

2012/13

The First National Competitiveness Report for Georgia

**By ISET Policy Institute in collaboration with the Economic Prosperity Initiative and
the financial support of G-PAC/USAID**

TBILISI
2013

THREE MAIN COMPONENTS:

- Macro performance
- Competitiveness performance
- Georgia as a multi-sector regional hub

Chapter 1

MACRO PERFORMANCE

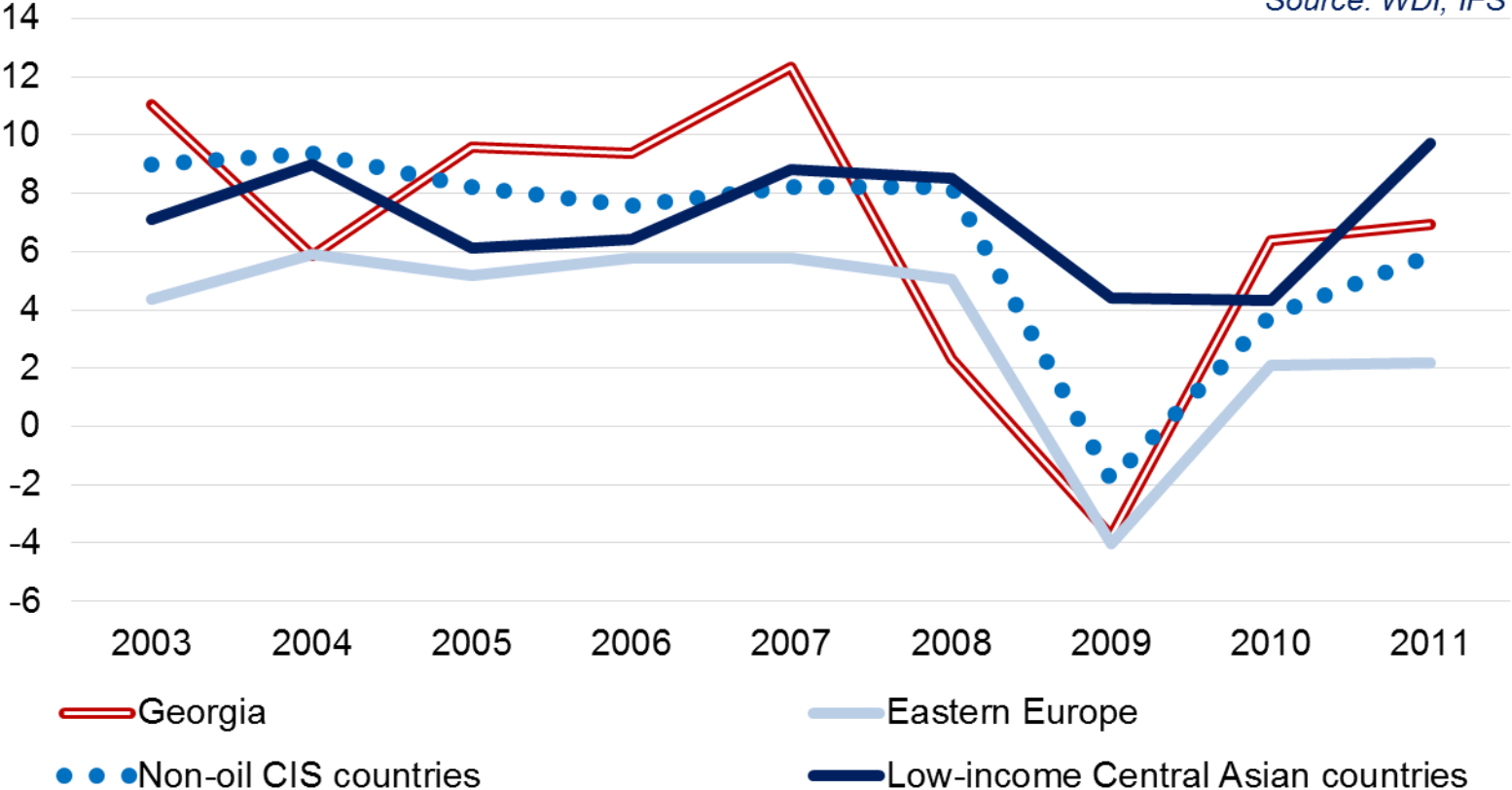
GEORGIA'S GROWTH PERFORMANCE

- One of the fastest growing economies in the region (6.6% per annum)
- Strong economic fundamentals allow for diversified growth
- Globally recognized reformer
- Highly geo-strategic position at a regional cross-roads
- Competitive factor costs at a regional level
- Opportunities to build a multi-sector hub for the Caucasus and beyond

BENCHMARKING GEORGIAN GROWTH (I)

Real GDP Growth

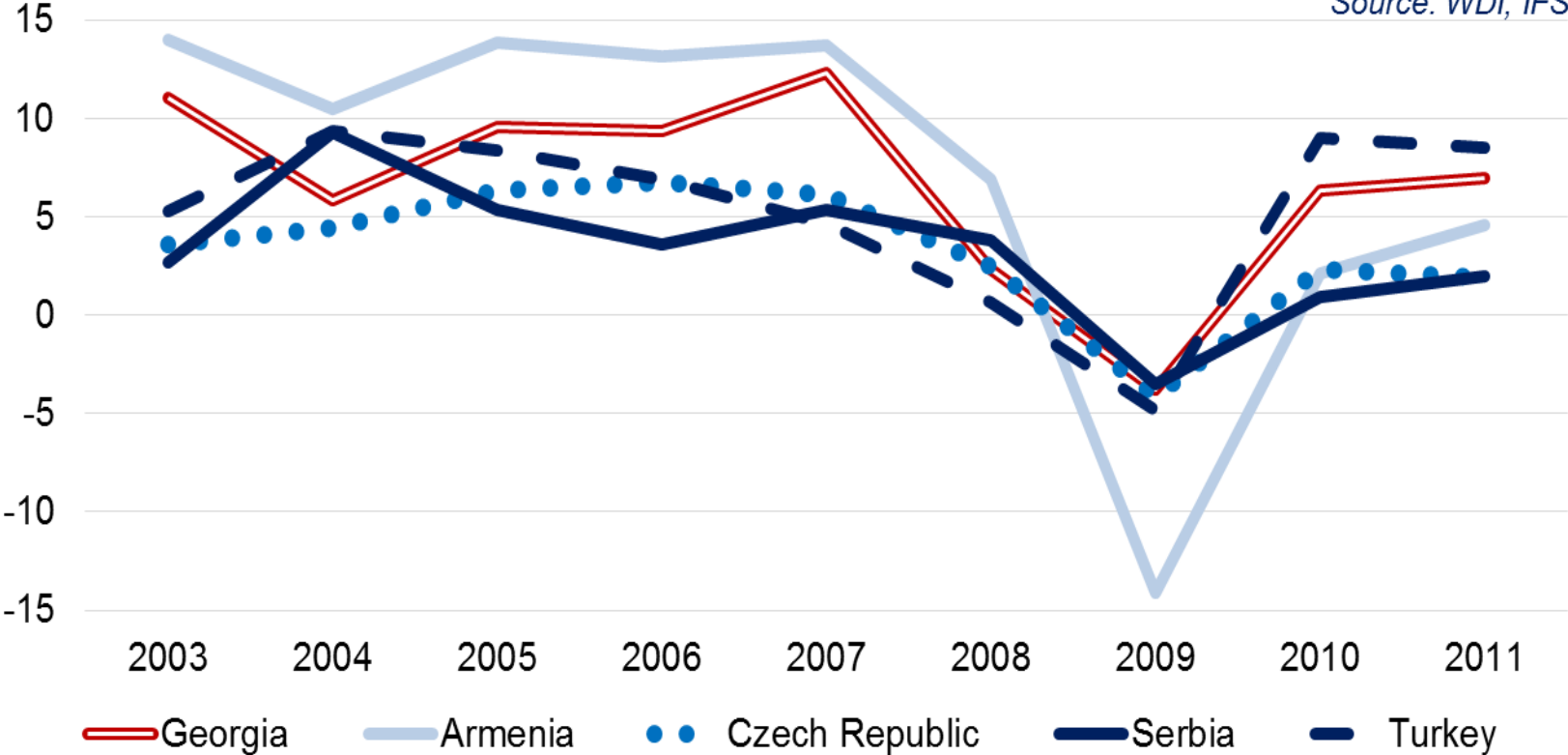
Source: WDI, IFS



BENCHMARKING GEORGIAN GROWTH (II)

Real GDP Growth

Source: WDI, IFS

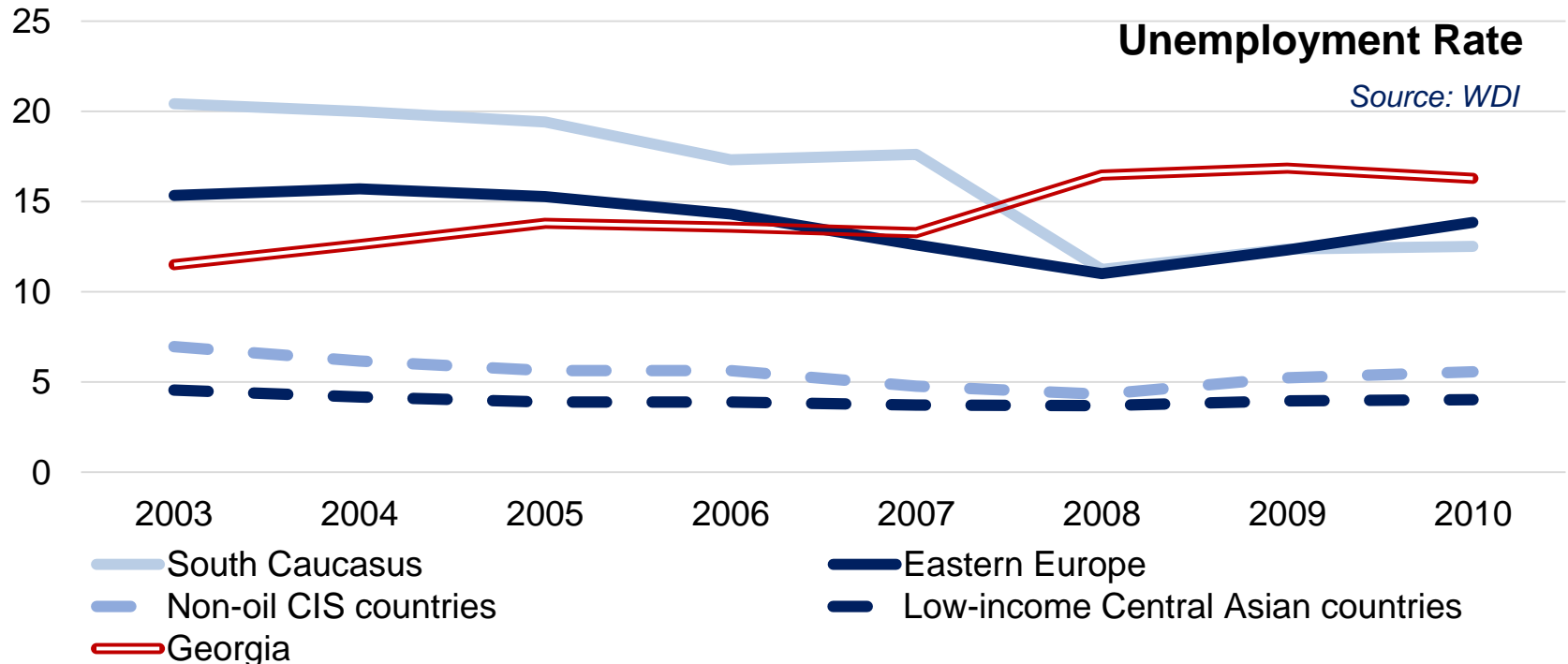


POLITICAL AND SOCIAL UNCERTAINTY

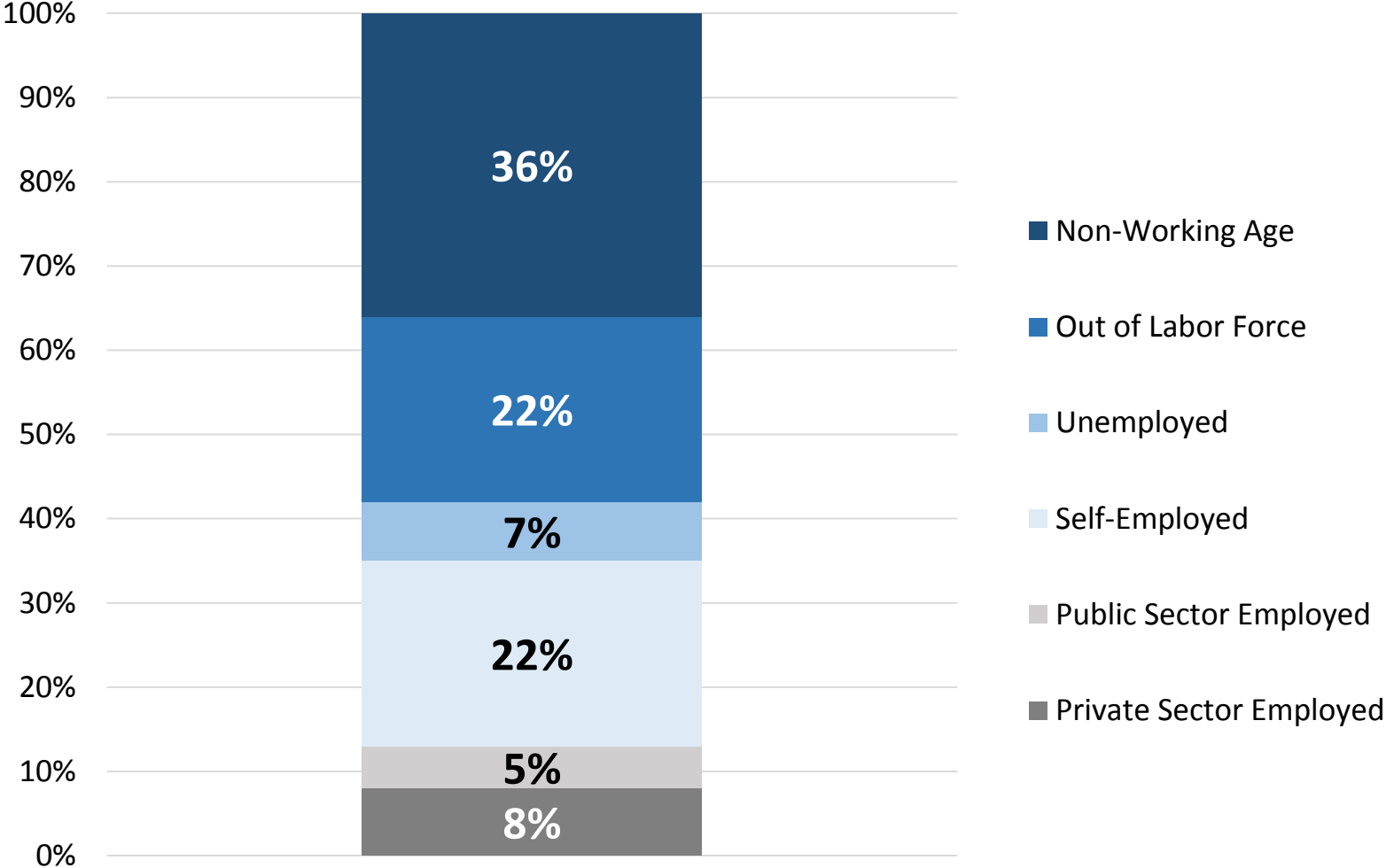
- Widespread poverty and inequality
- Political risks
- Risks of social upheaval
- Perception that achievements of the reforms may be jeopardized

GROWTH ACCOUNTING

- $GDP = TFP * L^\alpha K^\beta$
- $\widehat{GDP} = \widehat{TFP} + \alpha\widehat{L} + \beta\widehat{K}$
- Labor's contribution important
- Unemployment not too bright, not too alarming



