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# The Elements of Industrial Policy in Georgia

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## Abstract
Georgia does not have a national industrial policy strategy document to guide a long-term transformation of the country's economic structure. Officially, the Georgian state does not pursue an industrial policy. However, some of the state activities, such as the establishment of state agencies to facilitate investment by providing funding in promising sectors, overlap with the idea of industrial policy and its instruments. The present article addresses Georgia's socio-economic development strategy and the intervention tools of the state, with the aim of supporting industrial growth and diversification.


## Introduction
The history of economic development shows that the transformation of a country's economy towards more productive sectors is crucial for economic development. A country's economic transformation has not always occurred autonomously but rather as an outcome of an effectively designed and implemented industrial policy (Buur et al., 2015). As Wade (2016) notes, in Georgia, since the collapse of the USSR, the term "industrial policy" has been avoided, except in the understanding that "the best industrial policy is no industrial policy," as referenced by several economy ministers over the years. Given this background, it is no surprise that the administration of the government of Georgia has not come up with a national industrial policy strategy.

The definition of industrial policy (IP) has changed over time. According to Altenburg (2011), a goal of traditional IP used to be to enhance the productivity of land, capital, and labor. The states intervened in the markets by creating incentives (subsidies in the search process) to direct the flow of private capital into new sectors. In the 21st century, the task of IP is to provide a setting that allows the state and private sector to come together to learn about and discover the entrepreneurial opportunities and the constraints faced by the economic actors and to engage in strategic coordination (Rodrik, 2004, 2009). According to Pack and Saggi (2006), IP may refer to any selective intervention or policy that aims to modify the production structure in order to move it towards sectors that are expected to offer better chances for economic growth. Although the government of Georgia does not officially use the term industrial policy in reference to its intervention in economic activities, some of its economic policies do overlap with the idea of industrial policy.

## The Evolution of Georgia's Economic Policy Towards Promoting Industrial Development

Since gaining independence, Georgia's economic policy can be roughly divided into four phases. (1) The beginning of the 1990s was the period of massive deindustrialization. (2) Between 1994–1996, the state implemented a stabilization programme, reining in hyperinflation and restoring growth, which declined sharply after the collapse of the Soviet Union and the civil war at the beginning of the 1990s. However, in the years that followed, economic mismanagement and widespread corruption led to poor public services and political and economic uncertainty (WB, 2009). (3) In 2003, after the peaceful "Rose Revolution", the country experienced a change of power. The new government, headed by the United National Movement (UNM) party, united the policymakers who had a prevailing ideology that economic liberalization would bring economic growth. At the initial stage, in 2003–2008, the activities of the state were non-interventionist, leaving the economic development entirely reliant on market forces. The state implemented economic and institutional reforms for extensive liberalization, privatization and deregulation of the economy (Jobelius, 2011). The simplification of administrative procedures and a consistent introduction of e-governance systems were meant to diminish interactions between the public administration and businesses in order to limit opportunities for corruption (Engvall, 2012, p. 7). The reforms contributed to the improvement of the business environment, Foreign Direct Investment (FDI) flow in the economy and rapid economic growth. Due to these achievements, Georgia earned the status of the top global reformer for the 2005–2010 period (World Bank, 2012). Despite the government's non-interventionist dogma, it began intervening informally in economic processes (Bertelsmann Stiftung, 2014b). While most of the market barriers were removed, the state managed to regulate access to markets and resources on an informal basis (Timm, 2013). Since 2008, in the aftermath of the global financial crisis, the military conflict with Russia, and the sharp decline in FDI, Georgia shifted its official economic policy towards more formal, state-led, coordinating approaches (Timm, 2014). (4) In 2012, a new government headed by the Georgian Dream (GD) came into power. With a change in power, the state's economic policy also changed, as it initiated more formalized interventions to promote economic development by establishing state agencies that implemented state programmes that provide technical and financial support to the private sector to promote production and export growth and diversification. Among them, the state fund JSC Partnership Fund, the Entrepreneurship Development Agency (Enterprise Georgia) and the Georgia Industrial Development Group are implementing projects/programmes that support manufacturing development. The government remains cautious regarding industry-specific approaches. The underlying assumption of the government is that Georgia has been held back by "government failure," not "market failure," and that when the former is fixed, the market will work "by itself" to produce high levels of growth (Wade, 2014). However, the state pursues policies that support the operation of the markets in general and promotes specific activities across sectors. The term "industrial policy" and "industrialization" are either not referred to or carry a negative connotation due to the controversial Soviet experiences (Adeishvili, Khudadze, and Gunava, 2016).

