World Academy of Science, Engineering and Technology
International Journal of Economics and Management Engineering
Vol:13, No:4, 2019

An Overview of Georgia's Economic Growth Since 2012: Current Status, Challenges, and Opportunities for Future Development

V. Benidze

***Abstract*—**After the Rose Revolution of 2003, Georgia has achieved an unparalleled socioeconomic success. However, economic growth since 2012 has been sluggish and certainly not enough to rapidly improve the county's standard of living that still remains substantially low compared to that in developed nations. Recent poor economic performance has shown that some key challenges need to be addressed if Georgia is to achieve high future economic growth that will decrease the poverty rate and create a middle class in the country. This paper offers in detail analysis of the economic performance of Georgia since 2012 and identifies key challenges facing the country's economy. The main challenge going forward will be transforming Georgia from a consumption-driven to a production-oriented economy. It is identified that mobilizing domestic investment through savings, attracting foreign investment in tradable sectors and expanding the country's export base will be crucial in the facilitation of the above-mentioned structural transformation. As the outcome of the research, the paper suggests a strategy for accelerating Georgia' future economic growth and offers recommendations based on the relevant conclusions.

***Keywords*—**Challenges, development, economic growth, economic policy, Georgia.

I. Introduction

In November of 2003, after the "Rose Revolution", Georgia's newly elected government faced serious social, economic and political problems. Since then, Georgia has implemented free-market reforms, eliminated corruption, significantly reduced red tape, cracked down on criminals, resolved a fiscal crisis, implemented business-friendly economic legislation, strengthened the army and modernized the country's educational system to name a few. The new government was often criticized for its democratic credentials and for ways it carried out these reforms. Nonetheless, GDP per capita more than tripled [1] during 2003-2012 and Georgia took leading positions in popular international rankings, such as the Heritage Foundation's Index of Economic Freedom [2] and World Bank's Ease of Doing Business Report [3]. Despite these advances, poverty and unemployment, which in 2012 stood at 30% and 17.2%, respectively [4], still remained major issues facing the country's economy. This signaled the need for major structural changes in the years to come.

In 2012, the newly elected government, led by the Georgian Dream Coalition, made a promise to further modernize country's economy, generate high economic growth, and drastically reduce unemployment and poverty. To build on the success of its predecessor, the newly elected government had to implement major structural changes in the economy so that growth would be felt by all sections of the population. The adoption of the "Social-Economic Development Strategy of Georgia – Georgia 2020" [5], which stressed the importance of rapid and inclusive economic growth driven by the development of the real sector of the economy, gave a reason for optimism [6]. Unfortunately, the government fell short on its promises. The economic growth in recent years has been sluggish – the Georgian economy grew on average by 3.9% yearly from 2013 to 2018 (see Fig. 1) [7].

While GDP growth alone can only provide a rough image of the economic situation, it is worth noting that for a developing country like Georgia, the average growth of 3.9% is low when considering the "catch-up effect" advantage. Moreover, according to the 2018 National Democratic Institute (NDI) report [8], 62% of citizens believe that the country is going in the wrong direction and feel that their well-being has not improved. In this context, it is important to analyze what fuels economic growth in Georgia and identify key challenges that need to be addressed going forward.

II. Key Challenges Facing Georgia's Economy

The GDP of a country can be calculated using different approaches. The most common one is the expenditure approach, which attempts to calculate GDP by evaluating expenditures incurred in a given period by institutional units that are residents in the economy. Fig. 2 shows Georgia's GDP composition by categories of use for 2010-2017 [7]. It is clear that consumption and government spending have been the main drivers of the economy. This combined with the fact that the trade deficit still remains relatively large, shows that Georgian economy is consumption-oriented, and its productive capacities are underdeveloped. This facet of Georgia's economy is further demonstrated by the substantially low national savings rate, which stood at around 20% of GDP between 2012-2018 [9]. In this regard, the country lags behind not only Europe, but also former Soviet states. Low rate of national savings negatively affects the availability of financial resources, which is particularly important at this stage of development, when economic growth requires significant investments in different directions. Numerous studies have shown that the high national savings rate contributes to the rapid economic growth [10]-[12].

V. Benidze is a Lecturer of Economics at Caucasus University, Tbilisi, Georgia. He is a Ph.D. Candidate in Economics at Iv. Javakhishvili Tbilisi State University (phone: +995-599692222; e-mail: vbenidze@cu.edu.ge).