LABOR UTILIZATION



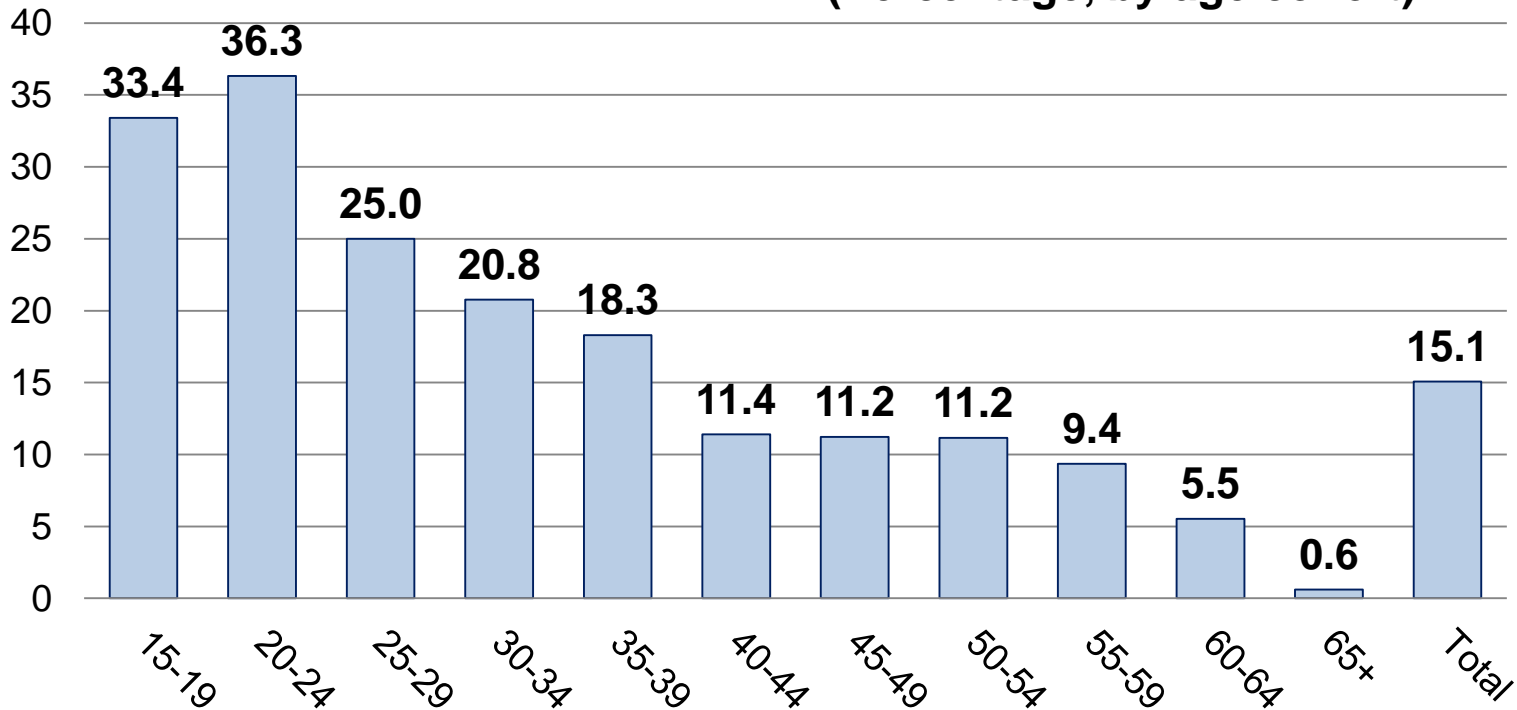
LABOR UTILIZATION

- 48% of the employed categorized as self-employed
- A huge part of self-employed are subsistence farmers
- Georgia has so far failed to engage the majority of its working age population in the formal sector of the economy

YOUTH UNEMPLOYMENT

Source: Geostat

Unemployment Rate
(Percentage, by age cohort)

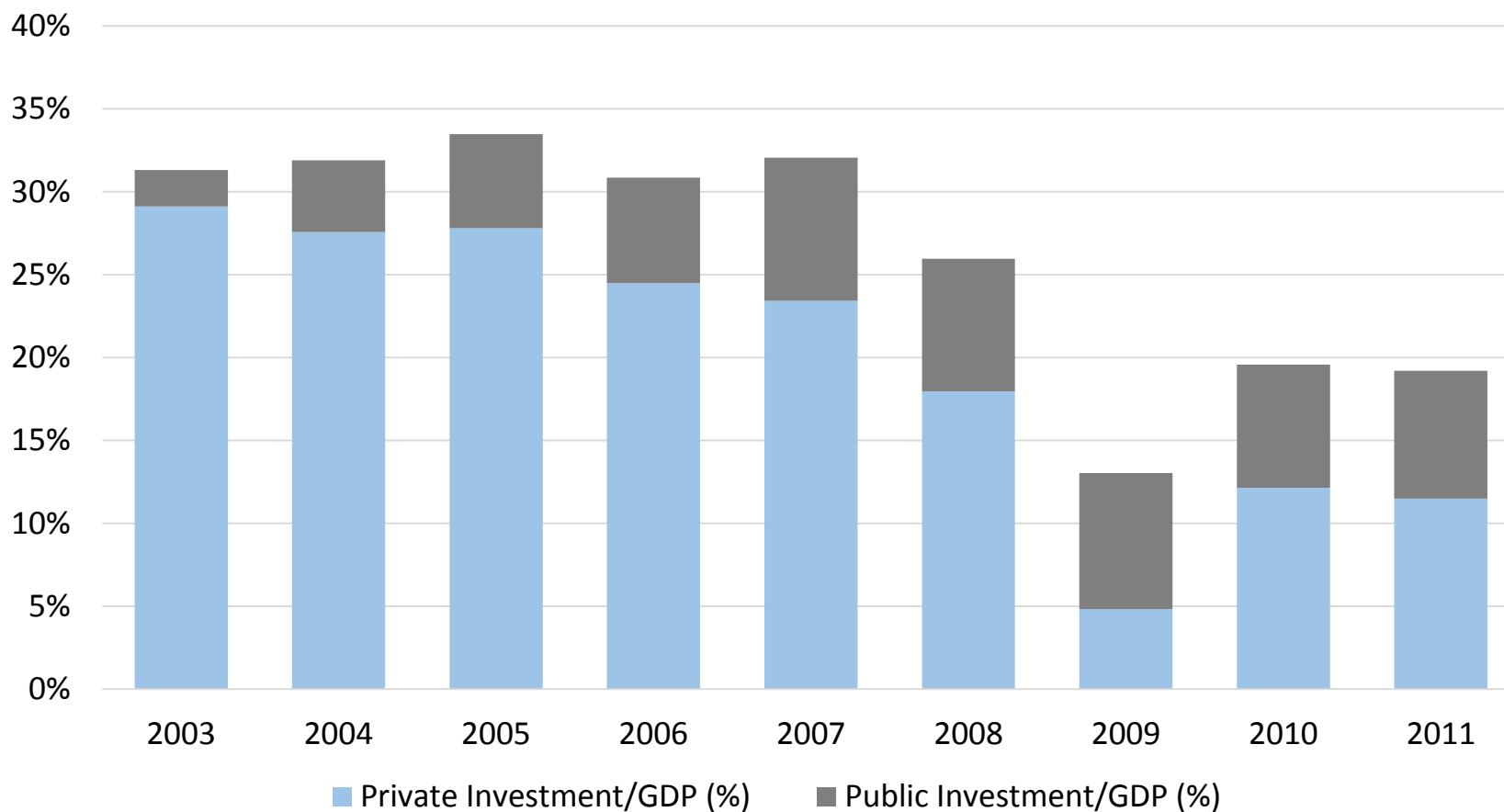


Jobless young today are less productive workers tomorrow

FIXED CAPITAL FORMATION

Source: MoF, WDI

Georgia: Shares of Investment in GDP (%)



REASONS FOR LOW INVESTMENT

- In early stages of development domestic savings can't fund investment
- (below a certain threshold level of income, households live in self-imposed financial autarky)
- $GDP = TFP * L^{\alpha} K^{\beta}$
- $\widehat{GDP} = \widehat{TFP} + \alpha \widehat{L} + \beta \widehat{K}$
- International financiers compare rates of return (adjusted for the risk, of course)
- Will not invest if low TFP

TOTAL FACTOR PRODUCTIVITY

- $GDP = TFP * L^{\alpha} K^{\beta}$ (aggregate output)
- Countries with high TFP can produce more with the same resources
- TFP high when
 - Macroeconomic environment is stable
 - corruption is low
 - compliance costs are low
 - etc.

TFP GROWTH IN GEORGIA

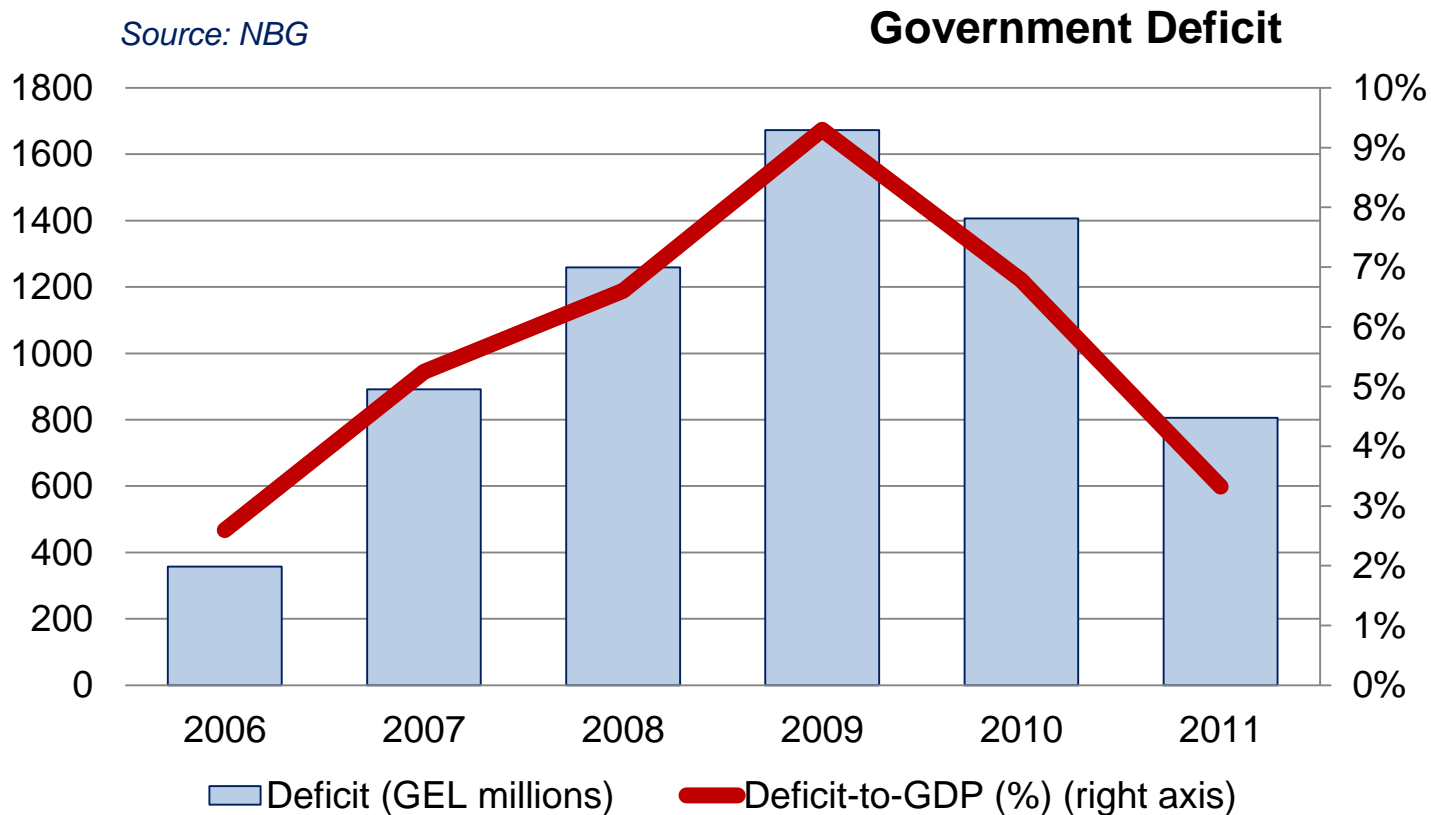
- Babych and Fuenfzig (2012):
Georgia's growth is largely attributable to growth in TFP rather than K.
- *process innovation vs. product innovation*
("implementation of a new or significantly improved production or delivery method")

TFP GROWTH IN GEORGIA

- Factors of TFP growth:
 - Macroeconomic environment
 - Financial environment
 - Political environment
- Institutions and markets
- Externalities

FISCAL POLICIES

- 2005, 2008: tax simplification and liberalisation
- Public revenues grew since 2005



FISCAL POLICIES

- 2009: fiscal consolidation
- Deficit stabilized at 3.3% of GDP in 2011
- The Economic Liberty Act (2011): commitment to small government and low tax rates
- Social spending and transfers limited
- Prioritized capital spending (7.5% of GDP)
- Fiscal authorities avoided spending excesses

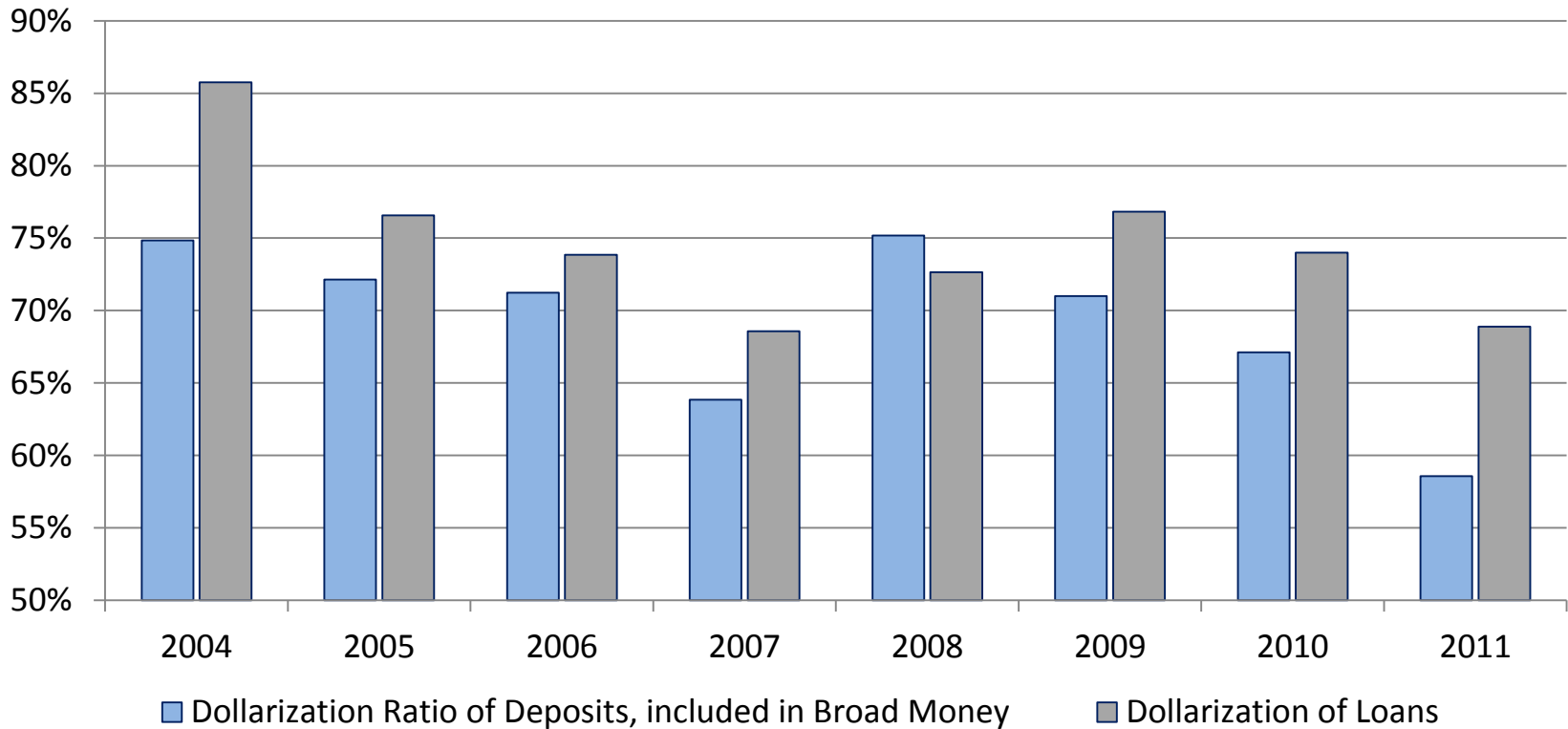
MONETARY POLICY

- Fiscal authorities avoided spending excesses
- No trend inflationary pressure in the economy
- NBG prudently sterilized hot money inflows in 2007 and 2011
- Domestic component of consumer inflation under control

DOLLARIZATION

Source: MoF, WDI

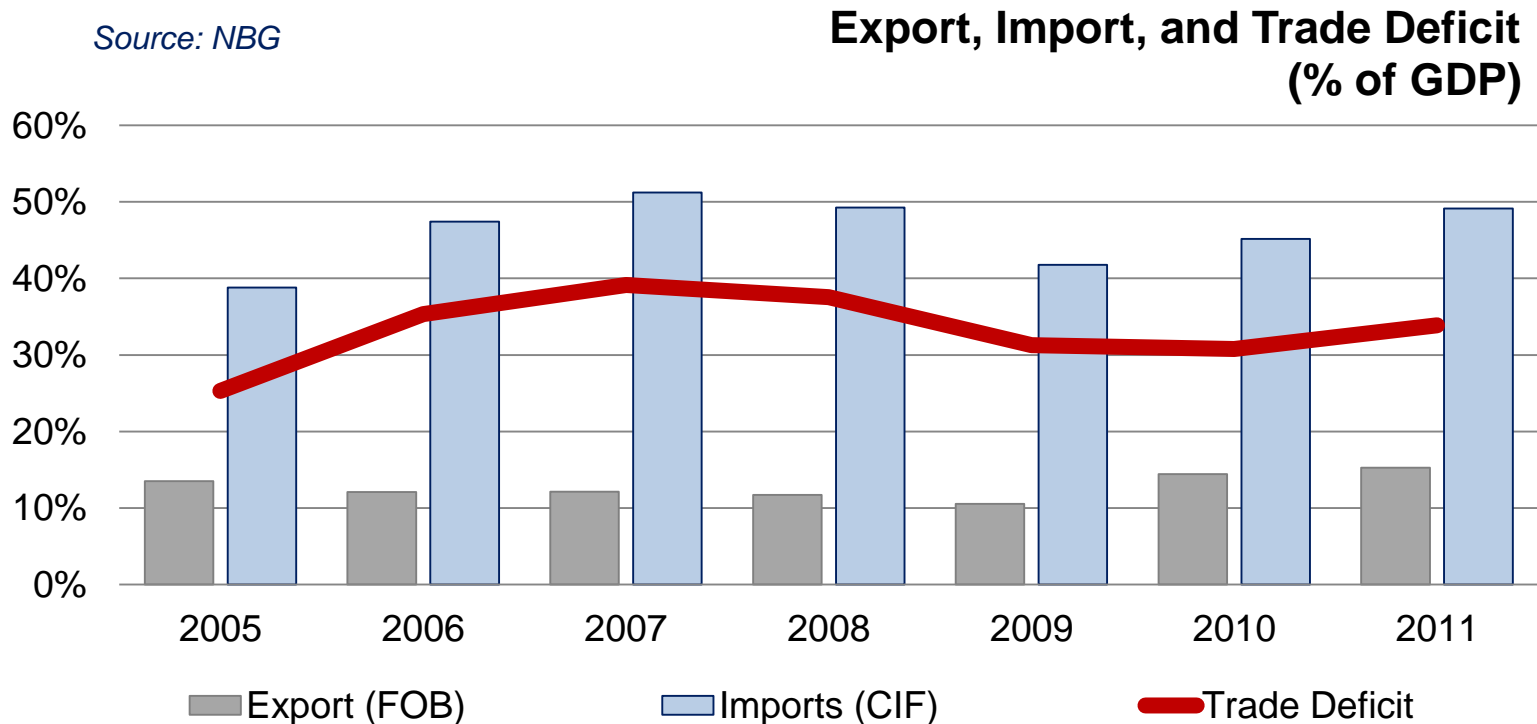
Dollarization Coefficients (%)



Dollarization rates as indicator of trust in financial system

BALANCE OF PAYMENTS...

