute, the Ministry of Culture and Monument Protection of Georgia and the Frankfurt Book Fair.

The Tax Code of Georgia specifies some preferences for the importation of scientific, creative editions and fiction, books and periodicals where the authors are citizens of Georgia as well as for the importation of Georgian classics published abroad. Guidelines are also set for the distribution, import, sale and printing of periodicals and fiction. The state supports publishing activities through governmental programmes. The publishing sector is developed more effectively than the cinema and showbiz sector which require a more powerful and stable economy and larger market than is available in Georgia.

The leading force in Georgian cinema is the film studio "Gruzia-Film", where 90% of the production capacities and cinematography staff are concentrated, and where most national films are produced. Some years ago the film studio was privatized and today it holds a special status in that two-thirds of the shares are held by the state. Today it is recognized by those working in the film industry that the privatization process was managed incorrectly, as it has brought no investment and the studio is in a more difficult situation than previously. The situation in the film distribution network is poor as well. Only 4-5 cinema theatres in Georgia meet modern standards. One of the main problems in the operation of cinemas is the piracy operating in private TV companies (which show dozens of unauthorized films each day), despite the active work of the Georgian National Communications Committee. Another issue of concern is the dominance of American films which must be addressed by developing and propagating Georgian national and European cinema with the help of public television companies.

However, in recent years there have been a few positive moves in the film industry, including 6 international film festivals and Cross-Border Cinema Culture (CBCC) is a new pilot project within the Kyiv Initiative carried out in Armenia, Azerbaijan, Georgia, Moldova and Ukraine, with the aim to support and development film production. Currently there are about 60 film and television, video and audio studios and about 20 NGOs operating in the field of cinematography.[89] Furthermore, to promote the film industry, the Ministry of Culture and Monument Protection of Georgia initiated an amendment to the Tax Code of Georgia which will mean that producers that obtain funding from the National Film Centre will be charged income tax only after the release of a film. Under the previous regulation, the funds allocated from the state budget were charged tax before the release of a film, which hindered film producers in their use of the funds. Film producers have been also authorized to charge the 100% depreciation on the released film as an intangible asset.

Regarding the availability and the development of the labor force in the creative industry sector, there have been some developments. In terms of the cultural industries, Georgian educational institutions and programmes offer training in the telecommunications and advertising business (e.g. The Georgian Telecommunication and Management Institute LAMPARI and the Institute of Media, Advertising and Arts). Furthermore, the Shota Rustaveli State University of Theatre and Film and the Tbilisi State Academy of Arts provide various courses which aim to train workers for the cultural industries (e.g. leather and fabric designers, clip makers etc.).

Furthermore, the development of the gaming industry has become one of leading priorities for Georgian creative industry development. In the summer 2010, the Ministry of Internal Affairs of Georgia initiated an innovative project aimed at the promotion and development of the gaming industry in Georgia. Within this ministry, a special studio has been created to work on 3D games technology.[90]

Demand conditions

There seems to be great domestic demand for creative industries, but it is currently not met due to financial restrains and the lack of appropriate integration into the industrial processes, which also results in minimized chances for postgraduate employment for students studying in the fields of creative industry.

Firm strategy, structure and rivalry

In terms of publishing, private companies offering cultural items and services (publishing houses, periodicals, providers of audio cassettes and CDs etc.), as a rule, are independent from state cultural policy and operate without any government support. Nevertheless, there are some partnerships between the Ministry of Culture and Monument Protection of Georgia and some companies engaged in the publishing business, concert activity etc. but, in general, the relations of central and local authorities with public agencies may be described as sporadic. The contacts between them are limited to non-permanent cultural events and projects. Concerning rivalry, some state programmes are open to the private sector on a competition basis, for example with regard to the publication of books, where competition is open to all publishing houses regardless of their ownership. However, the selection of a winner is not effective in all cases as the criteria for selection is not adequately specified and this affects the decision-making process. Often selection in these competitions is not transparent. [91]

Services

Category	*Grade*	*Comment*

[89] http://www.culturalpolicies.net/web/georgia.php?aid=423

[90] http://www.culturalpolicies.net/web/georgia.php?aid=423

[91] http://www.culturalpolicies.net/web/georgia.php?aid=423

▪ Sector	★★	*Georgia's limitations in terms of available human capital limit the ability to develop any type of outsourcing business service operations. The buildup of necessary capacities and capabilities would take too long.*
▪ Demand	★★★★	*There is high global demand for professional services especially in the areas such as IT, call centers etc.*
▪ Industry	★★	*Usually BPO operations are based in countries with competitive labor structure and sufficient technical expertise to provide these services.*
▪ Competition	★★	*In Georgia this sector developing and growing but not at the levels where a sustainable competitive advantage could be achieved.*

According to the National Statistics Office in Georgia, services can be divided into seven categories:[92]

- Services related to trade, repairs of motor vehicles and personal and household goods sector
- Services related to hotels and restaurants
- Transport and communication services
- Real estate, renting and business activity related services
- Community, social and personal services
- Services related to education
- Services related to health and social work

Factor conditions

Overall the service sector in Georgia is growing.

In 2014, the turnover for services related to trade, repairs of motor vehicles and personal and household goods amounted to GEL 25,265.2 million, which is 216% increase compared to 2010. Comparably the number of people employed in this category has also increased from 107.839 in 2010 to 139.073 in 2014 and the average monthly wage has also increased from GEL 548.9 to 702.1 GEL.

Services related to hotels and restaurants also achieved significant growth. The turnover increased from 383,9 million GEL in 2010 to 843,6 million GEL in 2014. The number of employees in this sector also increased from 16.106 in 2010 to 31.330 as have the wages (477.8 GEL in 2014 compared to 377,9 GEL in 2010).

The turnover for services related to hotels and restaurants also increased from 3.313,6 million GEL in 2010 to 5.179,1 million GEL in 2014. The number of employees has also increased from 50.388 in 2010 to 59.123 in 2014, as have their wages (1.071,7 in 2014 compared to 786,5 in 2010).

In real estate, renting and business activity related services the turnover has also grown (from 833 million GEL in 2010 to 2.350,8 in 2014). The number of employees in this sector has grown from 30.859 in 2010 to 59.313 in 2014 and their wages have increased from 765,1 GEL in 2010 to 998,8 GEL in 2014.

The turnover has also increased in community, social and personal services. It has increased from 285,8 million GEL in 2010 to 2.304,2 in 2014. The number of employees have increased from 17.169 in 2010 to 28.285 in 2014 and their wages have increased from 584,3 GEL to 801 GEL.

The turnover in education related services has also increased from 121,5 in 2010 to 241,2 in 2014. The number of employees has increased from 14.650 in 2010 to 21.164 in 2014 and the wages increased from 349,3 GEL to 489,1 GEL in 2014.

Services related to health and social work have also experienced significant growth. The turnover has increased from 431,9 million GEL in 2010 to 806,7 millon GEL in 2014. The number of employees has grown from 56.583 in 2010 to 58.270 in 2014 and their wages have grown from 435 GEL to 732,4 GEL.

Pharmaceuticals

Category	*Grade*	*Comment*
▪ Sector	★★★	*Pharmaceutical sector in Georgia has grown rapidly in the past years both in terms of production capacities as well as exports. The sector can continue to increase its capacities and export footprint in the future as well. This sector could*

[92] http://www.geostat.ge/?action=page&p_id=299&lang=eng

		be one of the beneficiaries of the DCFTA, however the demanding nature of clinical testing procedures in the EU make a short, mid-term impact or even market entry possibility highly unlikely.
▪ Demand	★★★★	*There is high demand for pharmaceuticals both domestically and globally.*
▪ Industry	★★★	*Georgian pharmaceutical industry is well developed in terms of production and packaging of pharmaceutical products. There is also high potential in the area of primary research that needs to be further developed (eg. Bacteriophages)*
▪ Competition	★★★	*There are two main competitors in the sector with several smaller competitors operating in the market. The smaller competitors would require further stimulation for growth and development beyond current size.*

The pharmaceutical market in Georgia grows at a rapid pace every year, with exports increasing by more than 40% over the past six years. The market size in 2015 is estimated to be around GEL 1.3 bln and is expected to grow in the future. Main growth opportunities will derive from growing wholesale revenue, enhancing retail margins and from expanding pharmacy footprint.[93]

Factor conditions

There are over 70 manufacturers in the Georgian pharmaceutical market, but overall there are only 3 key players that dominate Georgia's pharma market: GM Pharmaceuticals (PSP), Aversi-Rational and Ynnovas[94].

Furthermore, the industry is also an important employer in Georgia, with more than 13,000 employees activating in the industry. According to the data from 2010, there have been 2,409 employees in production, 8,120 in retail and 3,328 in wholesale, with the average gross monthly salary of USD 322, USD 265, USD 528 respectively.

Georgia also has historically had strong scientific research institutes, which still operate today. Two of these, related to the pharmaceutical industry, are the Kutateladze Pharmaco-Chemistry Institute under Tbilisi State University and the George Eliava Institute of Microbiology (directly under the Ministry of Education). Also, it is important to note that there are 7 universities in Georgia, which have faculties of natural sciences.[95]

Demand conditions

Pharmaceutical exports from Georgia have grown at an average 40% per year over the past six years, and Georgia's own demand for pharmaceuticals has experienced rapid growth, averaging 16% per year over the past six years. Continued growth can be expected due to rising incomes and overall economic growth.

Firm strategy, structure and rivalry

Pharmaceutical companies in Georgia enjoy a favorable business climate with simplified regulations and no price controls on pharmaceuticals and foreign pharmaceutical producers can choose to open a branch in Georgia in order to expand their activities or open a subsidiary in this country. The country automatically recognizes pharmaceuticals registered in other countries in an attempt to enhance competitiveness. The regulations and standards in this business field are set forth by the Agency for State Regulation of Medical Activities and by the Law on Medicines and Pharmaceutical Activity. The Agency is responsible for issuing the necessary licenses for pharmaceutical companies as well as for the monitoring of production and trade in this business sector. Pharmaceuticals in Georgia also benefit from an attractive taxation regime; there is no value added tax imposed on these types of products and there are no customs taxes for them.[96]

Start-ups

Category	*Grade*	*Comment*
▪ Sector	★★	*Startup sector is in its infancy in Georgia, however they represent the backbone of future sectors and young companies & SME's. There are active start-up hubs and incubators in the market that are stimulating growth and development.*

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93 http://ghg.com.ge/uploads/quarters/ghg-announces-acquisition-of-one-of-the-largest-retail-pharmacy-chains-in-georgia-03162016-78.pdf

94 http://enterprisegeorgia.gov.ge/en/media-center/news/Georgian-Products-Displayed-at-CPHI-Worldwide-2015-

95 https://www.occrp.org/documents/georgia-sweetheart-deal/1-Pharmaceutical_Sector_Study-03.pdf

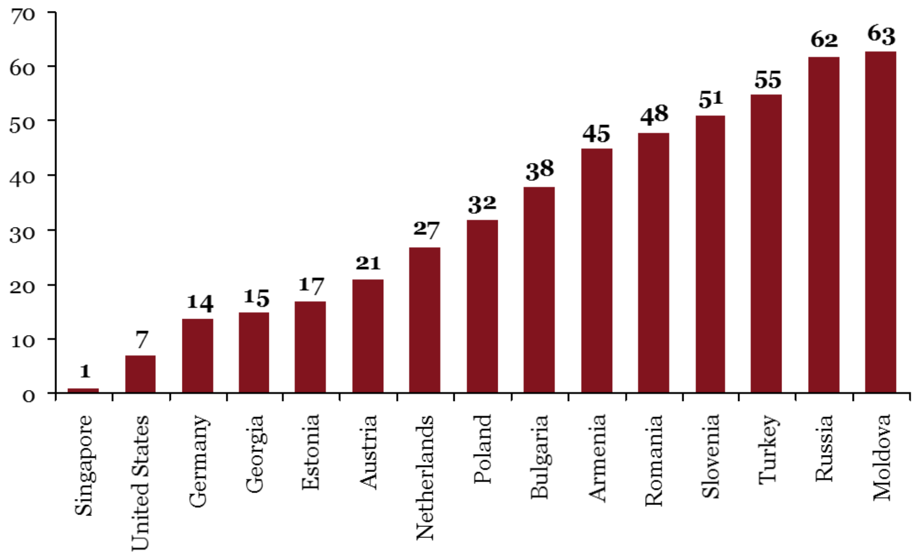
96 http://www.companyformationgeorgia.com/open-a-pharmaceutical-company-in-georgia

▪ Demand	★★★★	*Although start-ups are technically not a sector they are well versed in identifying market demand and potential future demand. The challenge for Georgian start-ups is to identify demand patterns that will be able to create global demand and not only satisfy local needs.*
▪ Industry	★★★	*Additional accelerators and start-up incubators need to be further developed and encouraged in order to accommodate the growing number of Georgian start-ups. Furthermore, the venture capital and business angel investments as well as the overall environment need to be established and promoted to facilitate the successful growth of the start-up ecosystem.*
▪ Competition	★★	*There have been some successful startups in the gaming industry and other competitors are trying to emulate their path. With additional success stories the competition will continue to intensify which will contribute to the maturity of start-ups.*

Factor conditions

Due to its favorable business environment Georgia ranks 6th in Starting a Business category in Doing Business report done by The World Bank. It takes only 2 days to start a business, compared to 8,3 days in OECD high income countries and 10 days in Europe and Central Asia. The number of required procedures to start a business is 2, compared to 4,7 OECD high income countries and Europe and Central Asia, while the relative cost of starting a business is also lower as in OECD high income countries and Europe and Central Asia.[97] Overall, Georgia holds a very solid 15th position (out of 189 countries) in the Ease of doing business category:

Picture 1: Rankings on the ease of doing business



Source: World Bank Group

In recent years some development in the start-up community in Georgia has been detected as the country set supporting and developing innovative companies as a national strategic priority. Innovation and creativity is a necessary precondition for the sustainable growth and development of the country and that's why Innovation and Technology Agency was established on February 19, 2014 in Georgia. The Agency participates in the private and public sector knowledge, innovation and commercialization of research results and promotes innovative entrepreneurship. The Agency contributes to the introduction and use of information and communication technologies and innovations in various fields in order to improve their efficiency. The Agency is actively involved in technology parks, innovation centers, innovation labs, accelerators and business-incubators for the creation and development. Furthermore, the agency is open to any international collaboration.

The country is still at the initial stage in terms of funding the start-up opportunities. Recently, however (May 2016), Georgia's Prime Minister Giorgi Kvirikashvili announced that the Government of Georgia is starting a new program to

[97] http://www.doingbusiness.org/data/exploreeconomies/georgia#close

finance start-ups in the country as a way to foster entrepreneurial spirit, encourage the creation of new businesses and develop the economy. The start-ups financing fund will initially distribute 11 million GEL (about $5 million/€4.33 million*) to new businesses in the first stage, while in the near future the amount of funds available will increase to 35 million GEL (about $15 million/€13.77 million*).[98]

Demand conditions

There seems to be great domestic demand for start-up activities. This can mainly be attributed to the liberalized environment as has been described above and the good educational level of Georgian citizens, who are eager to start a new business.

Infrastructure

Category	*Grade*	*Comment*
▪ Sector	★★★	*Infrastructure represents the backbone of the Georgian economy. In the past heavy investments have been made and will continue in the future.*
▪ Demand	★★★	*The demand for infrastructure and is efficiency is constantly increasing, this trend will continue in the future, infrastructure needs to match the demand requirements.*
▪ Industry	★★	*Currently insufficient infrastructure is limiting the development possibilities of several sectors.*
▪ Competition	★★★	*Sector competition is quite intense especially for larger infrastructure projects.*

Georgian infrastructure can be divided by function into two areas:

1. Infrastructure for transportation & logistics
2. Infrastructure for energy related services

Factor conditions

1. Infrastructure for transportation & logistics

Only access to the Black Sea for the Caucasus, Georgia's sea ports have been developing since 2000 and were privatized in 2008 (except for Supsa Terminal, which is 100 % nationalized by Azerbaijan). Currently, Georgia possesses four seaports:

- Poti Sea Port, which is the largest port in Georgia and it is used for handling liquid and dry bulk, ferries as well as containers
- Batumi Sea Port, which has four terminals (oil terminal, container and the railway ferry terminal, dry cargo terminal and marine passenger terminal)
- Kuhlevi Terminal, which is used for transporting crude oil and refined products
- Supsa terminal, which is used for providing storage capacity for crude oil transported via the Western Route Export Pipeline (WREP) before loading to oil tankers via offshore loading facilities

Furthermore, in 2016 Georgia's Ministry of Economy & Sustainable Development that the Anaklia Development Consortium LLC has been awarded the contract to build and develop a Deep Sea Port in Anaklia. Construction on the project is scheduled to launch by the end of 2016, subject to completion of environmental reviews. The Port will be operational three years after its groundbreaking. The project is expected to create as many as 3,400 jobs during the construction stage and 6,400 jobs to operate the Port upon completion. The Port will have the capacity to process 100 million tons of cargo and generate 0.5% of GDP annually by 2025.

The road network in Georgia consists of 1,603 kilometers of main or international highways that are considered to be in solid condition and some 18,821 kilometers of secondary and local roads that are, generally, in poor condition, as only 7,854 km out of over 20,000 km of Georgian roads are paved. Some investments in improving the road transportation have already began, as The World Bank is approved a US$140 million equivalent financing for the Fifth East-West Highway Corridor Improvement Project (EWHCIP) for Georgia. The completion of the East-West Highway corridor is a central piece in the Government's strategy of transforming Georgia into a regional transport and logistics hub. The Project will directly contribute to economic development by reducing transportation costs and linking rural communities and their

[98] http://agenda.ge/news/57352/eng

agricultural products to urban centers such as Tbilisi and once completed, the East-West Highway from Tbilisi to Batumi via Poti will provide direct access to 2.2 million people or more than half of the total population of Georgia

Georgia has 2100 km (95 % electrified) of railway infrastructure. Georgian Railway (GR) is mainly a transit railway as around 80 % of their revenue come from transit cargo, which is split roughly 50:50 between liquids and dry bulk.[99] Future developments for the Georgian railway system rely mostly on the development of the Baku-Tbilisi-Kars project, which intended to complete a transport corridor linking Azerbaijan to Turkey (and therefore Central Asia and China to Europe) by rail. The project envisages the rehabilitation, reconstruction and construction of 180 km length Marabda-Kartsakhi railway section consisting of: Marabda-Akhalkalaki reconstruction-rehabilitation section (useful length 153 km) and Akhalkalaki-Kartsakhi (Turkish border) new construction section (length 27 km).[100] The line is going to be functional in 2017 and is intended to transport an initial annual volume of 6.5 million tones, rising to a long-term target of 17 million tones.

