COUNTRY PRIVATE SECTOR DIAGNOSTIC

CREATING MARKETS IN GEORGIA

Unlocking Private Sector Opportunities to Achieve Georgia's Full Potential

Executive Summary

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EXECUTIVE SUMMARY

Georgia has strong potential to return to a pre-COVID-19 pandemic solid economic growth trajectory. The country's gross domestic product (GDP) growth averaged 5.3 percent from 2010–19 but suffered one of the largest contractions in Europe and Central Asia in 2020 (6.8 percent GDP) due to heavy reliance on the service industry and tourism that made Georgia's economy vulnerable to the economic consequences of the pandemic. Still, Georgia's economy has proved to be resilient in the wake of the pandemic and the resulting deterioration of global supply chains. The economic rebound was quite rapid and broad-based: economic growth reached 10.5 percent and 10.1 percent in 2021 and 2022, respectively. Georgia's dynamic private sector contributed more than 86 percent of GDP, about 81 percent of formal employment, and the bulk of export earnings in 2022. In addition, the poverty rate at US$6.85 per capita declined from 72 percent in 2010 to 52.2 percent in 2022.

Over 2024–25, economic growth is projected to converge to its potential of about 5 percent per year, supported by continued strong private consumption; robust investments, including in infrastructure; and a more favorable external environment. Downside risks to this scenario include weaker trading partner growth, tighter global financial conditions, lower external inflows, and sustained high global commodity prices.

Despite positive recent trends, structural challenges persist, notably weak productivity growth and limited high-quality job creation. During the past decade, growth in Georgia has been driven by capital accumulation, while the contribution of human capital has been modest, and the contribution of labor has declined. Firm-level analysis reveals that while capital has deepened and labor productivity has improved, total factor productivity has been stagnant across sectors (except for construction). The share of employment in agriculture declined from 48 percent in 2010 to 40 percent in 2021, but this remains the second highest in Europe and Central Asia. While there has been some structural transformation, its potential has not been fully realized: the value-added per worker in manufacturing and services remains about seven times higher than in agriculture, indicating further scope for sectoral labor shifts. While the share of jobs with a contract has increased over the past decade, well-paid high-quality jobs remain scanty.[1] Poor learning outcomes and shortages of modern skills constitute other barriers to private sector growth. In addition, Georgia's population is shrinking due to low fertility and outmigration, dragging down longer-term economic prospects.

The Government of Georgia recognizes the importance of tapping into the potential of the private sector to sustain economic growth, diversify the economy, boost shared prosperity, and create more and better formal sector jobs. The Government of Georgia's vision for private sector development, as reflected in its 2021–24 program, Toward Building a European State, focuses on three key medium-term priorities: (a) upgrading the country's competitiveness, (b) promoting competitive local production and exports, and (c) encouraging domestic and foreign investments.

Over the past two decades, the Government of Georgia's ambitious reforms to enhance the enabling environment for the private sector have brought about substantial progress in business deregulation (permits, licenses, and so forth); an advantageous and simple tax regime; and simplified, transparent tax administration. Georgia has an above-average score on three of the four components measuring the quality of the enabling environment in the Global Competitiveness Index (GCI).

Georgia's private sector is characterized by the significant presence of micro, small, and medium enterprises (MSMEs). In 2020, MSMEs contributed about 63 percent of total jobs and 61 percent of production value added in Georgia. That contribution is low compared with the average employment share of MSMEs among regional peers (new European Union [EU] members in Eastern Europe, with an MSME employment share of 70 percent). More than 98 percent of all firms in Georgia are privately owned, but state-owned enterprises (SOEs) still have a significant representation among large and medium firms and are concentrated in utility sectors such as energy, water, oil, and gas. Small firms account for the most significant share of total employment in the business sector but contribute relatively little to job creation. Large firms dominate employment growth: Average annual employment growth between 2012 and 2020 was 6 percent among large firms, compared with 3 percent growth among both medium and small firms.

Georgia's elevated firm exit rates suggest significant barriers to survival and market expansion aggravated by the lack of managerial capabilities. In 2020, firms' exit rate in Georgia amounted to 16.5 percent, which was about two times the rate in the EU. The country's lack of attractive job opportunities and low-cost firm registration explain the high level of entrepreneurial activity and business creation. Many new ventures are born out of a need for self-employment and often lack the critical fundamentals necessary for business success. Some progress has occurred in upgrading capabilities and management practices, but additional work must be done to expand access to finance, promote firms' formalization, and boost competitiveness.