## The Current Social Economic Development Strategy of Georgia

In regards to the economy, the approach of the GD can be referred to as horizontal industrial policy, which according to Warwick (2013), aims to improve the business environment and promote economic activities for markets that are missing or are difficult to create (UNCTAD, 2016). The GD elaborated on a social-economic development strategy document titled "Georgia 2020", which has been implemented since 2014. This strategy represents a broad agenda directed at long-term growth beyond 2020. The document reflects the priorities and the problems that need to be resolved to achieve long-term, sustained and inclusive economic growth. The economic policy of the government of Georgia targets three broad goals. These goals are (i) ensuring fast and efficient economic growth, (ii) implementing economic policies that facilitate inclusive economic growth and (iii) using resources rationally. The government aims to improve production capacity, stimulate exports, diversify production and exports and deepen free trade agreements. The strategy states that the critical obstacles to achieving these three economic development goals are the low competitiveness of the private sector, the access to financing and the low capacity of human capital. The strategy highlights some activities to overcome the mentioned obstacles. Improving the business environment, increasing innovation and technologies, facilitating export growth and realizing Georgia's full transit potential are all considered means to strengthen competitiveness. Mobilizing investments and developing financial intermediations are considered ways to maintain access to finances. Upgrading the skills of the country's workforce to the level of the labour market requirement, tightening the social security net and ensuring accessible and quality healthcare are considered the keys to human capital development.

## The State Activities to Support Industrial Development

Since 2011, under the umbrella of the Ministry of Economy and Sustainable Development, the JSC Partnership Fund, the Entrepreneurship Development Agency and the Georgia Industrial Development Group were established, which are implementing projects and programmes initiated by the Ministry of Economy and Sustainable Development. The state supports industrial development, specifically production and export growth and diversification, through these programmes. We observe, inter alia, that the provision of financial and technical assistance to the private sector is a means of state intervention in the economy. The state created various instruments, including co-financing foreign and local investments, subsidizing interest rates on bank loans and providing grants. Although the JSC Partnership Fund, the Enterprise Georgia and the Georgia Industrial Development Group were not specifically created to elaborate and implement industrial policy, their activities do overlap with the idea of industrial policy (Adeishvili, Khudadze, and Gunava, 2016).

## The Activities of the JSC Partnership Fund to Support Industrial Development

In 2011, the government of Georgia established the investment fund JSC Partnership Fund (PF) as an independent agency to manage the asset portfolios of the strategically important and the most profitable SOEs. The goal of establishing this fund was to facilitate investment projects in Georgia in joint ventures with private investors (foreign as well as local) in promising (in terms of the growth potential) sectors of the Georgian economy. The PF participates in greenfield (new business initiatives) and brownfield (investments in already existing businesses) projects as a passive partner with an exit strategy, which is determined in advance. The targeted sectors for investment co-financing include agro business, the energy sector, infrastructure and logistics, manufacturing, real estate, and tourism. The SOEs under PF receive shares (1.4 billion USD), assets (2.95 billion USD), and an annual income (50 million USD, which is 0.3% of the GDP of 2017) from assets and financial investments. The fund provides a maximum of 49% of the co-financing (equity, mezzanine) for the medium or long term in projects at their initial stage of development. The Partnership Fund has supported investments in the power engineering, real estate, agriculture and manufacturing sectors at their initial stage of development. Since 2013, twenty-two investment projects have been initiated, with a total value of 1500.9 million USD, which is equivalent to 9.9% of the GDP. Among them, three projects are in power engineering, eight projects are in real estate, four projects are in agriculture, two projects are in logistics, and five projects are in manufacturing. The projects in manufacturing that are co-financed by the Partnership Fund are the Avia Factory, the Sandwich Panel Factory, the Aerated Concrete Block Factory, the Brick Factory and the Corn Oil Factory. Of these five projects, two are finished, and three are ongoing. The total volume of the investment in manufacturing accounts is 110.5 million USD, which is only 7.3% of the total volume of the Partnership Fund's investment projects (1500.9 million).[1] This investment volume is quite low; hence, it might not be sufficient to have a significant impact on the overall industrial development.