The aviation market in Georgia has demonstrated considerable growth in recent years. Three international and one domestic airport currently operate in Georgia, all of which fully comply with International Civil Aviation Organization standards. Georgia's aviation market is primarily international, with the majority of flights being served by Tbilisi International Airport. Tbilisi and Batumi International Airports are run by the Turkish TAV Airports Holding Company. They started operations in February and May 2007, respectively. Mestia (Queen Tamar) Airport officially opened in 2011. The construction of Kutaisi's King David the Builder International Airport was finished in September 2012. The capacity of Tbilisi International Airport is 2,000 passengers/hour; the capacity of Batumi and Kutaisi International Airports is both 500 passengers/hour; and Mestia Airport's capacity is 100 passengers/hour. The opening of Kutaisi airport was marked by the launch of flights by the low-cost carrier (LCC) Wizz Air. Wizz Air was the third LCC to enter the Georgian market, after Pegasus and Fly Dubai. In 2014, Air Arabia, a new LCC entered the Georgian aviation market. According to the Georgian Civil Aviation Agency (GCAA), Turkish Airlines is the dominant air company operating in Georgia and carries the largest number of passengers. In 2014, it served 415,867 passengers (22%). Ukraine International Airlines is the second most popular airline with 279,389 passengers (15%). This is followed by Georgian Airways with 218,536 passengers (11%); Pegasus with 145,931 (8%); Siberia Airlines with 93,579 (5%); Belavia with 92,549 (5%); and Lufthansa with 65,475 (3%). In total, 32 international and three domestic airlines operated in Georgia in 2014. The major airlines operating are: Turkish Airlines, Georgian Airways, Ukraine International Airlines, Pegasus, Siberia Airlines, Belavia, Lufthansa, Atlasjet International, Qatar Airways, Fly Dubai, Air Astana, Azerbaijan Airlines, Air Baltic, and Air Italy.

2. Infrastructure for energy related services

Georgia has well developed grid infrastructure for the electricity transmission. Whole territory of Georgia is covered with over 3,000 km high, medium and low voltage lines and about 100 substations. In 2013, a new 400 KV line with HVDC back-to-back substation connecting Georgia with Turkey was commissioned, adding to already significant transmission capacity with all neighboring countries. Overall, Georgia plans to spend 600 million euros in order to upgrade transmission and grid infrastructure by 2018-2022.[101]

For the transmission of oil there are two pipelines pass through the territory of Georgia. The Baku-Tbilisi-Ceyhan (BTC) and the Western Route Export Pipeline (WREP). BTC pipeline exports oil from the Azeri-Chirag-Gunshli field to the Ceyhan port in Turkey and is the second longest pipeline in the world. The total length of the pipeline is 1,768 km with 249 km on territory of Georgia and from eight pumping stations, two are located in Georgia. WREP also known as the Baku-Supsa, was commissioned in 1999 and was it the first investment of international oil consortium in Georgia. The length of the WREP is 833 km and its diameter is 530 mm. The pipeline transports crude oil from the offshore Azeri-Chiragi-Guneshli oil field in the Caspian Sea through Sangachal to the Supsa terminal in West Georgia. The Supsa terminal with the capacity of 120,000 tons was constructed as part of the (WREP) pipeline construction project.

In the same corridor as BTC passes also gas pipeline The South Caucasus Pipeline (SCP). The length of the SCP is 691 with 249 km in Georgia. Pipeline was commissioned in 2006 and was connected to Georgian gas distribution system near Gardabani and in January 2007 first commercial gas was delivered to Georgian market through SCP. At full capacity, the pipeline can transport up to 20 mln scm's (standard cubic meters) a year and recently BP has started expansion of the SCP bringing additional gas supply opportunity and USD 2bn investment to the country. Furthermore, there is also the North South Main Gas Pipeline (NSMGP), which was built in the 1970s. The pipeline stretches from Russian to Armenian border (221 km) supplying Georgian and Armenian market with natural gas. Within the framework of the Millennium Challenge Georgia Fund, the pipeline was rehabilitated between years 2006-2009 and at full capacity, the NSMP can transport 12 bln cm of natural gas. At the border between Georgia and Turkey, the pipeline will link into other new pipelines to provide gas into Turkey and the European Union.

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[99] http://www.railjournal.com/index.php/freight/georgia-pins-hopes-on-the-iron-silk-road.html

[100] http://www.investingeorgia.org/en/keysectors/regional-logistics-hub

[101] http://www.investingeorgia.org/en/ajax/downloadFile/549/Investment_Opportunities_in_Energy

Financial services[102][103]

Category	*Grade*	*Comment*
▪ Sector	★★	*Georgia's financial sector is dominated by the banking sector, which accounts for 95% of financial sector assets. The Georgian banking sector is stable, but according to the International Monetary Fund (IMF) the sector faces key risks.*
▪ Demand	★★	*There is high market demand for financing, although the access to finance is limited to a couple of sectors due to a lack of bankable projects and risk profiles*
▪ Industry	★★	*The supply of finance is focused mostly on infrastructure and tourism industry, other sectors have much more difficulties in accessing finance.*
▪ Competition	★★★	*There are 21 banks currently operating in Georgia. They are innovative in terms of product development and offering however the market maturity is still too low to use these products to its full capabilities.*

Georgia's financial sector is dominated by the banking sector, which accounts for 95% of financial sector assets.[104] The Georgian banking sector is stable, but according to the International Monetary Fund (IMF) the sector faces key risks. Risks related to dollarization and reliance on nonresident deposits should be closely monitored. Dollarization increases credit and liquidity risks. There are two major dollarization-related problems: First, most of the borrowers in USD are unhedged, as their income and expenditures are in national currency (this is especially evident in case of households). The problem became obvious in the period of GEL depreciation against USD, in the end of 2014, when the borrowers having the loan in USD were in difficulties in respect to paying the payment amount.

Factor conditions

By the end of 2014 there were 21 banks operating with a market capitalization (by total assets) of GEL 20.6 billion (GEL 0.88 billion in 2001), but it is worth noting that only two banks account for more than 55 % of total assets (Bank of Georgia-31,65% and TBC Bank-24,12%).

Georgian banks offer a wide range of products to customers. They are innovative in terms of new product development and are trying to be in line with global trends in the industry. In terms of technology development, most of the banks are offering remote banking channels to customers, such as internet banking, mobile banking, telephone banking, online consultancy, online payments, etc. However, these services are not developed sufficiently and many customers are more or less illiterate in terms of the efficient usage of these resources.

For investors, deposit rates still remain high, e.g. term deposits range from 4% to 8.75 % in GEL, and from 3% to 5.25% in foreign currencies; Child deposits range from 7% to 8.75% in GEL and from 5.25% to 5.5% in foreign currencies; other products, such as saving accounts, on-call deposits, investment deposits, convertible deposits and others also exist for the savers. Few banks in Georgia have brokerage services, which gives the opportunity to the customers to invest in stocks on local and international financial markets, however this type of service is not well developed in Georgia, as the Georgian customers are not used to this type of investments yet.

Regarding loans, the main interest rates offered to retail customers for loans differ according to their purpose, for instance the interest rate for a mortgage loan is approximately 9 %; on consumer loans from 11% to 12.5%, on student loans from 19% to 20%, and for auto loans from 0% to 15%. Georgian banks are offering different debit/credit cards to their customers: visa (electron, classic, gold, platinum); maestro/cirrus; American express, which helps Georgian customers to easily handle all local and international monetary transactions.

In terms of wholesale banking, the banks have special terms for deposits and loans for corporate clients, which are dependent on the agreement between the parties.

Demand conditions

Today there is an increasing demand for financial (mostly banking) services, which can be attributed to a still relatively large un-banked population in the rural areas and further growth in demand can be expected in the years ahead.

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[102] http://www.eib.org/attachments/efs/econ_report_psf_and_the_role_of_rbi_georgia_en.pdf

[103] https://www.kpmg.com/GE/en/IssuesAndInsights/ArticlesPublications/Documents/2015/Financial%20analysis%20of%20Georgian%20banking%20sector.pdf

[104] http://www.eib.org/attachments/efs/econ_report_psf_and_the_role_of_rbi_georgia_en.pdf

Related and supporting industries

Even though the growth rate of financial services is immense, IT technology could be viewed as a potential bottleneck, as with improved IT systems the financial industry could achieve an even greater growth.

Firm strategy, structure and rivalry

The only allowable legal status of banks is a joint stock company. Capital requirements for commercial banks are in line with the standards of the Basel Committee on Banking Supervision and corresponding EU directives. The level of minimum capital for commercial banks is set by the NBG (National Bank of Georgia) at GEL 12 million for newly founded commercial banks and foreign bank branches and should be fully paid in cash. It should be noted, that Georgia does not impose any restrictions on the inflow or outflow of capital.

There is a fierce competition in the Georgian financial industry. In addition to the current 21 licensed banks competition is also coming from Micro-finance organizations (MFOs) and companies like 4Finance (vivus.ge), etc. who have generally seen a significant increase in their loan portfolios over the past few year.

To gain a competitive advantage the banks are supporting training and development of their employees to provide the best service to the clients. The banks invested in creation of professional training centers and they are paying the tuition fees for executive education of their employees in the leading Georgian and international educational institutions. The banks are headhunting for the best human resources in Georgia and are trying to create the best working conditions to attract the Georgians with international working experience. At the same time, each bank creates a unique concept of the physical environment of the service centers and branches and has its own brand concept, including the different brand attributes, to create a specific approach and to increase the brand image.[105]

Energy and utilities

Category	*Grade*	*Comment*
▪ Sector	★★★	*It is Georgia's strategic plan to invest more in energy production facilities as consumption continues to rise not only in Georgia, but in neighboring countries as well. According to estimates, only 25% of Georgia's energy potential is exploited meaning that there is huge untapped potential, mostly from hydro resources, but also from wind, solar, geothermal and biomass sources as well. Overall, utility prices (especially electricity prices) are one of the lowest in the region.*
▪ Demand	★★★★	*There is large demand for power and utilities from the industry.*
▪ Industry	★★	*The sector is of extreme importance for the Georgian industry. There are further efforts being made to upgrade the national power production capacities.*
▪ Competition	★★	*competition is still not as intense as it will be in the future when further capacities will be installed and operational.*

Factor conditions

Since 2012 twelve new HHPs have been commissioned and currently, 17 hydropower plants are under construction, seven of them, with total installed capacity of around 300 MW, started in 2015. By the end of 2015, a 230 MW gas-fired combined cycle Thermal Power Plant was commissioned and construction of first Wind Power Plant in Georgia has started. In 2016, construction works on 14 new HPP's will commence.[106]

With abundance of high mountains and fast-flowing rivers, Georgia has competitive advantage over neighbors in terms of generation cost. Most attractive export market is Turkey who ranks first in Europe and second in the world after China in terms of electricity demand increase. Turkey experiences electricity shortage during summer months, while Georgia has generation surplus. Over the last decade, Turkey's electricity consumption in 2014 was 250.38 TWh, with generation deficit of 5.1 TWh. The Turkish Electricity Transmission Company (TEIAS) forecasts that Turkish electricity consumption

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105 https://www.kpmg.com/GE/en/IssuesAndInsights/ArticlesPublications/Documents/2015/Financial%20analysis%20of%20Georgian%20banking%20sector.pdf

106 http://www.investingeorgia.org/en/keysectors/energy

will grow by 5.5% on average annually. Almost 80% of electricity was generated by gas and coal-fired power plants. So, even with lower oil and gas prices, it's expected that electricity prices in Turkey will remain high.

For electricity transmission Georgia has well developed grid infrastructure. Whole territory of Georgia is covered with over 3,000 km high, medium and low voltage lines and about 100 substations. In 2013, a new 400 KV line with HVDC back-to-back substation connecting Georgia with Turkey was commissioned, adding to already significant transmission capacity with all neighboring countries. Overall, Georgia plans to spend EUR 600 million in order to upgrade transmission and grid infrastructure by 2018-2022.[107]

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Demand conditions

Over the last decade electricity consumption has grown largely in line with real GDP growth rate and reached 10.4 TWh in 2015. If this trend continues, in 10 years Georgia will have significant generation deficit as without additional Power Plants Georgia's generation capacity will not be sufficient to meet domestic demand during winter and in the long term, as per capita electricity consumption continues to grow, estimated deficit by 2025 is more than 5 TWh. In 2015, Georgia's electricity generation reached 10.8 TWh, of which hydropower accounted for 78% (8.5 TWh). Because of seasonality of electricity generation, Georgia had to import 0.7 TWh during winter months, but still managed to export 0.7 TWh to its neighbors during summer.

Firm strategy, structure and rivalry

Overall, Georgia has a liberalized and deregulated energy market. Renewable projects are based on Build-Own-Operate (BOO) principle and there are no tariffs set for newly built HPPs. There is also no fee required for the connection to transmission grid, no license for export and all new HPPs have priority access to the capacity on the new interconnection to Turkey. Furthermore, generation and export activities are exempted from VAT tax.

Due to favorable business environment there are several domestic and international companies who operate in Georgian energy market. Major energy companies in Georgia include: Tata Group (India), K-Water (Republic of Korea), ILAG (Austria), Clean Energy Group (Norway), Skinnest Group (Estonia), Anadolu (Turkey), Agagolu (Turkey), KGM (Turkey), Trans Electrica Ltd. (India), Rusmetal (Georgia), Peri (Georgia), Hydrolea (Bulgaria).

Industrial manufacturing

Category	*Grade*	*Comment*
▪ Sector	★★	*There are no large industrial manufacturing clusters in Georgia except for mining related operations.*
▪ Demand	★★★★	*Global demand for industrial manufacturing projects is very high especially for automotive and construction sectors.*

107 http://www.investingeorgia.org/en/ajax/downloadFile/549/Investment_Opportunities_in_Energy

▪ Industry	★★	*Absence of related industries and industry clusters that would stimulate the development of industrial manufacturing. Also high capital investments required to set-up operations are limiting the development of the industry.*
▪ Competition	★★	*There is limited competition in the market with firms usually operation in a single/ dominant player per sub-sector situation.*

Production of iron, aluminum and steel dominate Georgia's industrial manufacturing sector. Georgia's current advantages in terms of handling large transshipment flows, favorable business environment, low costs of power generation, existing raw materials and intermediate products provide opportunities for large industrial projects, such as production of iron, aluminum and steel products.

Factor conditions

As explained in the following paragraph (Mining), Georgia poses fairly strong mining capabilities and skilled labor force for manganese and copper ores, therefore the raw materials are close to where they can be processed Furthermore, there are currently 4 big smelters in Georgia, which are used for production of base metals like silver, iron, copper and other base metals from their ores.[108]

Demand conditions

It is hard to quantify the internal demand for industrial manufacturing but some assumptions can be made on the basis of the import value. In 2015, large imports of iron and steel products have been recorded in Georgia (app. 285 million USD) and its neighboring countries and the trade deficit of copper products (alloys and final products e.g. wire, tubes, pipes) amounted to app. 60 million USD in the South Caucas countries. Furthermore, large transshipment flows of raw material /input (Bauxite) and aluminum have been recorded cross Georgia to/from Tajikistan.

In terms of external demand, Georgia exports waste and scrap metal, but ferro alloys dominate as approximately 290 million USD have been exported in 2015.[109]

Related and supporting industries

In terms of supporting sectors, low cost of electricity generation can be viewed as a favorable factor as the costs are relatively low. Furthermore, good strategic location plays a significant role in Georgia's export and import opportunities, but the handling and shipping cost need to be brought down and better international connections need to be established.

Mining

Category	*Grade*	*Comment*
▪ Sector	★★★★★	*Georgia has historically been an important mining site, but in recent times, even though the country's economy is growing the mining industry is stagnating*
▪ Demand	★★★	*There is high global and domestic demand for raw materials, however*
▪ Industry	★★	*The excavation capacities and resources are limited and do not enable additional expansion of the sector.*
▪ Competition	★	*The market is dominated by a few players, with little or no potential competition for the resources.*

The share of industrial production in the GDP in 2013 was 17.2%. Mining and quarrying accounted for 4.4% of the value of industrial production. In 2013, the real value of production in mining and quarrying decreased by 0.1%, whereas the real value of manufacturing production increased by 8.4%, indicating that Georgia's economy was growing after the economic reforms of the previous decade, but that the mining sector was lagging behind other sectors of the economy.110 There were, however, some investments into the mining industry as the total FDIs in the mining sector totaled 43,7 million USD in 2013.

[108] http://www.investingeorgia.org/en/ajax/downloadFile/520/Investment_Opportunities_in_Manufacturing

[109] http://www.investingeorgia.org/en/ajax/downloadFile/520/Investment_Opportunities_in_Manufacturing

[110] http://minerals.usgs.gov/minerals/pubs/country/2013/myb3-2013-gg.pdf

Factor conditions

There are several opportunities for mining in Georgia, but the full potential has not been quantified. The infrastructure for mining has become available as some major companies such as Noricum Gold Ltd, LTD RMG Gold & Copper, Georgian Manganese and Georgian Industrial Group invested in mining facilities.

LTD RMG Gold & Copper is one of the largest enterprises in Georgia and Caucasus region, engaged in mining activities in Bolnisi region, Georgia. The company produces the copper concentrate and gold Dore alloys (half-fabricates) by mining and processing copper and gold containing ores. It is also an important employer in Georgia as the company currently employs approximately 3000 employees, 90% of whom are local residents.