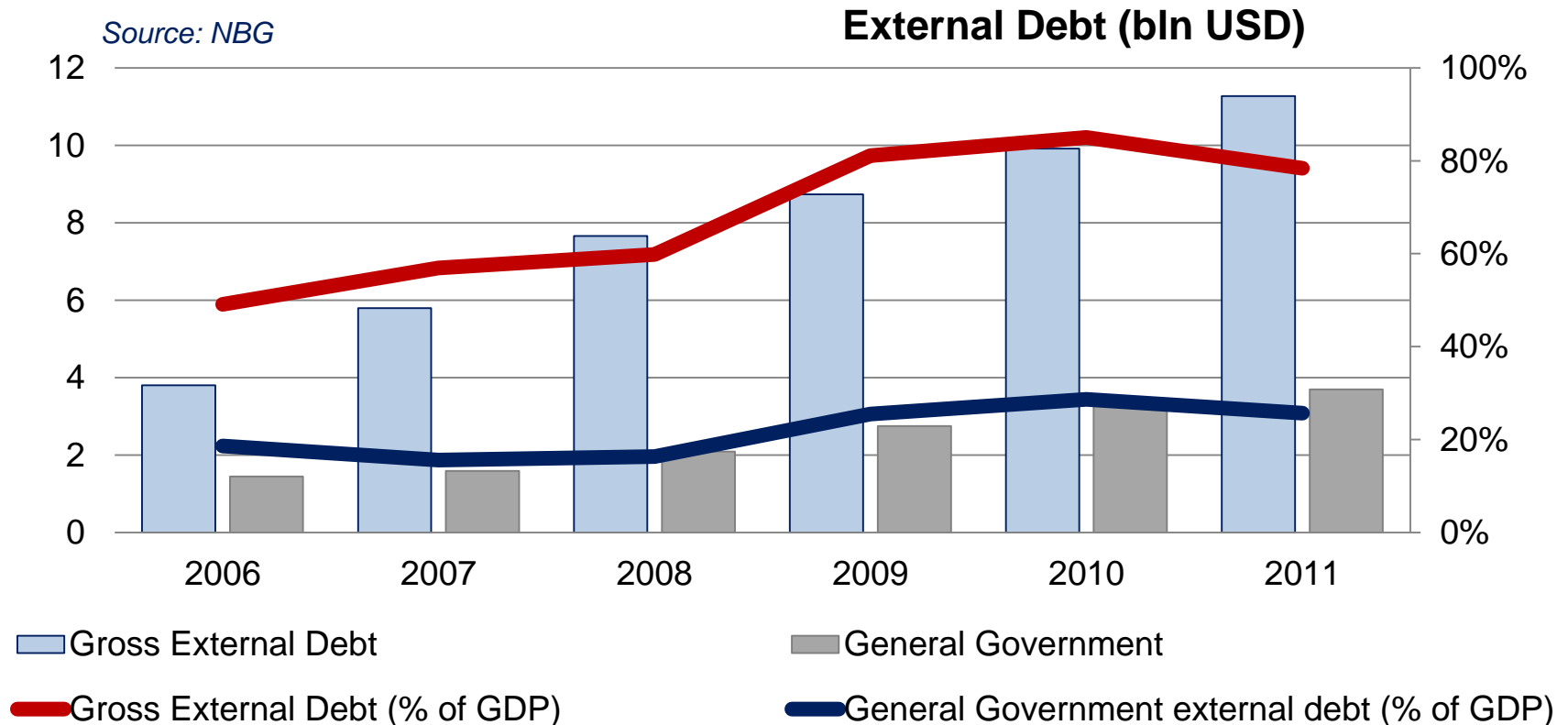
- Trade and current account deficits



- Borrowing resources from ROW to finance investment

... AND EXTERNAL DEBT

- External public debt to GDP and official reserves to short-term debt healthy



“FDI” IN CAPITAL ACCOUNT

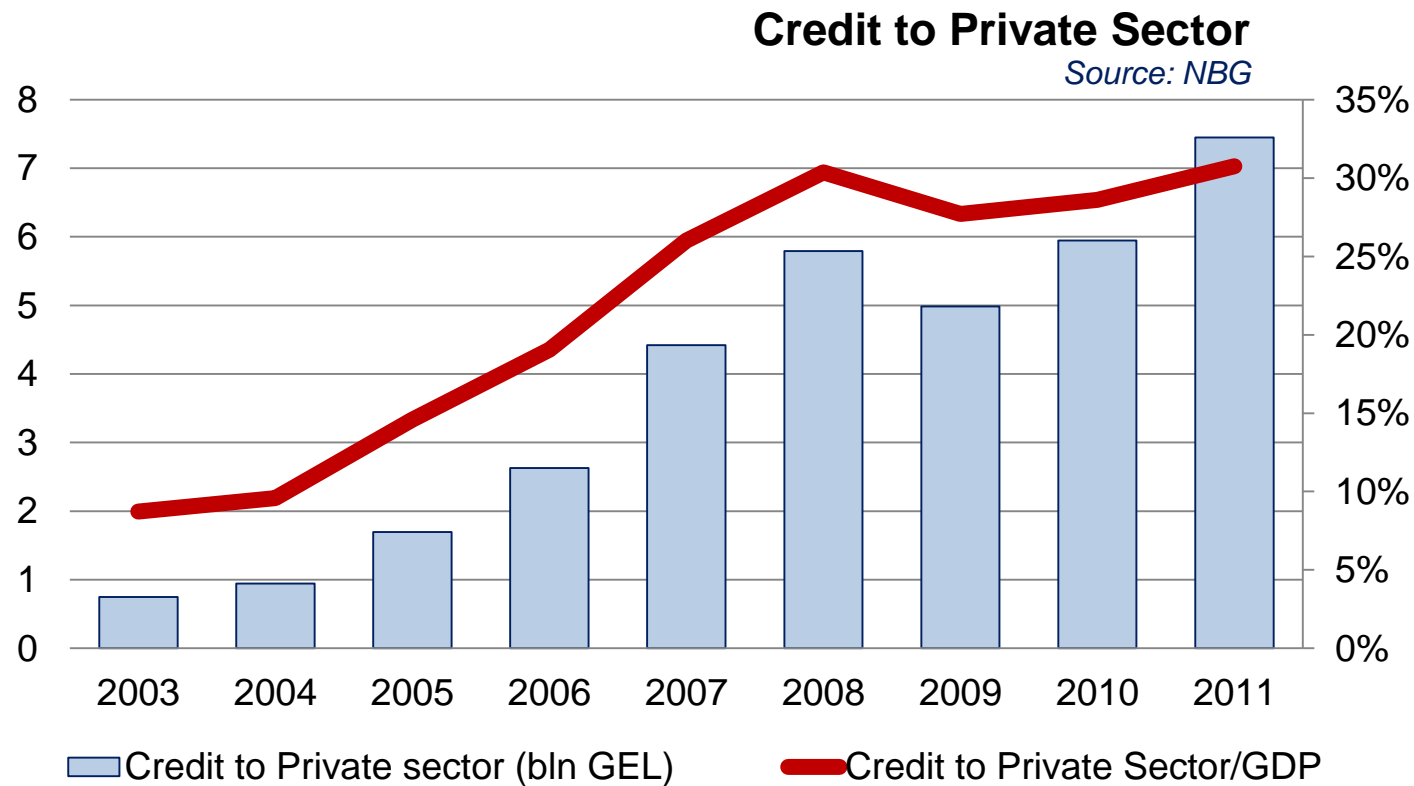
- Available statistics do not distinguish:
 - proper FDI (investment), and
 - changes of asset ownership and speculative inflows.
- Foreign purchases of domestic assets, including housing, major capital account item
- (Remittances are much more stable than asset purchases)

RISKS TO FINANCIAL STABILITY

- Growing reliance of banking sector on international short term funding
- Currency mismatch in domestic balance sheets
- Vulnerability to external shocks leading to depreciation
- Prudent management of foreign funding to avoid credit or market risk

BANKING SECTOR

- Modest degree of financial penetration

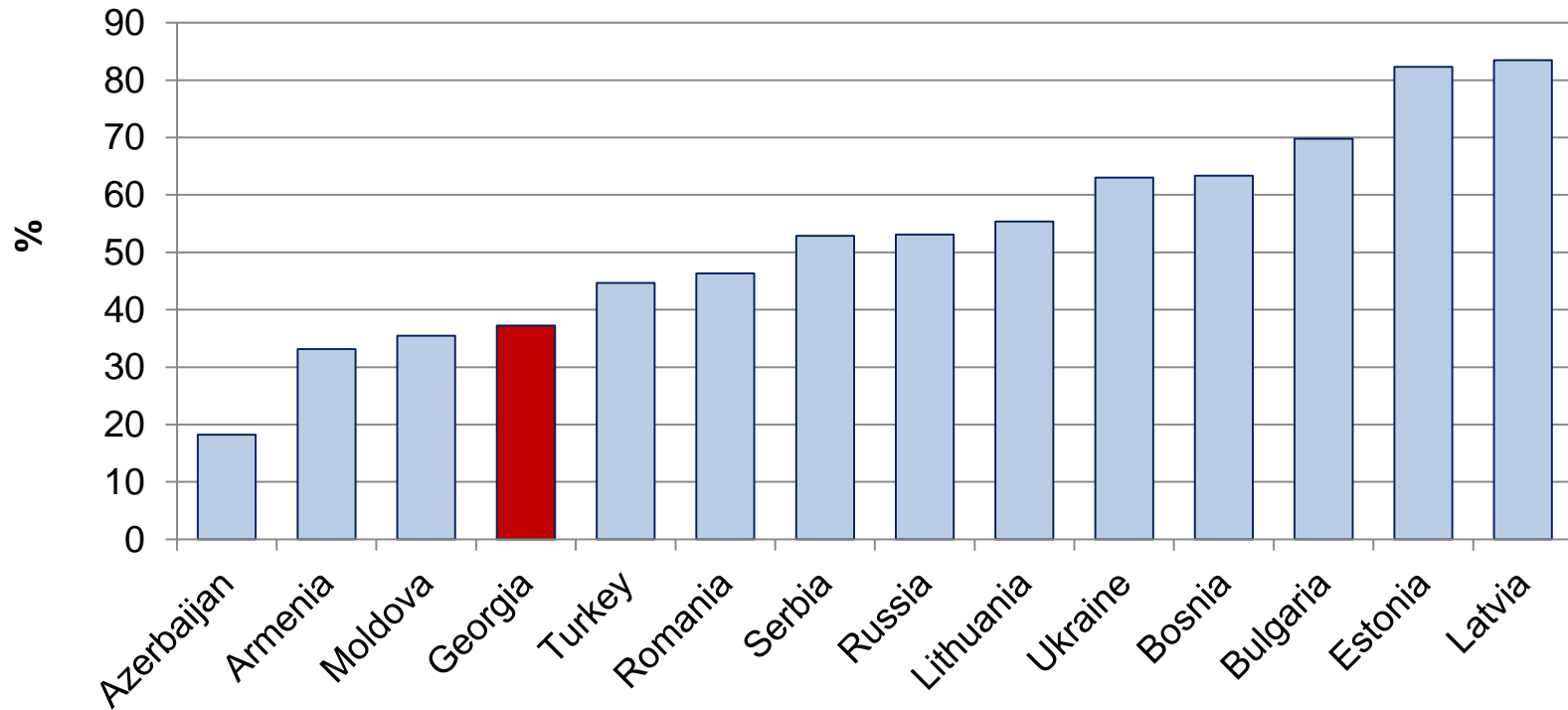


BANKING SECTOR

- Modest degree of financial penetration

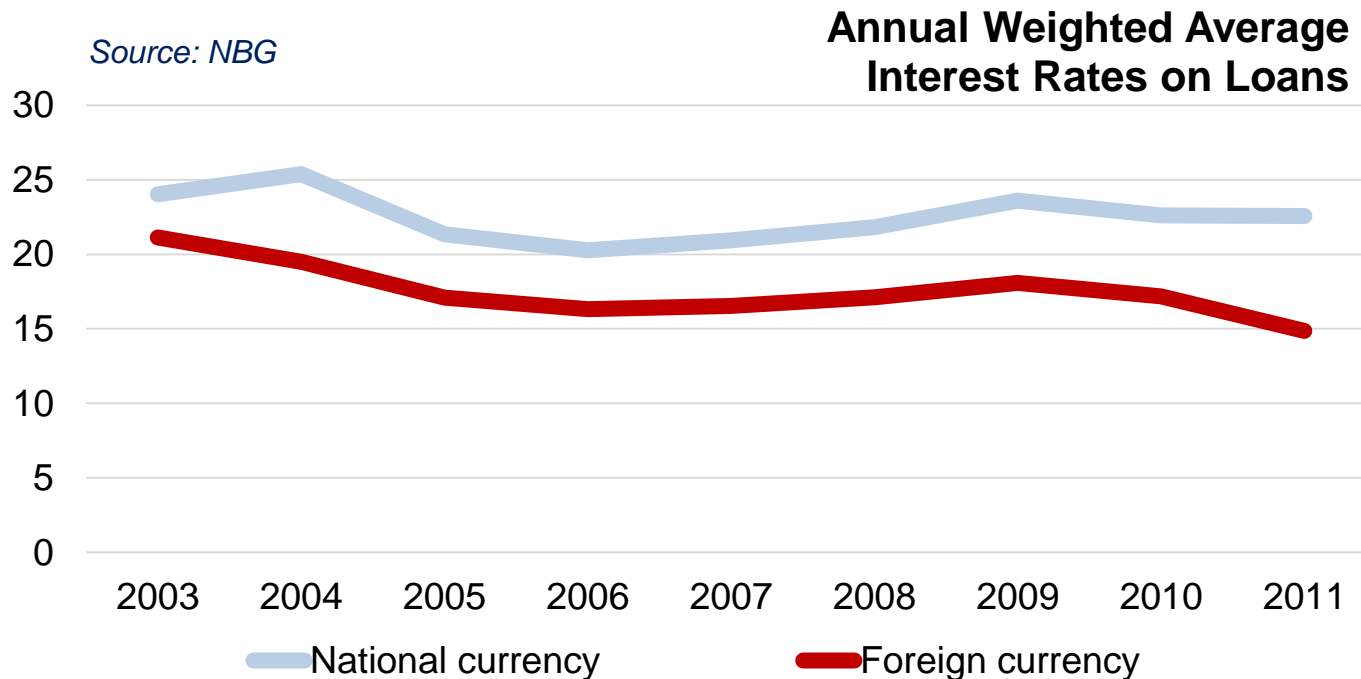
Loans/GDP (%), 2011

Source: WDI



HIGH LENDING RATES PREVENT CREDIT EXPANSION

- Crucial metric: lending rate



- Impediment to private investment

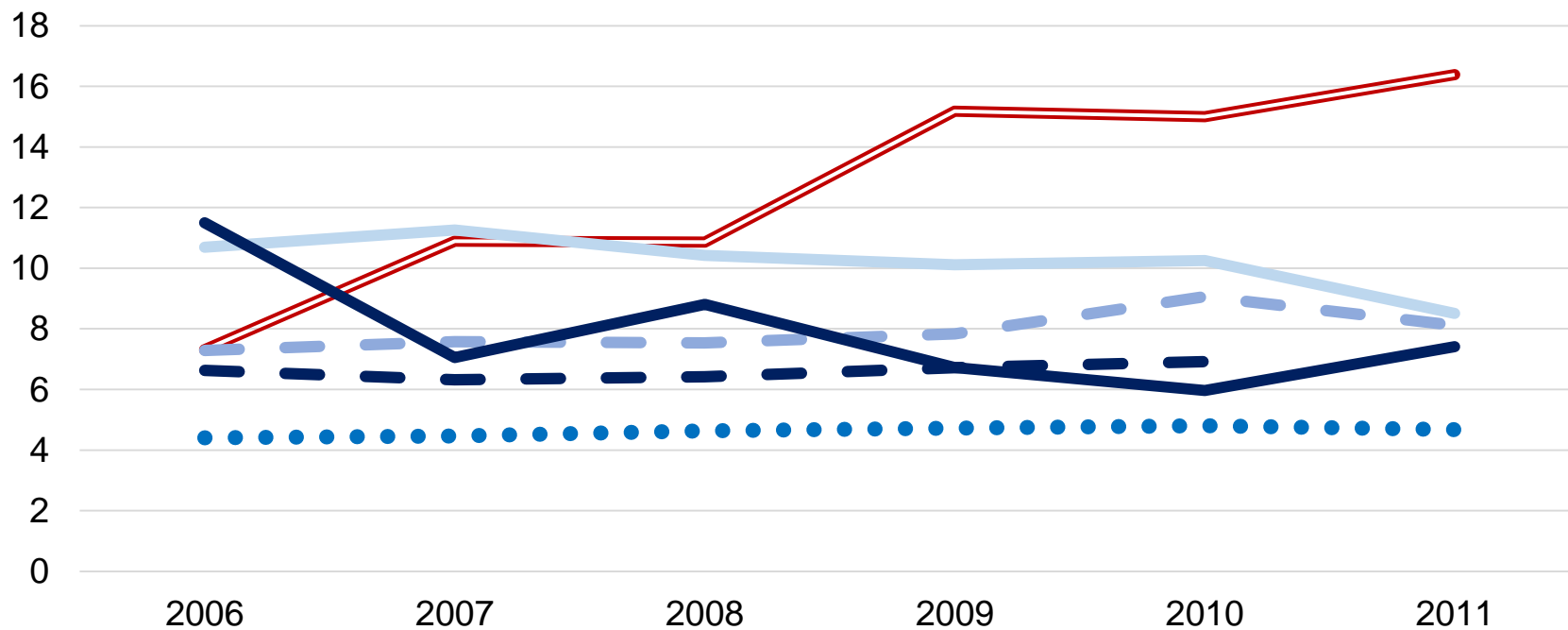
HIGH LENDING RATES: REASONS

- Babych and Fuenfzig (2012):
 - low domestic savings ✘
 - low competition among banks ✘
 - large risk premia ✓
- Major risks:
 - credit events due to political instability
 - impairments due to weak property rights
(lack of judiciary independence)