## The Activities of Enterprise Georgia to Support Industrial Development

The state agency Enterprise Georgia implements the components of the "Produce in Georgia" programme, which is supposed to support the production of industrial goods and promote exports. The "Produce in Georgia" programme was launched by the Ministry of Economy and Sustainable Development in 2014 to support private sector development by employing a variety of financial and technical assistance mechanisms, including subsidized credit, partial collateral guarantee schemes, and organized exhibitions to promote exports. By 2019, the Industrial Component of Enterprise Georgia supported 276 enterprises, with a total investment value amounting to GEL 638 million (269 million USD), which is 1.6% of the GDP in 2018. The instruments of financial support are credit or leasing. In the case of credit, the state co-finances the 10% of interest rate of bank loans with a minimum amount of GEL 150000 (55770 USD) and a maximum amount of GEL 5 million (2.1 million USD) during the first 24 months. The state also provides a 50% collateral guarantee during the first 48 months of the investment. In the case of leasing, the state co-finances 12% of the annual interest rate for the first 24 months. The value of the project should be a minimum of GEL 100 000 (37 174 USD) and a maximum of GEL 5 million (2.1 million USD). Within the Industrial Component, the state has supported the following industries: building materials (23%), food and beverages (21%), paper and packaging (21%), plastics (12%), pharmaceutical and chemicals (9%), apparel and textiles (4%), metals (4%), electri-

1 The author's calculations. The data source is the JSC Partnership Fund. Available online at http://www.fund.ge/site/projects/4

cal equipment (2%), wood processing (1%), other (rubber and plastics, bitumen products), and manufacturing (4%). According to the agency, this component created more than 11 480 new job positions[2].

Enterprise Georgia is the first state agency in Georgia that promotes export products and services in the international market. To facilitate export growth, Enterprise Georgia provides support to the private sector for participation in international exhibitions by providing the following: coordinating, organizing, and co-financing of exhibitions; helping Georgia-based companies build a network with other businesses; identifying potential partners; diversifying production; and penetrating new export markets. The agency provides the planning, organizing, and co-financing of meetings for Georgian exporters. It also supports the exporters to build networks, to diversify production and to penetrate new export markets. It provides information associated with the documentation and certifications necessary for exports from Georgia, including customs procedures and tariffs in foreign markets. It also provides education and training and increases the professional capacity of export managers working with export-oriented companies in Georgia. Through this component, the agency provided support to 135 export-oriented companies to participate in 10 exhibitions in seven different countries in 2017. However, the information on how many companies started exporting in new markets through this component is not available. That same year, Enterprise Georgia provided training to 305 SMEs.

## The Activities of the Industrial Development Group

The Industrial Development Group, established under the Ministry of the Economy and Sustainable Development in 2014, aims to identify projects with new economic activities, prepare business plans and develop recommendations for industrial policy, as well as coordinate activities between the PF and Enterprise Georgia. As Wade (2016) states, the group is tiny (9–12 people), and the members are employed on three-month contracts. Hence, it is difficult to imagine that employees are concerned about long-term development strategies. Activities carried out by the Industrial Development Group are based on three main principles: the establishment of a diversified economy, the diversification of production, and the export markets. At present, the total value of projects prepared by the Industrial Group exceeds 80 million USD (Adeishvili, Khudadze, and Gunava, 2016). The project targets the production of natural facing and ceramic tiles; the export of greens to Europe; the production of milk powder; sewing and textile factories; plants producing essential oils, carton boxes, and steel square pipes; and the establishment of match factories.