Access to finance has improved significantly, but remains a constraint, particularly for MSMEs. In recent years, Georgia has made significant strides in terms of financial sector regulation and supervision, as well as access to finance. Domestic credit to the private sector increased from 55 percent of GDP in 2016 to nearly 74 percent by 2021. Although the share of firms in Georgia with access to bank credit is higher than the regional average (43.3 percent versus 41.2 percent in the Europe and Central Asia region), the proportion of firms identifying access to finance as a major constraint for growth is significantly higher. The proportion of loans requiring collateral is also higher in Georgia than the regional average (80.5 percent versus 66.1 percent). Despite improvements in access to finance, a lack of diversity of other financial products and services coupled with incipient capital markets limit the ability of the financial sector to meet the diverse needs of firms throughout their lifecycle and hinders firm growth. The International Monetary Fund's Financial Development Index places the country lower than the emerging markets average (0.31 versus 0.33).

Geopolitical factors are another significant constraint to business growth in Georgia. According to the World Bank's 2019 Enterprise Survey, 29.9 percent of firms in Georgia regard political instability as their biggest development obstacle, compared with an average of only 9 percent in the Europe and Central Asia region. In addition, the country's vulnerability and political risk has increased since Russia's invasion of Ukraine. The invasion has intensified uncertainty and political division in the country, thereby discouraging investors and eroding business confidence.

Georgia has a small open economy that can accelerate GDP growth by strengthening export capabilities in the areas where it has shown a competitive advantage. During the past decade, the overall growth of exports has been outpacing GDP growth. Export growth was driven mainly by services, with about 43 percent of total exports in 2022 related to travel and tourism. While Georgia has strengthened its position as a trade hub for the region, with re-exports gaining a greater share of trade and some diversification in terms of both markets and products, merchandise exports are still dominated by primary products and resource-based manufactures. As a result, the most extensive contributions to export growth come from products of low or moderate complexity. The total unrealized export potential for Georgia stands at around US$1.6 billion (6.5 percent of GDP), as estimated by the International Trade Center.[2]

Georgia has an open trade regime and an extensive network of preferential trade agreements, although the degree of participation of local MSMEs in global value chains (GVCs) has been lower than expected. The integration process has been slower than in many other countries in the Europe and Central Asia region. As of 2019, 15.2 percent of Georgian firms were participating in international trade compared with an average of 22.6 percent in the Europe and Central Asia region. Many firms are unable to export because they cannot obtain internationally recognized quality certifications, which are required in the EU and other leading markets. Infrastructure and logistics constraints also have held back participation.

There are untapped opportunities for Georgia in the Deep and Comprehensive Free Trade Agreement (DCFTA) with the EU. The rate of use of EU preferences by Georgian exporters remains below average, reflecting the existing gaps in capabilities on the supply side. The EU is expected to provide more technical assistance for MSMEs in Georgia, especially in agriculture and food sectors, and would likely advise the government on a more effective design of support programs. At the same time, the EU's Carbon Border Adjustment Mechanism (CBAM), in its current form, is unlikely to have a severe impact on Georgia because of the limited contribution of the sectors covered by this mechanism to Georgia's current exports.

Georgia has attracted high levels of foreign direct investment (FDI) inflows over the past decade, although the majority has gone into nontradable sectors. The country has implemented various reforms that have led to increased investor confidence. Georgia's World Trade Organization (WTO) membership and its association agreement with the EU have further facilitated investment inflows. As a result, Georgia has been able to attract sizable levels of FDI (8.2 percent of GDP equivalent, on average, during 2016–22). But in contrast to many FDI-recipient countries in the region, FDI in Georgia has been highly concentrated in a few, mostly nontradable, sectors, such as energy (21.8 percent), real estate (21.5 percent), and finance (13.5 percent). This focus has limited the direct and immediate impact of FDI on productivity growth and provided local firms with fewer opportunities for integration into GVCs.

PRINCIPAL CROSS-CUTTING CONSTRAINTS TO PRIVATE SECTOR DEVELOPMENT

Overall, Georgia has a favorable business environment: starting a firm can be done with ease and very few distortions exist in product and factor markets. Georgia ranks 35th out of 162 countries in the Index of Economic Freedom by the Heritage Foundation, ahead of several EU member states. According to the 2019 Global Competitiveness Index of the World Economic Forum, Georgia ranked 37th in the labor market pillar and 48th in the product market pillar. In recent years, insolvency reform and a new entrepreneur's law have helped further cement a sound business environment.

Despite significant progress in streamlining the business environment, gaps in regulation and enforcement affect performance. The country needs to upgrade the regulatory frameworks at the sectoral level in several priority sectors, including the digital economy, financial technology (fintech), renewable energy, and logistics. Georgia adopted a Competition Law in 2014 and set up the National Competition Agency to ensure its implementation. However, the country's economy still has a relatively less competitive market structure, partly because of poor enforcement and other distortive market arrangements that diffuse competitive pressures in certain sectors.