SPREADS TAKE OFF

Source: WDI, IFS

Interest Rate Spread



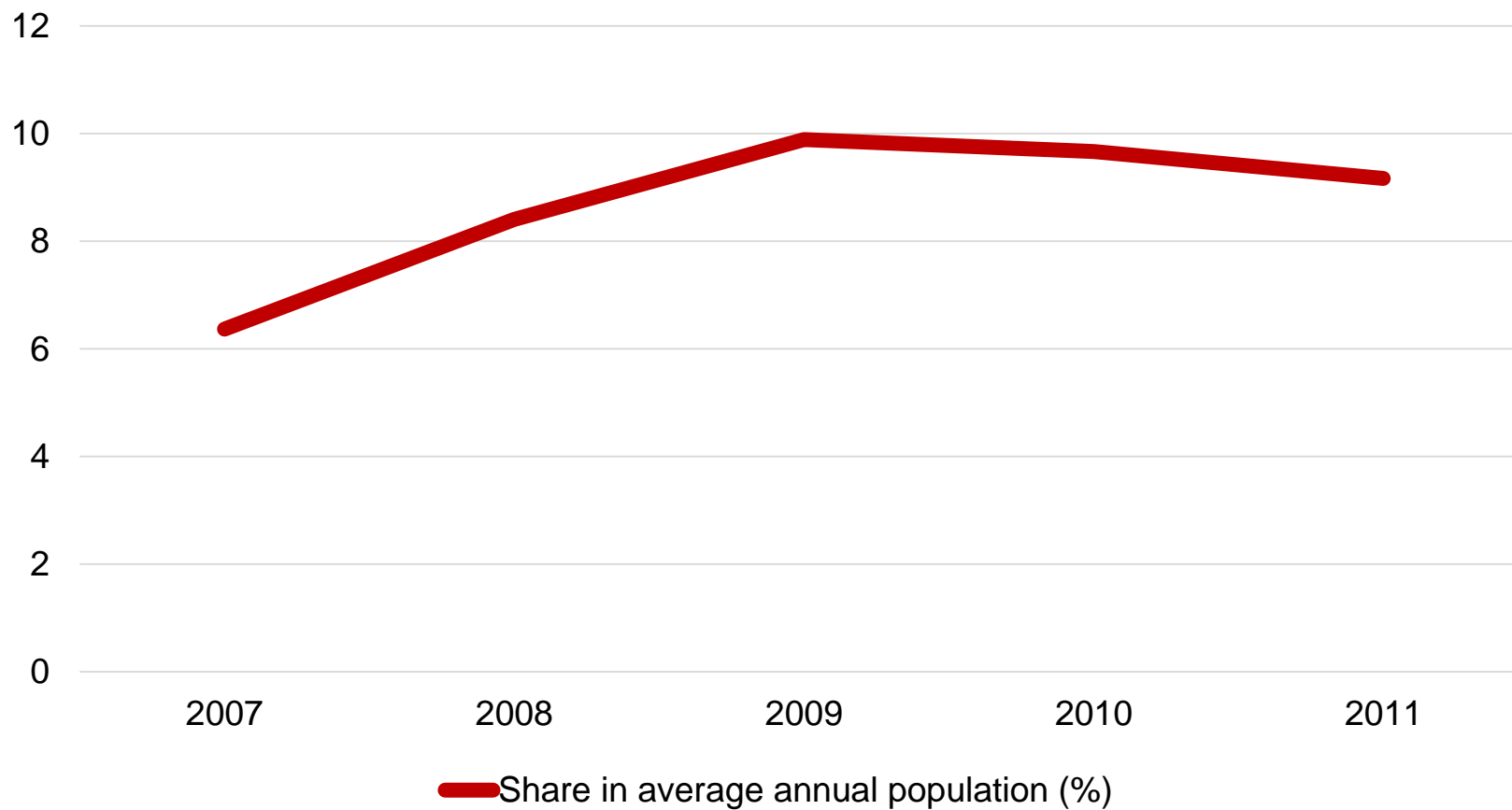
— Georgia
— Azerbaijan
— Serbia

— Armenia
••• Czech Republic
— Europe & Central Asia (developing only)

POVERTY AND INEQUALITY

Source: Geostat

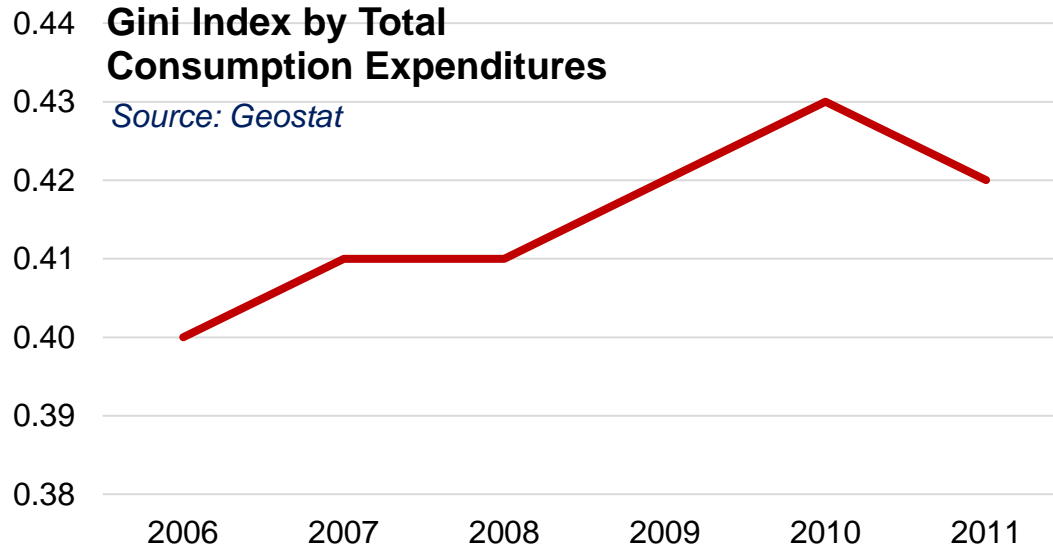
Population Under Poverty Threshold (%)



POVERTY AND INEQUALITY

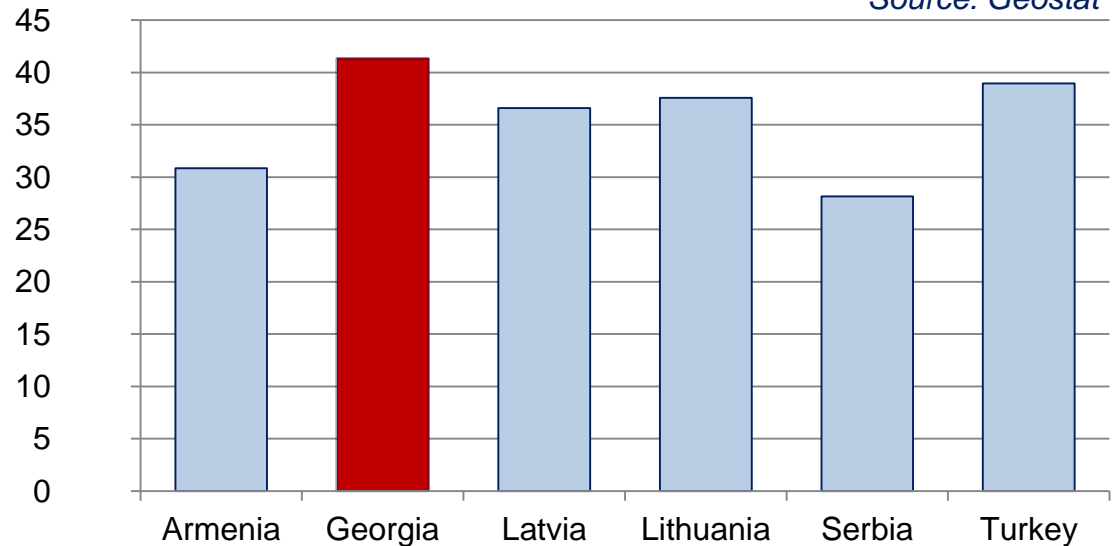
Gini Index by Total Consumption Expenditures

Source: Geostat



Benchmarking Gini Index

Source: Geostat



INEQUALITY SLOWS DOWN GROWTH

Persson and Tabellini (1994),
Alesina and Perotti (1996):

Inequality level is related to the likelihood of social turmoil. Increased political uncertainty depresses investment and growth.

- Growing perception among international donors and investors that Georgia is close to tripping the wire.
- Social discontent in Georgia, fueled by high unemployment rates and income inequality, poses risk to stability

INTERPRETING GEORGIAN POLITICS

- Conventional wisdom
 - “Georgian experiment”:
 - growth through eradication of cronyism and corruption
 - building democracy and liberalizing economy
- Perhaps, Georgia was not a democracy
 - lacking system of checks and balances
 - weak limits on the power of the executive

START OF THE NEW EXPERIMENT?

- 2012 parliamentary elections
 - May defuse political risks
 - May spark investor optimism (given prudent policies)
 - May lay foundations of inclusive growth
 - chance to bring growth rates back to their pre-2008 level

Chapter 2

COMPETITIVENESS PERFORMANCE

WHAT IS COMPETITIVENESS

- Not trade competitiveness
- And not necessarily about competition
- “Conditions” to make productive use of available resources (total factor productivity)
- And to attract additional resources (retain the best workers, pull labor out unemployment and underemployment, investment)
- Not current, but potential (future) productivity

WHAT AFFECTS COMPETITIVENESS?

- **INHERITED CONDITIONS** – location, natural resources, cultural norms e.g. punctuality and hospitality.

Very difficult to change

- **QUALITY OF INSTITUTIONS**, including legal and political framework, rule of law.

Can be changed, but often slowly

- **POLICIES** ensuring macroeconomic stability, provision of public goods, reduction of tax burden and compliance costs, regulations affecting trade and transactions costs, incentives to invest in human and physical capital.

Relatively easy to adjust provided there is political will

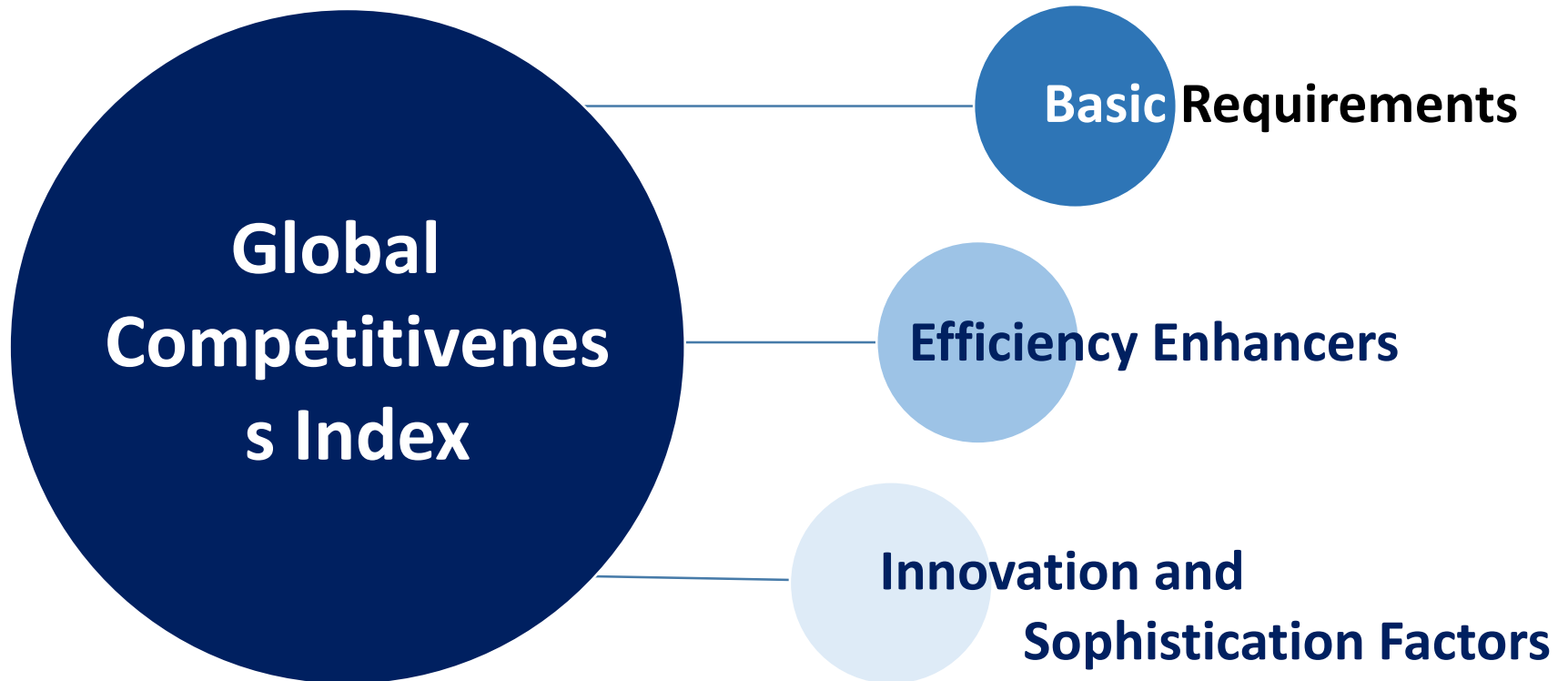
HOW CAN WE MEASURE COMPETITIVENESS?

- **ART, NOT SCIENCE.** Mix of subjective and objective data. Weighting. Cross-country comparisons may not be valid.
- **MANY INDICES** – Doing Business, Economic Freedom, Corruption Perceptions, etc. Based on different data. Often contradict each other. No way to aggregate.
- **GLOBAL COMPETITIVENESS REPORT** – attempts to provided a quasi-scientific, comprehensive methodology
- **PROBLEMS WITH DESIGN AND IMPLEMENTATION.** Subject to manipulation by governments eager to improve “ratings” (and those helping them). Hence “grade inflation”.

WHY BOTHER?

- Useful framework to think about the national policy framework
- Perceptions matter – can act as self-fulfilling prophecies

WHAT IS GLOBAL COMPETITIVENESS INDEX



BASIC REQUIREMENTS		40%	EFFICIENCY ENHANCERS		50%	INNOVATION & SOPHISTICATION FACTORS		10%
1	Institutions	25%	5	Higher education and training	17%	11	Business sophistication	50%
2	Infrastructure	25%						
3	Macroeconomic environment	25%	6	Goods market efficiency	17%	12	Innovation	50%
4	Health and primary education	25%	7	Labour market efficiency	17%			
			8	Financial market development	17%			
			9	Technological readiness	17%			
			10	Market size	17%			

Weight in Global Competitiveness Index

Weight in corresponding sub-index

Generally, weights are different for countries in different groups!

Factor-driven - Per-capita GDP less than USD 2000

Countries utilize their factor endowments, primarily unskilled labor and natural resources. Productivity hinges mainly on well-functioning public and private institutions, infrastructure, macroeconomic stability, and good health and primary education (pillars 1-4).

Transition Stage - Per-capita GDP between USD 2000-3000

Efficiency-driven - Per-capita GDP between USD 3000-9000

Countries must begin to develop more efficient production processes and increase product quality. Productivity hinges on higher education and training, efficient goods and labor markets, financial markets, existing technologies and market size (domestic and international (pillars 5-10)).

Transition Stage - Per-capita GDP between USD 9000-17000

Innovation-driven – Per-capita GDP more than USD 17000

Countries can sustain higher standards providing new or unique products. Productivity on technological sophistication and innovation (pillars 11-12).