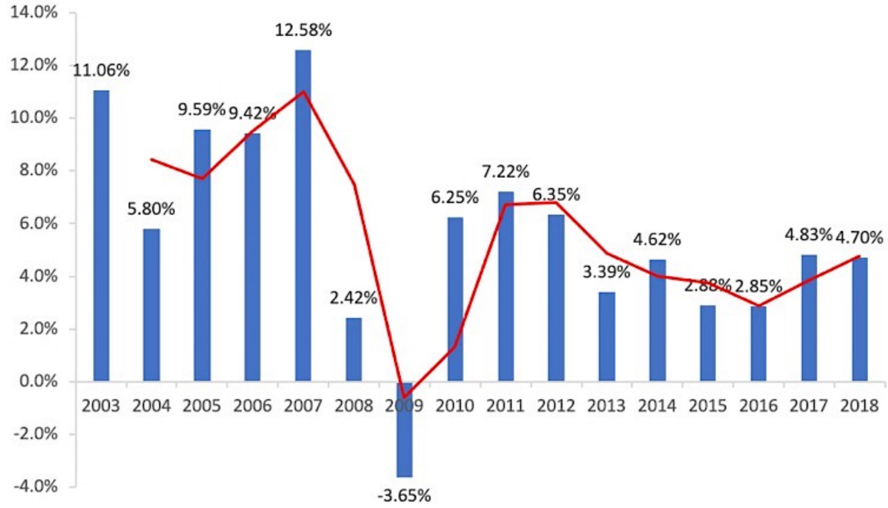

Fig. 1 Growth rate of the real GDP, 2003-2018

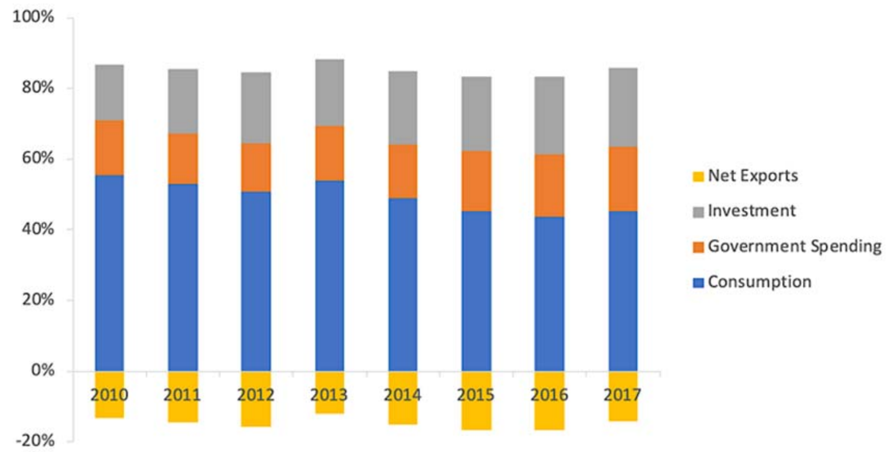

Fig. 2 GDP by categories of use (percent of total)

In order to finance investment, Georgia heavily relied on FDIs over the past few years. More specifically, more than 12% of total investment has been financed through FDIs since 2015 (see Fig. 3) [9]. FDIs are of great importance to Georgia as domestic savings are quite scarce. Despite the fact that FDI tendency in Georgia has been overall positive (see Fig. 4) [13], it is worth noting that, heavy reliance on FDIs is risky for the country due to its geopolitical location and increased competition from other developing countries in attracting FDIs. Sharp decrease after the 2008 global financial crisis and Russia-Georgian war, and the most recent 33% drop in FDIs, are proof of how sensitive they are to both global and local circumstances.

The concentration of FDIs matters too. According to the National Statistics Office of Georgia [13], in 2018, like in previous years, most FDIs were concentrated in the financial, transport, energy, tourism and real estate sectors (see Fig. 5). Such concentration in non-productive, non-tradable sectors will less likely develop the country's real economy and its production capacities, will create fewer jobs and thus have a relatively low impact on the well-being of Georgians [14]. These types of investments, in the case of Georgia, will be less efficient in generating economic growth and stimulating exports [15]. According to the National Bank of Georgia statistics, similar to foreign interest, the majority of local investments have also been concentrated in the financial, transport, energy, tourism and real estate sectors [16]. Excessive development of these non-productive sectors and underdevelopment of the real sector and export-oriented sectors of the economy are the reasons for the persistent trade deficit. The fact that Georgians import 80% of their consumer basket and food basket when almost 45% of workforce is employed in agriculture [17] is alarming and requires further attention.