Georgia's control of corruption is notable, although there are some aspects of regulatory governance that remain a challenge, such as uneven enforcement and inefficient courts. Building on the reforms introduced over the past two decades, Georgia has significantly reduced red tape and the prevalence of corruption within the state bureaucracy. Georgia ranks 41st out of 180 countries in the world in Transparency International's 2022 Corruption Perception Index. Although that is a relatively high ranking, in recent years there has been a perception of backsliding in the country's anticorruption efforts. To further enhance Georgia's anticorruption efforts, an Anti-Corruption Agency was created in 2022 to consolidate anticorruption responsibilities previously scattered among several law enforcement agencies. International partners have recommended strengthening the agency to address high-level corruption cases.[3] An aspect highlighted by entrepreneurs is that limited judicial accountability and delays in courts and dispute resolution hinder business performance and investment attraction.

The privatization process during 2004–10 led to a considerable reduction in the relative size of the SOE sector. Yet, Georgia's SOEs are still present within a range of economically significant sectors, including some competitive sectors where they operate along with private firms. Such sectors include communications, hospitality (hotels, restaurants), real estate, leasing, and other financial services. Over the past decade, the government has taken steps to strengthen SOE performance and ease market distortions associated with their operations. But this agenda remains far from complete.

Despite seamless labor market regulation, unemployment and inactivity levels remain high. Georgia's labor force is underutilized, with nearly 30 percent of the working-age population classified as jobless or inactive. Furthermore, women's economic participation and employment rates are much lower than that of men. In recent years, most jobs in Georgia have required relatively basic professional skills but job requirements are increasingly becoming more intense in basic digital and socioeconomic skills, which not all Georgians possess.

An inadequately educated workforce hinders the performance of Georgian firms and limits their growth prospects. About 42.5 percent of firms in the country cite this as a main obstacle, compared to the average of 24.8 percent in the Europe and Central Asia region. While the country's labor force is highly educated (as measured by the number of years of schooling), there is a gap between the skills taught in schools and the skills the labor market demands. For instance, according to International Telecommunication Union data, only about 1 percent of the population currently possesses even basic programming skills, well below the proportions found in most regional peer countries. Yet, only some firms provide formal training to their workforce, which disadvantages adult workers as their skills become increasingly obsolete with rapid technological advancement.

While Georgia's overall business environment is favorable, the ecosystem for adopting digital solutions by non-digital businesses across economic sectors is less developed. The ecosystem's weaknesses largely explain an apparent contradiction between dynamic and relatively successful growth within the digital business segment and the slow pace of adoption of digital solutions in the rest of the economy. According to the Network Readiness Index (NRI), in 2022 Georgia ranked 75th out of 131 countries in exploring business opportunities offered by information and communication technology (ICT). This underperformance partly reflects limited linkages between the erstwhile conventional economy and digital businesses in Georgia, and underdeveloped policy and digitalization capacity enablers. Moreover, the low digitalization level constrains broader business innovation development. On the Global Innovation Index 2020, Georgia is ranked 63th out of 131 countries, with underperforming peer economies.

IMPORTANCE OF DIGITAL BUSINESSES FOR GEORGIA'S GROWTH

This Country Private Sector Diagnostic (CPSD) considers accelerated development of digital businesses a strategic priority for driving economywide productivity and competitiveness, advancing the country's transition toward its aspirations for high-income status. Furthermore, digital technologies offer opportunities to bridge gender gaps and encourage female labor force participation. Chapter 3 identifies priorities related to the development of digital businesses, including those that are vital for catalyzing job creation and private sector participation, and contains an overview of the state of digitalization of conventional businesses in Georgia.

Georgia has achieved some encouraging results in digitalizing its economy, particularly in the development of center-of-government digital platforms and systems. In addition, the Georgia Innovation and Technology Agency (GITA) was established to coordinate the creation and development of a digital innovation ecosystem and has been developing innovation hubs and startup accelerator programs across the country.

Wide adoption and use of digital technologies and related accelerated development of the digital economy offer additional opportunities for Georgia to exploit its competitive advantages in both core and emerging sectors such as tourism, agriculture, energy, finance, and logistics. For example, in tourism, digital platforms and tools can diversify tourism geographically, open new markets, attract new investments, broaden product offerings, and help raise the effectiveness of destination marketing.[4] So far, however, the pace of adopting digital solutions by nondigital businesses has been slow, as mentioned, and this lag has become a serious structural constraint for sustainable growth.

Georgia's digital business sector remains relatively small. Few digital businesses are headquartered in Georgia, and most are relatively young. For example, of the 151 Georgia-headquartered digital businesses in the World Bank's Digital Business Database, more than 50 percent were founded in 2016 or later, compared with less than 20 percent in more mature peer economies, such as Croatia and the Slovak Republic. Although some countries with more established digital ecosystems, such as Estonia, also have a relatively large proportion of young digital businesses, they also have a record of larger absolute numbers of digital firms that have successfully scaled up or raised later rounds of external financing.