## The Structure of the Economy and Employment

Despite the changed approach of the state in terms of its economic activities implemented since 2012, the country did not show much transformation of the structure of the economy or of employment in the period of 2012–2016. The growth rate of the economy slowed but remained positive (2.8% in 2016), the share of agricultural VA in total VA remained the same, the share of industrial VA increased (0.4% point), and the share of services VA declined (0.4% point) (see Figure 1 overleaf).

Regarding the structure of employment during 2012–2016, this indicator shows a slight change (see Figure 2 overleaf). In the period 2012–2016, employment in the industrial sector increased (11%), and the share of industrial sector employment in the total employment increased as well (2% point); however, it remained low (14%).

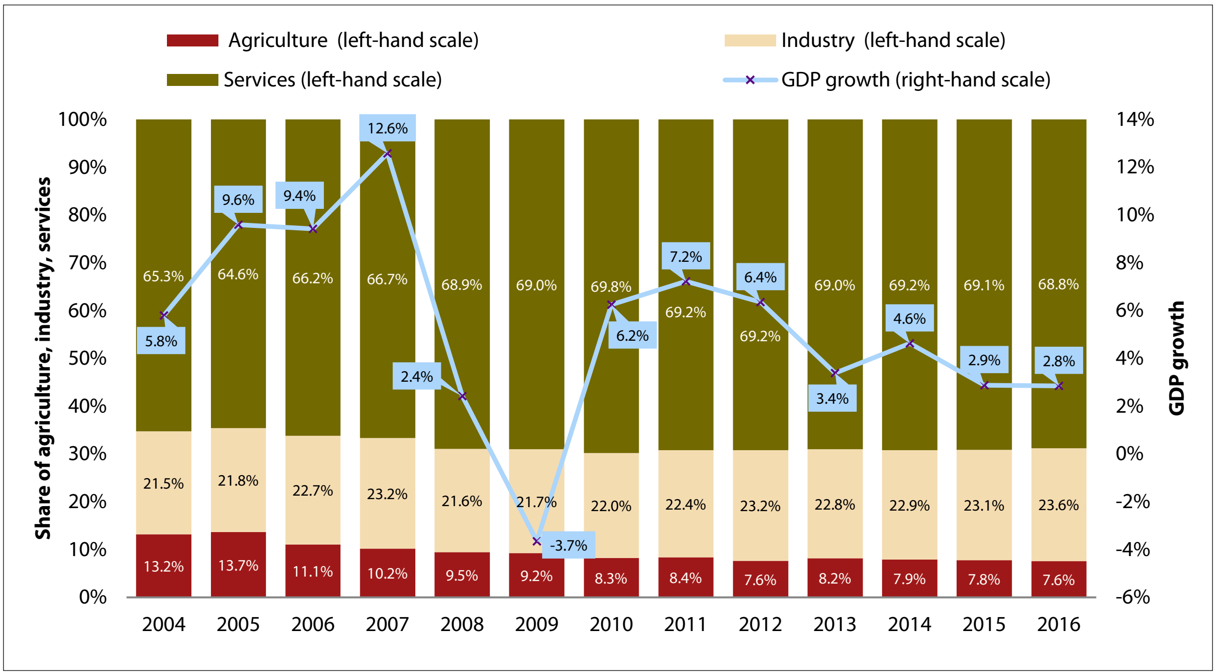
The VA of the industrial sector has an increasing trend during the period 2012–2016 (see Figure 3 on p. 19). The VA of the industrial sector exceeds its corresponding indicator in 2012 by 17%. However, the annual growth rate slowed from 3.7% in 2012 to 2.4% in 2016.