Noricum Gold Ltd has a 50% interest in, and operational control of, the 861 km2 Bolnisi Project. The Project which is located in the Republic of Georgia contains multiple, large copper & gold non-JORC resources. Total mineral resources (non-JORC, C1, C2 & P1 Soviet Reserves & Resources) for the overall project area are both significant and scalable, comprising 980,000 tonnes of contained copper; 6.6 million ounces of gold; and 22 million ounces of silver.

Georgian Manganese, LLC (“GM”) and Vartiske 2005 LLC (“Vartiske”) are wholly-owned subsidiaries of Miami, Florida-based Georgian American Alloys, Inc. (“GAA”). Based in Georgia, GM is the country’s top producer and exporter of silicomanganese. GM leverages its skilled workforce of more than 6,000 employees to extract, refine, and produce approximately 90 percent of Georgia’s ferroalloy exports.

Georgian Industrial Group is the largest industrial holding in Georgia with a diversified business portfolio, including energy generation, natural gas resale, real-estate and also coal mining. Extraction volumes amounted to 350 thousand tons of coal in 2014. The majority of the enriched coal produced is sold under long-term contracts (1 year or more) to the local consumers. In the long-term horizon, company plans to increase its extraction volume up to 1.5 million tons annually, both to meet Georgia’s growing demand and to start export sales.

It seems that Georgia possess skilled labor force for mining projects, but the workers have recently expressed some concerns regarding their working conditions and their wages, resulting in several strikes in 2012 and 2014.[111]

Demand conditions

There is no available data for the demand, but assumptions can be made on the basis of annual production. Until 2013 (the last available data), the annual production of copper, silver, manganese ore and gold experienced a decreasing trend. In 2013, the total output for copper amounted to 5.000 metric tonnes (compared to 6.700 in 2010), for silver 1.100 kilograms (compared to 1.200 in 2010), for manganese ore 380.000 metric tonnes (compared to 400.000 in 2010) and 4.300 kilograms for gold (compared to 5.000 in 2010).[112] According to most recent data there is, however, increasing demand for Georgian gold from the export markets as in 2015 export of unprocessed or semi-processed gold increased by 70% compared to 2014. [113]

Firm strategy, structure and rivalry

The mining companies are mostly private and export oriented. The Georgian government is now open to privatization and free markets, and has largely controlled corruption and experts believe that all these changes will certainly enable Georgia to attract further foreign investment to its mining sector and ensure that its unexploited mineral deposits are fully utilized to generate revenue in the coming years.

Fertilizers/ Chemicals

Category	*Grade*	*Comment*
▪ Sector	★★★	*Georgian Chemical Industry produces wide-range of products and is an important part of the Georgian economy.*
▪ Demand	★★★★	*Availability of domestic raw materials and high demand on wide-range chemical products resulted in rapid development of Georgian chemical industry*
▪ Industry	★★	*Overall, mineral fertilizers and nitrogen compounds present by far the greatest share in production and exporting business in the industry.*
▪ Competition	★★	*There is limited competition and potential for further development of the industry due to scalability and expansion possibilities.*

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[111] http://www.industriall-union.org/georgian-miners-to-go-on-strike

[112] http://minerals.usgs.gov/minerals/pubs/country/2013/myb3-2013-gg.pdf

[113] http://cbw.ge/economy/demand-for-georgian-gold-increases-worldwide/

Georgian Chemical Industry produces wide-range of products. Availability of domestic raw materials and high demand on wide-range chemical products resulted in rapid development of Georgian chemical industry after the Second World War.

Factor conditions

Georgian chemical factories consume domestic coal, gas generated from coke, manganese, barite (along with imported), fire-resistant clays, tin, tin and zinc alloy, scrap iron, diatomite and other mineral and organic raw materials. Georgian chemical industry produces mineral fertilizers, chemical fiber, and chemicals for agriculture, household chemical goods, pharmaceuticals, technical rubber products, and perfume.

Georgia possess solid infrastructure for the production of chemicals. The main centers are Rustavi - Nitrogen Fertilizer Factory (nitrogen fertilizers, potassium etc), Synthetic Fiber Factory, Chemical Fiber Factory; Kutaisi- Lithopone Factory (lithopone, varnish, water emulsion paint, liquid glass etc); Tbilisi - Chemical Factory, Factory of Polymeric Materials, Factory of Rubber Products, Paint and Varnish Factory, Factory of Synthetic Products, Pharmaceutical Factory; Batumi Pharmaceutical Plant. Furthermore, there are many other paint and varnish factories in small towns around the country and overall the share of chemical goods in total production is growing.[114]

Furthermore, the chemical/ fertilizer industry is also an important employer in Georgia as in 2013, 5.414 people were employed in the chemical production sector.

Demand conditions

Overall, mineral fertilizers and nitrogen compounds present by far the greatest share in production and exporting business in the industry. In 2014, 137,7 million USD of mineral fertilizers and nitrogen compounds were exported, mainly to Turkey (38 %) and the US (23 %). Nitrogen fertilizers present by far the greatest share in this category as Georgia produces only this chemical and in 2012 the production reached 168,4 tsd tons, with recent trends indicating further increase. Production is spurred also by a relatively high domestic demand as in 2012, the overall consumption of nitrogen fertilizers reached 39.000 tons.

Besides mineral fertilizers and nitrogen compounds, Georgia also export industrial gases, pigments and other coloring matter, and other basic organic chemicals, but their share in the chemical industry is fairly small (reaching approximately just over a million USD in export value).

Livestock (animals breeding)

Category	*Grade*	*Comment*
▪ Sector	★★	*Livestock was and is one of the major sectors of the agricultural sector in Georgia as it represents around half of total agricultural services.*
▪ Demand	★★★★	*Demand for Georgian livestock is limited to the Caucasus region, generation of demand from other geographic regions seems unrealistic due to capacity and meat specifications restraints*
▪ Industry	★★★	*Industry is lacking vertical integration across the supply chain*
▪ Competition	★★	*Competition is fragmented*

Factor conditions

Sheep breeding is an important activity for Georgia. There are two types of Georgian sheep: Tushuri and Imeruli. So called Tushuri sheep is mostly spread in Eastern part of the country. Such breed is very popular, mostly because of its main characteristic: endurance. Tushuri can walk about 600-700 kilometers per season, it has strong legs and can easily be adapted to environmental conditions. Tushuri doesn't need high quality food, it can be fed in semi-desert lands and weighs about 60-80 kilograms. Imeruli sheep is mostly spread in Western part of the country, has more rude wool and its uniqueness is in its reproduction functions. It can be bred any time of the year, it breeds about 2-3 sheep per gestation period and its pregnancy period is shorter, about 137-143 days. Such variety of sheep weights about 35-45 kilograms and its meat actually doesn't consists of fat and so is dietary kind of food. It should be emphasized that during Soviet Union about 2,000,000 sheep was recorded in the country, however nowadays the number came down to 800,000 units. Such

[114] http://www.cg.itnovations.ge/?40/Industry%20&%20Agriculture

decrease is the result of different factors, however it's mostly linked with finances. Since the taxes on pastures increased, the farmer that had limited financial abilities had to sell even such sheep that in future should have lambs.[115]

Breeding pigs and cattle is also important for Georgia's economy. Cows' average weight is between 350-459 kilograms and price for a cow is 500-718 USD, while pigs' weight is about 80-180 kilograms with a price of 270-500 USD. Despite the high demand on local market, farmers and small entrepreneurs are not able to satisfy the market and this shortage is filled with imported goods, but according to the experts, the most of this shortage space can be supplied by locally produced meat, which nowadays cannot be reached because of existing challenges.

Demand conditions

It's noteworthy that mutton consumption in Georgian is quite low, about 70 tonnes per year and is mostly depended on the Azerbaijanis living in the country. However the interest towards Georgian sheep, namely in Tushuri is quite high in foreign countries, as this breed is very similar to sheep from Middle East Awassi, which is very popular and quite expensive in Arabian countries. If the price for Australian Merinos sheep in Arabian countries is about $8 USD and for Syrian Awassi is $15, price for Georgian sheep occupies middle position between them. Nowadays, Tushuri sheep is exported in Libya, Syria, Jordan, Iran, Saudi Arabia, Egypt, Azerbaijan, Qatar, Kuwait, United Arab Emirates, Oman and in Israel. About 266,244 live sheep were exported in 2009 year from Georgia, in 2010 – 178,000, in 2011 – 150,000 and in 2012 about 120,000.

Domestic sheep is also interesting from wool point of view. If one sheep can give about 2-2.5 kilograms of wool and a lamb about 1-1.5, it comes out that Georgia has capacity to produce about 1,700,000 kilograms of wool per year. While domestic price per kilo of the product is about $6 USD. Sheep is also attractive in terms of milk production, especially for cheese production. It gives less milk than a cow, about 1-2 liters, however its milk is full of fat and is beneficial for health. Important to note is the fact that the export can be much more, as the interest towards Georgian sheep is large and considering the current world food trends it will only increase.[116]

Furthermore, it's worth noting that despite the high demand for pigs and cattle on the local market, farmers and small entrepreneurs are not able to satisfy the market and this shortage is filled with imported goods. According to the experts, the most of this shortage space can be supplied by locally produced meat, which nowadays cannot be reached because of existing financial constraints that prevent the farmers to modernize their technology and create economies of scale. In 2012, the import of beef has increased by 60.3% relative to 2011 and amounted to around 6.1 mill USD. And 92% from the total import was from India and the rest from Germany, Turkey and Brazil. Also, pork imports increased by 80% and consisted of 7.2 mill USD, from which 60% was from Brazil and 40% from Canada, Netherlands, United States and other countries.

Aerospace and defense

Category	*Grade*	*Comment*
▪ Sector	★★	*Sector has one larger flagship company it is questionable whether other companies will join the cluster*
▪ Demand	★★	*This is a sensitive industry due to security restrictions, global demand is limited and carefully selected.*
▪ Industry	★	*Currently there is one larger player in the market no cluster building or vertical integration is ongoing in the market.*
▪ Competition	★★	*Almost no competition.*

Factor conditions

Georgia offers significant capabilities for aerospace and defense related activities. The State Military Scientific-Technical Center "Delta" is a Georgian government-owned, autonomous R&D and production center for military and civilian hardware. Headquartered in Tbilisi, Delta was formed in 2010 on the basis of six scientific research centers and production facilities, histories of which go back to the early 1940s under the Georgian SSR. Employing nearly 2.000 people, Delta is focused on research and development of new military projects, as well as the modernization and production of already established Soviet military hardware. Delta fell under the jurisdiction of the Georgian Ministry of Defense until March 2014,

[115] http://emerging-markets-investment-news.blogspot.si/2013/03/livestock-industry-in-georgia.html

[116] http://emerging-markets-investment-news.blogspot.si/2013/03/livestock-industry-in-georgia.html

when the government passed the control over the enterprise to the Ministry of Economy and Sustainable Development of Georgia. The organization produces the following products:[117]

- Armored vehicles
- Artillery systems
- Aviation products (Multifunctional Unmanned Helicopter and Unmanned Aerial System)
- Personal protection equipment
- Explosive weapons
- Police gear
- Small arms
- Upgrade programs
- Other products

Furthermore, Tbilisi Aircraft Manufacturing (TAM), which is also a part of STC DELTA, is responsible for the development of civilian aircrafts and the production includes one four-seated private jet and one seven-seated private jet.

Demand conditions

From 2010 until 2014 Georgian defense expenditure registered a growth rate of -2.71%, which resulted in US$0.38 billion expenditures in 2014. But, recently Georgia announced that its military expenditure will increase to US$0.54 billion by 2019, registering a CAGR of 8.92% over the forecast period. The country's military expenditure will be driven by the country's participation in NATO, imminent threats from Russia, and the Defense Ministry's military modernization plans. The Defense Ministry is expected to procure fighter aircraft, air defense systems, anti-tank and anti-aircraft defense systems, and command, control, communication, computer, and intelligence systems (C4I).[118]

Firm strategy, structure and rivalry

There is basically only one company (DELTA), which operates in this field and is 100% under government control.

5.1.1 Sectors where Georgia has a an existing or can develop a Competitive Advantage

Six sectors based on the above scoring with existing competitive advantage or with the potential to develop one, have been identified:

- Agriculture
- Light manufacturing
- Transportation & Logistics
- Creative industries
- Pharmaceuticals
- Start-ups

5.1.2 Timing analysis (quick win/ mid/Long term)

In order to utilize on this potential and existing advantages the following measures are proposed

Agriculture

Short-term objective: **Increase existing import substitution and export opportunities, bring new technology and new blood into the system**

- Facilitate the integration of capable smallholders and coops into existing value chains (addresses raw material supply problem for processors, improve productivity and build capacity to implement EU food safety and environmental norms)
- Work with sectoral/sub-sectoral associations to promote Georgia as a brand in wine, qvevri wine, other alcohols, mineral water, honey, cheese, kiwi, herbs, olive oil, apple/pears, citrus, berries, herbs, etc.

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[117] http://delta.gov.ge/en/product/

[118] http://www.prnewswire.com/news-releases/future-of-the-georgian-defense-industry---market-attractiveness-competitive-landscape-and-forecasts-to-2019-265226981.html

- Target financial assistance (vouchers, subsidies, irrigation, seedlings, etc) to capable and innovative farm operations
- Support creation of sectoral and sub-sectoral clusters to gain scale, professionalize production, reduce costs; work with cluster leaders to certify exportable products and develop export facilitation mechanisms (to aggregate, deliver to, and distribute products in export markets; identify and develop new markets such as UAE, China)

Medium and long-term objectives: **Bring FDI into export-oriented sectors, improve access to land, develop relevant skills**

- Promote PPPs in industry-led vocational training to address human capital bottlenecks.
- Bring global food industry leaders interested in outsourcing raw material production or processing and in this way help put Georgian on the global map such as a major wine manufacturing, baby food (Hipp), juices (Rauch), organic produce, etc.
- Reduce transportation costs (from both western/eastern Georgia, increase frequency of flights, add destinations) to improve market access for fresh products.
- Promote technological upgrading via credit, model farms, training measures and PPPs involving industry leaders
- Support the industry to maximize capacity and increase exports by addressing key industry issues that are currently influencing the sector competitiveness, such as, for example: Logistics prices.
- The Ministry of Agriculture shall promote existing institutions, which provide services to farmers such as training, research and consulting services and ensure that they serve farmers effectively.
- The Ministry of Agriculture shall also make legal and regulatory reforms so that individual farmers are encouraged to shift to market-oriented production, and to adopt greater use of modern farming practices.

Light manufacturing

Short term objective: **Increase existing exports**

- Increase contract manufacturing volume for operating producers by active promotion
- Scale up manufacturers to do private labeling for local and international brands by access to finance and promotion
- Attract FDI in sectors with high labor intensiveness, generous use of electricity and ability of satisfying rules of origin
- Resolve industry-specific taxation issues, further liberalize taxes
- Award international scholarships for creative industry studies, engineering, chemistry

Medium-term objective: **Reduce manufacturing costs**

- Increase utilization of trade regimes by developing high quality raw material base and intermediary export industries (packaging)
- Improve worker productivity by investing in vocational education system for timely supply of skilled and productive labor force
- Maintain electricity prices and improve quality of power supply
- Invest in domestic transport infrastructure, East-West highway, Anaklia port, more container terminals for cheap rail transportation, more direct flights to strategic markets

Long-term objective: **Increase value-added**

- Invest in education to develop professional technical and creative staff with higher education to take over engineering, design and branding of locally manufactured product lines and creating maximum value-added locally.

Transportation & Logistics

Development of infrastructure is key for the future of Transportation and Logistics in Georgia

- T&L can be important in itself as a target for FDI, jobs, value added.
- But, is also important for all exporting sectors.
- Currently rail and port handling costs are very high and they need to be reduced

- Air transport is a bottleneck for tourism but also for agricultural exports – there is a need for regular, direct, frequent and cheap flights from east AND west Georgia (Kutaisi and Batumi) to target markets (example: Amsterdam for flowers; Dubai for mushrooms, etc.).

Infrastructure development has to support export possibilities, without proper and functional infrastructure export possibilities will be limited as well as T&L sector development

Creative industries

Short-term objective: **support the consolidation of creative industries professionals into clusters**

- DCFTA does not impact the development of the creative industries directly in terms of their export potential, creative industries need to be stimulated and developed
- Support the development and creation of creative clusters to enhance the ability to attract more customers and provide access to specialist goods/services and labor inputs
- Human capital development – support the clusters by developing tailor made classes or educational programmes for industries with high potential

Medium/ Long-term objective: **Develop internationalization platform for strongest cluster**

- Develop internationalization platform for key creative industries in Georgia, that will give creative industry professionals access to global markets
- Leverage spill-over effects from creative industries to grow other priority sectors
- Establish and develop universities/colleges/institutions, which will provide sufficient and high standard knowledge in Creative Industry sectors.
- Try to bring Creative Industry international, leading companies in Georgia by for example, subsidizing them, which would develop local market efficiently.
- Promote ideas and support start-ups to be "Successors" on global market, which will promote country and motivate other local bright people to develop their ideas.

Pharmaceuticals

Short-term: **Motivate current market players to grow and export**

- Build on existing experience in of packaging and exporting generics into the CIS market
- Due to clinical testing requirements entry to EU markets to benefit from the DCFTA is limited
- Motivate existing market players to grow beyond their current size
- Support pharmaceutical industry in becoming GMP compliant
- Support local producers with introduction to strategic investors and market opportunities outside of their „view point"

Medium/ Long-term: **develop human capital and biotech opportunities**

- Can diversify products and export markets (including EU) with the help of international (European) partners. Example is Lausanne-based Ferring, which is about to enter Georgia in a small way (for now)
- Build up human capital and know how to support development of contract manufacturing and research (enhance university programmes to promote development of Pharma and natural sciences)
- Further develop the biotech sub-sector in high potential areas (usage of Georgian innovations for food processing, Agriculture and water purification)

Start-ups

Short-term: **Increase in knowledge and measures for supporting environment**

- Encourage students to start developing their own ideas already during their studies– special grants for starting a start-up company, which also includes mentoring programme to obtain required business skills
- Further development of the supporting environment – incubators, mentoring, technology parks
- Encourage students toward highly competitive IT sector (especially in regards of salaries)

Medium-term: **Promote business development and specific added-value industries**

- Establish and develop universities/colleges/institutions, which will provide sufficient and high standard knowledge in IT sector.
- Try to bring international IT and Creative Industry international, leading companies in Georgia by for example, subsidizing them, which would develop local market efficiently
- Connect start-ups with potential investors depending on their development phase (seed capital, venture capital)

Long term: **Increase value-added**

- Promote ideas and support start-ups to be "Successors" on global market, which will promote country and motivate other local bright people to develop their ideas

5.2 Prioritization of countries

Countries/ regions in focus were primarily EU, China, Middle East, Turkey, India, and Caucasus.