E-Commerce, fintech, entertainment technology, software, software as a service, and marketing technology consistently rank among the most promising digital subsectors in the country. In Georgia and neighboring countries, these subsectors have attracted the most investor attention, measured by the number of funding rounds raised and the number of exits achieved. In addition, the most promising Georgian digital businesses have generally been business-to-business (B2B) due to Georgia's small domestic market. B2B businesses are also generally better able to scale internationally because they need lower upfront marketing investments.

Digital infrastructure is not perceived as a direct binding constraint by digital businesses and investors, and internet and mobile telephony access in Georgia is high, although it trails high-income countries. Still, further improving Georgia's digital infrastructure (for example, broadband connectivity), particularly in rural areas with lower digital penetration, would be beneficial because it would help increase digital inclusion and support improving the tech talent pipeline.

To realize the full potential of its digital business ecosystem, Georgia must address binding constraints that are related to (a) insufficient technology and entrepreneurial talent, (b) underdeveloped early-stage finance, and (c) immature entrepreneurial support ecosystems. Although the legal and regulatory framework is not considered a critical constraint to ecosystem development, the opportunity exists to fine-tune regulatory aspects related to data privacy, consumer protection, and regulation of fintech.

Georgian digital businesses need more technically skilled labor because competition over existing talent has been intense. Competition for the existing tech talent is fierce, and multinational enterprises possess both inherent and policy-generated advantages in hiring tech talent vis-à-vis smaller local digital businesses.

The Russian Federation's invasion of Ukraine offers an unprecedented opportunity for Georgia to attract foreign tech talent. However, Georgia's programs need to be more strategic and to reflect the efforts of other countries that pursue similar objectives and have systematized those efforts. Russia's invasion of Ukraine has created significant out-migration flows from Belarus, Russia, and Ukraine. Although many new immigrants from those countries have temporarily settled in Georgia, the country's existing visa and immigration programs do not allow for easy identification of tech workers or matching of tech workers with potential employment opportunities.

A more mature early-stage finance and entrepreneurial support system will help Georgian digital businesses fine-tune their strategies and scale up. The Georgia Innovation and Technology Agency (GITA), a public agency, currently plays an outsize role in providing funding for digital businesses, which is not sustainable or scalable in the long run. Existing actors in Georgia often lack sufficient expertise to invest in early-stage digital businesses. Although multiple incubation, acceleration, and mentorship programs are available for digital businesses in the country, significant knowledge gaps related to market testing, valuation, and other critical business skills persist in the founder community.

Fintech

Fintech is transforming the global financial landscape, offering wide-ranging opportunities while also presenting certain risks. Fintech can strengthen financial sector development, competition, inclusion, and efficiency. However, it may also pose risks to consumers and investors, the financial system's stability and integrity, and operational and cyber resilience.

The banking sector, one of the leading sectors in Georgia in terms of information technology service development, has been playing a significant role in the evolution of the digital ecosystem. The National Bank of Georgia and Georgia's Banking Association have jointly been implementing the Open Banking project to stimulate the development of fintech solutions, including the introduction of a digital currency.

Georgia's bank-centric financial sector serves a largely banked population. The banking sector has total assets of about 100 percent of GDP. The two biggest lenders, TBC Bank and Bank of Georgia, control 70 percent of the country's banking assets. Both institutions have expanded into other financial sector activities and focus efforts on either developing in-house fintech solutions or acquiring such solutions in the market, although the entrenched market position of these two banks may also make it harder for other firms to develop and scale fintech solutions.

Although still nascent, the local fintech market in Georgia is seen by stakeholders as one of the sectors with the most potential to grow. As of 2022, Georgia had 64 fintech firms, mainly operating out of Tbilisi, with more than half of them focused on the payments space. Georgia is among the top three countries worldwide for contactless payments. In addition, several e-money providers are active in the market, seeking to provide an alternative to traditional payment cards and money transfers linked to bank accounts. This focus of firms identified in the market fits a familiar pattern of evolution seen in other concentrated markets. Evidence indicates that Georgia also has significant business activity in the international Web 3.0, gaming, and decentralized finance (DeFi) ecosystem.

Georgia has several conditions that are favorable for the accelerated development of fintech. A combination of a well-capitalized financial sector, good internet connectivity, solid growth in digital payments, and the regulator's openness make the country an ideal testing ground for financial innovation. The ICT infrastructure for supporting growth of fintech firms in payments is good but should be further enhanced. For example, third parties still need help accessing the payment infrastructure.

