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2020 Deliverables: How Strong is Strong Enough for Georgian Economy?

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EXECUTIVE SUMMARY

In 2016, the EU and the EaP countries agreed on an ambitious agenda to deliver strengthened economies by 2020. In line with this agenda, Georgia has developed an institutional and regulatory framework as foreseen by the Deliverables and has attracted mostly positive marks for its progress on reaching the 2020 Targets. However, in practice, the operational environment for the new regulatory frameworks remains weak and the country struggles to reap the benefits of aligning its laws with the EU. As a result, despite the significant progress Georgia has achieved within the EU's Eastern Partnership (EaP), its bilateral cooperation with the EU as set out in the EU-Georgia Association Agreement (AA) and the Deep and Comprehensive Free Trade Area (DCFTA), the Georgian economy still faces a number of systemic problems and remains fragile to regional and global shocks. This policy paper reviews the progress made by Georgia on delivering economic strengthening by 2020 and puts forward actionable policy recommendations for Georgia, as well as for the EU.

Key words: Georgia, economy, DCFTA, Association agreement, trade, digital market.

In 2016, within the Eastern Partnership (EaP) the EU and the partner countries agreed on “20 Deliverables for 2020”. This acted as a work plan for the EaP countries to achieve concrete results by 2020. Having a “Stronger Economy” was defined as one of the four priority areas implying improvements in the investment and business environment, growth of small and medium-sized enterprises (SMEs), improving access to finance, creating new job opportunities, harmonising digital markets and boosting trade flows among the EaP countries and the EU.

Among the six EaP countries, Georgia has attracted mostly positive marks on its progress on the Deliverables, including the ones on strengthen the economy, and was labelled as the best-performing country on several occasions (Maragos 2019). However, despite developing a legal and institutional framework as foreseen by Deliverables 2020, Georgia’s economy still faces a number of systemic problems and remains fragile to regional and global shocks. Even though prior to the outbreak of the pandemic the country had stable GDP growth at around 4% annually, access to finance remains problematic, particularly for SMEs; around half of the employed labour force is self-employed and at regional level employment records hardly any improvements; the country faces immense digital inequality and trade flows with the EU are stagnating. Although Georgia benefits from the EU-Georgia DCFTA and other cooperation frameworks put forward by its association with the EU, reaping the full benefits of the AA and the DCFTA remains challenging.

This policy paper reviews the progress made by Georgia to achieve the targets of “Deliverables 2020” on strengthening the economy and puts forward actionable policy recommendations for Georgia as well as for the EU.

INVESTMENT AND BUSINESS ENVIRONMENT, ACCESS TO FINANCE AND SMES

Georgia has made significant progress in terms of improving its business environment, that is well reflected in Georgia’s international ratings, including in the World Bank’s Ease of Doing Business 2020, which lists Georgia as the seventh best in the world. Yet, the Georgian economy remains sensitive to global shocks and political instability in the region. The Georgian Lari has been devalued sharply since 2015 and the share of domestic credit in the private sector continues to be the highest across the whole region: while most of the EaP countries keep their lending levels under 40%,^[1] Georgia’s lending level reaches 70% (World Bank Indicators 2019). Moreover, access to long-term low-cost finance remains challenging due to the underdeveloped capital market. In January 2019, a state-run contributory pension scheme was introduced, however, there is still little trust from the public in the fund as there is no clear strategy in place on investment possibilities and profitable use of the funds (Tsimakuridze 2020).

SMEs are the backbone of Georgian economy, presenting 99.7% of Georgian enterprises, providing 64% of business sector employment and sourcing 61% of value added (SME Policy Index 2020). As foreseen by Deliverable N5, Georgia has adopted a SME Development Strategy and Action-Plan 2016-2020 and established public agencies to support the growth of SMEs.^[2]

[1] Except Armenia where the lending level is under 60%.

[2] Enterprise Georgia, the Agricultural and Rural Development Agency (ARDA) and the Georgian Innovation and Technology Agency (GITA) operating under the authority of the Ministry of the Economy and Sustainable Development.