Separate analysis has been performed for individual foreign markets (please find it attached in a separate excel Appendix) in order to identify the most attractive foreign export markets. The following data for individual foreign markets have been collected:

- top imported products;
- top importer countries;
- existing top commodities that Georgia has already been exporting.

The triangulation of this data together with the available literature has enabled prioritization of the foreign markets that present good export potential for Georgia.

Furthermore, the following categories also influenced the selection of countries/regions:

- existing and new DCFTA effects;
- existing relationships with non-EU trading partners;
- potential new large market export destinations.

EU

Analysis of EU markets is key for this research as the DCFTA can potentially have the largest impact on Georgian exports to the EU. Therefore it is important not only to look at the structure of EU imports in comparison to Georgian exports but also understand some of the individual markets within the EU. The chosen markets are Germany, UK, France, Italy, Estonia Lithuania and Poland. Our analysis tackles both EU28 as well as these markets individually due to their importance in EU and international trade.

Germany

Almost all forms of industry are represented within the broad-based German economy. As befits a country with high employment costs but with a well-educated population and a well-trained workforce, the most exciting prospects today are offered by industries in the forefront of technology and by the providers of sophisticated technical, commercial and financial services. Agriculture and tourism are less significant, although they are of social and cultural importance, especially for the preservation of living and recreational standards.

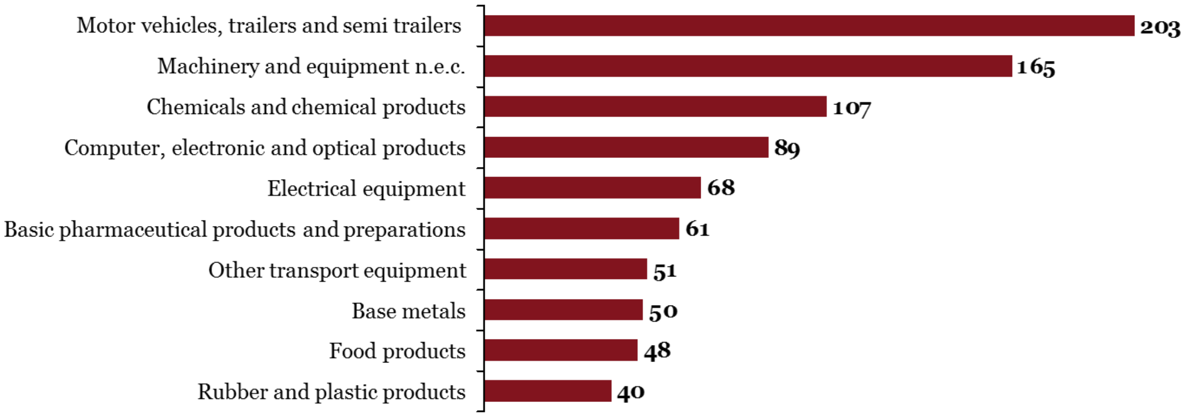
Traditionally, the German economy is oriented towards manufacturing. This extends to the service sector, where there are many companies developing and applying leading-edge technologies for industrial use. For decades, manufacturing output has exceeded the consumption requirements of the domestic economy; in effect, Germany is and remains a major exporting nation in order to maintain domestic employment. In keeping with this tradition, Germany’s recovery from the economic crisis was export-led. Nevertheless unemployment remains a concern. In December 2014 it was running at 6.4%, roughly similar to the previous year and to the pre-crisis level.

Germany has a social market economy, meaning that she embraces the spirit of free enterprise, but tempered with controls and other administrative legal measures designed to prevent large economic participants from seriously damaging other interests. Laws against unfair competition, including the antitrust provisions, and for the protection of the environment, as well as those protecting employees, all illustrate this latter point. In general, the work force is highly motivated, and highly trained and disciplined. The strong and well-established trade union movement usually keeps to established bargaining procedures and, over the years, has achieved an impressive degree of protection for employees. As a result, cases of serious industrial unrest are rare although there are instances of demarcation disputes (conflicts between rival employee representations, rather than between labour and management), especially in the passenger transport sector.

Most German industry is dynamic and, except in the depressed areas, expanding. The state does not encourage the development of specific industries as a deliberate act of policy, but it does offer substantial subsidies and other support for, in particular, research and development likely to lead to new marketable products. There is thus a move toward high-tech industries and the more sophisticated parts of the services sector are also expanding. The labour force numbers some 42.3m gainfully employed by 3.7m enterprises. 24% of the latter are corporate entities, the remainder being partnerships, sole traders and public utilities.

The typical business in Germany is a small family-owned unit. Any outside shareholders are usually long-term employees or others with long-standing personal relations with the original family. Most large businesses are publicly held

Picture 2: The main German trading goods, 2014 (EUR bn, export)



corporations with many shareholders. However, the original family owners often retain a significant minority holding and there are still a few large businesses closely held by only a few individuals. Many medium-sized publicly-listed corporations issue a different class of shares to the public (quite frequently non- voting preferred stock) in order to give the original owners a greater degree of control and influence than warranted by their investment.

Source: Preliminary results from Statistische Bundesamt, Wiesenbaden 2015

Import restrictions

The only import restrictions of general application are those imposed in accordance with UN sanctions. Otherwise, there is a special licensing procedure for certain specific types of goods, mostly military equipment and drugs. Some import quotas are imposed by the EU (e.g. for textiles), and these are also applied by Germany, which issues licences freely until the quota is filled. Products whose sale is prohibited in Germany can sometimes be imported, but they will not be cleared through customs and will therefore have to be re-exported. Since the EU member states constitute a single European market, deliveries to and from Germany and other EU countries do not qualify as imports or exports. Within the EU there are no longer any border controls of any description or any customs duties or other restrictions on intra-union traffic apart from certain minor formalities for travelers. The terms “export” and “import” therefore technically now only refer to trade between Germany and non-EU countries.

Import duties

Customs duties are the main duties effectively increasing the price of foreign goods over that of domestic or EU products. German customs duties are all based on value and are levied at rates dependent on the type of goods and on the country of origin. Imports from Iceland, Liechtenstein, Norway and Switzerland are generally free of duty, and the same applies to most imports from Turkey and the other EU candidate or associate countries. The rate of duty on imports of manufactured products from other countries is often zero and rarely rises above 10%. Additional duties are levied from time to time on specific products from specific countries at the direction of the EU, usually as a result of an anti-dumping case.

Goods are classified for customs duty purposes under the Harmonised System and the TARIC (integrated customs tariff of the European Union) nomenclature, and the valuation principles follow the internationally recognized customs code. The basis for assessing duties is usually the supplier’s invoice unless it is obviously incorrect. This basis is subject to amendment, either in response to subsequent price adjustments, or because of other charges and credits raised separately or otherwise borne by the importer that directly affect the import value of the goods. Customs duty auditors regularly inspect the books of German importers to establish whether they have appropriately accounted for such adjustments.

Special procedures are in force with respect to agricultural products. These are subject to special EU levies, usually based on net weight. Maximum rates by value have been fixed for certain items.

Except for large importers with their own bonded warehouses, the administration of customs duties is substantially completed at the point of entry into the country by the carrier or other forwarding agent. The duties imposed, together with the VAT on imports (Einfuhrumsatzsteuer – EUSt) and any excise or other taxes levied (see Chapter 12), are charged back to the importer as cash outlays. The importer must also comply with the reporting and return requirements of the Intrastat system of the EU and must, of course, establish a suitable filing system for the retention and recovery of the import documentation as needed for customs or tax audits.

Authorised economic operator

Regular importers and logistics businesses are increasingly aware of the benefits of registration as an "authorised economic operator" under EU-harmonised rules. Authorisation will be granted to businesses who have shown themselves to be reliable from the financial, record keeping and, as relevant, technical points of view. Authorisation is granted locally, but is valid throughout the EU. Thus an authorised economic operator from another member state does not need to re-apply in Germany in order to enjoy the benefits here.

Two types of authorisation are available. A business, the "economic operator", may apply for either or both. Customs simplifications are the one and security and safety the other. Neither authorisation frees the holder from the obligation to declare imports and pay the relevant duty, or from the security and safety regulations currently in force, although both enable Customs to grant the holder priority in dealing with his requests for permits or rulings. Other benefits include fewer test checks of transactions and a more flexible approach to routine examinations.

Local representation

From the point of view of processing imports, local representation is neither necessary nor helpful. The actual processing is done in any case by the carrier.

Foreign businesses may freely sell and then ship most goods to Germany. The import will be the responsibility of the purchaser, who will have to obtain customs clearance.

A foreign business may require access to local German storage and onward delivery facilities. Logistic services of this nature are offered by most well-known carriers and courier services.

Foreign exporters who wish to station their own employees in Germany or to appoint their own German representatives may well meet the preconditions of a taxable "permanent establishment" in Germany under the terms of the relevant double tax treaty. Effectively, part of the net profit earned on the sale of the goods to German customers then becomes chargeable to German income taxes and the foreign business is subject to German accounting and record-keeping requirements.

It is also quite usual for a foreign business to establish a German sales subsidiary or branch to regularly and systematically access the German market. There are usually no fundamental reasons why this should be impracticable, although it does lead to taxation in Germany.

UK

UK GDP growth slowed a little in 2015, but consumer spending growth remains relatively strong, helped by lower oil prices. The United Kingdom mainly imports machinery and transport equipment (35 percent); manufactured products (26 percent); mineral fuels, lubricants and related materials (13.5 percent) and chemical products (11 percent). U.K. main import partners are: Germany (13 percent), China (8 percent), United States (8 percent), Netherlands (7 percent) and France (5.5 percent).

Customs and import duties

Imported goods from outside of EU need to be declared for customs purposes and may be subject to customs duties and import VAT. It should be noted that the European Union is a customs union, which means that the EU is treated as a single territory for customs purposes and the same rules and rates apply in each member state. This means that once goods are in "free circulation" (i.e. all duties paid and import formalities completed) in one member state, they can move freely between all other member states without further payment of customs duty. There are essentially three areas that determine the amount of duty payable on goods imported from outside the EU:

- **Classification-** the amount of duty payable depends on how the goods are classified for customs purposes, as the commodity code (also known as the tariff heading or HTS code) determines whether goods are subject to ad valorem duty rates or to specific duty rates based on volume. The commodity code is also used to determine whether a particular product may be eligible for preferential treatment or subject to additional measures. It is also used for trade statistics.
- **Valuation**- where goods are subject to ad valorem duty rates, EU customs valuation rules require the addition of certain cost elements, e.g. freight and insurance. Certain elements may, in certain circumstances, be excluded. It should be noted that, where the parties are related, the customs authorities may require evidence that prices are at arm's length. Service agreements and agreements relating to intellectual property, particularly royalties should also be reviewed from a customs perspective
- **Origin**- it should be noted that the EU has many free trade agreements and preferential trade arrangements in place for a large number of countries, which means that eligible goods enter the EU at reduced or zero rates of duty. Conversely, certain goods from certain countries may be subject to trade defense measures, such as antidumping, anti-subsidy (also known as countervailing) or safeguard measures, which generally take the form of additional duty. Careful consideration must therefore be given to the customs implications of any sourcing or production decisions.

Depending on whether imported goods undergo further processing or are stored for any length of time, there is a range of customs reliefs, regimes and simplified procedures available to UK importers to delay or suspend the payment of customs duty and import VAT. The rules relating to these areas are complex and it is, therefore, important to seek advice before imports commence.

Excise duties

Excise duty becomes payable upon the importation or manufacture of an excise product. The European Commission sets minimum rates for excise duty per product type and provides guidance on how excise duty is to be calculated. However, unlike customs duty, each EU Member State sets its own excise duty rates, providing they are set above this minimum level. Therefore, there is a wide range of excise duty rates applicable to alcohol, tobacco and oil products across the EU. In addition, each Member State will have its own procedures for the reporting and collection of excise duty. In the UK, excise duty rates on alcohol, tobacco and oil are high when compared to other indirect taxes. It is not unusual for excise duty to represent over half the final retail price and, when VAT is taken into account, the tax amount within the retail price can be as high as 70%. Due to the high rates of excise duty, products are highly regulated with registrations needed before importing, manufacturing, bottling, storing under duty suspension, transporting or selling goods. If you wish to move duty paid excise goods, or excise goods under duty suspension, strict criteria must be met to ensure the correct duty treatment of the movement.

France

France is the 6th largest export economy in the world and the 13th most complex economy according to the Economic Complexity Index (ECI). **In 2014, France exported $571B and imported $654B**, resulting in a negative trade balance of $83.1B. In 2014 the GDP of France was $2.83T and its GDP per capita was $39.3k. France is the world's 6th largest importer and during the last five years the **imports of France have increased at an annualized rate of 4%,** from $537B in 2009 to $654B in 2014[119]

Top import products are:

1. Crude petroleum (5,4% of all imports)
2. Cars (4,8% of all imports)
3. Packed medicaments (2,6% of all imports)

Top import origins are:

1. Germany (18,2%)
2. Belgium-Luxemburg (8,56%)
3. China (8,13%)
4. Italy (7,61%)
5. Spain (6,38%)

[119] http://atlas.media.mit.edu/en/profile/country/fra/

As in all EU countries, France also requires for all imports and exports a customs declaration. Customs declaration must be filled using the **Single Administrative Document (SAD).** The main items on the SAD are the name of the company, the type of declaration (according to the source of the merchandise), and the type, origin and value of the goods, net of tax. Invoices and any documents required to claim preferential tariff treatment or for inspection of certain imports (agricultural products, etc.) must also be provided. The SAD information is used to calculate the duties and taxes due, and for physical and statistical identification of the goods.

Italy

Italy is the 8th largest export economy in the world and the 22nd most complex economy according to the Economic Complexity Index (ECI). In 2014, Italy exported $509B and imported $466B, resulting in a positive trade balance of $43.5B. In 2014 the GDP of Italy was $2.14T and its GDP per capita was $35.5k[120].

Top import products are:

1. Crude Petroleum (8,14%),
2. Cars (4,91%)
3. Packed Medicaments (3,2%)

Top import origins are:

1. Germany 15,06%)
2. France (8,48%)
3. China (7,12%)
4. the Netherlands (5,86%)
5. Russia (4,91%)

Import duty and taxes are due when importing goods into Italy from outside of the EU whether by a private individual or a commercial entity. The import duty and taxes payable are calculated on the CIF value, i.e. the sum of the value of the imported goods and the cost of shipping and insurance. [121]

The duty rates applied to imports into Italy typically range between 0% (for example books) and 17% (for example Wellington Boots). Some products, such as Laptops, Mobile Phones, Digital cameras and Video Game consoles, are duty free. Certain goods may be subject to additional duties depending on the country of manufacture (anti-dumping measures). The standard VAT rate for importing items into Italy is 22%, with a few exceptions attracting VAT at reduced rates of 10% or 4%. VAT is calculated on the value of the goods, plus the international shipping costs and insurance, plus any import duty due. [122]

For imports into Italy, there are minimum thresholds below which duty and VAT are waived.

Duty is not charged if[123]:

- the FOB value, i.e. the value of the goods excluding shipping and insurance cost, does not exceed €150

VAT is not charged if:

- the FOB value, i.e. the value of the goods excluding shipping and insurance cost, does not exceed €22

Poland

Poland is the 24th largest export economy in the world and the 24th most complex economy according to the Economic Complexity Index (ECI). In 2014, Poland exported $205B and imported $218B, resulting in a negative trade balance of $12.8B. In 2014 the GDP of Poland was $544B and its GDP per capita was $25.3k.

Top import products are[124]:

1. Crude Petroleum (6,76%),
2. Vehicle parts (3,01%)
3. Packed Medicaments (2,1%)

Top import origins are:

1. Germany (23,52%)
2. China (10,32)

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[120] http://atlas.media.mit.edu/en/profile/country/fra/

[121] http://www.dutycalculator.com/country-guides/Import-duty-taxes-when-importing-into-Italy/

[122] http://www.dutycalculator.com/country-guides/Import-duty-taxes-when-importing-into-Italy/

[123] http://www.dutycalculator.com/country-guides/Import-duty-taxes-when-importing-into-Italy/

[124] http://atlas.media.mit.edu/en/profile/country/pol/

3. Russia (8,12%)
4. Italy (5,64%)
5. The Netherlands (3,93%)

As in all EU countries, Poland also requires for all imports and exports a customs declaration. Customs declaration must be filled using the **Single Administrative Document (SAD).**

Estonia

Estonia is the 73rd largest export economy in the world and the 29th most complex economy according to the Economic Complexity Index (ECI). In 2014, Estonia exported $17.8B and imported $19.8B, resulting in a negative trade balance of $2B. In 2014 the GDP of Estonia was $26.5B and its GDP per capita was $28.1k.

Top import products are:

- Refined petroleum (14,8 %)
- Telephones (5,1 %)
- Cars (4,5 %)

Top import origins are:

- Russia (14,7%)
- Germany (10,1%)
- Finland (9,7%)
- China (7,6%)
- Sweden (5,9%)

Trends in customs policy

As the member of EU Estonia implements common customs regulation. Thereof no country-specific trends exist. The priority of Estonian customs authorities has been and will be in the future the contraband trade, especially tobacco products and alcohol

Temporary import relief

Under the temporary admission procedure, non-Community goods intended for re-export may be used in the customs territory of the Community, with total or partial relief from import duties, and without being subject to any of the following:

- Other charges as provided for under the other relevant provisions in force;
- Commercial policy measures, insofar as they do not prohibit the entry or exit of goods into or from the customs territory of the Community.
- VAT is not imposed on the import of goods subject to immediate tax warehousing on the condition that the recipient of the imported goods is the keeper of the tax warehouse. The import of goods specified in Chapter 1 of Council Regulation 918/83/EEC and goods with customs preferences specified in Title 6 of the Community Customs Code is not subject to VAT under the conditions prescribed for entitlement to customs duty relief.