As a result of such tendency, the Georgian national currency (Lari) has lost 51% of its value against the dollar since 2013. Since the level of dollarization is quite high in the country, depreciation of the Lari increased burden of loans on citizens and the government, put country's financial stability under risk, caused price hikes and reduced overall economic activity. Under these circumstances, improvements in living standards have been unattainable; unemployment still remains high and more than one in every five Georgians lives below the poverty line [18].

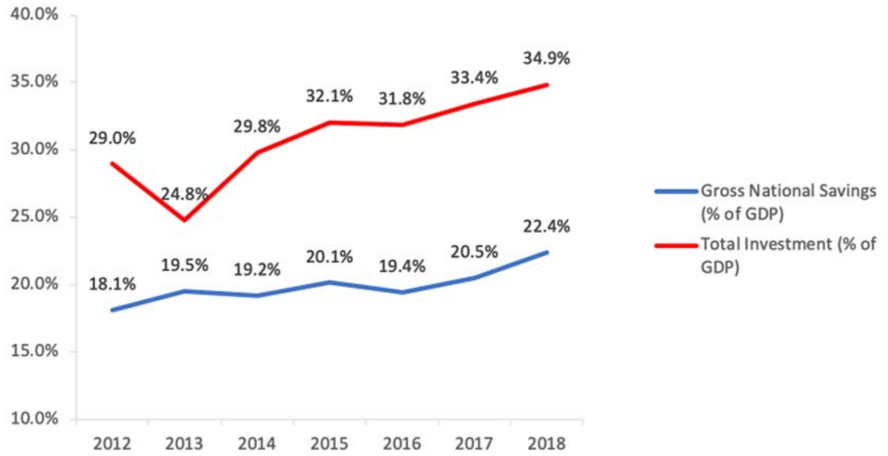

Fig. 3 Gross National Savings & Total Investment (% of GDP)

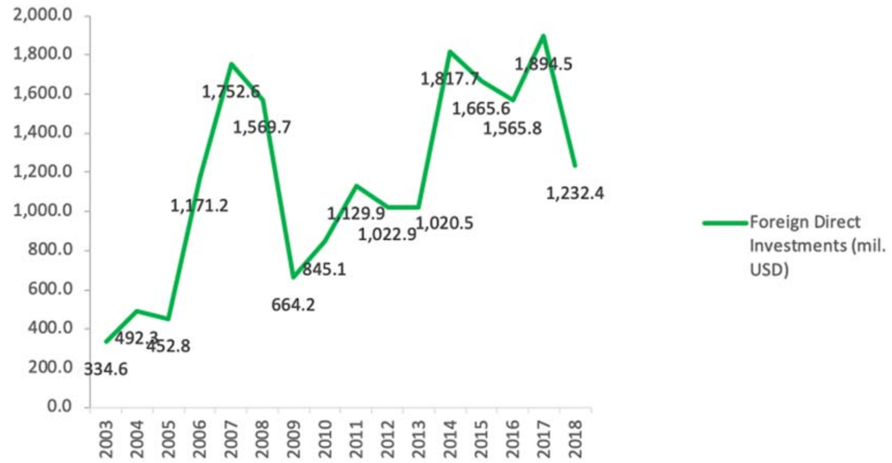

Fig. 4 Amount of Foreign Direct Investment received (million USD)