The authorities have embarked on ambitious reforms to facilitate further growth in the fintech sector. Still, an explicit long-term strategy is necessary for fintech to crystallize its intended trajectory and its role in deepening the financial sector. A holistic national fintech strategy would help authorities set a clear reform agenda, integrating the ongoing and planned strategic considerations in open banking, digital onboarding, and virtual assets, as well as identifying key dependencies. Such a strategy would also provide a clear perspective on leveraging fintech to attain wider strategic goals, such as strengthening financial inclusion and access to finance for MSMEs.

The development and operation of regulatory sandboxes and open banking are the Georgian authorities' two main initiatives to foster innovation and efficiency in the financial sector while still fulfilling their mandate to protect the stability and integrity of the country's financial system and to protect consumers. Accordingly, these areas were at the center of the analysis undertaken under the CPSD, and they were assessed as the most promising policy and regulatory avenues to help the fintech subsector reach its full potential in Georgia.

The National Bank of Georgia generally has maintained an open and constructive dialogue with the fintech industry. However, the regulator is currently seen as reactive rather than proactive. A rapidly changing landscape calls for a more proactive approach, which requires developing new monitoring tools and establishing dedicated organizational arrangements with a mandate for proactive monitoring. Overall, more active coordination and information exchange is needed between the regulator and the market.

A PATHWAY OF TRANSFORMATION: TWO SECTOR ASSESSMENTS

The CPSD identifies two sectors (renewable energy and transport and logistics) offering additional short-term opportunities for accelerated market creation and relatively large potential for economywide development impact.

Renewable energy

Georgia has substantial undeveloped renewable energy (RE) potential. The country has an estimated potential of 11.8 gigawatts of hydropower, 1.4 gigawatts of wind power, and 1.5 gigawatts of solar power capacity. The target is to increase the share of RE in its energy mix to 27.5 percent by 2030 from the current level of about 20 percent. Such expansion in renewable generation is expected to take place against the background of the overall rapid growth in total installed power capacity—from the current 4.6 gigawatts to 9.7 gigawatts in 2030.

Georgia's power generation is currently dominated by hydropower and natural gas. Hydropower accounted for 74 percent and thermal plants for 26 percent of the total installed capacity in 2021. Due to the strong reliance on hydropower, the availability of electricity is highly dependent on weather conditions and characterized by seasonal variations.

During the winter, Georgia relies on imported electricity and natural gas for thermal power plants to meet demand. The average cost of imports increased from US$0.053 per kilowatt hour in 2012 to US$0.08 per kilowatt hour in 2022—higher than the levelized cost of energy that could be generated in Georgia on the basis of modern wind, solar, and hydropower technologies. Energy poverty is a problem in Georgia. Even though the government subsidizes natural gas for electricity production and household consumption, household expenditure on natural gas is among the highest in the Europe and Central Asia region.[5]

The electricity demand-supply gap has been increasing since 2011.[6] Electricity demand has increased steadily by an average of 4.2 percent per year since 2011 (driven by average economic growth of 5.6 percent), while electricity production has grown at an average rate of 2.3 percent.

The development of new renewable power has stalled since 2017 largely because of communities' resistance to new hydropower projects. In 2017, following advice from the International Monetary Fund on the financial risks to Georgia's budget, the Government of Georgia suspended the signing of new power purchase agreements with private investors. This change significantly weakened the project pipeline: among new projects, only small-scale power plants have been able to secure full financing and move to the implementation stage. At the same time, strong environmental and social concerns from communities and nongovernmental organizations have halted the construction of several previously agreed-on hydropower projects.

The Government of Georgia has been promoting power sector reforms as part of its Association Agreement with the European Union and within the United Nations Framework Convention on Climate Change. This focus led to the adoption of key pieces of legislation and national programs, including the 2019 law, Promotion of the Use of Energy from Renewable Sources.

A key building block in the Government of Georgia's RE strategy is the newly launched Contract for Differences[7] support plan for RE projects. The new plan was introduced to unlock domestic RE potential by facilitating access to finance through addressing the risks associated with the high initial costs of RE and unstable market conditions in the sector. The plan is based on competitive capacity auctions, and the first auction, for 300 megawatts, was launched on February 10, 2023.

As part of the RE sector assessment, a special survey of private investors and financiers was administered to identify the private sector's perspective on existing gaps and barriers to RE development in Georgia. The survey respondents were generally satisfied with their prior investment experience in Georgia's power sector. They plan to continue investing in energy in the South Caucasus region in the next three years. The key incentives for investors derive from the country's encouraging investment climate, untapped energy resources, steady growth in demand for electricity, existing support plan for RE (Contract for Difference), and the possibility of exporting electricity to higher-price markets.