VAT is not imposed on the import of goods upon the placing of non-Community goods under the customs procedure of release for free circulation, provided that the following conditions are met:

- The importer of the goods is an Estonian taxable person;
- Immediately after the goods have been imported, they are transported, in the same condition, to another member state where such goods will be received by a taxable person or a taxable person with limited liability of the other member state;
- Intra-Community supply is created as a result of the transport of the goods to another member state;
- Upon importation of the goods, the importer confirms the intention to transport the goods to another member state where such goods will be received by a taxable person or a taxable person with limited liability registered by the other member state and, after the goods have been transported, provides the customs authority with documentation of proof of the intra-Community supply of the goods
- A security is provided in order to guarantee the performance of the tax liability which may arise as a result of the failure to perform the tax obligation provided in this subsection. The security is given, released, used and calculated pursuant to the procedure provided by the customs rules.

VAT is not imposed on the import of the following goods:

- Books, periodicals or other electronic media sent to libraries or to research, development or educational institutions;
- Confiscated counterfeit clothes and footwear transferred to state or local government health care or social welfare institutions pursuant to law

Documentation and procedures

Starting from 1 July 2009 any economic operator established in the EU needs to have an EORI number. Economic operators established outside the EU have to be assigned an EORI number if they lodge a customs declaration, an Entry or an Exit Summary Declaration. A special authorization from the customs authorities is required for the following:

- The use of the inward- or outward processing procedure, the temporary admission procedure or the end-use procedure.
- The operation of storage facilities for the temporary storage or customs warehousing of goods, except where the storage facility operator is the customs authority itself.

The conditions under which the use of one or more of the procedures referred to above or of the operation of storage facilities is permitted is set out in the authorization. The authorization will be effective from the date of issue and is usually at a fixed date. No special charges are applied. Except where otherwise provided for in the customs legislation, the authorization mentioned above is granted only to the following persons:

- Persons who are established in the customs territory of the Community;
- Persons who provide the necessary assurance of the proper conduct of operations and, in cases where a customs debt or other charges may be incurred for goods placed under a special procedure, provide a guarantee required; in the case of the temporary admission or inward processing procedure, the person who uses the goods or arranges for their use or who carries out processing operations on the goods or arranges for them to be carried out, respectively.

All customs clearance is carried through electronically.

Lithuania

Lithuania is the 65th largest export economy in the world and the 33rd most complex economy according to the Economic Complexity Index (ECI). In 2014, Lithuania exported $30.3B and imported $34.5B, resulting in a negative trade balance of $4.22B. In 2014 the GDP of Lithuania was $48.4B and its GDP per capita was $27.7k

Top import products are:

- Crude Petroleum (15 %)
- Refined Petroleum (4,9 %)
- Cars (3,2 %)

Top import origins are:

- Russia (20,75 %)
- Germany (10,31 %)
- Poland (8,96 %)
- Latvia (6,70 %)
- The Netherlands (4,75 %)

As the member of EU Lithuania implements common customs regulation. The EU **customs legislation** has been adopted in Lithuania in full since 1 May 2004 (with no transitional periods), and its provisions to a large extent are set out in Council Regulation No. 2913/92 and Commission Regulation No. 2454/93.

Excise duties are imposed on the following goods produced in or imported into Lithuania:

- Ethyl alcohol and alcoholic drinks, including beer and wine
- Processed tobacco, including cigarettes, cigars, cigarillos and smoking tobacco
- Energy products, including fuel, petrol, kerosene, gasoline, fuel oil, coal, coke, lignite, and electricity.

Turkey

Turkey is the 27th largest export economy in the world and the 51st most complex economy according to the Economic Complexity Index (ECI). In 2014, Turkey exported $165B and imported $217B, resulting in a negative trade balance of $51.2B. In 2014 the GDP of Turkey was $798B and its GDP per capita was $19.8k.

Top import products are[125]:

[125] http://atlas.media.mit.edu/en/profile/country/chn/

- Refined petroleum (7,2 %)
- Cars (3,7 %)
- Gold (3,5 %)
- Scrap Iron (3,1 %)

Top import origins are:

- China (11,34 %)
- Germany (10,83 %)
- Russia (6,77 %)
- Italy (5,67 %)
- US (5,44 %)

The country is starting to set up the Integrated **Tariff of the European Union (TARIC)** in third countries and in order to do this, it is lowering its Customs duties from 10% to about 5% especially with the United States. There is a list of sensitive products (furniture, ceramics, porcelain, motorbikes, and some leather goods) for which Turkey applies Highest Customs duties. These are going to be abolished progressively within the next 5 years. Turkey is a member of the **WTO, of the Black Sea Economic Cooperation (BSEC), of the Economic Cooperation Organization (ECO) and of the Southern Europe Cooperative Initiative (SECI),** which encourages trade with all its member countries thanks to preferential tariffs.

Customs duties are calculated Ad Valorem on the CIF value of the goods. Customs surcharges include a value-added tax (VAT) levied on most imported goods and services. The importer is responsible for paying the VAT. The VAT is calculated on a C.I.F. basis plus duty rate and any other applicable charges levied before the goods clear customs. Agricultural products, whatever their origin, remain subject to a surcharge destined for the Housing Fund, but this has been abolished for imported industrial goods.[126]

Azerbaijan

Azerbaijan is the 70th largest export economy in the world and the 108th most complex economy according to the Economic Complexity Index (ECI). In 2014, Azerbaijan exported $25.7B and imported $13.9B, resulting in a positive trade balance of $11.8B. In 2014 the GDP of Azerbaijan was $75.2B and its GDP per capita was $17.5k.

Top import products are[127]:

- Cars (6,4 %)
- Gold (3,3 %)
- Wheat (2,8 %)
- Packed Medicament (2,0 %)

Top import origins are:

- Turkey (17,34 %)
- Russia (14,96 %)
- UK (7,48 %)
- Germany (7,34 %)
- China (5,61 %)

There are no general trade barriers or embargos for the import of goods into Azerbaijan. Exports are not subject to customs duties or restrictions. Regulations exist only for the export of strategic commodities such as electricity, petrol, cotton and non-ferrous metals.

Generally, VAT is charged at the rate of 18% for each taxable operation and for the value of each taxable import. There are detailed requirements for registration and accounting for VAT, with penalties for non-compliance. From 1 January 2013, equipment, imported by residents of industrial and technology exempt from VAT for the period of 7 year.The VAT exemption is also applicable to goods imported into special economic zones (excluding those that are subject to an excise tax). Additionally, certain categories of imported goods are exempt from VAT as defined by the Cabinet of Ministers.

[126] https://en.portal.santandertrade.com/international-shipments/turkey/customs-procedures

[127] http://atlas.media.mit.edu/en/profile/country/aze/

India

India is currently not a major trade partner of Georgia, however the market size and its rapid development could represent some interesting trade opportunities in the future for Georgian exports

India is the world's third-largest economy as per gross domestic product (GDP) in purchasing power parity (PPP) terms and is expected to lead the world as well as emerging nations in terms of growth this year and the next. According to the International Monetary Fund (IMF)—at a time when global growth is projected at 3.3% in 2015 and 3.8% in 2016—India is projected to grow at 7.5% in each of these years, up from 7.3% in 2014.1 The World Bank too has projected India's growth at 7.5% in 2015. The Government of India has provisionally estimated GDP growth of 7.2% for FY 2014-15.2 Further, the Reserve Bank of India (RBI) has projected the Indian economy to grow at 7.6% in FY 2015-16. With over 7% projections from almost all sides, globally and domestically, the mood is positive. It is no wonder that India is expected to accelerate its growth among emerging nations, which are expected to grow at 4.2% on an average this year. India ranks second in the world in terms of population. Apart from its demographic dividend of more than 1.2 billion people—out of which nearly two-third comprise its working age population—the country is also increasingly becoming an investment hub with its pro-reform government announcing various enabling policies. This being said, India will also be a source of human resources for most of the ageing developed world in the coming decades.

With the current government completing one year in office this year, India looks poised to enter a secular growth phase with increased emphasis on inclusive growth. 'Jan-Dhan Yojana', a national mission on financial inclusion, 'Swachh Bharat Abhiyan', a campaign on hygiene and preventive healthcare, and 'Housing for all by 2022', are new initiatives that are expected to ensure sustainable development. Developing infrastructure, improving the business environment, building a robust and predictable tax regime, attracting more foreign direct investment (FDI) and nurturing international relations and empowerment of the masses are other growth-oriented initiatives that will help India intensify the vibrancy in its economy.

Tariffs and import taxes

India maintains fairly complex procedures and documentation for both imports and exports, and many application forms must be completed and certificates furnished, depending on the scheme or product category. These are listed in a handbook of trade procedures published by the Ministry of Commerce and Industry.

The Customs Act governs the levying of tariffs on imports and exports and sets the rules for customs valuation. The Customs Tariff Act specifies the tariff rates and provides for anti-dumping and countervailing duties.

India's tariff system is based on the Harmonised System of Nomenclature (HSN) of the Customs Co-operation Council. India's Directorate-General of Commercial Intelligence and Statistics revised the eight-digit codes of the Indian Trade Classification system in 2008, based on the HSN. The government also updated commodity classifications under the HSN, beginning March 2008.

Most tariffs are ad valorem. The annual budget revises tariff rates, excise duties, regulatory duties, countervailing duties and the like.

Import restrictions

India's basic trade law, the Foreign Trade Development and Regulation Act 1992, empowers the government to prohibit, restrict or otherwise regulate imports or exports. The trade policy formulated under this act is published in two parts: the policy itself and a handbook of procedures. The Ministry of Commerce and Industry eliminated its last quantitative restrictions in March 2001, in accordance with India's commitments to the World Trade Organisation. Most items are now freely importable without import licences. However, licences are still required to import some items, such as certain types of animals, some aircraft, antiques, arms, some chemicals, some communications equipment, some explosives, birds, fish, marble, newsprint and paper, some nuclear reactors, ozonedepleting substances, plants and seeds, and meat. Only state trading agencies are allowed to import maize, petrol, rice, wheat and urea. (Although the government deregulated sugar in 1997, it can still regulate export quantities by invoking the provisions of the Essential Commodities Act.) The only items prohibited for imports are the following: animal tallow, fat and oils; animal rennet; wild animals, including their parts, products and ivory; beef; and certain hazardous wastes. To protect consumers from substandard imports, the government has directed that various imported products must comply with mandatory quality standards applicable to domestic products and must be registered with the Bureau of Indian Standards. The list includes food preservatives and additives, milk powder, infant milk food, household and similar electrical appliances. Moreover, all imported packaged products must comply with the Standards of Weights and Measures (Packaged) Commodities Order if the order applies to the same domestic products.

5.3 Prioritization by export opportunities

France

* Main high trade value product, imported in France in 2014 and Georgia can be potential Medium/Long Term exporter of the commodity, is Pharmaceutical product.

* The group of top 10 importers in France includes 8 EU and 2 Non-EU countries, with whom Georgia can potentially have trade advantage with France in terms of DCFTA, this countries are - China and USA.

* Total China and USA Pharmaceutical products' import in France, in 2014 amounted to USD 4,4bn, which can be regarded as potential market size in France, for Georgia in Pharmaceutical market sector.

* There are over 10 commodities Georgia exports to France, but comparing top 10 France's overall imports to top 10 Georgias exports to France there are 5 current, main commodities in trade flow between France and Georgia, these are: Organic chemicals, Textile, **Iron & Steel** and Vehicles and parts.

Italy

* The group of top 10 importers in Italy includes 8 EU and 2 Non-EU countries, with whom Georgia can potentially have trade advantage with Italy in terms of DCFTA, this countries are - China and USA.

* There are over 10 commodities Georgia exports to Italy, but comparing top 10 Italy's overall imports to top 10 Georgias exports to Italy there are 6 current, main commodities in trade flow between Italy and Georgia, which have high demand in Italy and export potential for Georgia.

* There are 4 commodities, which are: i. highly demanding in Italy - in top 10 of total 2014 imports by trade value ii. highly exported by China and USA to Italy - in top 10 commodity exports to Italy by trade value iii. Is current potential for Georgia to export - in top 10 high trade value commodities, exported to Italy in 2014.

* All other high demanding import products in Italy, current, Georgian export commodities and China/USA import products can be considered as possible, potential export objectives for Georgia.

Spain

* The group of top 10 importers in Spain includes 7 EU and 3 Non-EU countries, with whom Georgia can potentially have trade advantage with Spain in terms of DCFTA, this countries are - China, USA and Turkey.

* There are over 10 commodities Georgia exports to Spain, but comparing top 10 Spain's overall imports to top 10 Georgia's exports to Spain there are 6 current, main commodities in trade flow between Spain and Georgia, these are - Pharmaceutical products, Plastics and articles, Articles of apparel and clothing accessories, knitted or crocheted, Articles of apparel and clothing accessories, not knitted or crocheted, Iron and steel, Vehicles other than railway or tramway rolling-stock.

* China is one of the biggest Non-EU importer of top 10, selected commodities, therefore we can conclude that DCFTA can be used as advantage for Georgia to compete with China on EU (Spain in this case) market and/or cooperate with China, so China can use Georgia as platform to export goods to EU with help of Georgia.

Germany

* The group of top 10 importers in Germany includes 8 EU and 2 Non-EU countries, with whom Georgia can potentially have trade advantage with Germany in terms of DCFTA, this countries are - China and USA.

* There are over 10 commodities Georgia exports to Germany, but comparing top 10 Germany's overall imports to top 10 Georgia's exports to Germany there are 5 current, main commodities in trade flow between Germany and Georgia, these are - Plastics and articles, Articles of apparel and clothing accessories, knitted or crocheted, Articles of apparel and clothing accessories,not knitted or crocheted, Vehicles other than railway or tramway rolling-stock, Aircraft, spacecraft, and parts.

* About 65% of total trade value exports from Georgia to Germany is just one commodity - "Articles of apparel and clothing accessories, knitted or crocheted", which also is top trading commodity for China with value (It is about 15% of total Chinese exports to Germany and is equal to USD 4.84bn). Georgia has several competitive advantages over China on German market: i. Location. ii. DCFTA iii. Flexible business environment - Tax and Labor Cost.

United Kingdom

* The group of top 10 importers in United Kingdom includes 7 EU and 3 Non-EU countries, with whom Georgia can potentially have trade advantage with United Kingdom in terms of DCFTA, this countries are - China, USA and Turkey.

* There are over 10 commodities Georgia exports to United Kingdom, but comparing top 10 United Kingdom's overall imports to top 10 Georgia's exports to United Kingdom there are 5 current, main commodities in trade flow between United Kingdom and Georgia, these are - Beverages, spirits and vinegar, Articles of apparel and clothing accessories, knitted or crocheted, Articles of iron or steel, Aircraft, spacecraft, and parts, Commodities not specified according to kind.

Turkey

*There are over 10 commodities Georgia exports to Turkey, but comparing top 10 Turkey's overall imports to top 10 Georgia's exports to Turkey there are 3 current, main commodities in trade flow between Turkey and Georgia, which are also imported mainly by top 10 importers in Turkey (for list please refer to the chart, below). Depending on the fact that Georgia is neighboring country to Turkey and both, easy, cargo and sea transportation is available between countries and additionally other Georgia's advantageous business environmental factors, such as low cost of labor and flexible tax environment, Georgia can compete abovementioned top 10 importer countries in Turkish market in following commodities - Fertilizers, Plastics and articles, Articles of apparel and clothing accessories, knitted or crocheted, Iron and steel, Aluminium and articles. Another important fact is that Georgia is one of the top importer of Textiles and Fertilizers in Turkish market and has further potential to increase capacities of production which means that there is potential to increase exports of the commodities from the country.

Appendix 6: Building Block 2: Recommendations and Action Plan

The aim of this chapter is to outline the key recommendations from the main findings of previous chapter and make them actionable in the sense of policy recommendations aimed at increasing the level of FDI and Georgian exports.

The Georgian government plays a prominent role in the development of Georgia's international competitiveness. This role in creating and sustaining the competitive advantage of several sectors and sub-sectors is significant it has to be noted that it is only partial as the companies in the sector have to be the final drivers of Georgian global competitiveness. The key role of the Government policy is to support Georgia's deployment of resources such as labor and capital to achieve higher levels of productivity which will in turn lead to a higher standard of living for Georgia.

6.1 Recommendations and measures for attracting FDI and increasing export

The measures developed in this chapter will have two objectives; supporting export efforts of Georgian companies and attracting new FDI's. These measures will fall in two main categories;

- Cross-cutting measures
- Targeting specific sectors or industries.

Georgia can improve its economic prosperity by impacting the constraints to upgrading their industry. The process of upgrading requires the continuous development and growth of key Georgian sectors and subsectors in terms of technology, capabilities and strategies if they want to become or remain competitive against the ever improving international competitors. The role of the Georgian government is to develop the policies that will provide the foundation of human resources, science and technology and infrastructure that will allow for this upgrading to happen. Also important the government has to encourage, challenge and even pressure its firms to advance, but not do the work instead of them.

Human resource development (develop workforce to match future demands and needs of the priority sectors and Georgian economy)

Measure objective:

Develop the Georgian workforce to match future demands and needs of the priority sectors and Georgian economy. The lack of adequately educated work force was one of the overriding issues across several sectors we have observed. Objective of this measure is to firstly identify the exact human capital requirements of the priority sectors and compare them with the current supply and technical skill set present in Georgia. Based on the identified gaps policies have to be developed that would close these gaps covering all areas of the formal and informal educational sphere.

Due to the lack of qualified and educated staff that is an issue for most of the Georgian sectors, the industry has been developing more on the foundation of informal rather than formal education and training. The ability to upgrade priority sectors will require a stronger and better qualified human resource foundation. To keep developing and learning on the job Georgians will require better skills in engineering, computing and other basic areas. In order to accommodate the export and FDI ambitions a more formally educated human resource pool will be a perquisite. More and better trained engineers, programmers and scientist are a requirement as are skills in other advances specialties.