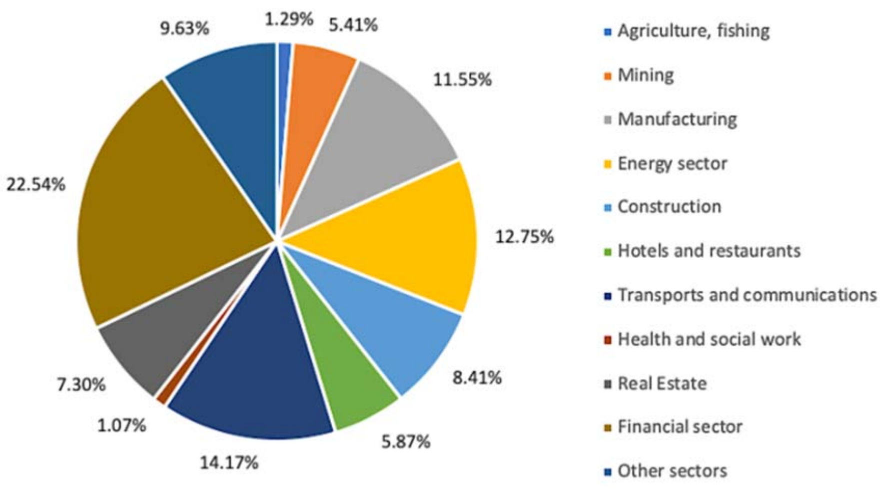

Fig. 5 FDI distribution by economic sectors (2018)

III. Opportunities for Future Development

A. Raise National Savings

Ensuring strong economic growth and a sustainable source of financing for investment will require raising both public and private savings. In order to achieve these goals, the following recommendations are suggested:

- Urbanization is very low in Georgia, as almost half of the population lives in rural areas [19]. People living in rural areas often do not have access to financial services and lack financial literacy, which negatively affects their saving habits [20]. Improving access to financial services and increasing financial literacy of rural population will encourage higher private savings rates.

- The social pension system that Georgia has been using since 1995 relies on government revenues to finance the cost of flat pension benefits. Such system discourages savings and increases the tax burden on taxpayers [21]. In this regard, the introduction of the private pension system by the Ministry of Economy and Sustainable Development of Georgia [22] at the beginning of 2019 is a step in the right direction. Nevertheless, experts and influential NGOs express their concerns over ways the reform has been carried out. The fact that the Pension Agency of Georgia is still searching for qualified employees and accumulated pension funds have not yet been invested [23], raises serious questions as to whether the government was adequately prepared for the reform. Prompt resolution of these issues and further betterment of the pension system will be crucial in improving private savings prospects.
- Raising national saving will require reducing the budget deficit, which in 2018 stood at 3.3% of GDP [24]. Many heavily funded programs are not directed to improve the situation and do not satisfy the basic requirements of program budgeting. In this regard, optimization of social, healthcare and education costs, as well as, reduction in current expenditures will be key.

B. Attract More Quality FDIs

Generating higher rates of economic growth will require a continuous stream of FDI inflow. The shift in sectoral composition of the FDI inflows, and directing them towards productive and tradable sectors, will also play a significant role in contributing to Georgia's economic growth. In this regard, the following recommendations are proposed:

- A favorable business climate is essential for foreign investors. Georgia has achieved tremendous success in this direction over the last 15 years. The country now has low corporate taxes, simplified registration procedures, low barriers to business operations and a corruption-free environment, to name a few [25]. However, problems remain. Precisely, recent reports published by Heritage Foundation and Freedom House, express concerns over the country's judicial effectiveness, rule of law and political stability [26]. As investment decisions of foreign investors are highly affected by the political risks of the recipient country [27], deeper and speedier institutional reforms are necessary to enhance judicial independence and overall democracy of the country. Macroeconomic stability matters too. In this regard, ensuring a strong and stable currency exchange rate will play a key role.
- Economists agree that the impact of infrastructure on foreign direct investment, especially in tradable sectors, is significant [28]. While Georgia has made progress in improving its trade, logistics, and internal infrastructure in recent years, considerable progress is yet to be made to reach the levels of top performers among middle-income countries [29].
- Attracting quality FDIs in tradable and productive sectors requires a skilled workforce. Foreign investors in the tradable sectors value a productive and educated labor force rather than simply a low-cost labor [14]. According to the 2018 Global Competitiveness Report, the most problematic factor of doing business in Georgia is the inadequately educated workforce [30]. To address this issue, strengthening the vocational education system and improving overall education quality will be important. Furthermore, government expenditure on education, which stands at 3.8% of GDP, should be increased alongside the creation of quality-oriented policy [31].