06 As a result, for SMEs' market access and uptake of business development services, Georgia scores the highest across the whole region (SME Policy Index 2020). However, SMEs in Georgia are mostly concentrated in low-value-added sectors, such as wholesale and retail trade, are not well integrated into the global value chains and suffer from low productivity growth. In addition, their access to finance remains problematic, mostly for two reasons. Firstly, SMEs cannot provide sufficient collateral. For instance, SMEs in agricultural sectors cannot show their assets as their land is not registered and the ones which can present their assets usually do not meet the threshold level of collateral requirements. Secondly, access to finance remains very expensive, as Georgia continues to charge one of the highest interest rates among developing countries. In fact, interest rates are so high on loans denominated in Georgian Lari, that SMEs have an incentive to take loans in foreign currencies as they offer lower interest rates (Tsimakuridze 2020). Yet, the ongoing devaluation of the Georgian Lari makes borrowing in foreign currencies unfavourable on currency conversion.

The country has gained important benefits from EU funded projects. For instance, the European Neighbourhood Programme for Agriculture and Rural Development (ENPARD) has helped to establish 1200 cooperatives and 59 information and consultation centres for farmers throughout the country and Horizon 2020 has made available loans worth €130 for microenterprises and farmers. However, the Georgian government does not have in place any monitoring and evaluation system to assess either the outcomes of the EU programs or any of the domestic policies implemented in the country.

NEW JOB OPPORTUNITIES AT LOCAL AND REGIONAL LEVEL

In line with Deliverable N6 Georgia has committed to defining smart specialisation strategies for economic modernisation and to implementing a plan for local economic development, but the country has not yet fulfilled its commitments. However, it is promising that with the EU's support the country is currently working on the elaboration of strategies and qualitative studies on regional and national smart specialisation. After some delays due to the outbreak of the pandemic, more progress is expected by 2021.[3]

Even though the unemployment rate has been slowly decreasing over the past decade, according to the International Labour Organisation unemployment in Georgia stands at 15%, which is the second worst in the whole EaP region after Armenia and more than twice as high as the EU average (6%) (World Bank 2019). Overall, 62.9% of the Georgian population are economically active out of which only half are hired while the other half are self-employed, mostly on small-scale trade and small agricultural farms. Unemployment among youth is particularly high: every third person (29.6%) of age group 20-24 and every fifth person (20.8%) of the age group 25-29 is unemployed. As a result, educated young workers try to migrate to higher income countries, while the less motivated young graduates first join the unemployed then after a while stop looking for a job and become marginalised from the labour market (Akhvlediani and Emerson 2020). Informal employment is as high as 35% and every fifth person lives under the absolute poverty line (Kardava 2020).

The country benefited from EU programmes through Local Action Groups, which have supported 360 local development initiatives and improved employment conditions for over 1,000 households in rural areas. However, by 2020 most of the employment still occurs in in the country's capital and a huge disparity remains across the regions in terms of the economic development. In almost all regions, around two thirds of employed people are self-employed, compared to the capital where only half of the employed workforce is self-employed. Self-employment is even higher in villages, where around 70-80% of population are self-employed. As tangible improvements in employment are hardly observed, unemployment remains the most commonly cited pressing problem in Georgia (ECORYS, Annual Survey Report Georgia 2019).

[3] Phone interview and internal reports of the Ministry of Foreign Affairs of Georgia.

Deliverables 2020 put forward ambitious targets on harmonizing digital markets among the EaP countries and with the EU. Although, this agenda delivered substantial results, the 2020 targets turned out to be too ambitious as many of them have not yet been met by the EaP countries. For instance, not in place are EaP-wide platforms and harmonized legislation for eHealth, eCommerce, eCustoms, eDelivery and eLogistics. Neither are the Digital Transport Corridors (DTC) between the Baltic and the Black Seas yet established. Major progress has been recorded in setting up the Regional Roaming and Spectrum Areas, however, and joint roadmaps are put forward and the Regional Roaming and Spectrum Agreements (RRA and RSA) are expected to be signed in early 2021.

While the EaP-wide RRA is not yet signed, the country has concluded bilateral Memorandum of Understanding (MoUs) on the Reduction of Roaming Tariffs with Latvia and Lithuania,[4] which nicely complement the visa-free travel of Georgian citizens in the Schengen Area. The country has also made significant progress in providing digital public services and scores the second best across the region in eGovernance (UN E-Government Survey 2020). Another area where Georgia achieved 2020 targets is on digital signatures. [5] The country has approximated the EU legislation on electronic signatures and seals, which should facilitate Georgia's eTrade with the EaP and the EU and should also help Georgian companies to participate in tenders and EU funding grants online (Akhvlediani 2019). This legislative approximation goes beyond Georgia's commitments under the AA and thus complements and enhances Georgia's Association process with the EU.