Factor-driven - Per-capita GDP less than USD 2000

Transition Stage - Per-capita GDP between USD 2000-3000

In **2012** Georgia moved from Transition 1-2 category (with per capita GDP USD 2658) to Efficiency Driven economies as its per capita GDP increased to USD 3210



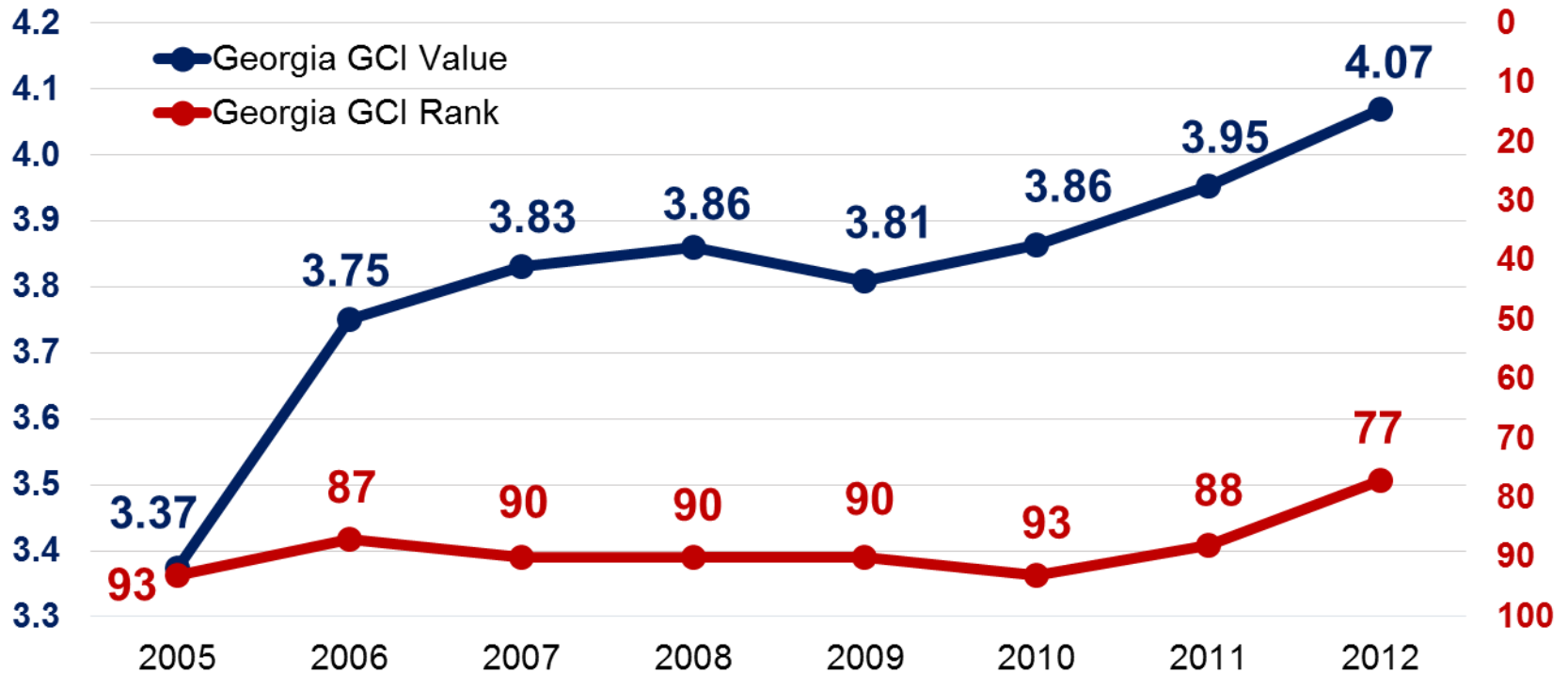
Efficiency-driven - Per-capita GDP between USD 3000-9000

Transition Stage - Per-capita GDP between USD 9000-17000

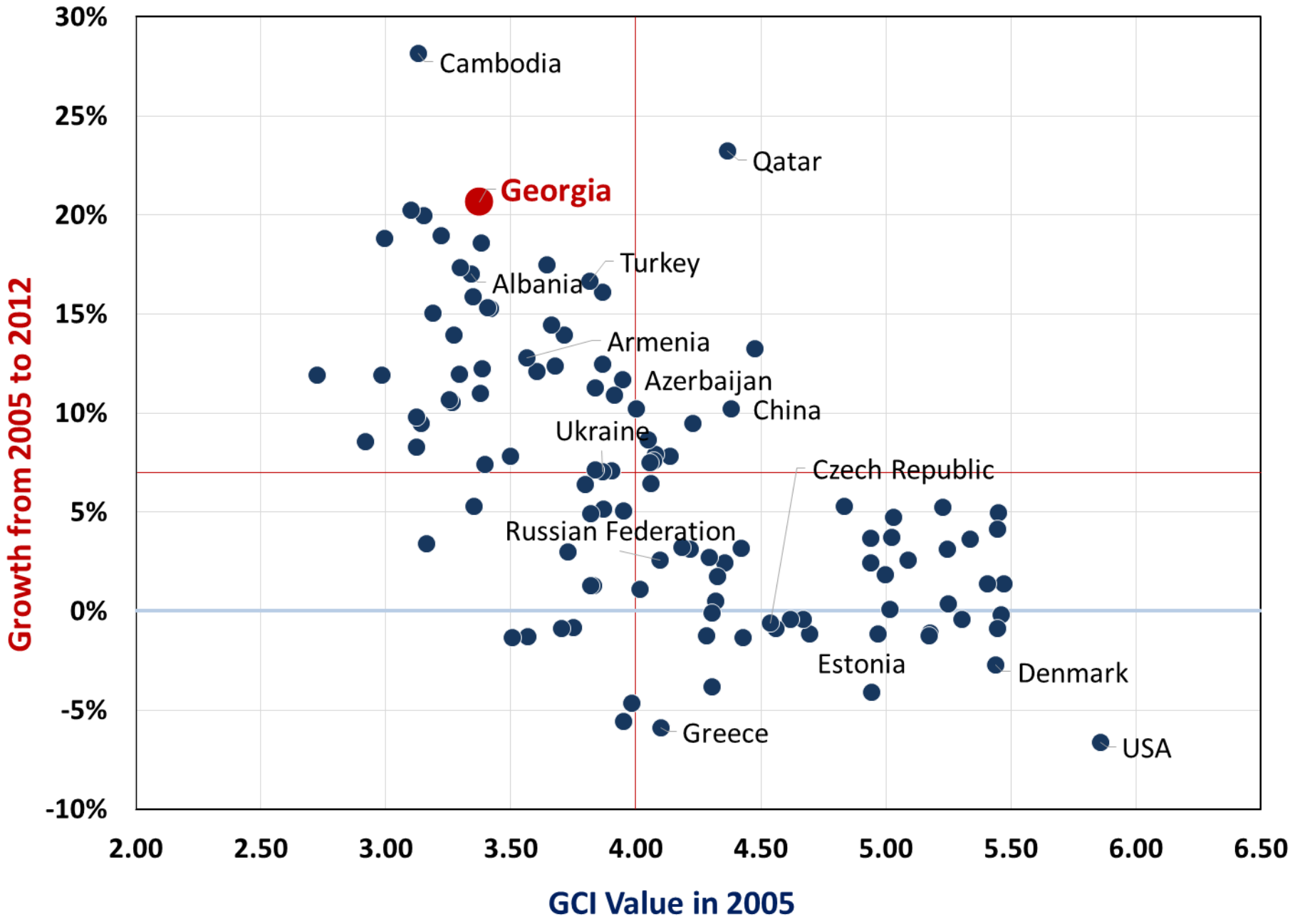
Innovation-driven – Per-capita GDP more than USD 17000

Factor Driven	1-2	Efficiency-driven	2-3	Innovation-driven
Bangladesh	Algeria	Albania	Argentina	Australia
Benin	Azerbaijan	Armenia	Bahrain	Austria
Burkina Faso	Bolivia	BiH	Barbados	Belgium
Burundi	Botswana	Bulgaria	Brazil	Canada
Cambodia	Brunei Darussalam	Cape Verde	Chile	Cyprus
Cameroon	Egypt	China	Croatia	Czech Rep
Chad	Gabon	Colombia	Estonia	Denmark
Côte d'Ivoire	Honduras	Costa Rica	Hungary	Finland
Ethiopia	Iran, Islamic Rep	Dominican Rep	Kazakhstan	France
Gambia, The	Kuwait	Ecuador	Latvia	Germany
Ghana	Libya	El Salvador	Lebanon	Greece
Guinea	Mongolia	Georgia	Lithuania	Hong Kong SAR
Haiti	Philippines	Guatemala	Malaysia	Iceland
India	Qatar	Guyana	Mexico	Ireland
Kenya	Saudi Arabia	Indonesia	Oman	Israel
Kyrgyz Rep	Sri Lanka	Jamaica	Poland	Italy
Lesotho	Venezuela	Jordan	Russian Fed	Japan
Liberia		Macedonia, FYR	Seychelles	Korea, Rep
Madagascar		Mauritius	Trinidad and Tobago	Luxembourg
Malawi		Montenegro	Turkey	Malta
Mali		Morocco	Uruguay	Netherlands
Mauritania		Namibia		New Zealand
Moldova		Panama		Norway
Mozambique		Paraguay		Portugal
Nepal		Peru		Puerto Rico
Nicaragua		Romania		Singapore
Nigeria		Serbia		Slovak Rep
Pakistan		South Africa		Africa
Rwanda		Suriname		Slovenia
Senegal		Swaziland		Spain
Sierra Leone		Thailand		Sweden
Tajikistan		Timor-Leste		Switzerland
Tanzania		Ukraine		Taiwan, China
Uganda				UAE
Vietnam				UK
Yemen				USA
Zambia				
Zimbabwe				

Georgia in GCI: Value & Rank

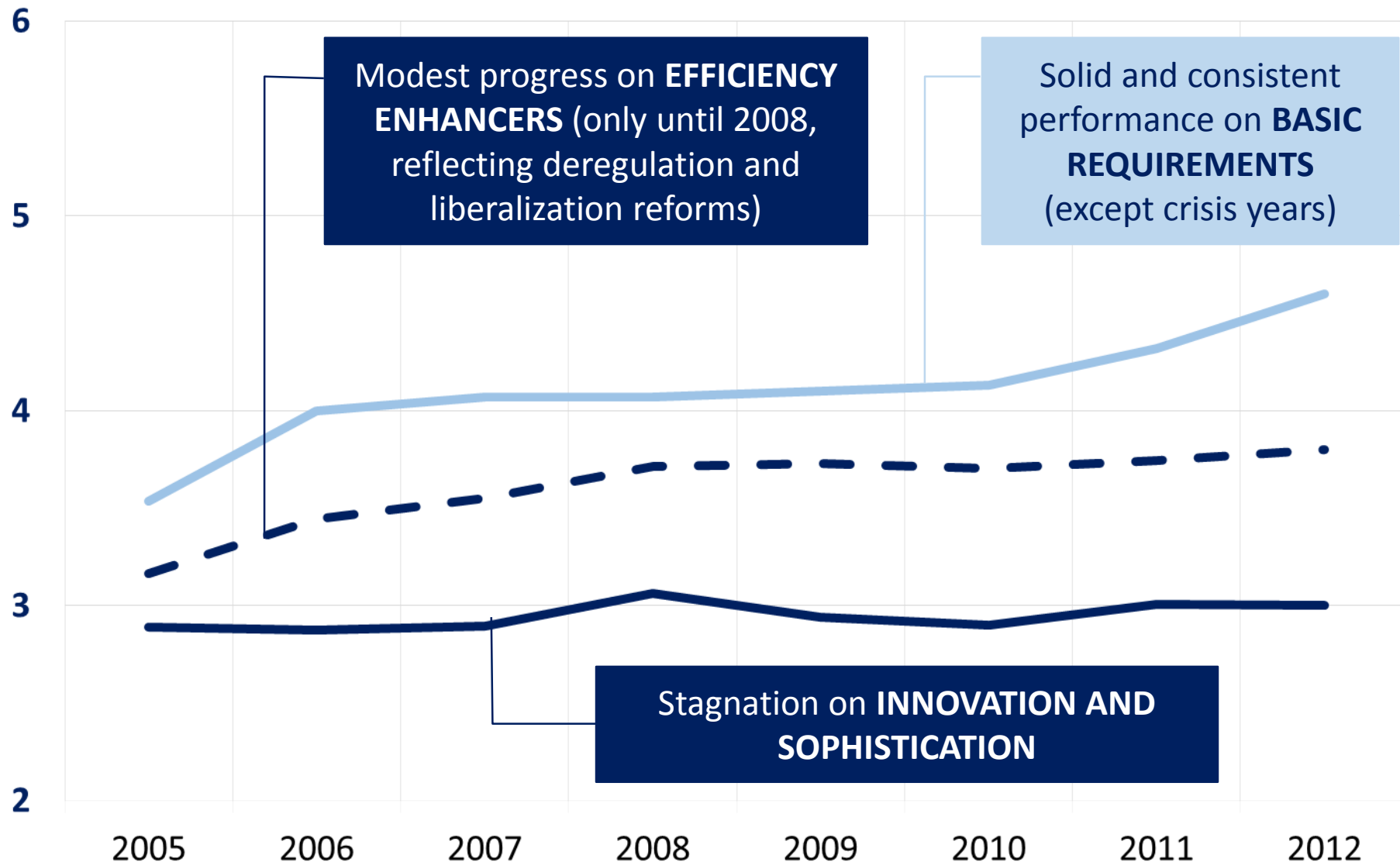


- Georgia first appeared in GCR in 2005
- In 2006, Georgia was named as #1 reformer in the world by the World Bank Doing business survey



* Red lines represent averages

OPENING THE BLACK BOX: UNEVEN PROGRESS ON GCI SUB-INDICES



A CRITICAL LOOK AT 2011/2012 COMPETITIVENESS PERFORMANCE

Progress **from 88th to 77th** position, joining the club of efficiency-driven economies, however it is mostly explained by:

- A one time jump in MACROECONOMIC ENVIRONMENT pillar (from 137 to 88)
- favorable changes in the set of GCI indicators (exclusion of the **interest rate spread** indicator, addition of **mobile broadband** indicator).

PERFORMANCE REALLY A MIXED BAG WHEN LOOKING AT THE VARIANCE WITHIN EACH PILLAR

- highest within the GOODS MARKET EFFICIENCY pillar:
 - ✓ #2 in number of days to start a business, #11 in total tax rate, and #13 in burden of customs
 - ✓ #141 in quality of anti-monopoly regulation, #127 in intensity of local competition
- And within the INSTITUTIONS pillar
 - ✓ #9 in burden of government regulation
 - ✓ #131 in property rights protection

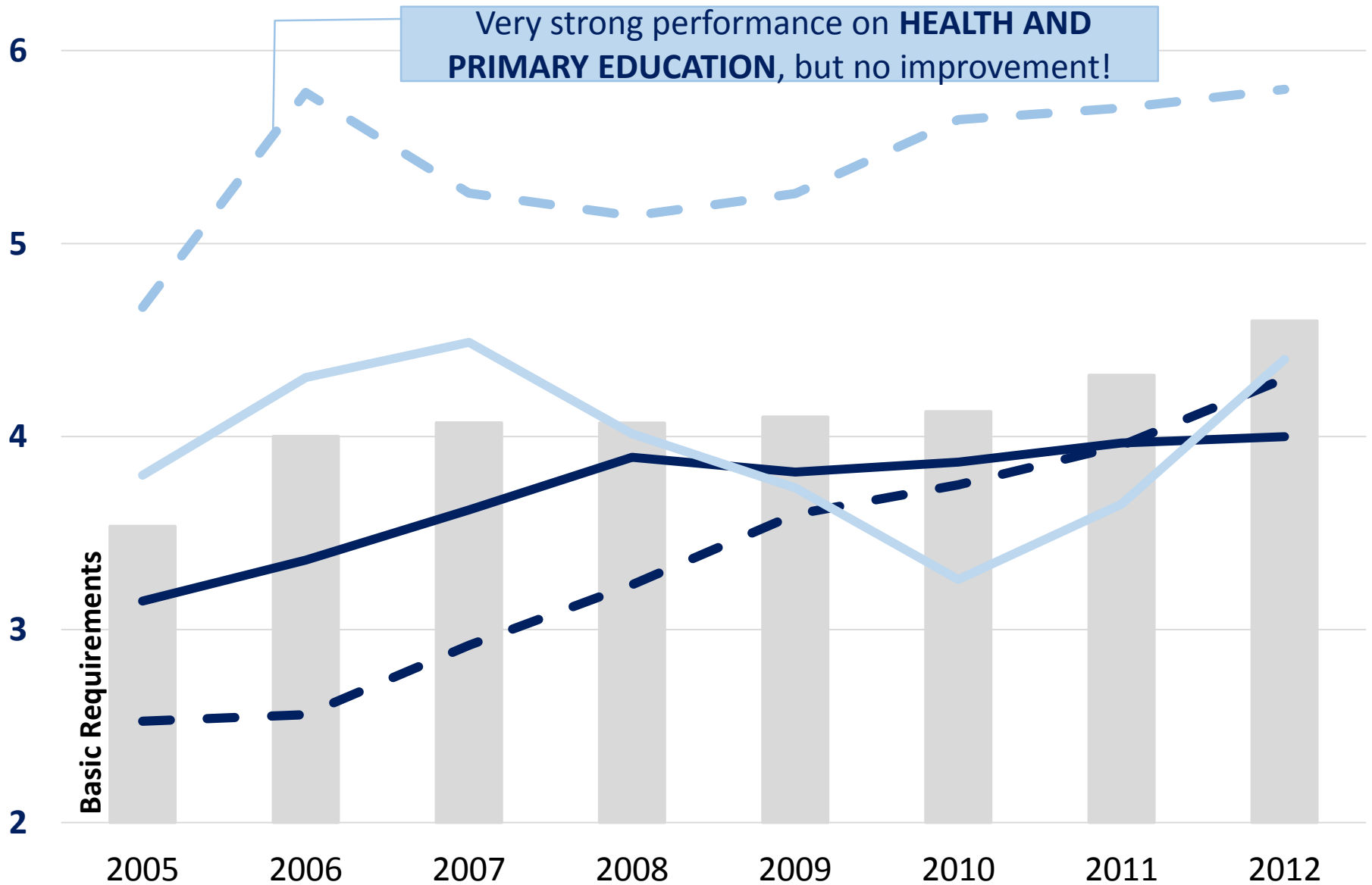
SUMMARY OF PROGRESS TO-DATE:

- The first round of law & order, anti-corruption, liberalization and deregulation reforms cleaned the slate for future development until 2008. However:
- Barring very recent improvement in the MACROECONOMIC ENVIRONMENT pillar, Georgia stopped progressing in the overall GCI rank after 2008.
- Continued improvements in infrastructure but there was regress or stagnation in many other indicators, including INSTITUTIONS – possibly the main achievement of the Saakashvili administration

SUMMARY OF PROGRESS TO-DATE:

- Business environment is liberal but DOING BUSINESS is difficult for objective reasons (small market size, lack of reliable suppliers).
- These problems should not be compounded by (PERCEPTIONS OF) ANTI-COMPETITIVE PRACTICES, FAVORITISM IN DECISIONS OF GOVERNMENT OFFICIALS, and OVERLY COMPLIANT JUDICIARY.
- Investors in “ELECTIONS PAUSE” – FDI fizzled out in the course of 2012 since political uncertainty aggravated problems with rule of law and property rights protection, broadly defined.