C. Develop Export Potential

Enhancing productivity will be key in achieving high economic growth and improving the living standards of citizens through good job creation. Consequently, the country will need to reorient its economic growth model from consumption-driven to production-driven by capturing new markets and investing heavily in tradable sectors. In this regard the following recommendations are suggested:

- Export-oriented growth will require substantial development of Georgia's small and medium-sized enterprise (SME) sector. As of 2019, out of 726,449 registered business entities, most were SME, yet only 2.9% of small and 15.2% of medium-sized enterprises exported their goods abroad [32]. Corresponding indicators in Europe and Central Asia are 15% and 25.6%, respectively [33]. In order to increase the export potential of the SME sector in Georgia, much of the same problems relating to FDI attraction need to be addressed (see Fig. 6) [30]. In addition, access to finance is a key barrier to SME growth in Georgia, as SMEs are less likely to access external finance and typically face higher costs than larger firms and similar companies in comparable countries [33]. Henceforth, affordable financial recourses should become more available for SMEs through various channels.
- SME sector alone will not be enough to boost export-led economic growth. Recent literature argues that the SME sector needs a large enterprise sector as a source of inputs, the market for its output and also as a source of individual entrepreneurial leadership [34]. Joseph Schumpeter argued that big companies are the best catalyst of innovation [35], which is often vital for transitional economies like Georgia. Unfortunately, large firms in Georgia lack the capacity to innovate and R&D spending (% GDP) as of 2016 was only 0.3%, which is one of the lowest in the world [36]. To address this issue, the creation of industrial policy for large firms is recommended. The primary focus of the policy should be centered on innovation-driven production in order to encourage skills development, boost the growth and manufacture of export-worthy products. Currently, Georgia's export structure is similar to that of low-income countries, where leading export commodities are agricultural products and natural recourses that are very low in value-added (see Fig. 7) [32]. Therefore, the shift

to high value-added exports and knowledge-intensive manufacturing will be key in achieving future prosperity. In this regard, attracting FDIs that can provide scale and expertise will be vital. However, with the current educational level and workforce qualification, prospects seem gloomy. Consequently, the government should be focused on improving the quality of education above all else.

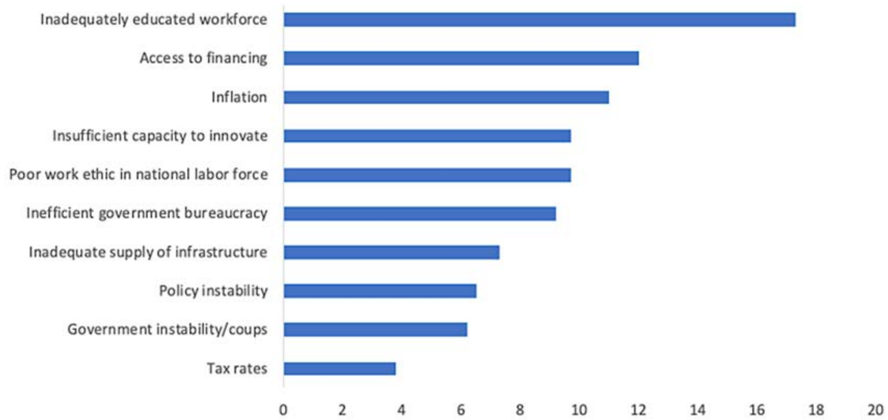

Fig. 6 Most problematic factors for doing business in Georgia (2018)

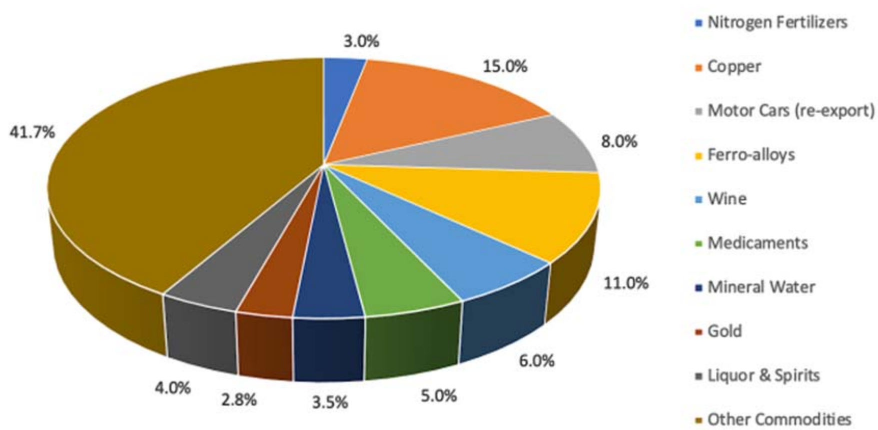

Fig. 7 Georgian exports by commodity groups (2017)

- More than half of Georgia's population live in rural areas and over 45% of country's workforce is employed in agriculture, with added value (% GDP) at only 6.9% in 2017 [37]. Low value added does not represent a problem itself, as most developed countries show a similar trend. However, the fact that 45% of the workforce produces only 6.9% of GDP shows how low the country's agricultural productivity is. Low agricultural productivity and large agricultural employment is one of the main reasons of persistent poverty in the country [38]. Gradual migration of the workforce from rural to urban areas and technology adoption in the sector will be key to raising agricultural productivity and creating shared prosperity.