In line with Deliverable N7 and the provisions of the AA (Articles 104-113, 324-327 and Annex XV-B), Georgia has implemented a number of legislative changes (into the Law on Electronic Communications) and in 2018 even amended its Constitution with a provision stating that everyone has the right to access and freely use the internet (amendments to the Article 17 of the Constitution of Georgia). However, in practice, access to the internet remains problematic as the digital infrastructure is still very poor in Georgia. By July 2020 one in five households had no access to the internet, and in 2019 only one fourth (26%) of Georgian companies used a DSL connection, and only one fifth (19.5%) used broadband Internet through mobile phones and laptops (World Bank and Geostat, 2019). In addition, internet penetration is very uneven throughout the country due to underdeveloped internet infrastructure across the regions: in Racha-Lechkhumi and Kvemo Svaneti the penetration rate stands as low as 15%, while the internet penetration exceeds 100% in Tbilisi (125.7%) and in Adjara (124%). The country has introduced a new National Strategy and Action Plan for the Development of Broadband Networks for 2020-2025, which aims at providing 99% 4G coverage throughout the country. Thanks to the EaP-wide programme EU4Digital,[6] the World Bank has already approved the sum of \$40 mln to construct broadband infrastructure in a pilot region. However, around \$600 million is still needed to meet the targets of the new national strategy (estimates of the World Bank).

Similarly to the situation with the underdeveloped digital infrastructure, digital literacy also remains low in the country. One third (38%) of Georgian households do not own a computer, and around half of the population (47%) do not have the basic knowledge to use computers (Caucasus Barometer 2019). For instance, among the main purposes cited for Internet use, nearly everyone (95%) uses the Internet for social media, while only one in seven (14%) looks for jobs online and one in six (17%) installs software and programmes other than gaming applications (Geostat 2020). As low digital literacy is coupled with a high presence on social media, the Georgian population remains highly exposed to disinformation. Notwithstanding such gaps in digital skills, the country is behind schedule in setting up a national coalition for digital skills and jobs as foreseen by Deliverable N7, and falls behind Armenia and Ukraine, which have already established such coalitions.

[4] Letter N 4314-გ-20-17-2-202012280956 from the Georgian National Communications Commission, as a response to my inquiry.

[5] Georgia has adopted the law "On Electronic Document and Electronic Trust Services" and the laws on electronic document exchanges with the government and the Qualified Electronic Signature and Seal, in line with the EU's eIDAS Regulation No 910/2014.

[6] EU4Digital – Broadband strategies in the EaP region (2018-2020), a project implemented by the World Bank to support Eastern Partner countries in developing and implementing national broadband strategies.

08 Georgia has done its homework better in cybersecurity. In line with the 2020 targets, Georgia has in place a Computer Emergency Response Team (CERT) and the country ranked as the 9th best in Europe and the 18th best in the world, according to the Global Cybersecurity Index (GCI) 2018.[7] Among the EaP countries, Georgia is also the most advanced in the approximation of the EU's legislation on cybersecurity (Directive on Network and Information Security (NIS), Directive (EU) 2016/1148). However, despite Georgia's significant achievements, the country's access to EU cybersecurity bodies remains limited. Georgia has already expressed its interest in enhancing cooperation on cyber matters with the EU on several occasions (for instance in its contribution to the Eastern Partnership structured consultation) and now it is up to the EU's will to improve Georgia's access to its cybersecurity bodies and networks. Bilateral cooperation on cyber between the two parties should also improve after the timely enforcement of the bilateral agreement between the EU and Georgia "on the security procedures for exchanging and protecting of classified information" signed in 2016.