University programs lack consistent quality and are too slow in reflecting new advancements in knowledge and new fields. Master's programs are undeveloped and doctoral programs are almost nonexistent. Crucial skills are short in supply.

However the development of these crucial skills cannot be left only to the government. Georgian companies must create more internal training programs to supplement the role of schools. Public education is most effective in more generalized disciplines. Corporate training and efforts of trade associations most address the narrow fields and specialties necessary in particular industries.

Recommendation:

Continued progress of the Georgian priority sectors will require a major commitment to upgrading the Georgian public education. The educational system has much opportunity for improvement at the university and postgraduate levels. Georgian companies must take a greater role in investing and supporting the improvement of public and private education.

Impacted priority sectors:

Agriculture and food processing: basic skill set of the workforce that comprises the largest part of the Georgian economy needs to be upgraded. Two main challenges how to switch from manual labor tasks to a higher level of automation and the second to improve knowledge and awareness on food safety and standards. **Time Frame: Short-term/ Mid-term**

Pharmaceuticals: lacking resources in research areas, new generations of pharmaceuticals and healthcare professionals has to be produced as the current generation that was educated during the Soviet times is slowly going into retirement. New generation that will take their place is currently not available in sufficient numbers. Enrolment needs to be stimulated, existing market players need to take on a more active role in developing on-the-job training programs to accelerate the people development cycle. **Time Frame: Short-term/ Mid-term**

Start-ups: main lacking resource are computer programmers. There are not enough programmers in Georgia. There is more demand for programmers than there currently is supply. Their cost is currently disproportionately high due to lack of resources locally. Currently only universities offer classes that offer appropriate educational levels for programmers. More enrollment should be stimulated to guide more students to programming type educational programs. **Time frame: Mid-Term**

Creative industries: creative industries is lacking in staff that could produce creative content such as computer graphic etc., many of these are similar as to the requirements that start-ups display so these programs for star-ups and creative industries should be developed hand in hand. **Time frame: Mid-Term**

Research and development

Measure objective:

text

Georgian success has generally been in industries and segments that do not require large R&D investments. To allow continued upgrading of competitive advantage and competing successfully in existing and new sectors and sub-sectors a more formal approach to R&D will be required in companies and priority sectors. Georgia will require the capacity to innovate in more fundamental ways as well as the technological foundation to enter new industries and sectors. Georgia's research establishments appear to be underfunded and underdeveloped compared to that of more developed nations. University research is spotty. Facilities that would enable research are not on the required standards. Public research investment is lagging behind those of other nations. Top Georgian scientist often decide to develop their career path abroad. More support for research especially at the university level is required. However this research should not be focused on "high-tech" areas as this would only replicate the path of other nations failing to recognize the Georgian context. The creation of programs in fields such as automated apparel production and control systems for production machinery will leverage and upgrade existing Georgian industries.

Georgian firms will also need to make a more growing commitment to research and development. Georgian firms will require the capacity to master new technologies early to hold their position from improving competitors in the Caucasus region.

Recommendation:

The Georgian economy will be better served by increasing the overall level of technological capacity in all industries and sectors. A larger focus should be placed on applied and advanced manufacturing technologies. Active university programs in such will also stimulate entrepreneurship an as students and faculty form new companies. A Georgian research strategy will also contribute most to industrial upgrading if it places central emphasis on technologies relevant to priority clusters of that drive or will be driving Georgian development. Companies must create more formal internal research programs complemented by research institutes that are sponsored by industry associations and research contracts with universities. Barriers that limit the development of relationships between university research institutes and industry should be removed.

Impacted priority sectors:

text: text. **Time Frame: text**

text: text. **Time Frame: text**

text: text. **Time Frame: text**

text: text. **Time Frame: text**

text: text. **Time Frame: text**

Development and deepening of industry clusters

There is a vital missing link in most of the identified sectors, which is the presence of related and especially supporting industries. Clusters of industries have to be formed and deepened if the Georgian economy is to progress. While it has been noted in many interviews that the Georgian firms are very dependent on imported parts and machinery in their value chain. The issue here is not the input cost of these materials or currency exposure, but the effects in the innovation process within Georgian firms. Without strategic relationships with capable domestic suppliers Georgian companies will lag behind in process technology and will lack the inputs required to serve new product segments.

There are some signs in Sectors such as food processing of upgrading in the domestic machinery and other supplier industries across the value chain. However the corporate focus in most of the Georgian companies that have been analyzed in this report is still exclusively on the end products. Companies show little or no emphasis on having access to their own production equipment that would be produced in Georgia.

Recommendation:

Success of companies that are part of industry clusters will depend on the adoption and implementation of new and advanced manufacturing technologies as well as the establishment of vertical relationships between Georgian firms that are as yet unformed and untested. Policy makers should support the identification of these clusters in the economy and encourage/ coordinate their establishment.

Infrastructure

Current levels of Georgian infrastructure are standing in the way of greater competitiveness in many sectors. Poor ports, poor airport connections and road network benefit no one. Frequent threat of strikes by unions make vital services uncertain. The costs of companies are therefore needlessly elevated. Success in sectors that are dependent on efficient logistics and other infrastructure is made difficult.

Georgian economic progress will depend partly on the future development of infrastructure in the country, part of this is already being solved by ongoing investments in the upgrading of the infrastructure.

Recommendation:

Georgia has a strategic geographical location and the country must facilitate on this competitive advantage for future development. Policy makers must support any domestic and foreign investments into the existing infrastructure and support the development of the new one, which will in turn lead to greater competitiveness in many sectors.

Financial markets

The structure of the Georgian financial markets places a constraint on the further upgrades of the Georgian industry. Georgian SME's have difficulty in raising resources to grow and invest abroad or diversify into related fields that require significant capital. Underdeveloped financial markets not only constrain progress in existing areas but also limit the development of new capital intensive industries that could absorb excess labor being created by raising productivity levels. The result is that Georgian companies if they are present in capital intensive industries tend to have a dominant and protected domestic position and are rarely dynamic enough to achieve international success.

Georgian banks tend to be risk averse and most bank capital flows to government projects, utilities (power generation) tourism and large groups. The availability of capital for other companies is limited and most fund themselves with own resources rather than lending.

Venture capital is also scarce in Georgia. Venture capital markets are in its infant stages, much of the available venture capital is not invested in new businesses at all mainly due to risk aversion.

Georgia will have difficulty in further developments unless its financial markets develop further. Access to capital and finance needs to be expanded further.

Recommendation:

Georgia will have difficulty in further developments unless its financial markets develop further. Access to capital and finance needs to be expanded further.

Access to finance

Further upgrading of the Georgian industry is being constrained due to the relatively high cost of capital, this is especially relevant for small and medium sized enterprises. They are facing a much higher real interest rates than large companies with better access to the banking system. An opening of the Georgian capital markets will lower the cost of capital to the industry.

Recommendation:

Policymakers must support better access to finance for SMEs as they have the potential to become one of the driving forces in Georgian economy.

Regulation

Regulation in Georgia is currently creating unnecessary costs in some industries. The lack of regulation that is partly to keep the competitiveness of local producers, who would not be able to implement international standards or would have severe issues investing into regulatory compliance that could potentially run them out of business. Lack of regulations and implementation of international manufacturing standards would not only lead to decreased export potential but also could potentially cause favoritism in the industry sectors.

Recommendation:

The Georgian regulation will be more effective if it shifts to the implementation of standards as set forth by the DCFTA that will create incentives for corporate compliance moving away from direct intrusion into corporate behaviour. Implementation of regulations that will stimulate innovation and competition instead of protecting existing products and producers will have the greatest benefits.

Company strategy and structure (reorientation of companies competitive strategy)

Most of the identified competitive advantages of Georgian firms have been due to strategies focused on or coming from cost competition. Cost competition in price-sensitive segments and sub-segments (which most of the Georgian sectors are) is usually not profitable in the long-term. These types of strategies are always vulnerable to the next low labor cost nation or nation's willing to subsidize investments in large scale operations that will steer existing demand their way. Georgian firms in the majority of cases compete with cost-based strategies.

Recommendation:

Georgian firms must upgrade their competitive advantage by learning to compete on value differentiation instead of exclusively on costs. This demands innovation instead of imitation of international competitor's business models, products and processes. Georgian firms must also learn to distinguish themselves and their strategies from those of other Georgian international competitors.

Changing role of the government

It is important to reconsider the role of the Georgian government in terms of direct intervention in individual sectors, protectionist mechanisms, emphasis on basic factors and directing capital through government decisions. These policies have to be upgraded by a new set of priorities to enable the future development of Georgian priority sectors. The task of factor creation has to move away from the government into the domain of individual sectors as well as Universities and research institution that have to be closely connected to the industry sectors. This is difficult to achieve if a government has been used to the more activist role, however we have encountered many cases during the development of the report that Georgian government policy has been evolving, which bodes well for Georgian future.

Recommendation:

Economic decision making should be decentralized into a growing number of private sector initiatives. The primary role of the government should shift from direct intervention to providing the resource foundation for upgrading the environment in which Georgian firms compete. This includes rule setting, efforts to stimulate investments in advanced and specialized factors, implementation of world class product and environmental standards, stimulation competition and rivalry.

6.2 Action plan for the implementation of recommendations

All development areas are not relevant for all priority sectors, therefore we have prepared in the table below the connection between the individual measures and priority sectors for which the measures are relevant.

Areas for development/Priority sectors	Agriculture	Light manufacturing	Transportation and logistics	Creative industries	Pharmaceuti-cals	Start-Ups
Human resource development	x		x	x	x	x
Research and development	x	x	x	x	x	x
Development and deepening of ind. clusters	x	x	x	x	x	x
Infrastructure		x	x		x	
Financial markets		x	x		x	x
Access to finance		x		x		x
Regulation	x	x	x		x	
Company strategy and structure	x	x	x		x	
Changing role of the government	x	x	x			

These measures differ from sector to sector as does their level of implementation difficulty.

Action points:

Human resource development

6.3 Investor Packages for identified sectors

Agriculture

DCFTA impact

While the agricultural sector is the most effected by the DCFTA, there have been both positive and negative effects since the implementation of the agreement.

Some Georgian niche exports, such as hazelnuts and fruit juices have doubled or even tripled in the first six months of DCFTA. Furthermore, it is expected that the DCFTA will positively influence not only the wine and spirit exporters directly, but it will also have a promising effect indirectly on the entire value chain, including the primary producers of grapes. But on the other hand high EU standards related to food traceability, safety and quality hinder Georgia's competitiveness and due to obvious lack of competitive advantages related to lack of land and capital resources, the room for big positive effects is rather limited for Georgian small-holder farmers, which represent the majority in the agricultural sector.

Market landscape, trends and drivers

Georgia is traditionally an agricultural country as agriculture and agribusiness account for 9.2% of the GDP and 17.5% of trade volume and approximately 53 % of all labor force works in this industry. Georgia has good climate conditions and fertile land (soils are of volcanic origin located in the river valleys) as there are over 21 micro-climates in Georgia allowing a wide range of grain, vegetables, hard and soft fruits, meat and dairy, to be farmed. Nuts and wine are considered the most important exports as they represent nearly half of all agro-related exports, while other products such as water, spirits, live animals and citruses represent the rest.

Labor costs are very low, as employees in agricultural sector, although very experienced, receive 30%-40 % less wage than the national average. The average gross monthly salary in the agricultural sector in Georgia is USD 206 and wages can be expected to remain competitively low given the high level of unemployment in Georgia. Furthermore, as Georgia has big amount of water resources, the access on water is easy and cheap. Also, other utility prices such as energy and gas are generally low. But it is important to note that productivity level is generally lower than in most regional economies and the root-causes for underperformance lie in fragmented industry structure, lack of investments and obsolete machinery.

Investment Opportunities

In recent years the Georgian government has become very supportive concerning the investments in the agriculture business. Land ownership and farming is highly fragmented with a low level of membership in cooperatives. This offers a great opportunity for the investor to enter and consolidate the market, as there are no restrictions on foreigner ownership. The government has created an environment that promotes the entry of foreign companies to help develop agricultural businesses in Georgia. The projects of building new agricultural products processing plants can get a grant from the government with a total value of up to 250 000 USD (maximum 40% of the value of project). Additionally, investor can buy state owned immovable nonagricultural property for 1 GEL (symbolic price) if the investment made on processing plant is 4 times more than its market value. Furthermore, there are also many untapped business opportunities in most of the areas in the value chain. There are business opportunities not only in farming but also in supplying equipment and services (storage, deep-freeze facilities, processing, packaging and other).

Recommendations for future development

The short-term objective should be to: **Increase existing import substitution and export opportunities, bring new technology and new blood into the system**

- Facilitate the integration of capable smallholders and coops into existing value chains (addresses raw material supply problem for processors, improve productivity and build capacity to implement EU food safety and environmental norms)

- Work with sectoral/sub-sectoral associations to promote Georgia as a brand in wine, qvevri wine, other alcohols, mineral water, honey, cheese, kiwi, herbs, olive oil, apple/pears, citrus, berries, herbs, etc.
- Target financial assistance (vouchers, subsidies, irrigation, seedlings, etc) to capable and innovative farm operations
- Support creation of sectoral and sub-sectoral clusters to gain scale, professionalize production, reduce costs; work with cluster leaders to certify exportable products and develop export facilitation mechanisms (to aggregate, deliver to, and distribute products in export markets; identify and develop new markets such as UAE, China)

Medium and long-term objectives should be to: **Bring FDI into export-oriented sectors, improve access to land, develop relevant skills**

- Promote PPPs in industry-led vocational training to address human capital bottlenecks.
- Bring global food industry leaders interested in outsourcing raw material production or processing and in this way help put Georgian on the global map such as a major wine manufacturing, baby food (Hipp), juices (Rauch), organic produce, etc.
- Reduce transportation costs (from both western/eastern Georgia, increase frequency of flights, add destinations) to improve market access for fresh products.
- Promote technological upgrading via credit, model farms, training measures and PPPs involving industry leaders
- Support the industry to maximize capacity and increase exports by addressing key industry issues that are currently influencing the sector competitiveness, such as, for example: Logistics prices.
- The Ministry of Agriculture shall promote existing institutions, which provide services to farmers such as training, research and consulting services and ensure that they serve farmers effectively.
- The Ministry of Agriculture shall also make legal and regulatory reforms so that individual farmers are encouraged to shift to market-oriented production, and to adopt greater use of modern farming practices.

Light manufacturing

DCFTA impact

There is no direct effect on this sector.

Market landscape, trends and drivers

While Georgia's trade balance of processed goods is vastly negative, there has been some growth in light manufacturing industry throughout the last 5-7 years, although it is poorly diversified and most of its sectors lack scale. However, there are sub-sectors with export-ready products, intermediary export products and products with developing export potential. Sectors like apparel and pharma have significantly stood out as export oriented and generated about 10% of total exports in 2015. Production of glass bottles, PET bottles and accessories, cardboard packaging and wood processing has grown significantly and these products are mostly consumed locally, but represent significant input for Georgia's export products (beverages, agro-products, furniture) and contribute additional value to exports. Certain other sectors like furniture production (HS: 94) have resurfaced throughout the last several years and started to actively substitute imports. Some of the subsectors of the above industries will soon reach full capacity at local market and are expected to start exporting, as well as serving Georgia's growing hospitality industry (hotels) and increasing value-added of service exports (tourism).

Furthermore, as light manufacturing is less capital-intensive than heavy industry and there is an increasing trend by famous brands to outsource manufacturing to developing countries, because they generate largest share of their profit margin through markups for branding. The main cost drivers in manufacturing are semi-processed raw materials, labor, power, taxes, logistics and transportation. Georgia has competitive advantage in terms of labor, power, taxes (including free trade regimes) and location.

Georgia's location also offers number of competitive advantages that precondition development of export of goods:

- Georgia is the nearest EU-free-trade zone for number of Far-Eastern and South-Eastern countries, including Russia and all Eastern CIS.
- It is also the nearest CIS-free-trade zone for Europe and rest of the western world.

Investment Opportunities

Georgia is not listed and ranked among other countries in global competitiveness researches and indexes for manufacturing, thus providing no visibility for potential investors. However, Georgia could benefit greatly due to its strategic location. Georgia's location has been logistically advantageous due to regional restrictions in trade between the conflicting countries in the region. The country has become increasingly attractive in this context after recent Russia-Ukraine conflict, resulting in trade restrictions between Russia and the EU. While Ukraine also enjoys DCFTA with EU, the country's PEST index falls far behind that of Georgia's. Georgia is the sole West-East transit route for Armenia due to closed borders with Turkey and Azerbaijan. Because of Azerbaijan-Armenia conflict, Georgia also serves as regional representation location for many retailers entering South-Caucasus region. It is also a platform for Iran to access Europe more cost-effectively. While Iran is not a member of WTO and has certain restrictions on trade from developed countries, its imports in WTO members' territories are taxed heavily. It is also one of the largest raw material producers (plastics, chemicals) for manufacturing industries. The raw materials could be processed to final goods in Georgia and exported to EU duty free. There are already several successful cases of Iranian investments in export-oriented agriculture. Furthermore, Georgia also offers advantageous location and business environment for China, especially until its favorable trade negotiations with EU (underway) enter into force. Recent launching of Chinese cargo rail route through Georgia, high interest in construction of Anaklia deep-sea port and initiation of China-Georgia free trade negotiations put Georgia on China's strategic map. Due to Georgia's free trade regimes across the West-East route (EU, CIS, Turkey), it has the potential of becoming a strong link in the supply chain of manufacturing industries of these regions. The main advantages are the proximity to the both, the low-cost raw material trader countries (CIS, Iran, South-Eastern Asia) and highest value-adders (Europe). This means that investing in manufacturing of export products in Georgia can be attractive for both parties: Eastern producers willing cost-effective access to EU markets and EU producers and retailers targeting Eastern part of the world.