Small and medium hydro plants and utility-scale solar are identified as subsectors that are "ready" for private investment in Georgia. Hydropower has an established track record, mature technology, and sufficient local technical expertise. Utility-scale solar farms are regarded as more attractive for investing (versus other types of RE) because of less social and environmental opposition.

Investors see environmental and social challenges and policy and regulatory uncertainty as the main sources of risk to RE investment in Georgia. This belief results in higher costs of financing and elevated risks of projects being suspended during implementation.

Transport and logistics

Georgia is in a strategic location, serving as the gateway to the Caucasus and Central Asia, and aspires to become a regional hub. Georgia needs to develop its transport infrastructure and improve and modernize its logistics infrastructure and services (particularly those related to agriculture) to realize its potential and increase its participation in global value chains. In doing so, the country will need to identify areas where the private sector can enhance operational performance and stimulate economic growth. The 2023 National Transport and Logistics Strategy and related 2023–24 Action Plan aim to position the country as a regional logistics and transport hub.

Georgia's role in the international transit logistics system is largely driven by the performance of the Middle Corridor (MC), a multimodal transport network that connects Central Asia, the Caucasus and Europe via the Caspian and Black Seas. The MC's performance is undermined by high costs and lengthy transportation and transit times, which, until recently, did not look attractive compared with the available alternatives, such as the Northern Trade Corridor. However, the impact of the COVID-19 pandemic and the effects of Russia's invasion of Ukraine have enabled the MC to emerge as a viable option for diversified transport routes connecting China with Europe and Central Asia with the global economy. Various physical and nonphysical bottlenecks should be addressed in the short to medium term to secure a sustainable competitive position of the MC route.

The MC will have to improve its operational effectiveness to fulfill its potential and capture additional growth opportunities in energy and mining. Georgia has traditionally lagged in logistics, although it should be noted that recent improvements have seen the country rise in the World Bank Logistics Performance Index from 119th in 2018 to 79th in 2023. Capacity limits in the Caspian Sea ports and ferries are the most significant bottleneck for the movement of containerized cargo along the MC, and bulk handling capacity of the Georgian seaports requires additional handling equipment and storage space. The Government of Georgia has encouraged the private sector to develop a new deep-water port at Anaklia on the Black Sea to address these port bottlenecks. The Government of Georgia is in negotiations to expand the port of Poti. In addition, progress has been already achieved in strengthening the MC by improving infrastructure capacities, simplifying railway procedures, establishing integrated services, and providing competitive tariffs. To build on this progress, and in addition to investments in port infrastructure, further regulatory coordination is needed between intermodal services along the MC.

Developing the MC will also support the integration of Georgia's agriculture into the global economy, alongside further investments in agricultural logistics infrastructure. A modernized, scaled agricultural logistics network is key to improving the efficiency of agricultural production and upgrading the market for agricultural products. The development and enforcement of food safety and packaging standards is another critical prerequisite for realizing Georgia's agricultural potential. This objective will require improvements in farmers' capacity to meet downstream market standards to supply processing and trading companies, for which public support should be provided by the Ministry of Environmental Protection and Agriculture.

Improving Georgia's inland logistics services—through investment in third-party logistics (3PL) facilities—is also required to improve value chain efficiency and reduce transit times. The logistics market in the country is currently dominated by second-party logistics companies with limited services and low efficiency levels, is beset by fragmented and dated warehousing facilities, and lacks proper regulation. The Government of Georgia, has assessed the potential for the Tbilisi Integrated Logistics Center (TILC) project at Kumisi (southeast Tbilisi), including the development of a dry port and 3PL facilities. The TILC has a high potential to handle Georgian gateway volumes, moderate potential for transit volumes for Azerbaijan and Armenia, and limited potential for MC transit containers. The Government of Georgia is expected to finance the common infrastructure that is needed for the TILC, and the private sector will finance the TILC's facilities. Additional financing could be obtained through a variety of sources, including from international finance institutions, which may facilitate or leverage private sector participation.

EXPANDING INVESTMENT OPPORTUNITIES FOR THE PRIVATE SECTOR

Renewable energy

The CPSD highlights the need for three core prerequisites to foster private sector investments:

- A clear and reliable policy, regulatory, and permitting framework for RE investments.
- Sustainable incentive schemes.
- Cost-reflective end-consumer pricing.

The Government of Georgia has taken steps in this direction, launching a first round of renewable energy auctions, preparing to open a competitive wholesale market, and identifying social and environmental mitigation measures to back up renewable energy development. In addition to continued reforms to improve the investment framework, this effort will require investments in transmission infrastructure and regional interconnections of the power grid, including the Black Sea submarine interconnector, to improve the reliability and stability of RE supply and to ensure the readiness of the electricity grid to handle larger amounts of renewable energy.