TRADE

In line with Deliverable N8 Georgia has introduced a new customs code aligned with the EU's new Union Customs Code, a fully-fledged E-procurement system and an Authorised Economic Operator (AEO). The country is now working on a new Dispute Resolution Board and consultations are also ongoing on the recognition agreement with the AEOs of Turkey.[8] Yet, market surveillance remains weak and Georgia is not yet a signatory of the Agreement on Conformity Assessment and Acceptance of Industrial Products (ACAA), foreseen by 2020 Targets. The latter can be justified as the benefits of joining the ACAA would be modest given Georgia's limited industrial exports to the EU and constraints on Georgia's industrial imports from the third countries, including cheap imports from China and the CIS countries. Instead, Georgia could accelerate the implementation of the Convention on a common transit procedure to further simplify formalities in trade.

The country made significant progress in legislative approximation of the EU acquis in sanitary and phytosanitary measures (SPS) and technical barriers to trade (TBT). So far nearly half of the SPS measures listed in the DCFTA have been adopted and 98% of registered standards in Georgia are already European and international. In 2017, Georgia also became authorised to export four new groups of animal origin to the EU market. As a result, the number of Georgian companies exporting to the EU has increased by 46% in 2014-2019.[9] But the number of exporting companies is still low and roughly amounts to 800, which is only 0.6% of the total number of Georgian enterprises (SME Policy Index for Eastern Partners, 2020).

Overall, Georgian exports as well as imports with the EU have been growing, however the EU share in Georgia's trade in 2019 was mostly the same as in 2014. In particular, the EU's share in Georgia's exports remained the same (at around 21.8%), whereas the EU's share in total Georgian imports even declined slightly (from 27.8% in 2014 to 25.61% in 2019).

There are no significant structural changes observed in the data, either, other than the lost EU market for Georgian hazelnuts. Georgia used to export large amounts of hazelnuts to the EU, yet, in 2018-2019 the invasion of the brown marmorated stink bug caused exports to drop by 69% and Turkey's cheaper hazelnut supply overtook Georgian exports to the EU market.

[7] The Index is developed by the International Telecommunication Union (ITU) on the basis of legal, technical, organisational, capacity building and cooperation measures of the countries.

[8] Throughout this process the country benefited importantly from the EU and OCED programmes aiming to improve the governance (Twinning, SIGMA).

[9] As of November 2020, reported at the EaP platform 2 meeting dedicated to the Economic Development and Market Opportunities.

09 Georgia had to redirect its hazelnut exports to Russia. Other than this, Georgia keeps exporting low value-added goods, mainly raw materials, to the EU and exports remain concentrated on few EU partners. For instance, in 2019, one third of Georgia's exports (34%) were sent to Bulgaria and one fifth to Romania (21%) (Eurostat 2020). The other traditional Georgian exports, such as wines, spirits and mineral waters, saw some increase, but the overall volumes remain small. Imports from the EU remain large and mainly contain industrial goods, with Germany being the main supplier. Yet, from the EU's perspective, imports as well as exports with Georgia remain of very small importance as the trade with Georgia fluctuates at only around 0.1% of the EU's total external trade (European Commission 2018).

Georgia's trade with the EaP is more balanced, as the country's exports and imports with EaP partners are roughly the same in value terms (Gogolashvili 2020). Yet, as with the EU, Georgia keeps exporting low value-added goods to its EaP neighbours, including re-exports of motor vehicles to Armenia and Azerbaijan, which take up a large share in Georgian exports.

In 2014-2018, foreign direct investments (FDIs) from the EaP were mostly sourced from Azerbaijan, which was the largest FDI provider for Georgia through the Azerbaijan-Georgia-Turkey gas pipeline project. FDIs from the EU increased by 18.2% in 2015-2018 compared to 2011-2014. Although, as in trade, the EU share in the total Georgian FDIs decreased a little from 43.6% to 40%. The EU investments were mainly made in the gas pipeline and construction sectors, which are not directly related to the DCFTA. Thus, the EU-Georgia DCFTA has not yet had direct implications on the FDI dynamics in Georgia (Kovziridze 2020).

CONCLUSIONS AND RECOMMENDATIONS

Georgia has made significant progress in developing an institutional and regulatory framework for a stronger economy as foreseen by the Deliverables for 2020. The country has improved its business environment, introduced a new customs code and a fully-fledged eProcurement system, worked hard to reduce technical barriers to trade, developed strong eGovernance and digital services and progressed importantly in building cybersecurity. A few setbacks are observed in establishing the national coalition for digital skills and jobs and implementing smart specialisation strategies for modernisation and development of local economies. However, these delays, together with other hold-ups in Deliverables on digital markets, go hand in hand with the lack of the progress throughout the whole region. This indicates that some of the 2020 Targets have turned out to be too ambitious for EaP states, including Georgia.