LOOKING INSIDE BASIC REQUIREMENTS



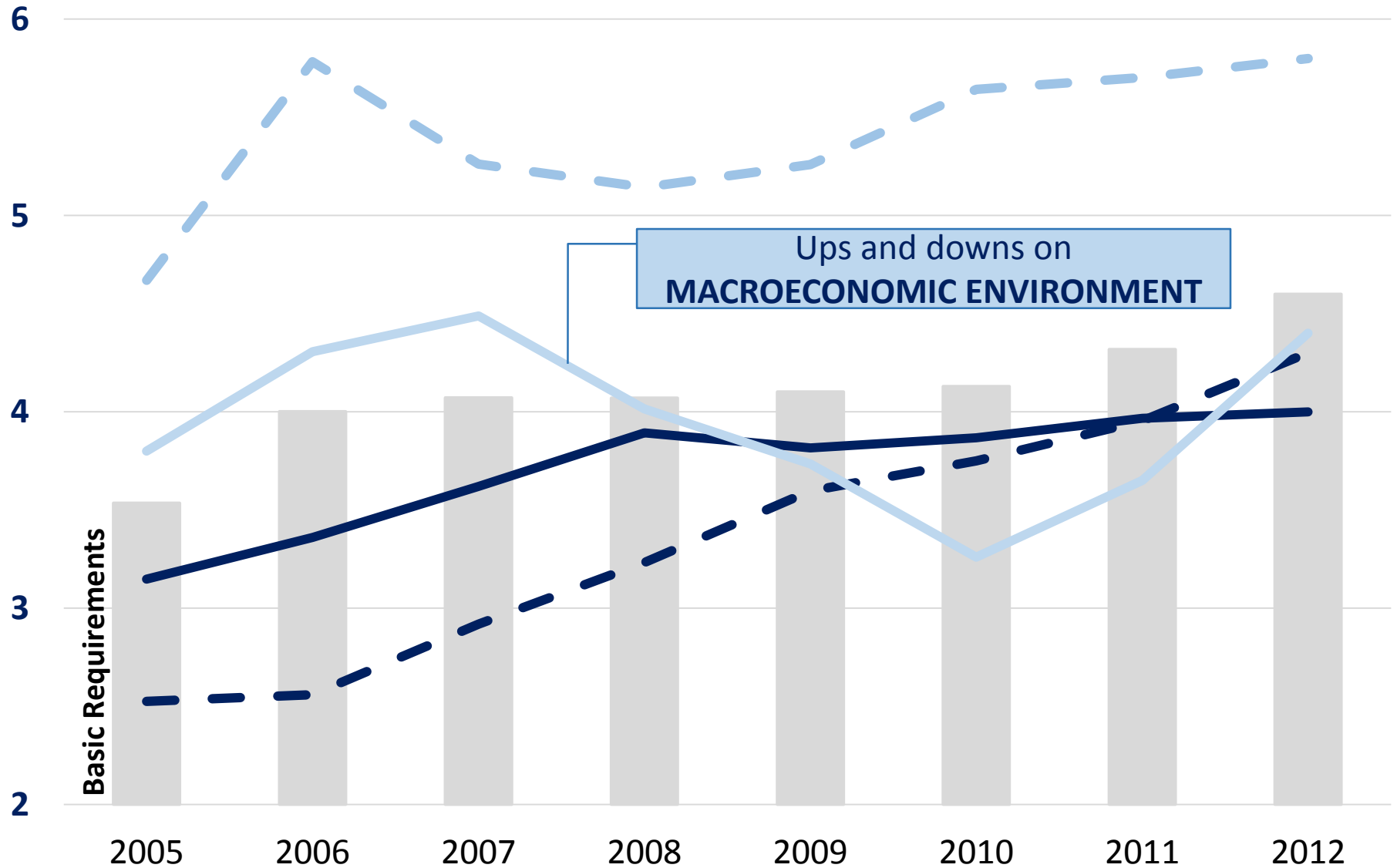
FUTURE REFORM AGENDA

HEALTHCARE AND PRIMARY EDUCATION pillar:

Relatively high level of performance but no progress

- a. Improve access to healthcare service beyond the category of the very poor
- b. Consider out-of-the-box solution to improve the quality of primary schooling outside Tbilisi,
- c. including improved access to pre-school education

LOOKING INSIDE BASIC REQUIREMENTS



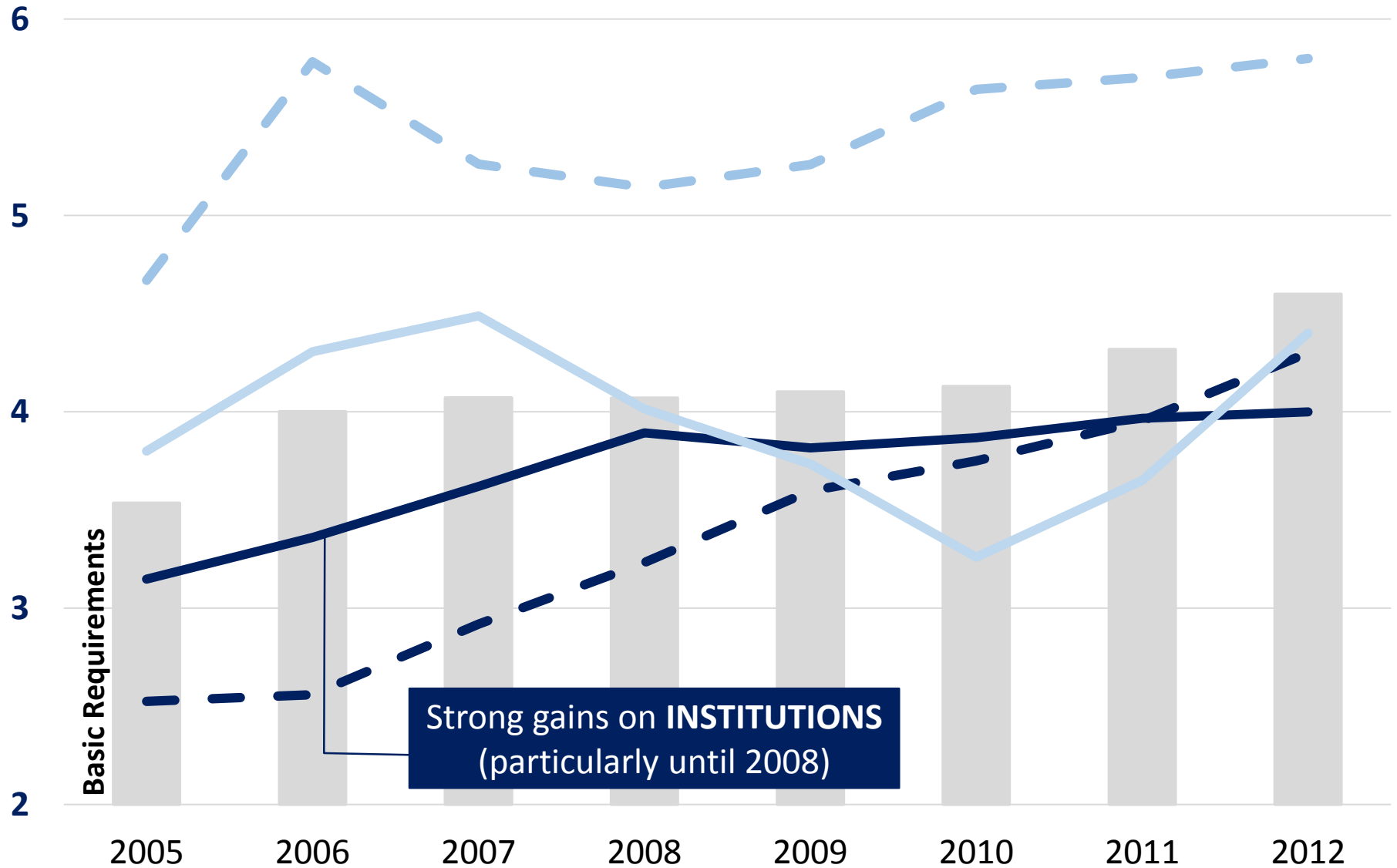
FUTURE REFORM AGENDA

MACROECONOMICS pillar:

Macroeconomic policy has been prudent in the past. Stability has to be maintained (strikes and labor protest, populist fiscal measures are serious threats).

- a. Prioritize reforms reducing the cost of financing (via country credit ratings (#91))
- b. Improve employment in the official economy, raise productivity in agriculture so as to induce a more equitable income distribution, improve demand conditions (domestic market size - #96) and savings (#122)

LOOKING INSIDE BASIC REQUIREMENTS



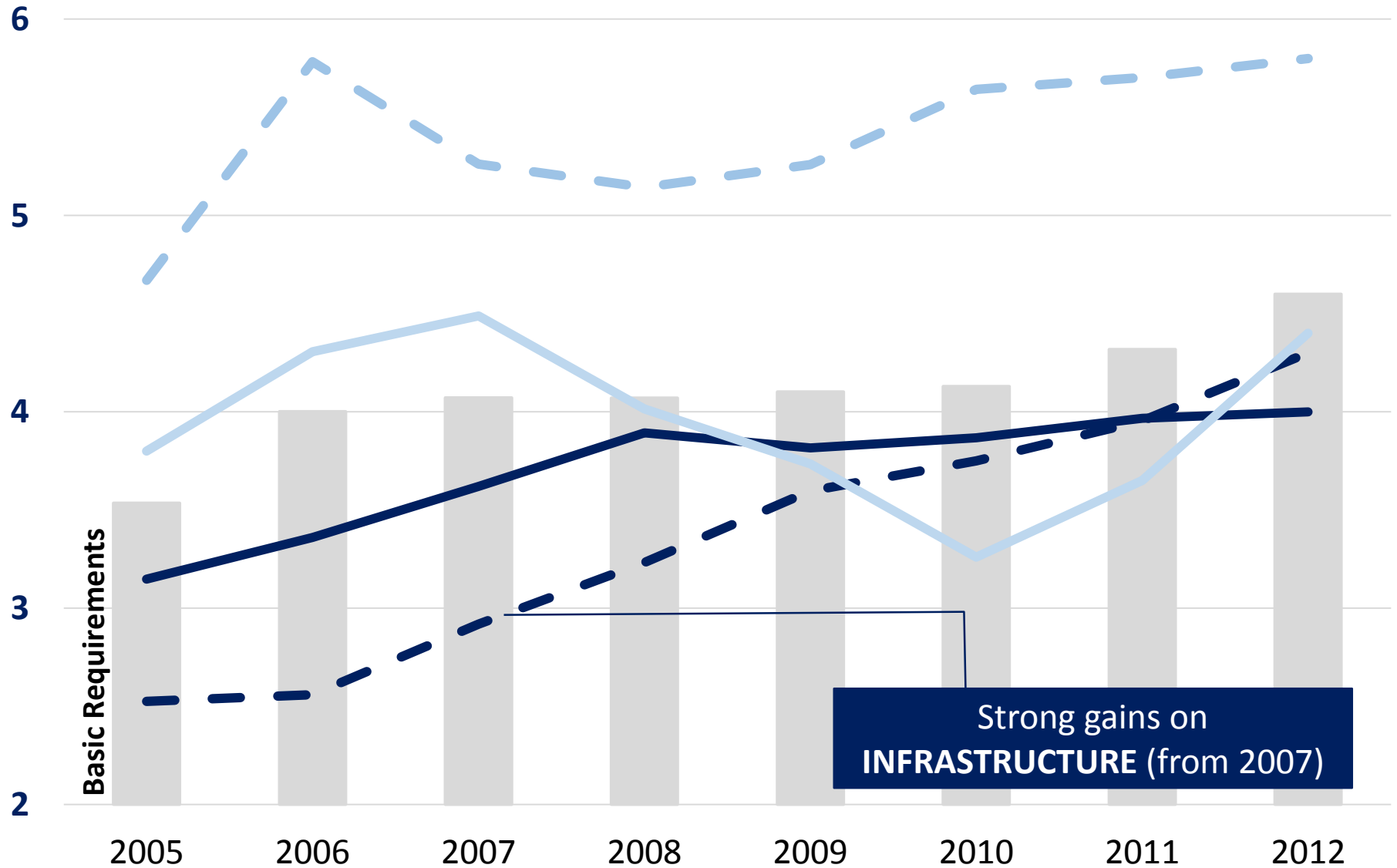
FUTURE REFORM AGENDA

INSTITUTIONS pillar:

- a. judicial independence (current rank #95)
- b. efficiency of the legal framework in challenging the legality of government actions and/or regulations (#106)
- c. property rights protection (#131)

(Consistent with statements by Minister Tsulukiani, reports by American Bar Association, analysis by Babych and Fuenfzig)

LOOKING INSIDE BASIC REQUIREMENTS



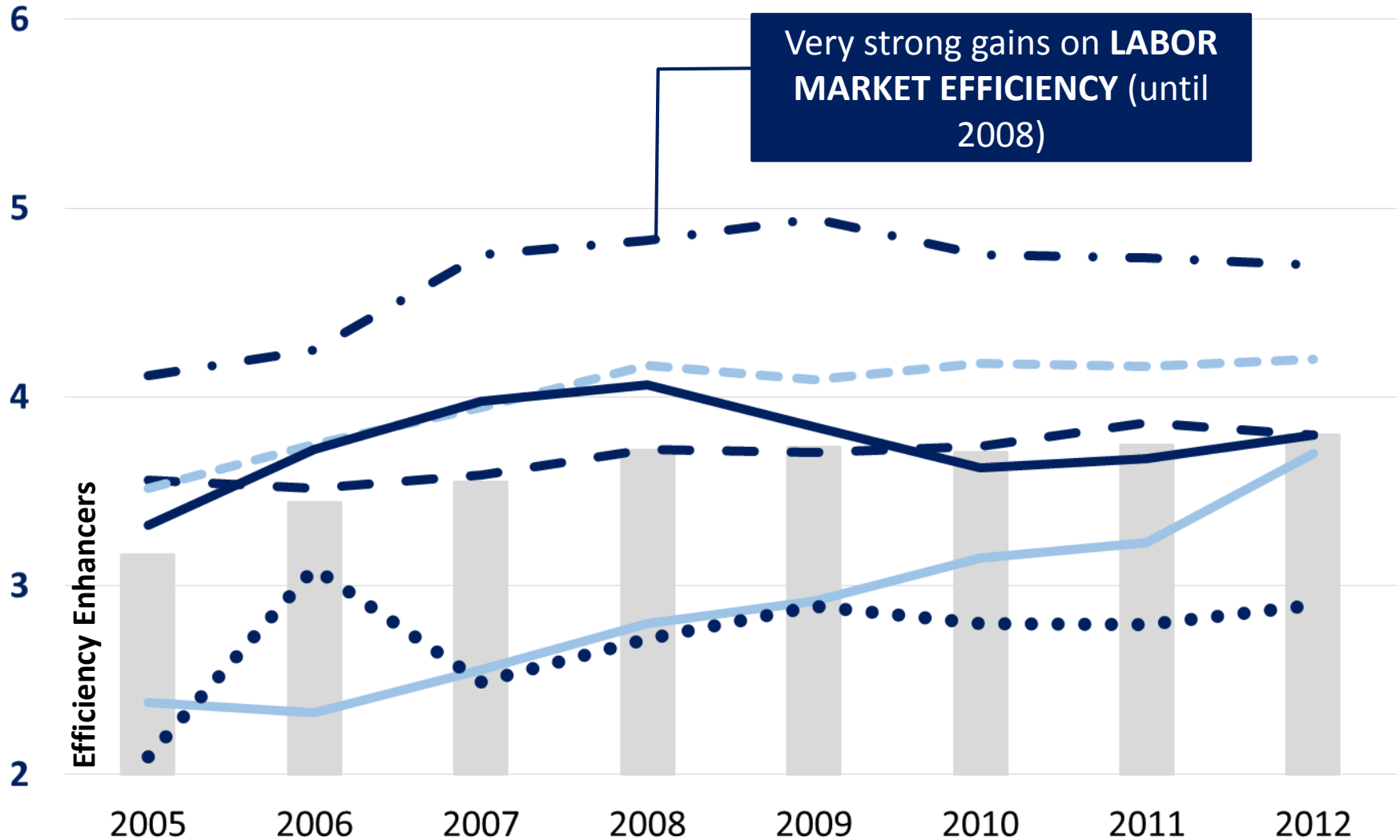
FUTURE REFORM AGENDA

INFRASTRUCTURE pillar:

- a. Past improvement very impressive (#93 to #53), particularly electricity supply (111 to 46)
- b. Complete ongoing investment projects in transport and logistics infrastructure which has spillovers to all sectors of the economy
- c. Continue to upgrade international electricity transmission and oil and gas pipeline infrastructure

LOOKING INSIDE EFFICIENCY ENHANCERS

Huge variance in performance on different pillars: leading the world in labor market efficiency, tailing on market size



FUTURE REFORM AGENDA

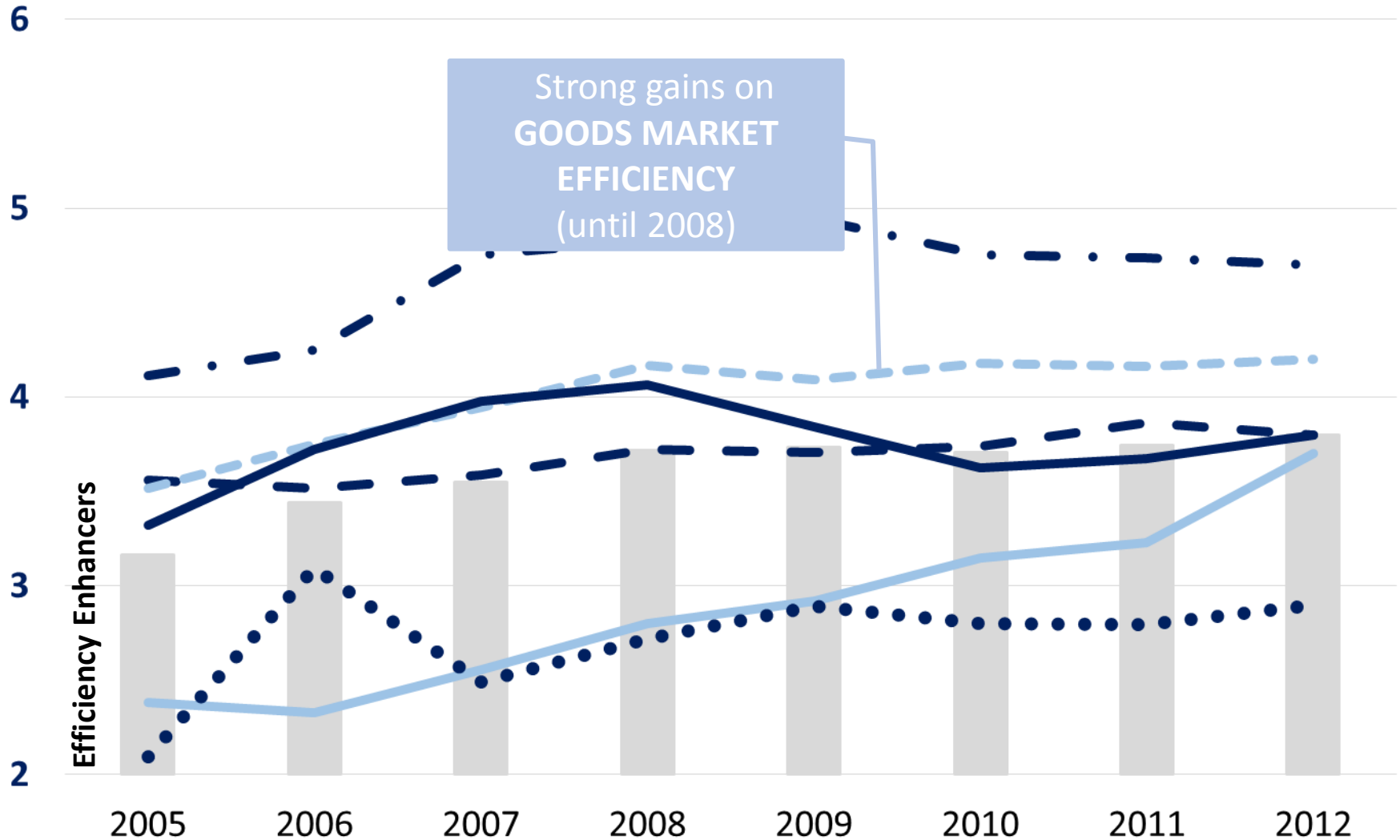
LABOR MARKET EFFICIENCY pillar:

Georgia is a global leader in the ease of hiring and firing practices and redundancy costs (#9 and 13).

- a. Need to safeguard these achievements while amending the labor code. Measures like minimum wage requirement and very strict firing regulations may backfire (hurting the poorest)
- b. Advance in small steps and evaluate impact

LOOKING INSIDE EFFICIENCY ENHANCERS

Huge variance in performance on different pillars: leading the world in labor market efficiency, tailing on market size



FUTURE REFORM AGENDA

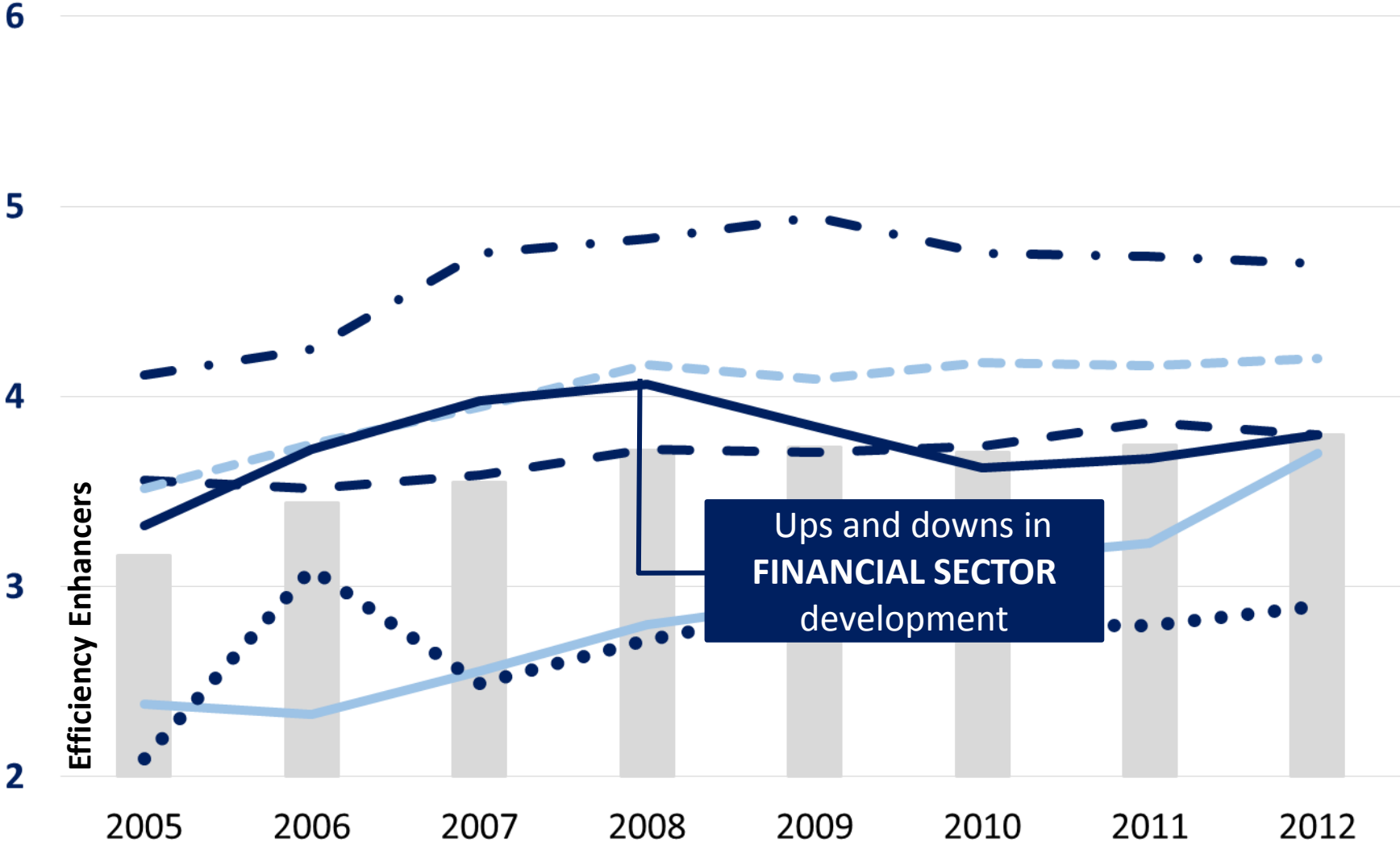
GOODS MARKET EFFICIENCY pillar:

Excellent progress on trade liberalization, and reduction of the tax burden and compliance costs for businesses.

- a. Need to exercise care in maintaining the liberal framework while implementing an effective but not overly draconic anti-monopoly policy (current rank #141). Competition (#127), given small market size, is likely to remain limited, however.
- b. Ensure level playing field among businesses (extent of market dominance currently #121).

LOOKING INSIDE EFFICIENCY ENHANCERS

Huge variance in performance on different pillars: leading the world in labor market efficiency, tailing on market size



FUTURE REFORM AGENDA

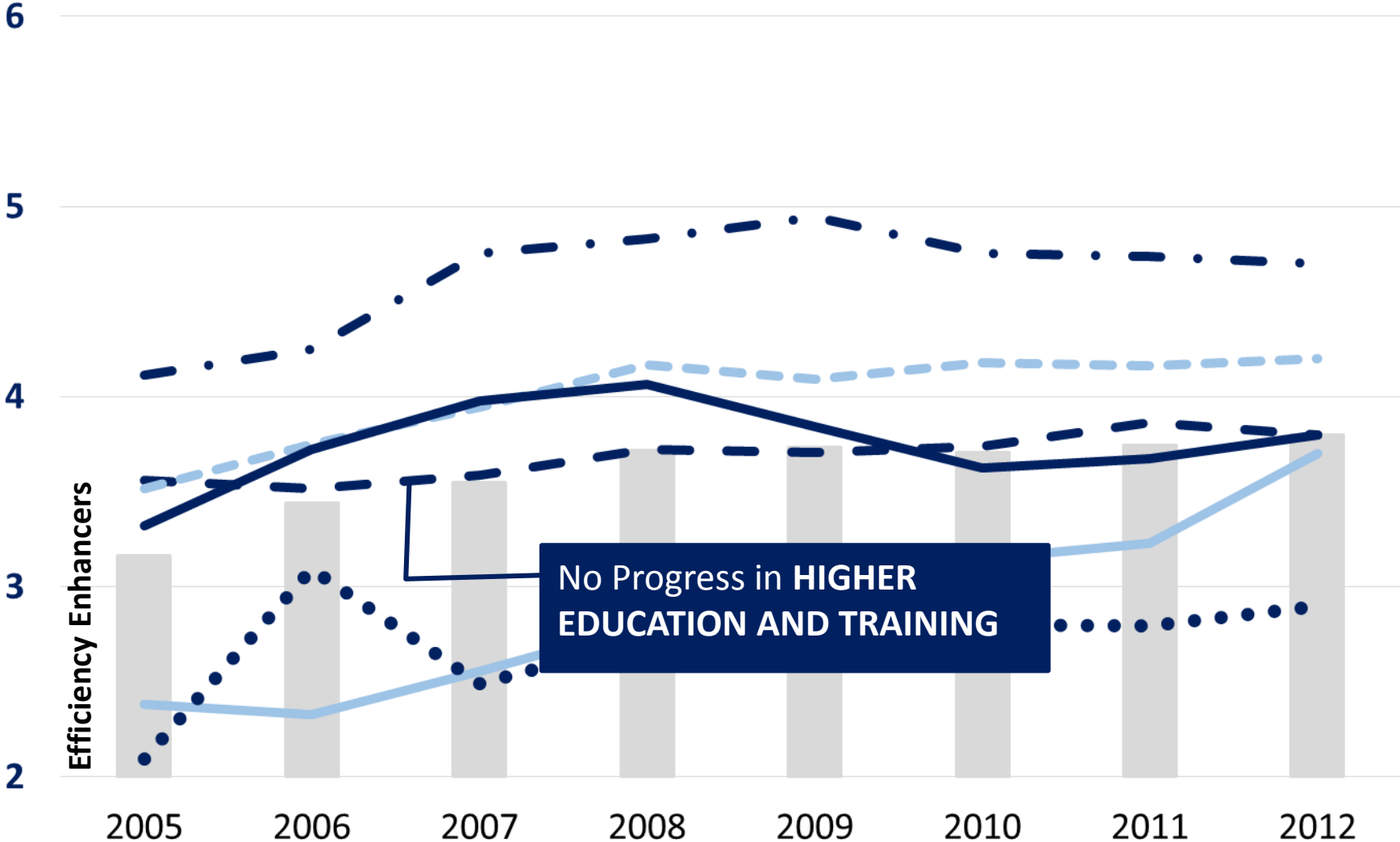
FINANCIAL MARKET EFFICIENCY pillar:

The banking system is sound, competitive and well capitalized. Other elements of the system (insurance, local equity market, etc.) remain underdeveloped.

- a. Implement measures to improve access to loans (#93) and reduce lending interest rates
- b. Encourage private savings
- c. Expand the range of available services

LOOKING INSIDE EFFICIENCY ENHANCERS

Huge variance in performance on different pillars: leading the world in labor market efficiency, tailing on market size



FUTURE REFORM AGENDA

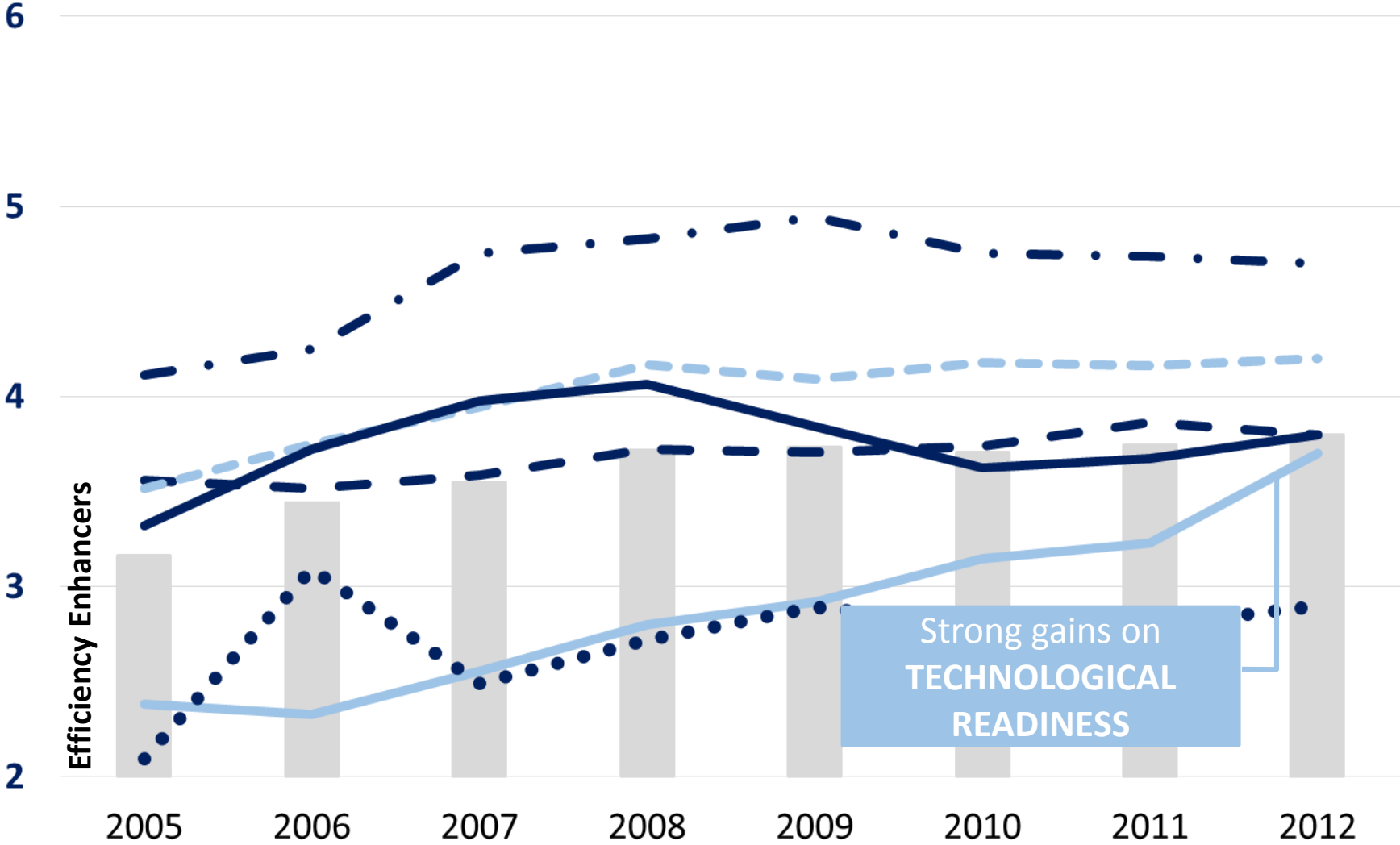
HIGHER EDUCATION AND TRAINING pillar:

Successful anti-corruption reforms, including the national exam, more rigorous university accreditation, but no notable improvements in quality.