Recommendations for future development

In order to make this sector more attractive the short term objective should be to: **Increase existing exports**

- Increase contract manufacturing volume for operating producers by active promotion
- Scale up manufacturers to do private labeling for local and international brands by access to finance and promotion
- Attract FDI in sectors with high labor intensiveness, generous use of electricity and ability of satisfying rules of origin
- Resolve industry-specific taxation issues, further liberalize taxes
- Award international scholarships for creative industry studies, engineering, chemistry

Medium-term objective: **Reduce manufacturing costs**

- Increase utilization of trade regimes by developing high quality raw material base and intermediary export industries (packaging)
- Improve worker productivity by investing in vocational education system for timely supply of skilled and productive labor force
- Maintain electricity prices and improve quality of power supply
- Invest in domestic transport infrastructure, East-West highway, Anaklia port, more container terminals for cheap rail transportation, more direct flights to strategic markets

Long-term objective: **Increase value-added**

- Invest in education to develop professional technical and creative staff with higher education to take over engineering, design and branding of locally manufactured product lines and creating maximum value-added locally.

Transportation and logistics

DCFTA impact

There is no direct effect on this sector.

Market landscape, trends and drivers

In recent years, increasing amount of investment has been directed towards developing transportation infrastructure in Georgia. Georgia has a strategic location as it is the only country from the Caucasus that has access to the Black Sea. Georgia's seaports have been developing since 2000 and were privatized in 2008 (except for Supsa Terminal, which is 100 % nationalized by Azerbaijan). Currently, Georgia possesses four seaports:

- Poti Sea Port, which is the largest port in Georgia and it is used for handling liquid and dry bulk, ferries as well as containers
- Batumi Sea Port, which has four terminals (oil terminal, container and the railway ferry terminal, dry cargo terminal and marine passenger terminal)
- Kuhlevi Terminal, which is used for transporting crude oil and refined products
- Supsa terminal, which is used for providing storage capacity for crude oil transported via the Western Route Export Pipeline (WREP) before loading to oil tankers via offshore loading facilities

Furthermore, in 2016 Georgia's Ministry of Economy & Sustainable Development that the Anaklia Development Consortium LLC has been awarded the contract to build and develop a Deep Sea Port in Anaklia. Construction on the project is scheduled to launch by the end of 2016, subject to completion of environmental reviews. The Port will be operational three years after its groundbreaking. The project is expected to create as many as 3,400 jobs during the construction stage and 6,400 jobs to operate the Port upon completion. The Port will have the capacity to process 100 million tons of cargo and generate 0.5% of GDP annually by 2025.

The road network in Georgia consists of 1,603 kilometers of main or international highways that are considered to be in solid condition and some 18,821 kilometers of secondary and local roads that are, generally, in poor condition, as only 7,854 km out of over 20,000 km of Georgian roads are paved. Some investments in improving the road transportation have already began, as The World Bank is approved a US$140 million equivalent financing for the Fifth East-West Highway Corridor Improvement Project (EWHCIP) for Georgia. The completion of the East-West Highway corridor is a central piece in the Government's strategy of transforming Georgia into a regional transport and logistics hub. The Project will directly contribute to economic development by reducing transportation costs and linking rural communities and their agricultural products to urban centers such as Tbilisi and once completed, the East-West Highway from Tbilisi to Batumi via Poti will provide direct access to 2.2 million people or more than half of the total population of Georgia.

Georgia also has 2100 km (95 % electrified) of railway infrastructure. Georgian Railway (GR) is mainly a transit railway as around 80 % of their revenue come from transit cargo, which is split roughly 50:50 between liquids and dry bulk. Future developments for the Georgian railway system rely mostly on the development of the Baku-Tbilisi-Kars project, which is intended to complete a transport corridor linking Azerbaijan to Turkey (and therefore Central Asia and China to Europe) by rail. The project envisages the rehabilitation, reconstruction and construction of 180 km length Marabda-Kartsakhi railway section consisting of: Marabda-Akhalkalaki reconstruction-rehabilitation section (useful length 153 km) and Akhalkalaki-Kartsakhi (Turkish border) new construction section (length 27 km). The line is going to be functional in 2017 and is intended to transport an initial annual volume of 6.5 million tones, rising to a long-term target of 17 million tones.

The aviation market in Georgia has demonstrated considerable growth in recent years. Three international and one domestic airport currently operate in Georgia, all of which fully comply with International Civil Aviation Organization standards. Georgia's aviation market is primarily international, with the majority of flights being served by Tbilisi International Airport. Tbilisi and Batumi International Airports are run by the Turkish TAV Airports Holding Company. They started operations in February and May 2007, respectively. Mestia (Queen Tamar) Airport officially opened in 2011. The construction of Kutaisi's King David the Builder International Airport was finished in September 2012. The capacity of Tbilisi International Airport is 2,000 passengers/hour; the capacity of Batumi and Kutaisi International Airports is both 500 passengers/hour; and Mestia Airport's capacity is 100 passengers/hour. The opening of Kutaisi airport was marked by the launch of flights by the low-cost carrier (LCC) Wizz Air. Wizz Air was the third LCC to enter the Georgian market, after Pegasus and Fly Dubai. In 2014, Air Arabia, a new LCC entered the Georgian aviation market. According to the Georgian Civil Aviation Agency (GCAA), Turkish Airlines is the dominant air company operating in Georgia and carries the largest number of passengers. In 2014, it served 415,867 passengers (22%). Ukraine International Airlines is the second most popular airline with 279,389 passengers (15%). This is followed by Georgian Airways with 218,536 passengers (11%); Pegasus with 145,931 (8%); Siberia Airlines with 93,579 (5%); Belavia with 92,549 (5%); and Lufthansa with 65,475 (3%). In total, 32 international and three domestic airlines operated in Georgia in 2014. The major airlines operating are: Turkish Airlines, Georgian Airways, Ukraine International Airlines, Pegasus, Siberia Airlines, Belavia, Lufthansa, Atlasjet International, Qatar Airways, Fly Dubai, Air Astana, Azerbaijan Airlines, Air Baltic, and Air Italy.

In general the transport infrastructure is developing, but nevertheless this sector is still regarded as a bottleneck for many other sectors such as tourism and agriculture.

Investment Opportunities

Georgia aims to develop an efficient, sustainable transport system in line with its vision of making the nation an international gateway and to promote inclusive growth. In order to do so the country aims to engage private investors, thus providing plenty of room for investment in all sectors of transportation. Private participation in railway development for increased container transport, leasing for replacement of older vehicles used in commercial transport, and establishment of sector training structures and programs is expected.

Recommendations for future development

Development of infrastructure is key for the future of Transportation and Logistics in Georgia

- T&L can be important in itself as a target for FDI, jobs, value added.
- But, is also important for all exporting sectors.
- Currently rail and port handling costs are very high and they need to be reduced
- Air transport is a bottleneck for tourism but also for agricultural exports – there is a need for regular, direct, frequent and cheap flights from east AND west Georgia (Kutaisi and Batumi) to target markets (example: Amsterdam for flowers; Dubai for mushrooms, etc.).

Infrastructure development has to support export possibilities, without proper and functional infrastructure export possibilities will be limited as well as T&L sector development

Creative industries

For the purpose of this report we understand creative industries as those industries which have their origin in individual creativity, skill and talent and which have a potential for wealth and job creation through the generation and exploitation of intellectual property.

DCFTA impact There is no direct effect on this sector.

Market landscape, trends and drivers

In Georgia, the creative industries are still in the process of development and have not yet been formally established. Currently, only publishing seems to be quite well developed as Georgia is one of the leading countries in the world with 1 547 titles per million people. Furthermore, the development of the gaming industry has become one of leading priorities for Georgian creative industry development. In the summer 2010, the Ministry of Internal Affairs of Georgia initiated an innovative project aimed at the promotion and development of the gaming industry in Georgia. Within this ministry, a special studio has been created to work on 3D games technology, but it is fair to say that this project is still in the development phase.

Also, regarding the availability and the development of the labor force in the creative industry sector, there have been some developments. In terms of the cultural industries, Georgian educational institutions and programmes offer training in the telecommunications and advertising business (e.g. The Georgian Telecommunication and Management Institute LAMPARI and the Institute of Media, Advertising and Arts). Furthermore, the Shota Rustaveli State University of Theatre and Film and the Tbilisi State Academy of Arts provide various courses which aim to train workers for the cultural industries (e.g. leather and fabric designers, clip makers etc.).

Investment Opportunities

Identified areas with the biggest potential in the creative sphere are: gaming, music, design as well as publishing.

Recommendations for future development

Short-term: **support the consolidation of creative industries professionals into clusters**

- DCFTA does not impact the development of the creative industries directly in terms of their export potential, creative industries need to be stimulated and developed
- Support the development and creation of creative clusters to enhance the ability to attract more customers and provide access to specialist goods/services and labor inputs
- Human capital development – support the clusters by developing tailor made classes or educational programmes for industries with high potential

Medium/ Long-term: **Develop internationalization platform for strongest cluster**

- Develop internationalization platform for key creative industries in Georgia, that will give creative industry professionals access to global markets
- Leverage spill-over effects from creative industries to grow other priority sectors

- Establish and develop universities/colleges/institutions, which will provide sufficient and high standard knowledge in Creative Industry sectors.
- Try to bring Creative Industry international, leading companies in Georgia by for example, subsidizing them, which would develop local market efficiently.
- Promote ideas and support start-ups to be "Successors" on global market, which will promote country and motivate other local bright people to develop their ideas.

DCFTA impact

The effect of DCFTA on the pharmaceutical industry is both negative, as well as positive.

It is expected that the value of exports will increase, but Georgian manufacturers would need to comply with EU GMP (Good Manufacturing Practice) requirements, so it might take some time and additional investments for exports to actually increase. Furthermore, a significant reduction of the presence of cheap, low quality (but possibly also some generic) chemicals including pharmaceuticals in Georgia may imply a rise in average prices, negatively affecting purchasing power of some groups.

Pharmaceuticals

Market landscape, trends and drivers

The pharmaceutical market in Georgia is growing rapidly in recent years, with exports increasing by more than 40% over the past six years. The market size in 2015 is estimated to be around GEL 1.3 bln and is expected to grow in the future. There are over 70 manufacturers in the Georgian pharmaceutical market, but overall there are only 3 key players that dominate Georgia's pharma market: GM Pharmaceuticals (PSP), Aversi-Rational and Ynnovas. Main growth opportunities are expected to derive from growing wholesale revenue, enhancing retail margins and from expanding pharmacy footprint.

Investment Opportunities

Pharmaceutical companies in Georgia enjoy a favorable business climate with simplified regulations and no price controls on pharmaceuticals and foreign pharmaceutical producers can choose to open a branch in Georgia in order to expand their activities or open a subsidiary in this country. The country automatically recognizes pharmaceuticals registered in other countries in an attempt to enhance competitiveness. Pharmaceuticals in Georgia also benefit from an attractive taxation regime; there is no value added tax imposed on these types of products and there are no customs taxes for them. Currently, there are many growth opportunities in this sector and their realization will likely require foreign strategic investors. Some of the most advantageous investable sectors include:

- Existing or start-up pharmaceutical manufacturers,
- Existing or start-up retail chains/distributors,
- Bacteriophages,
- Natural / herbal medicines,
- R&D / Clinical testing.

Recommendations for future development

Short-term: **Motivate current market players to grow and export**

- Build on existing experience in of packaging and exporting generics into the CIS market
- Due to clinical testing requirements entry to EU markets to benefit from the DCFTA is limited
- Motivate existing market players to grow beyond their current size
- Support pharmaceutical industry in becoming GMP compliant
- Support local producers with introduction to strategic investors and market opportunities outside of their „view point“

Medium/ Long-term: **develop human capital and biotech opportunities**

- Can diversify products and export markets (including EU) with the help of international (European) partners. Example is Lausanne-based Ferring, which is about to enter Georgia in a small way (for now)
- Build up human capital and know how to support development of contract manufacturing and research (enhance university programmes to promote development of Pharma and natural sciences)
- Further develop the biotech sub-sector in high potential areas (usage of Georgian innovations for food processing, Agriculture and water purification)

DCFTA impact

There is no direct effect on this sector.

Start-Ups

Market landscape, trends and drivers

Georgia offers a very favorable environment for starting a business. Georgia ranks 6th in Starting a Business category in Doing Business report done by The World Bank and overall, Georgia holds a very solid 15th position (out of 189 countries) in the Ease of doing business category. In terms of funding opportunities for start-ups the country is still at the initial stage. Recently however (May 2016), Georgia's Prime Minister Giorgi Kvirikashvili announced that the Government of Georgia is starting a new program to finance start-ups in the country as a way to foster entrepreneurial spirit, encourage the creation of new businesses and develop the economy. The start-ups financing fund will initially distribute 11 million GEL (about $5 million/€4.33 million*) to new businesses in the first stage, while in the near future the amount of funds available will increase to 35 million GEL (about $15 million/€13.77 million*).

Investment Opportunities

There are several opportunities in the start-up area, but it seems that IT sector and the sector covering Creative Industries hold the most potential.

Recommendations for future development

Encouragement of the supporting environment and promotion of perspective industries is key for start-up development

Short-term: **Increase in knowledge and measures for supporting environment**

- Encourage students to start developing their own ideas already during their studies– special grants for starting a start-up company, which also includes mentoring programme to obtain required business skills
- Further development of the supporting environment – incubators, mentoring, technology parks
- Encourage students toward highly competitive IT sector (especially in regards of salaries)

Medium-term: **Promote business development and specific added-value industries**

- Establish and develop universities/colleges/institutions, which will provide sufficient and high standard knowledge in IT sector.
- Try to bring international IT and Creative Industry international, leading companies in Georgia by for example, subsidizing them, which would develop local market efficiently
- Connect start-ups with potential investors depending on their development phase (seed capital, venture capital)

Long term: **Increase value-added**

- Promote ideas and support start-ups to be "Successors" on global market, which will promote country and motivate other local bright people to develop their ideas

Appendix 7

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Executed interviews

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24.feb.16	Partnership Fund
26.feb.16	Investment Agency
7.mar.16	European Investment Bank
11.mar.16	Geo Steel
11.mar.16	DWV
15.mar.16	Bacteriophage
15.mar.16	Georgian Americal Alloys
15.mar.16	Amcham
15.mar.16	BAG
16.mar.16	Galt&Taggart
17.mar.16	Gebruder Weiss
17.mar.16	GHG
17.mar.16	GITA
17.mar.16	GPC
18.mar.16	Paravani HPP
18.mar.16	Galt&Taggart
18.mar.16	MOA
21.mar.16	CCI France
21.mar.16	Head of Economic Section at German Embassy
21.mar.16	Commercial Counselor Turkish Embassy
22.mar.16	MRDI
22.mar.16	Elkana
23.mar.16	EUGBC
23.mar.16	Georgian Railway
23.mar.16	GSE
23.mar.16	MOE
24.mar.16	Tetri Kudi
24.mar.16	Rustavi Azot
24.mar.16	Hipp
25.mar.16	MoF 3rd Floor
29.mar.16	Silk Road Group
30.mar.16	Vega Startup Lab
1.apr.15	Caucasus Travel

Appendix 8: DCFTA – Risks and Opportunities for Georgia

Introduction

Both the AA and the DCFTA belong into the toolkit of the European Neighborhood Policy (ENP), the official aim of which is to create a belt of "prosperity, stability and security along Europe's borders."128 ENP policies apply to countries to Europe's south (e.g. North Africa) and east, including Georgia and most other former Soviet republics.

Georgia and the EU signed the Association Agreement and the Deep and Comprehensive Free Trade Area (AA/DCFTA) on 27 June 2014. Georgia ratified the AA on 18 July 2014. The AA/DCFTA have been provisionally applied since 1 September 2014.

The DCFTA can be analytically broken into two major components. The "FTA" part is about free trade in goods and services between Georgia and EU member states. As the official formulation goes, the DCFTA "removes all import duties on goods and provides for broad mutual access to trade in services."129 An addition, provision on "establishment" clears the way for Georgian and European companies to set up branches and bid on public procurement contracts in a non-discriminatory fashion. The Deep and Comprehensive ("DC") part of the agreement is about large scale harmonization of laws, norms and regulations, aligning key sectors of the Georgian economy to EU standards. The purpose of the "DC" component is to make sure that while opening the EU market for goods and services produced outside the EU (and thus competing with EU companies), the agreement paves the way for European companies to enter new markets. The main burden of "harmonization" will fall on Georgia's agriculture and food processing sectors, which will have to comply with the EU's food safety regulations. The same regulations will also apply to any food products imported into Georgia, thus allowing European companies to compete with producers that are not subject to similar regulations, such as those operating in Iran, Russia, China, etc.

In the remainder of this policy brief we will discuss 1) the main implication of the agreement's DC and FTA components for Georgian producers and consumers and 2) policies Georgia should pursue in order to both minimize the cost of harmonization provisions and take advantage of the opportunity to trade freely with the "world's largest single market with transparent rules and regulations."[130]

AA/DCFTA Free Trade Area provisions: what do they imply for Georgia's potential to export to the EU?

Georgia has been enjoying low tariff barriers in trading with Europe since December 2005 under the so-called Generalized System of Preferences + (GSP+), which offer "trade incentives to developing countries … to implement core international conventions on human and labour rights, sustainable development and good governance."131 Thus, since 2006, Georgia has been facing zero duties on about 75% of all tariff lines. The DCFTA expands on GSP+ by setting zero duties on 100% of product categories, including agricultural products that are of potential interest for Georgian exporters, such as wine, cheese, live animals, sheep and goat meat, yogurt, chocolate, animal skins and wool (previously not be covered by GSP+ preferences), berries, fruit, vegetables (including canned and processed), and fruit juices, which enjoyed partial preferences under GSP+. Georgia will continue to be a beneficiary of GSP+ until 31 December 2016, but, as of April 2016, all 28 member states have already ratified the AA, including its DCFTA component.[132]

While the free trade provisions of the DCFTA seem like a significant improvement over GSP+, the extent to which Georgia can benefit from them will depend on whether or not Georgian products can gain market share in Europe (and/or whether Georgian producers will be willing to invest in expensive EU-targeted marketing and branding efforts).