However, implementing Deliverables does not directly produce a stronger economy in Georgia as the operational environment for the new institutional and legal framework remains weak. In particular, despite the launching of several dedicated programmes and agencies, SMEs hardly access finance, operate at low productivity and struggle to grow and integrate in the global value chains. In terms of employment, the country is the second worst in the EaP region, most employment is still created in the capital and progress at the regional level can hardly be seen. Georgia made more progress in developing strong eGovernance and cyber capacity. Yet, digital literacy among the population remains low, the country still faces a huge digital divide and its access to the EU cybersecurity bodies remains limited. Neither does Georgia seem to reap the full benefits of the DCFTA with the EU: growth in trade with the EU is slowing, the country keeps exporting goods with low added-value, mostly raw materials, to both the EU and the EaP, and the DCFTA does not seem to have direct implications on the FDI dynamics in Georgia.

10 In brief, Georgia's economy still remains weak and fragile, yet EaP policy is not to blame for this: while implementing Deliverables helped Georgia to set strong foundations for a stronger economy, it is still up to Georgia to implement the economic policy that is needed in the country. To make use of the foundations set up by Deliverables for 2020, Georgia needs to:

- Develop capital market and increase availability and access to low-cost long-term finance.
- Improve SMEs' access to finance, create a national credit guarantee fund for SMEs, lower or subsidize interest rates on loans and provide alternative sources of financing other than loans. To help improve SMEs productivity, more investments are needed in upscaling their digital and financial literacy.
- Conduct more in-depth research to study systemic problems of unemployment at regional level and speed up developing and implementing strategies for smart specialisation and economic modernisation, foreseen by Deliverable N6.
- Devote more funding to upgrading the skills of the labour force through intensive training and vocational education, particularly among unemployed and economically inactive youth. Targeted programmes should be put in place to form bridges between universities and vocational schools and the private sector.
- Develop internet infrastructure and bridge the digital divide throughout the country. More investments should be made in upgrading the digital skills of the population through intensive training programmes and targeted projects. Georgia also needs to speed up establishing a national coalition for digital skills and jobs as foreseen by Deliverable N7.
- Show more interest in developing digital corridors between the Baltic and Black Seas. Setting up such e-corridors will let Georgia reap the benefits of its progress in digitalisation and eGovernance and will help to strengthen business-to-business links with the Baltic States, two other DCFTA states and the EU.
- Identify the main constraints that Georgian enterprises face to grow and start exporting to the EU as well as to the EaP and develop special export-support programmes for them.
- Continue working on reducing technical barriers to trade and accelerate joining the EU-promoted conventions related to customs, trade facilitation and transit of goods.

The new EaP policy put forward by the EU on March 18, (2020) corresponds to Georgia's needs as it puts emphasis on the digital transformation, green economies and youth entrepreneurship, along with the full implementation of the DCFTAs. Georgia, therefore, needs to show more interest in enhancing cooperation with the EU in these areas, while the EU should respond better to Georgia's, as well as the other EaP states' willingness and readiness to commit to more ambitious agendas. Deliverables 2020 have already set foundations for stronger economies, now more attention should be devoted to the implementation of the proposed policies. In addition to this:

- The EU should incorporate Georgia and other interested EaP states in its new agendas on green deal, digital single market and sustainable recovery plans from the pandemic.
- As the SMEs represent the backbones of the EaP economies, the EU should devote more funds to promoting the growth of SMEs in Georgia and the EaP countries, including via the European Investment Fund (EIF), and the InnovFin SME Guarantee.
- Given Georgia's progress in cybersecurity, the EU should make its cybersecurity bodies more accessible to Georgia, including the EU CSIRT community, EU Agency for Cybersecurity (ENISA) and the European Centre of Excellence for Countering Hybrid Threats (Hybrid CoE).
- To better monitor the progress on deliverables, the EU could incorporate Georgia and the other EaP countries in several EU-wide statistical reviews, such as, EU's Social Policy Progress Index (EU-SPI) and Digital Economy and Society Index (DESI).

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