## Conclusion

Even though Georgia does not admit that it is pursuing IP, we observe that the state intervenes in the economy to support industries in various ways and applies the instruments of IP, such as co-financing investment projects, co-financing interest rate subsidies on loans and providing grants. However, the existence of these elements does not imply by itself that this type of policymaking is successful. The industrial sector has been growing; however, considering that the scale of the state-supported projects in this sector is low in comparison to the GDP, it is difficult to conclude that the causes of the increased performance of the industrial sector are state-initiated projects, as some of them are still in the implementation phase.

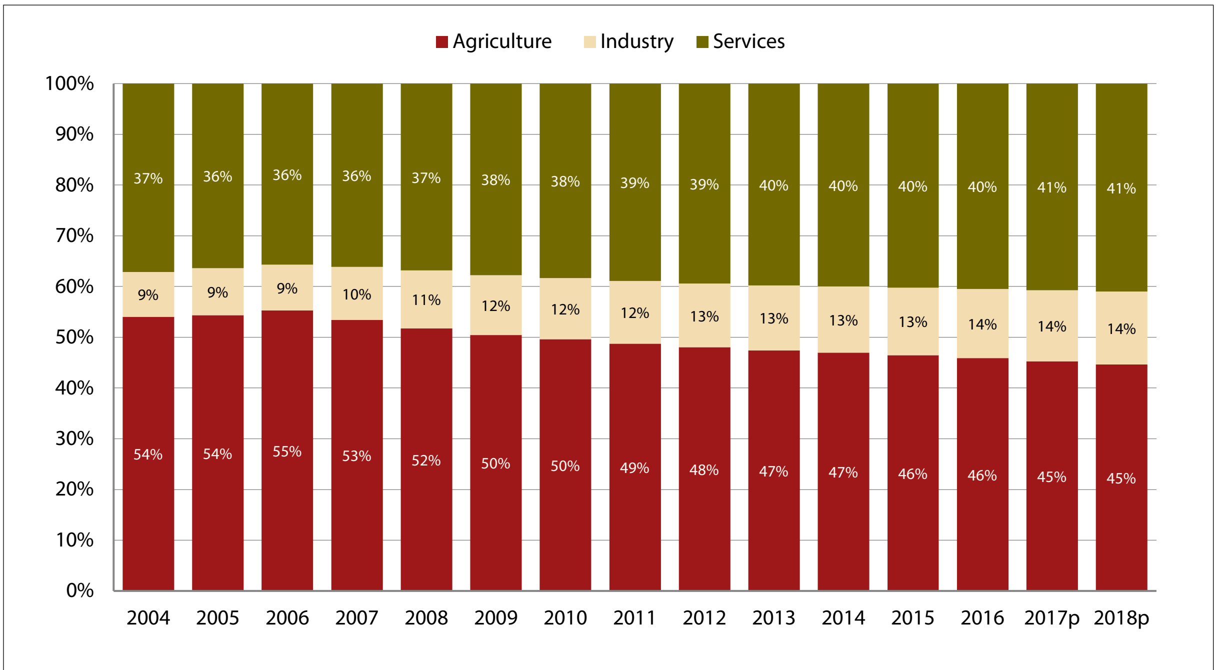
2 The author's calculations. The data source is Enterprise Georgia. Available online at http://www.enterprisegeorgia.gov.ge/en/business-development/INDUSTRIAL-COMPONENT