The key export and foreign direct investment (FDI) statistics reported fail to reveal any major breakthroughs within a year of DCFTA provisional application. This is not surprising because most Georgian products that are relevant to the EU market have been covered by GSP+ whereas increasing capacity in new niche (mostly agricultural) products such as wine, fruit or berries will require time (e.g. it takes 5-6 years from the planting of new orchards to commercial production of hazelnuts, apples). Still, Georgia's trade with the EU is on an upward trajectory. In 2015, Georgia's exports to the EU expanded in absolute terms by 4%, despite an overall trade slowdown (Georgia's exports in 2015 shrank by 22%). Currently, Georgia's exports are extremely concentrated in very few product categories: about 80% of total exports consist of minerals, metals and food products (vegetables, wine and other beverages).

128 http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=URISERV%3Ar17100.

129 http://ec.europa.eu/trade/policy/countries-and-regions/countries/georgia/

130 http://ec.europa.eu/trade/policy/eu-position-in-world-trade/

131 http://trade.ec.europa.eu/doclib/press/index.cfm?id=1006

132 http://eeas.europa.eu/delegations/georgia/documents/news/2016/20160426_01_en.pdf

There are two principal ways in which Georgia can promote its exports to the EU. First, it can invest in existing sectors or develop new niche products that have market potential in the EU. This is the case for berries, kiwifruit, special kinds of alcoholic beverages (qvevri wine or chacha), olives, etc. Second, Georgia can leverage its DCFTA status as well as its corruption-free, safe and efficient business environment to attract foreign investment into export-oriented industries. Using Georgia as an *export platform* to the EU may be particularly beneficial for countries that don't have free access to EU markets, such as China, Iran, Azerbaijan and Russia.

How should Georgia go about implementing DCFTA harmonization measures?

In order to ensure effective DCFTA implementation, on July 28, 2014 the Government of Georgia's EU Integration Commission adopted the DCFTA Implementation Action Plan 2014-2017.[133] The plan, which was drafted by The Ministry of Economy and Sustainable Development of Georgia, provides a detailed list of reforms to be adopted during this period and assigns relevant responsibilities. It can be conceptually divided into two major parts. The first part focuses on measures to ***facilitate trade***: streamline customs procedures, create systems to enforce rules of origin regulations, and generally promote Georgia's production and exports capacity (e.g. by developing SMEs and diversifying exports). The second part covers a broad range of measures to ***achieve legal approximation and harmonize regulations:*** technical standards, protection of intellectual property rights, labor regulations, competition law, and, last but not least, Sanitary and Phytosanitary (SPS) measures.

While there is much desire on the Georgian side to quickly implement the DCFTA agenda, there is a lack of proper understanding – in both government and industry – as to the precise harmonization requirements (for each subsector) and the optimal timetable for their implementation. Agricultural producers and food processors are certainly going to bear significant compliance costs associated with the implementation of SPS measures. Yet, no analysis has been conducted to date as to a feasible timetable for phasing in traceability and other SPS requirements. There has been no government communication on whether and when these requirements will apply to small and medium enterprises. And because there has been no official communication, SMEs (and not only) continue business as usual instead of planning ahead and investing in relevant skills and systems.

Importantly, the imposition of SPS measures on any food products sold in the Georgian market (including imports) will inevitably lead to an increase in the price of goods sold through official channels. Higher food prices will hurt consumers, putting political pressure on future Georgian governments who may choose to relax food safety regulations (e.g. by exempting SMEs), or turn a blind eye to informal activities in the food production and trade sectors.

Last but not least, by harmonizing its regulations with the much more developed EU countries, Georgia will diminish the ability of its producers to substitute for imports. To the extent that domestic production costs will go up (e.g. in the food industry), Georgian companies will find it more difficult to compete with larger scale, modern producers in the EU and elsewhere. Some sectors are likely to be more severely affected than others (e.g. meat production and processing), calling for expensive measures to restructure companies and retrain their staff.

Setting harmonization timetables and priorities is not all that straightforward. There are *tradeoffs* to consider. For example, SMEs and smallholders may not be able to fully comply with DCFTA measures (e.g. SPS or environmental regulations). Exempting them from any or all EU-style regulations might be good from the social and political points of view. However, unequal treatment of small and large producers would harm the latter. Larger, capital intensive business are not employing as many people but are nevertheless important for the Georgian economy given their potential to export or serve as import-substitution-oriented companies. They would be subject to full compliance costs while competing for raw materials with small businesses which can afford to pay more at the expense of not complying with the regulations (as has been the case with Hipp-Georgia, which was forced to shut down its modern processing plant in Shida Kartli). Therefore, before committing to any timetable and concrete measures, the Government has to better understand sector-specific tradeoffs.

Taking advantage of DCFTA provisions: promoting domestic producers

Georgia has limited capacity to expand its exports to the EU in the short run. Georgia's largest exporters, such as RMG Copper, Georgian American Alloys and Rustavi Azoti, are already operating at the limit of their capacity at the going global price for relevant commodities (copper, ferroalloys, and ammonium nitrate fertilizer). Any increase in their production and exports is predicated on additional investment. The agricultural sector, which does have considerable capacity for expansion, is dominated by small producers, the vast majority of which are subsistence farmers. Most large food processors, such as Nikora and Chirina, are focused on import substitution. Georgia's agriculture and food exports to the EU by and large consist of one product: hazelnuts (22% of total exports to the EU in 2015). Wine and mineral water come in remote second and third places with 1.70 and 1.67%, respectively. See Table below for further details.

133 Georgia's Action Plan for the Implementation of DCFTA 2014-2017, http://www.economy.ge/uploads/dcfta/DCFTA_Action_Plan_ENG.pdf

Table 6: Top Georgian Exports to the EU, 2015

Top 10 Commodities to EU in 2015	% in total
Copper ores and concentrates	23.87%
Nuts, edible; hazelnuts or filberts (corylus spp.), fresh or dried, shelled	22.92%
Oils; petroleum oils and oils obtained from bituminous minerals, crude	12.14%
Fertilizers, mineral or chemical; nitrogenous, ammonium nitrate, whether or,not in aqueous solution	10.27%
Ferro-alloys; ferro-silico-manganese	3.25%
Wine; still, in containers holding 2 liters or less	1.70%
Waters; mineral and aerated, including natural or artificial, (not containing added sugar or other sweetening matter nor flavored)	1.67%
Helicopters; of an unladen weight exceeding 2000kg	1.52%
Vehicles; compression-ignition internal combustion piston engine (diesel or semi-diesel), cylinder capacity exceeding 2500cc	1.51%
Rubber; new pneumatic tires, of a kind used on motor cars (including station wagons and racing cars)	1.37%

Source: Geostat

In the absence of clear “locomotives” to lead DCFTA-induced exports to the EU, Georgia has to settle for industrial policies that promote broad sectoral or even economy-wide improvements, rather than pick specific winners.

One option for the Georgian government is to facilitate intra-sectoral coordination on joint investment decisions (including those related to implementation of DCFTA-related regulations), provision of inputs, skills and downstream services; product certification and quality control; export facilitation, transport and logistics; international branding and marketing. Such coordination may help Georgian producers achieve scale in production and exports which would be needed in order to effectively compete in the EU market, develop and promote new niche products and/or expand existing activities. Such coordination would be most effective if led by recognized leaders (large, foreign-invested businesses) within each sector or sub-sector, such as:

- AgriGeorgia (Ferrero’s Georgian outpost) in the *hazelnuts* sector,
- Hipp in organic *horticulture and fruit processing*,
- Marneuli Agro in *vegetable* production and processing.

Intra-sectoral coordination can be used to facilitate discussion of measures such as vocational training (to address common skill deficits), product standards, infrastructure and logistics bottlenecks, and common branding/marketing challenges. The marketing challenge could be addressed by jointly advertising *Georgia* as a cradle of wine, source of healthy and unique foods and/or a fabulous touristic attraction. In doing so, Georgia would be following in the footsteps of new wine countries (Australia, New Zealand, Chile, and Argentine) that have used such strategies to carve out their niche in the global marketplace.

Taking the skill bottleneck as an example, the government could propose using the Public Private Partnership (PPP) framework to establish *vocational colleges* owned and managed by industry clusters. Such colleges could operate based on the German/Swiss model of dual education whereby apprentices are hired by relevant companies and acquire most of the relevant learning outcomes on the job.

Other important bottlenecks to be addressed include:

- **Lack of innovation**. The Partnership Fund (or a similar organization) could be used to transparently promote experimentation with new products and activities (to be properly evaluated). Commercial banks are too conservative (and rightly so) to be able to support truly innovative (and therefore, risky) projects.
- **Lack of access to and high cost of finance**. This bottleneck could be addressed in a general way (reduction of country risks) or for specific projects by providing government loan guarantees, making grants and coordinating investment decisions, etc.
- **Cost of transport** (sea, rail) and travel to/from Georgia. This is about accelerating transport infrastructure projects (East-West, railway modernization, expansion and deepening of sea ports, etc.) and undertaking special measures to bring budget airlines, introduce greater competition for travel to/from high value destinations and/or providing rebates.
- **Weak local government.** Given excessive fiscal centralization (almost all tax revenues go to the central budget; allocations from the central budget are made based on perceived need, not merit), Georgia’s municipal governments have weak incentives to cooperate with and promote businesses. Introducing elements of fiscal federalism and strengthening the capacity of local governments may help address this bottleneck.
- **Excessively strict tax administration system**. The current zero-tolerance and zero-discretion practice of subjecting businesses to maximum allowable penalties and freezing their bank accounts in every case of (suspected) tax evasion is clearly counterproductive in today’s realities. Giving tax auditors some discretion in

dealing with delinquent taxpayers (and subjecting their decisions to court review) may marginally increase corruption risks and reduce tax collection (in the short run). However, the benefits of doing so (in terms of improved business climate, investment, business activity, and, ultimately, tax revenues) clearly outweigh any such risks.

- **Cost of, and access to, electricity**. The government may want to rethink Georgia's energy strategy whereby Georgia's surplus hydropower resources are exported to Turkey. Georgia may have more to gain from increased electricity supply for domestic value-adding activities, including deeper processing of locally available raw materials and manufacturing. Switching to this alternative strategy may imply a greater role for government in building and operating large HPP projects.
- **Lack of professional skills**. This bottleneck can be addressed in several ways: Georgia should strive to maintain its "open border" policies to allow for the arrival of skilled workers and in this way to compensate for the lack of professional capacities on the domestic labor market; the government should also allow and, moreover, incentivize businesses to run their own German-style dual education programs or even establish vocational colleges.
- **Lack of protection for domestic investors**. Georgia is proud of having fully liberalized its trade. Indeed, doing so makes full sense for a small country that has to supply its needs and gain external market size. At the same time, the Georgian government should demonstrate its willingness to step in and provide protections, in compliance with WTO provisions concerning 1) anti-dumping, 2) anti-subsidy and 3) safeguard measures. Georgia's steel industry is currently on the verge of bankruptcy because of a sudden change in terms of trade with Russia and Ukraine. Investors will be more likely to commit their funds to Georgia if temporary protection measures will be available to them in case of need.

Taking advantage of DCFTA provisions: promoting FDI

Georgia's duty-free access to the EU carries the promise of attracting FDI in the production of goods for export to the EU market. Georgia can be attractive for EU investors given its low labor and energy costs, proximity to European and Eurasian markets. For non-EU investors, Georgia can serve as a duty free "export platform" for EU-oriented goods and services.

Decisions by non-EU investors will depend on Georgia's attractiveness from the business environment point of view considering such factors as a geographical location, transport costs, input costs, availability of necessary raw materials and labor inputs. Very importantly, their decisions will also depend on the tariff differential for EU exports vis-à-vis investor home country. The greater this differential, the stronger Georgia's attractiveness as an export platform.

Export-platform investment can be done by setting up of a whole production chain or some elements of it (not necessarily the final stage of production). The type of investment (sector, production phase) will depend on the "Rule of Origin" regulations that apply in each specific case (i.e. the share of Georgia, EU and/or other eligible countries in the final value of the product), Georgia's comparative advantages in production inputs (labor, land, water, energy, natural resources), and, of course, investors' know-how.

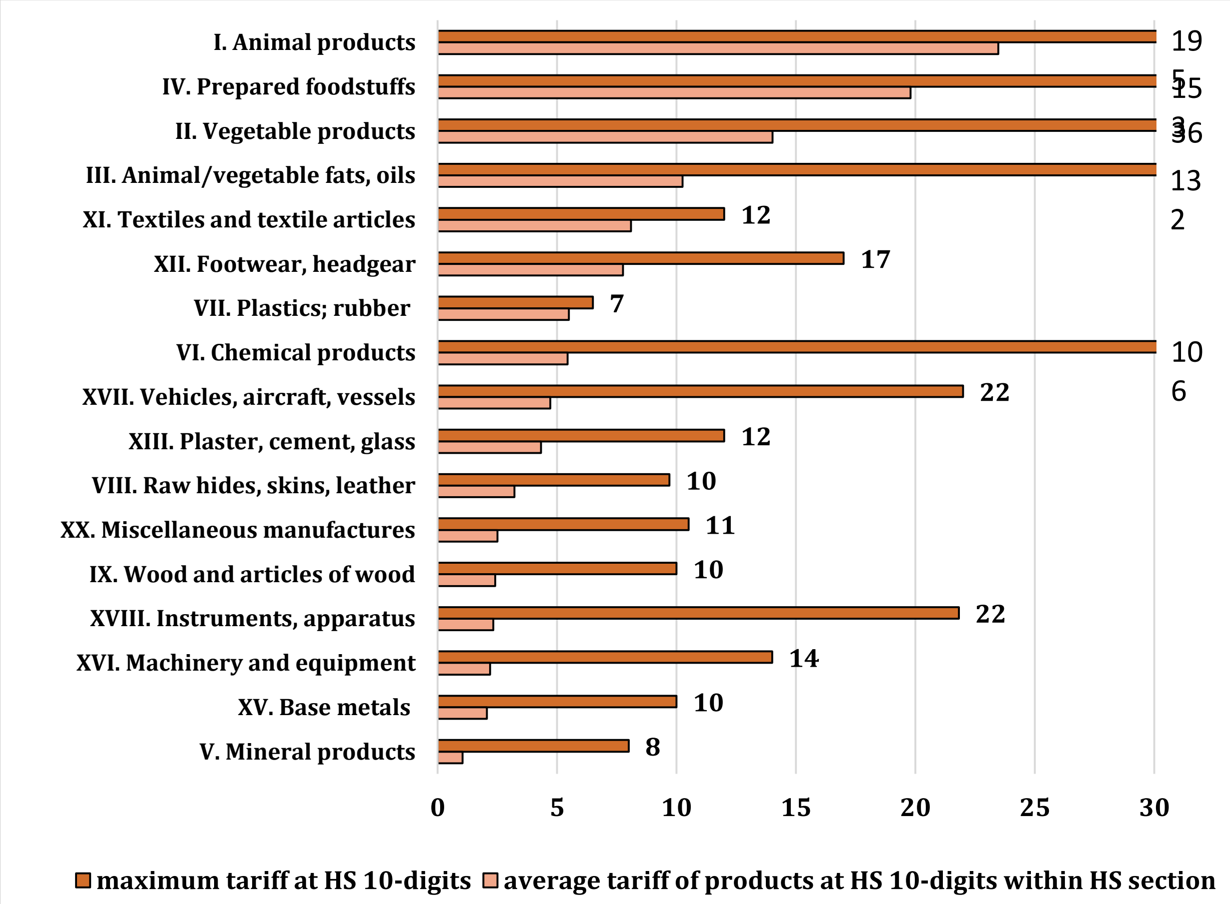
To identify non-EU countries that could be sources of such investment we analyzed tariff differentials and rules of origin. Tariff differentials are defined as the difference between the tariff rates enjoyed by Georgia through the DCFTA and those applied on exports to the EU under the Most Favored Nation (MFN) trade regime.[134] The so-called Harmonized System (HS) of tariff nomenclature includes about 15,000 tariffs defined at the 10-digit level. In our analysis we focused on broader categories of goods (HS 1 digit and 4 digits), using maximum and average tariff levels within each category[135].

Figure below summarizes the maximum and average tariff levels within 17 relevant categories.

[134] MFN is the highest tariff level applied by the EU both to WTO and non-WTO members.

[135] Excluded from the analysis are: 1) goods that are subject to tariff rate quota and entry price; and 2) goods with less than 5% tariffs differential. We did include animal products even if their export is not possible in the short run for food safety reasons.

Figure 1: Tariff Differentials



Source: Potential for FDI-attraction from non-EU countries: The role of the EU-Georgia DCFTA

The EU market for agricultural products is heavily protected but there are significant tariffs on industrial goods as well. Two basic groups can be identified which have potential to attract investment:

- Agriculture and food, particularly animal products and prepared foodstuffs. These are the products with the highest tariffs.
- Industrial goods, particularly textiles, footwear, chemical products, also selected engineering goods: Lower tariffs, but with some tariff peaks.

The next step in the analysis is to identify source countries that have restricted access to European countries but are already exporting the above mentioned products. Currently the EU has free trade arrangements with over 50 countries, and more are being negotiated. At the same time, the EU has introduced a revised GSP, as a result of which trade preferences have been terminated for more than 20 high and upper middle-income countries. Overall, 33 countries currently trade with the EU under MFN tariffs.

We used the following criteria to identify source FDI countries: relative geographical proximity to Georgia, sufficient level of economic development, preferential tariff regime, and current state of economic ties with Georgia. According to these criteria possible source countries for export-platform FDI include: Azerbaijan, China,[136] Iran, Kazakhstan, Kuwait, Russia, Saudi Arabia, and United Arab Emirates.

In attracting investment, Georgia would have to compete with more than 50 countries that have similar EU market access. This competition will be about domestic costs and conditions, suggesting an urgent need for Georgia to continue investing in a friendly business environment: improve trade infrastructure, transport and logistics so as to facilitate fast and secure delivery of Georgian products to EU markets. Increasing the quality of political and economic institutions will provide an additional impetus for the much needed foreign investment.

[136] China lost its EU GSP preferences in 2015 and should have stronger incentive to use Georgia's DCFTA.

Appendix 9: Disclaimer

This document has been prepared only for the Department for International Development (DFID) and solely for the purpose and on the terms agreed with DFID in our agreement dated 28th September 2015. We accept no liability (including for negligence) to anyone else in connection with this document.