IV. Conclusion

Based on the analysis of the Georgian economy, key challenges and future growth opportunities were identified. It is clear that the country needs to mobilize investment recourses and transform itself from a consumption-oriented to a production-oriented economy. In this context, raising national savings and attracting larger amounts of quality FDIs will be crucial. Furthermore, both local and foreign investment recourses should be directed towards the productive and export-oriented sectors of the economy in order to increase the country's production capacities. In addition, growth will require development of the SME sector and creation of innovation-driven industrial policy to encourage skills upgrading, stimulate exports and ensure high future economic growth. Steering the Georgian economy into this direction should create a substantial amount of jobs and encourage the sectoral shift of labor from the low productivity agricultural sector to more high value-added ones. This structural transformation will play a critical role in mitigating poverty and creating shared prosperity. Building a better educational system and improving the quality of education, which remains the biggest problem across all areas of economic activity, will be the catalyzing force in the facilitation of this transformation.

REFERENCES

[1] Gross Domestic Product, World Bank Open Data, 2019, data.worldbank.org/indicator/NY.GDP.MKTP.CD?locations=GE.
[2] Rankings & Ease of Doing Business Score, World Bank, 2019, www.doingbusiness.org/en/rankings.
[3] World & Global Economy Rankings on Economic Freedom, The Heritage Foundation, 2019, www.heritage.org/index/ranking.
[4] Unemployment and Poverty, National Statistics Office of Georgia, 2019, http://www.geostat.ge/index.php?action=page&p_id=143&lang=eng
[5] "Social-Economic Development Strategy of Georgia – Georgia 2020" Asian Development Bank, Government of Georgia, 2014, www.adb.org/sites/default/files/linked-documents/cps-geo-2014-2018-sd-01.pdf.
[6] Papava, Vladimer. "Georgia's Economy: From Optimism to Primitivism." SSRN Electronic Journal, 2017, doi:10.2139/ssrn.2939627.
[7] Gross Domestic Product, National Statistics Office of Georgia, 2019, http://www.geostat.ge/index.php?action=page&p_id=119&lang=eng.
[8] "NDI Poll: Heading into the Presidential Election, Georgians Concerned about Country's Direction, Economy, and Environment; Dissatisfied with Political Options." National Democratic Institute, 2018, https://www.ndi.org/georgia-polls.
[9] "IMF World Economic Outlook - IDB Aggregates - 2017 - Islamic Development Bank - Data Portal." Knoema, data.isdb.org/boqmnyg/imf-world-economic-outlook-idb-aggregates-2017?tsId=1020380.
[10] Piotr Misztal, 2011. "The Relationship between Savings and Economic Growth in Countries with Different Level of Economic Development," "e-Finanse", University of Information Technology and Management, Institute of Financial Research and Analysis, vol. 7(2), pages 17-29, August.
[11] Patra, Suresh, et al. "Revisiting the Causal Nexus between Savings and Economic Growth in India: An Empirical Analysis." Egyptian Journal of Medical Human Genetics, Elsevier, 20 May 2017.
[12] Marwan Thanoon & Ahmad Baharumshah, 2005. "What happened to savings during the financial crisis—a dynamic panel analysis of Asian-5 countries," Economic Change and Restructuring, Springer, vol. 38(3), pages 257-275, December.
[13] Foreign Direct Investments, National Statistics Office of Georgia, 2019, http://www.geostat.ge/index.php?action=page&p_id=2231&lang=eng.
[14] Kinoshita, Yuko. Sectoral Composition of Foreign Direct Investment and External Vulnerability in Eastern Europe. IMF, 2011, www.imf.org/en/Publications/WP/Issues/2016/12/31/Sectoral-Composition-of-Foreign-Direct-Investment-and-External-Vulnerability-in-Eastern-24886.