**Figure 1: Shares of Agriculture, Industry and Services in the Total Real Value Added**



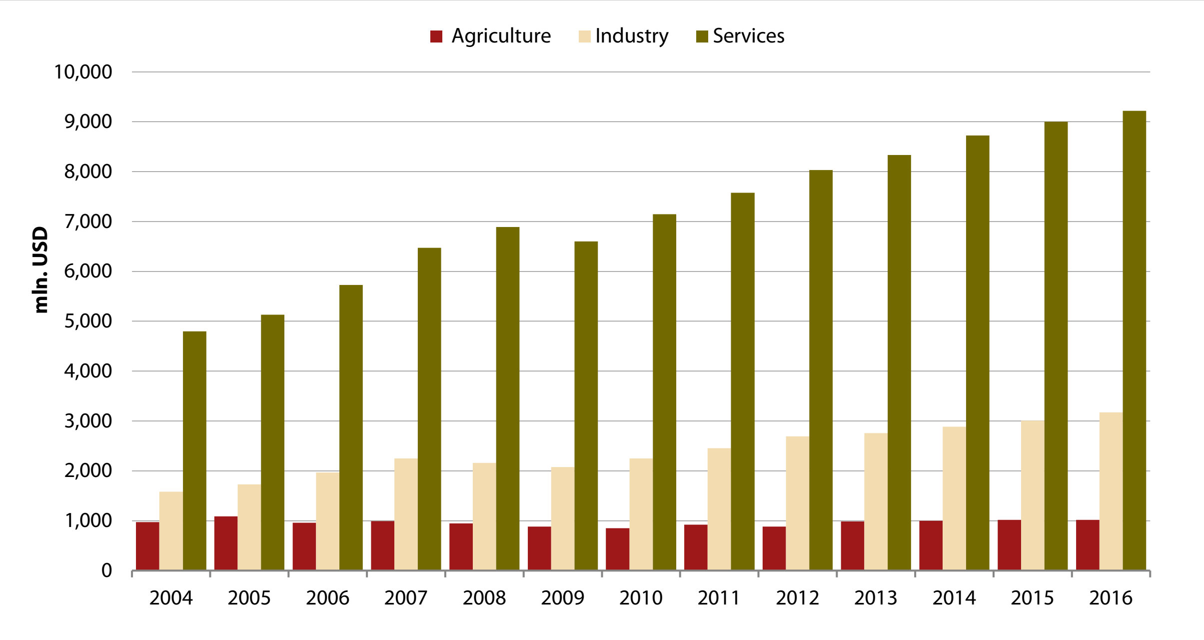

*Data sources: UN Statistics, author's calculations*

**Figure 2: Share of the Total Employment in Industry, Agriculture and Services**




*Data sources: ILO, author's calculations*

**Figure 3: The Dynamics of the Economic Sectors of Georgia**




| | Agriculture | Industry | Services |
|---|---|---|---|
| 2004 | 972,066,205.2 | 1,581,499,577.0 | 4,795,010,363.9 |
| 2005 | 1,085,789,984.4 | 1,732,535,501.2 | 5,134,508,299.9 |
| 2006 | 958,713,339.2 | 1,968,459,140.1 | 5,731,364,835.4 |
| 2007 | 988,785,340.0 | 2,248,705,763.4 | 6,474,044,236.3 |
| 2008 | 945,584,891.0 | 2,158,769,508.3 | 6,890,075,894.3 |
| 2009 | 884,206,590.9 | 2,077,248,333.4 | 6,600,566,953.4 |
| 2010 | 847,121,530.2 | 2,248,089,732.1 | 7,144,065,662.7 |
| 2011 | 919,215,785.9 | 2,455,623,994.2 | 7,574,680,703.2 |
| 2012 | 884,599,322.2 | 2,692,556,954.5 | 8,031,272,370.2 |
| 2013 | 984,801,922.0 | 2,757,640,484.3 | 8,333,909,786.5 |
| 2014 | 1,000,960,011.9 | 2,885,896,883.7 | 8,723,566,812.6 |
| 2015 | 1,016,220,430.3 | 3,004,671,237.3 | 9,001,292,608.6 |
| 2016 | 1,016,557,057.1 | 3,170,743,086.9 | 9,219,772,217.8 |

*Data sources: UN Statistics, author's calculations*

*About the Author*

Tamar Jugheli is a Ph.D. candidate at the University of Groningen and a member of the Governance in Emerging Economies Research Group in Berlin. Her research project addresses the role of institutions in economic development, with a specific focus of the institutional settings of state business relations in the food and agriculture sector of Georgia. She has over seven years of professional experience in economic development and policy-related research. Previously, she worked as a Research Director at the PMCG Research Center, one of the leading economic think tanks based in Georgia, and as a statistician at the National Statistical Office of Georgia. She has also taught courses in public economics and applied statistics and SPSS at the University of Georgia and at the Center of Social Science at Tbilisi State University.

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