Transport and logistics

The CPSD recommends prioritizing the development of logistics infrastructure for agriculture value chains that would provide additional opportunities for public-private-partnership-based investments, especially in establishing agro-logistics hubs. Furthermore, to promote private investment in downstream agribusiness, the report highlights the importance of farmers' capacity to meet market standards. Because farmer capacity is an important enabling factor for investment mobilization, this area should receive targeted public support. Beyond agriculture logistics, the CPSD identifies numerous market niches in the sector that present business opportunities for private investors, including the development of Class A warehousing, 3PL operations, railway car financing, and rail terminal operations.

Digital business

Private sector investment would focus on a few key subsectors of digital business in which Georgian companies may have greater chances of expanding abroad. Those areas include software as a service, gaming, and financial services that support mobile and e-commerce. Software services (such as for managing invoices, accounting, procurement, and sales channels) and specialized services (such as for tourism or hospitality businesses) could offer opportunities for Georgian companies to service regional markets in areas that are complementary to financial services. Given that the sector is still relatively new, private investors in the near term are well positioned to continue supporting early-stage start-ups through accelerator and seed investment programs. Start-ups servicing emerging needs created by new regulations and infrastructure or transitioning business models from the DeFi space to the regulated and more mainstream financial sector could warrant regular monitoring and support in the hope that some will emerge as regional leaders.

On the basis of the sector assessments and cross-cutting analysis of digital businesses, the CPSD proposes the following set of policy recommendations to facilitate private sector development-driven growth in renewable energy, transport and logistics, and digital business in Georgia (table ES.1).

TABLE ES.1. SUMMARY OF KEY CONSTRAINTS AND POLICY RECOMMENDATIONS

CONSTRAINT	RECOMMENDATION
RENEWABLE ENERGY (RE)	
Social and environmental resistance	• The government should facilitate stakeholder engagement, awareness raising, community education, and training to promote RE projects. The Government of Georgia should require all RE projects to undergo social and environmental impact assessments, engage with local communities, and prioritize using degraded, non-arable land. The Government of Georgia should ensure transparency, accountability, and environmental and social standards monitoring during the process of approval and implementation of RE projects. Property taxes from RE projects should be directed to local budgets of communities hosting the projects.
Unstable legal and regulatory environment	• The government should finalize the drafting and launch of clear and consistent policies and legal frameworks for RE development, in line with the EU standards, to improve predictability and reduce investment risks.
Lack of financial incentives	• To promote energy-efficient RE, and clean technologies, the government should start offering incentives such as tax credits, subsidies, and other financial benefits that are fiscally affordable and transparent.
Bureaucratic permitting process and lack of additional capacity in the distribution grid	• The Government of Georgia should facilitate the coordination of state entities to avoid interference with the projects from different sectors and encourage new investments in the development of the distribution grid.

CONSTRAINT	RECOMMENDATION
TRANSPORT AND AGRO-LOGISTICS	
MIDDLE CORRIDOR (MC)	
Gaps and weaknesses in MC enabling infrastructure	• Leverage private sector participation to increase port capacity. • Invest in additional rolling stock to improve railroad operations. • Invest in container facilities and associated infrastructure to increase capacity for containerized cargo.
Lack of clarity on priority intermodal project pipeline, as well as no transparency in MC operations	• Operationalize the recently adopted National Transport and Logistics Strategy for 2023–30 and identify priority investments to support the development of intermodal infrastructure and intermodal transportation, with inputs from key stakeholders. • Create a centralized information system for MC users.
Inadequate governance in the ports and roads subsectors	• Develop upstream governance reforms in the ports subsector to ensure appropriate government regulatory oversight of port operators and to ensure performance and compliance, taking into account the privatized nature of the subsector. • Improve the legal framework for domestic road transport, and enhance the existing regulatory framework for trucking, where necessary.
Insufficient international cooperation that undermines private sector incentives to invest	• Facilitate transnational agreements for cross-border operations. • Prepare an action plan with Azerbaijan to further improve border and customs operations. • Work together with affiliated MC countries to harmonize regulations to create an open access policy for the participation of third-party operators and private investors in the MC. • Involve the main potential beneficiaries of the MC—China and the EU—to expand their engagement with other MC stakeholders and encourage more cooperative behavior.
AGRICULTURE LOGISTICS PERFORMANCE	
Underdeveloped and outdated packaging and safety standards	• Develop and enforce national packaging standards. • Enhance food safety legislation and strengthen its enforcement through inspections; use relevant reform experience of new EU members.
Low quality of, and limited access to, market information	• Promote the development of electronic marketplaces to increase market transparency and information availability • Increase the frequency of the publication of agriculture and food security information through the National Statistics Office of Georgia.
Inadequate cold-chain capacity	• Encourage the development of regional logistics centers, including cold-chain storage capacity, at strategic locations. • Assess the potential role of private sector and the need for public funding support.