[15] Charaia, V. "The Role of Multinational Enterprises' Investments in Emerging Country's Economic Development, Case of Georgia". World Academy of Science, Engineering and Technology, International Science Index 123, International Journal of Social, Behavioral, Educational, Economic, Business and Industrial Engineering, (2017), 11(3), 721 – 724.
[16] Loans by Purpose, National Bank of Georgia, 2019, www.nbg.gov.ge/index.php?m=306&lng=eng.
[17] Distribution of employed by economic activity, National Statistics Office of Georgia, 2019, https://bit.ly/2HJFUZd.
[18] "Welfare Monitoring Survey 2017." UNICEF Georgia, 2017, www.unicef.org/georgia/reports/welfare-monitoring-survey-2017.
[19] "Georgia Urbanization." Georgia Urbanization - Demographics, www.indexmundi.com/georgia/urbanization.html.
[20] Brockman, Paul and Michayluk, David, How Does Financial Literacy Affect the Savings Decision? (September 29, 2015). CIFR Paper No. 078/2015. Available at http://dx.doi.org/10.2139/ssrn.2667283.
[21] Samwick, Andrew A.. "Is Pension Reform Conducive to Higher Saving?" Review of Economics and Statistics 82 (2000): 264-272.
[22] Georgian Pension Reform. Ministry of Economy and Sustainable Development of Georgia, 2016, Final Report, March 2016. www.economy.ge/uploads/meniu_publikaciebi/ouer/Goverment_Report_on_pensions_Final_ENG.pdf.
[23] "Pension Agency to Select Investment Board Members." Georgia Today on the Web, georgiatoday.ge/news/14983/Pension-Agency-to-Select-Investment-Board-Members-.
[24] Budget Deficit % GDP, 2018, mof.ge/en/4555.
[25] "Explore Economies: Georgia." Doing Business 2019, World Bank, 2019, www.doingbusiness.org/en/data/exploreeconomies/georgia.
[26] "Nations in Transit 2018: Georgia Country Report." Georgia Country Report | Freedom House, 2 Oct. 2018, freedomhouse.org/report/nations-transit/2018/georgia.
[27] Erkekoglu, H, Kilicarslan, Z. (2016). Do Political Risks Affect The Foreign Direct Investment Inflows To Host Countries?. Journal of Business Economics and Finance, 5 (2), 218-232. DOI: 10.17261/Pressacademia.2016219263.
[28] Shah, Mumtaz Hussain. "The Significance Of Infrastructure For Fdi Inflow In Developing Countries." Journal Of Life Economics, 2014, Doaj.Org/Article/Af333c8cf55d40c7a6f99401e23dc445.
[29] Benmaamar, et al. "Georgias Transport and Logistics Strategy." Open Knowledge Repository, World Bank, Washington, DC, 1 Jan. 2015, openknowledge.worldbank.org/handle/10986/22097.
[30] "The Global Competitiveness Report 2017-2018." World Economic Forum, www.weforum.org/reports/the-global-competitiveness-report-2017-2018.
[31] Namchavadze, Beso. "We Spend More and More on Low Quality School Education." www.transparency.ge, Swedish International (Sida), 2018, www.transparency.ge/sites/default/files/we_spend_more_and_more_on_low_quality_school_education.pdf.
[32] External Trade, National Statistics Office of Georgia, 2019, http://www.geostat.ge/index.php?action=page&p_id=134&lang=eng.
[33] EBRD/WB (2013), "Business environment and enterprise performance surveys – Georgia country profile", webpage, EBRD, www.enterprisesurveys.org/data/exploreeconomies/2013/georgia.
[34] McIntyre, Robert. "The Role of Small and Medium Enterprises in Transition." UNU-WIDER, 17 Nov. 2016, www.wider.unu.edu/publication/role-small-and-medium-enterprises-transition.
[35] Schumpeter, Joseph Alois. Capitalism, Socialism and Democracy. 3rd ed., Harper Perennial Modern Thought, 2008.
[36] R&D expenditure (% of GDP), World Bank Open Data, 2019, https://data.worldbank.org/indicator/GB.XPD.RSDV.GD.ZS?locations=GE&view=map.
[37] Agriculture value added (% of GDP), World Bank Open Data, 2019, https://data.worldbank.org/indicator/NV.AGR.TOTL.ZS.
[38] "Georgia: Recent Trends and Drivers of Poverty Reduction." World Bank, 2016, www.worldbank.org/en/country/georgia/publication/georgia-poverty-assessment.