- a. Target labor market mismatch through training
- b. Prioritize technical education and vocational training through government scholarships and (maybe) public-private partnerships involving university departments.

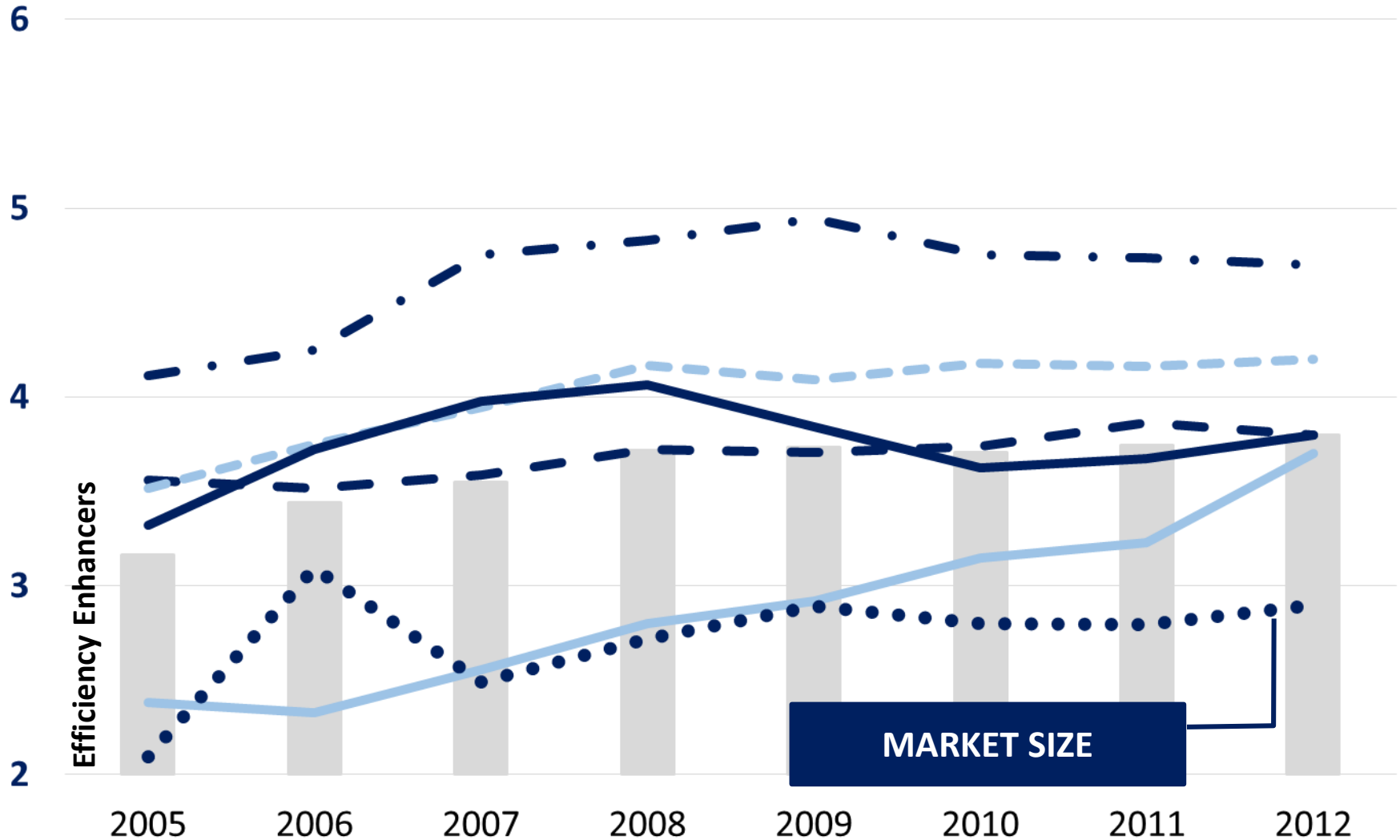
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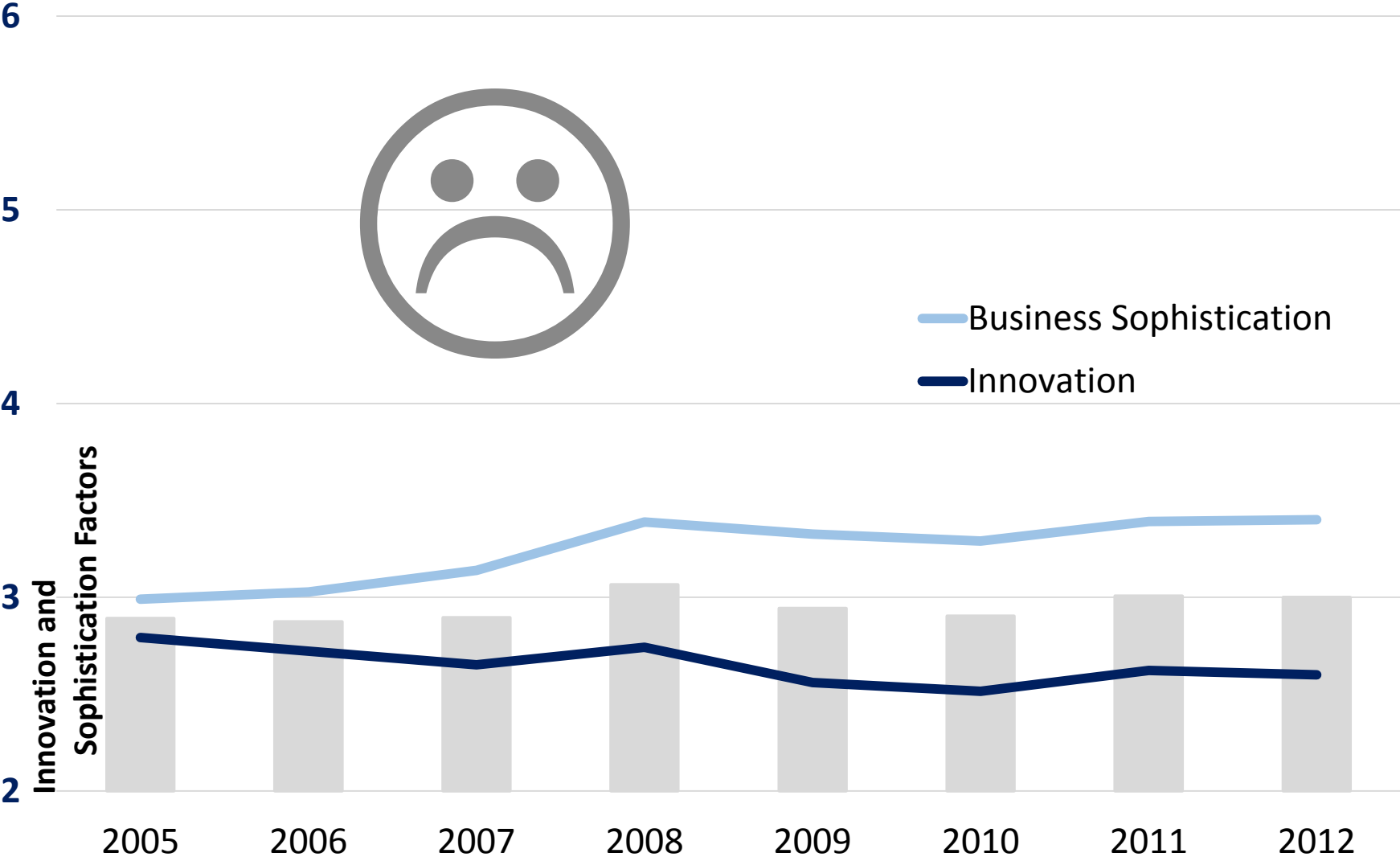


LOOKING INSIDE EFFICIENCY ENHANCERS

Huge variance in performance on different pillars: leading the world in labor market efficiency, tailing on market size



LOOKING INSIDE INNOVATION AND SOPHISTICATION FACTORS



FUTURE REFORM AGENDA

MARKET SIZE, BUSINESS SOPHISTICATION AND INNOVATION pillars:

Future progress on these pillars brings us to the topic of the last chapter in our report – Georgia’s potential as a regional hub economy.

Chapter 3

GEORGIA AS A MULTI-SECTOR REGIONAL HUB

OUTLINE OF THE TALK

- **Social planner on a shoestring**
 - Low TFP, spillovers and coordination failures
 - Policy response to coordination failures
 - Reduction of tax burden and transaction costs
 - The criterion for public spending
- **Review of sectoral strategies**
 - Agriculture and agribusiness sector
 - Tourism and Hospitality
 - Hydroelectric power generation
- **Transport and trade logistics**
 - TRACECA and the Caucasus Transit Corridor
 - Georgia's potential as a trade logistics hub
 - Pharmaceuticals
 - Hub prospects

EXTERNALITIES

- Reminder: TFP growth
- *external economies* or
productivity spillovers
 - If not internalized, depress output, investment and growth
even in ideal world with perfect institutions and
without macroeconomic or political risk

EXTERNAL ECONOMIES

- Economies of scale – powerful engines of growth
- Examples: Silicone valley, Qiaotou, “chair triangle” in Udine
- Require coordination if effects are external to private parties

EXTERNAL ECONOMIES

- Complementarity of physical capital and human capital
- Frictional labor market
- Examples of simultaneous investment later in the talk (HPPs and power transmission lines)

EXTERNAL ECONOMIES

- May be external to a sector, an area, or the world
- Externalities may be internalized
 - Private associations
 - State
 - International coordinating bodies (Kyoto protocol vs. OPEC)
- If not — coordination failure

POLICY RESPONSE TO COORDINATION FAILURES

- Subsidy or public investment
- But: beware of private manipulation
- E.g. solar industry in Europe

EXPORT SUBSIDY TO GAIN MARKET SHARE

- Manipulation by export sector by overinvestment in capacity
- It may be better to join a Free Trade Agreement, like WTO

EXPORT PROMOTION POLICIES

- State export promotion expenditures have no effect on probability of exporting
 - export grants may encourage exporting firms to produce more,
 - do not encourage non-exporters to start exporting

FRUGAL SOCIAL PLANNER

- Bureaucrats have no information advantage
 - huge subsidies can create big industries
 - but the cost may exceed the benefit
- Can't subsidize activity across the board
- Public funding is scarce
- Even if credit is available,
public debt damages credit ratings and causes
higher capital costs

FIGHTING EXTERNALITIES

- Start with reforms that cost no or little money
 - Reducing the tax burden
 - Reducing tariffs and non-tariff trade barriers
 - Establishing Free Industrial Zones
 - Establishing international agreements
 - GSP, GSP+, MFN within WTO, DCFTA
 - Providing Free Warehouse Company status
 - Reducing compliance and transaction costs
 - Simplifying customs clearance procedures

CRITERION FOR PUBLIC SPENDING

- Reduction in trade and transaction costs may not be enough to kick-start investment
- Public money commitment may be required, but where?
- Addressing externalities at the broadest national level
 - *weigh magnitude of externality against the risk of failure*

AGRICULTURE AND AGRIBUSINESS

- Sector provides social safety net to subsistence farmers
- Very fragmented, low productivity, ripe with externalities
- But private sector may help coordinate activity
 - HIPP, Carrefour, and Ferrero Rocher
 - Aggregators guarantee demand, offer technical assistance, provide training, enforce standards

SOCIAL RISK

- Cannot let the private sector deal with the coordination failures alone
- Time is scarce and social risk may create negative spillovers on the rest of the economy
- Goal: promote rural development and agriculture

POLICY TOOLS (+)

- Build strategic transportation infrastructure
- Use international mechanisms to improve market access
- Sector-specific policies:
 - vaccination programs, prevention, monitoring and control of animal and plant diseases
 - education and training
 - extension centers
 - through a public-private partnership (USAID's EPI project)
 - irrigation and drainage

POLICY TOOLS (-)

- It is important to abstain from some policies
 - export promotion
 - price supports
 - subsidized credit campaigns that create arbitrage
 - babysitting farmer cooperatives (Nikozi)
 - provide disincentives through free lunch

TOURISM AND HOSPITALITY

- Scale effects and threshold effects
 - transport and tourist amenities
 - minimum number of daily users for a ski lift
 - minimum number of beds to engage major travel agency
 - staff training programs
 - water supply and sewage systems

POLICY

- Target spillover sources with broadest possible footprint
 - affordable, frequent and direct flights
 - upgrading railways
 - local roads and signs
- But note that a lot of spillovers are sectors specific and can be internalized privately

HYDROELECTRIC POWER GENERATION

- externality in investment decisions that require coordination:
 - transmission lines (esp. to Turkish grid)
guaranteed access to the regional markets
 - building of new HPPs
- Chosen approach
 - public investment into the transmission infrastructure
(funded by EBRD, EIB, EU NIF, KfW)
 - liaising with Turkish authorities

HYDROELECTRIC POWER GENERATION

- But:
 - HPPs offered to investors on Build-Operate-Own (BOO) basis, hence extract natural rent
 - Hardly any economy-wide spillovers

TRANSPORT AND TRADE LOGISTICS

- Strategic location on the crossroads between Europe, Central Asia, and the Far East
- Political situation in the region
- TRACECA



- **RAILWAYS**
- **PORTS**
- **LOGISTICS**

RAILWAYS

- Baku- Tbilisi- Kars Railway project
- Modernization and upgrades in Central Georgia
- Tbilisi bypass project

PORTS

- Poti:
 - shallow draft imposes restrictions on vessel sizes
 - low off-dock capacity for container storage
- Batumi
 - no refrigerated storage facilities
- Aktau, Turkmenbashi, Baku
 - infrastructural, regulatory and logistical issues
 - insufficient ferries in the Caspian
 - corruption
 - the “last mile” from Aktau

PORTS

- Poti
 - dredging
 - \$100 million in constructing new container and bulk cargo terminals
 - should reduce total cost of maritime portion by 40-50%
- Lazika (uncertain)
 - construction costs in the region of \$600mIn to \$900mIn

LOGISTICS

- In 2012, 7% of Georgia's GDP and 3% of employment
- Few modern warehouses
- Warehouse management systems lacking
- Lack of cold storage facilities
- Lack of skilled human resources
- 72000 empty containers making return trips

LOGISTICS

- Tbilisi Logistics Center linking with Tbilisi Railway Bypass
- Direct connections to Poti, Batumi; Azerbaijan and Armenia; East-West highway
- 26 to 38 million USD invested, led by Swiss Global Logistics Investment AG.
- Competitor: Tegeta Motors in partnership with Gebruder Weiss

HUB POTENTIAL

- Georgia manufactures no cars, yet car exports 25% of total exports in 2012
 - efficient customs administration and low compliance costs
 - seed investment into central logistics facility
 - Low potential for spillovers or long-term comparative advantage

PHARMACEUTICALS

- Light regulation makes it easy for wholesalers to import and export
- regulator does not require additional certification for new drugs
- 2009 fiscal reform eliminated VAT or customs duties
- main export markets are Kazakhstan, Ukraine, Azerbaijan and Armenia
- AversiPharma to make GEL 7 mln investment in new lab

HUB PROSPECTS

- Tunnel under the Bosphorus Strait: new rail corridor from Caspian Sea to Europe
- North-South rail corridor from Russia to Turkey
- But Georgia is only part of CTC
 - resolve regulatory problems in Azerbaijan and Kazakhstan
 - coordinate with Azerbaijan to add ferries on Caspian sea routes
- Turkmenistan and Uzbekistan interested in Navoi-Turkmenbashi-BTK link

CONCLUSIONS AND RECOMMENDATIONS (I)

Interventions need to address three main areas:

1. **The socio-political externality.** Options are:

- a) Raise productivity in agriculture (promote cooperation and integration of smallholder farmers into value chains; reduce the cost of capital, invest in public infrastructure and export facilitation)
- b) Reform vocational education and implement training programs in partnership with the private sector to deal with the labor market mismatch and youth unemployment
- c) Expand healthcare coverage beyond the “very poor”
- d) Increase pension benefits above subsistence level

IMPACT: *Increased transfers (c,d) defuse the risk of social unrest, reduce risk premia, but slow down growth. Options (a) and (b) also increase labor force available to the official economy, boosting production and domestic market size*

CONCLUSIONS AND RECOMMENDATIONS (II)

2. External economies of scale. Options are:

- a) Continue to improve transport and trade logistics infrastructure, sea and air connectivity
- b) Deepen trade integration within the region (reduce non-tariff barriers), Russia and the EU (DCFTA)
- c) Improve international coordination related to the promotion of TRACECA

IMPACT: *Increase in external market size, improved supplier quality, spillovers to all other sectors of the economy*

CONCLUSIONS AND RECOMMENDATIONS (II)

3. Market-friendly institutions. Options are:

- a) Ensure judicial independence and better property rights protection
- b) Maintain labor market flexibility while implementing changes in the tax law
- c) Maintain low regulatory burden while introducing the new competition law

IMPACT: Reduced risks and costs for foreign and domestic investors, increase in capital investment and productivity growth