CONSTRAINT	RECOMMENDATION
TBILISI INTEGRATED LOGISTICS CENTER (TILC)	
Prospects for TILC project implementation uncertain	• Prepare a competitive public-private partnership (PPP) transaction process to attract the best possible financial value from the TILC business case. • Build PPP capacity and enhance understanding of new PPP legislation within the public administration.
Lack of coordination in development of logistics facilities	• Centralize regulation and coordination in the development of integrated logistics centers within the Tbilisi region. • Develop and adopt policies to cluster logistics facilities in suitable suburban locations to reduce trucking traffic in central Tbilisi.
DIGITAL BUSINESSES	
LOW AVAILABILITY OF AND ACCESS TO TECH TALENT	
Less than 1 percent of the Georgian population with programming skills	• Improve traditional tertiary education with respect to computer science and other tech disciplines via international accreditation, PPPs, and financial incentives. • Expand support to nontraditional tech bootcamps via market-based support (such as, vouchers) and building links with traditional education institutions and private sector employers.
Number of tech graduates and quality of IT education in traditional education system inadequate	• Invest in marketing campaigns and online platforms to brand Georgia as an attractive destination for foreign tech workers. Develop tailored visa programs for foreign tech workers.
Lack of level playing field in competition for tech talent between Georgian start-ups and international firms (due to income tax incentives)	• Develop tailored investment promotion and attraction programs for Belarusian, Russian, and Ukrainian digital companies to raise awareness about relocation to Georgia. • Adjust the International Company Status program to remove current distortions to competition for tech talent.
UNDERDEVELOPED EARLY-STAGE FINANCE AND SUPPORT ECOSYSTEM	
Lack of early-stage investing experience among local angels, limited partners (LPs), and general partners (GPs).	• Institute arrangements to crowd in experienced foreign investors such as hybrid funds or co-funds rather than government-as-GP models.
Government matching grant programs have been successful in generating entrepreneurial interest but are not currently structured to build up or crowd in investor expertise.	• Provide early-stage investment capacity-building support for GPs and LPs, develop model documents and templates in line with EU norms, and potentially provide support for the formation of corporate venture capital.
Persistent knowledge gaps among entrepreneurs despite the presence of entrepreneurial mentorship and support programs	• Improve mentorship and ideation support services to entrepreneurs via tweaks to procurement criteria where government funding is involved.

CONSTRAINT	RECOMMENDATION
POLICY CONSTRAINTS FOR E-COMMERCE	
Law on e-commerce not yet adopted and implemented	• Align data privacy and e-commerce frameworks with EU norms by amending the draft e-commerce bill and passing it.
Data Protection Act not well aligned with GDPR Open Banking Initiative not yet expanded to nonbank institutions	• Pass reforms covering the Second Payment Directive (PSD2) to enable the complete implementation of Open Banking Initiative for fintech.

NOTES

1 World Bank, *Georgia Systematic Country Diagnostic Update: Keeping the Reform Momentum* (Washington, DC: World Bank, 2023).

2 International Trade Center data, 2022.

3 European Commission, *Georgia 2023 Report* (European Commission, Brussels, Belgium, 2023); Organisation for Economic Co-operation and Development (OECD), *Anti-Corruption Reforms in Georgia: Pilot 5th Round of Monitoring under the Istanbul Anti-Corruption Action Plan* (OECD Publishing, Paris, 2022); OECD (2022a). Transparency International, "From Concentrated Power to State Capture: Georgia's Backsliding Anti-Corruption Reforms" (Voices for Transparency Blog, February 14, 2019), https://www.transparency.org/en/blog/from-concentrated-power-to-state-capture-georgias-backsliding-anti-corruption-reforms.

4 World Bank, *Georgia Systematic Country Diagnostic: From Reformer to Performer* (Washington DC: World Bank, 2018). .

5 While preferential gas prices are funded through price discounts obtained through operations of the transit gas pipeline, it is still considered a subsidy public service obligation.

6 "The recent trends for 2022-2023, however, have been more positive, with significant increases in power generation, exports, and transit. Moreover, electricity exports exceeded imports in 2022. But this shift could not be interpreted as a reversal in the long-term trends underlying the analysis in this report. It is likely that the main factors explaining the recent shifts in electricity balance are temporary and include unusually high prices in Türkiye and better weather conditions for hydro generation in Georgia."

7 In the energy world, *contract for difference* is a subsidy model in which both positive and negative deviations from a fixed reference prce are paid out to the contractual partner. Contract for difference is also called symmetrical market premium.

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