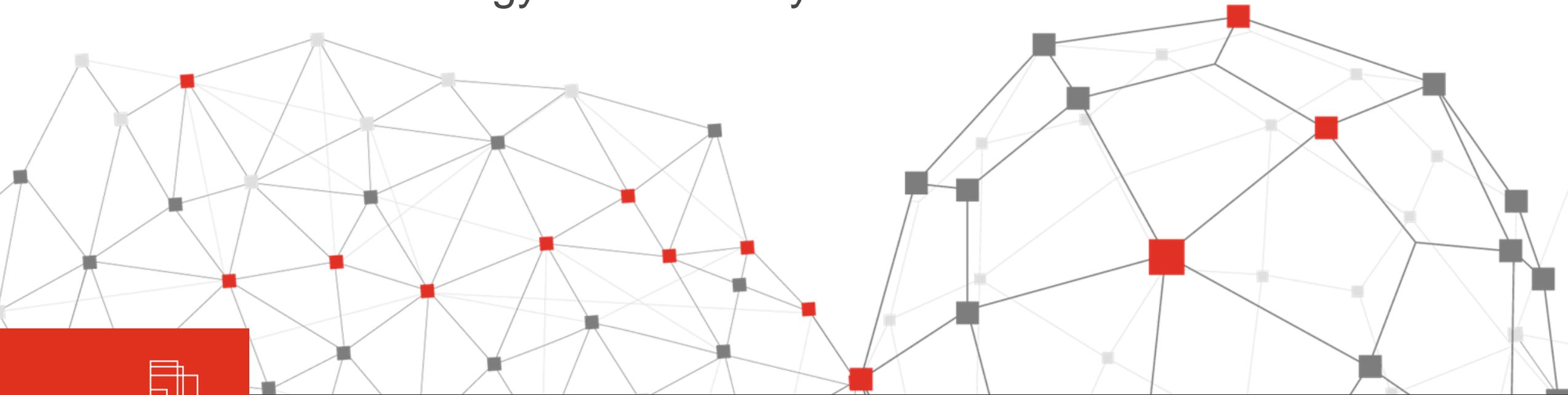


COVID-19

Impact of COVID-19 on the Georgian Economy & Medium-term Strategy for Recovery



Our approach



5 Sectors

- Professional business services (BPO & IT)
- Electric and electronic products
- Pharmaceutical production and medical research
- Apparel and textile industry
- Logistics (distribution, cold storage, warehouse, etc.)

All Sectors

- Competitive advantages of Georgia
- External view
- Policy recommendations

- Best international practices in fiscal measures
- Designing fiscal measures

Our key findings

 **01**

Changing perceptions and improve country's image

01
Finding

02
Finding

 **02**

Focusing on the right communication channels relevant to investors and provide high-quality information

KEY FINDINGS

 **03**

Developing critical infrastructure to provide connectivity and build on country's strategic position as a getaway between Europe and Asia

03
Finding

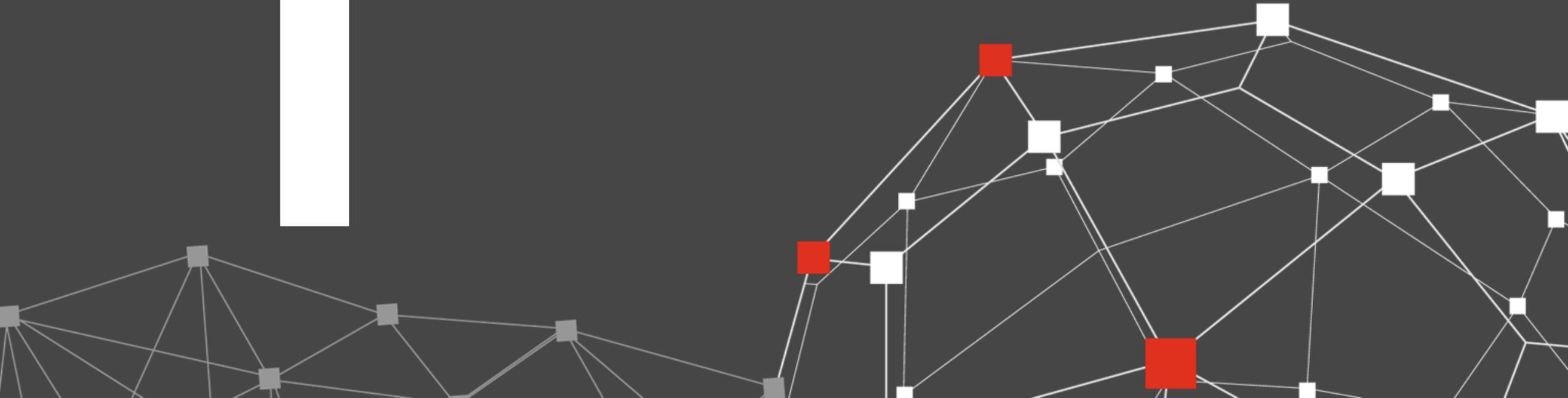
04
Finding

 **04**

Focusing on education and alignment of skills with needs of business (esp. languages and technical upskilling)

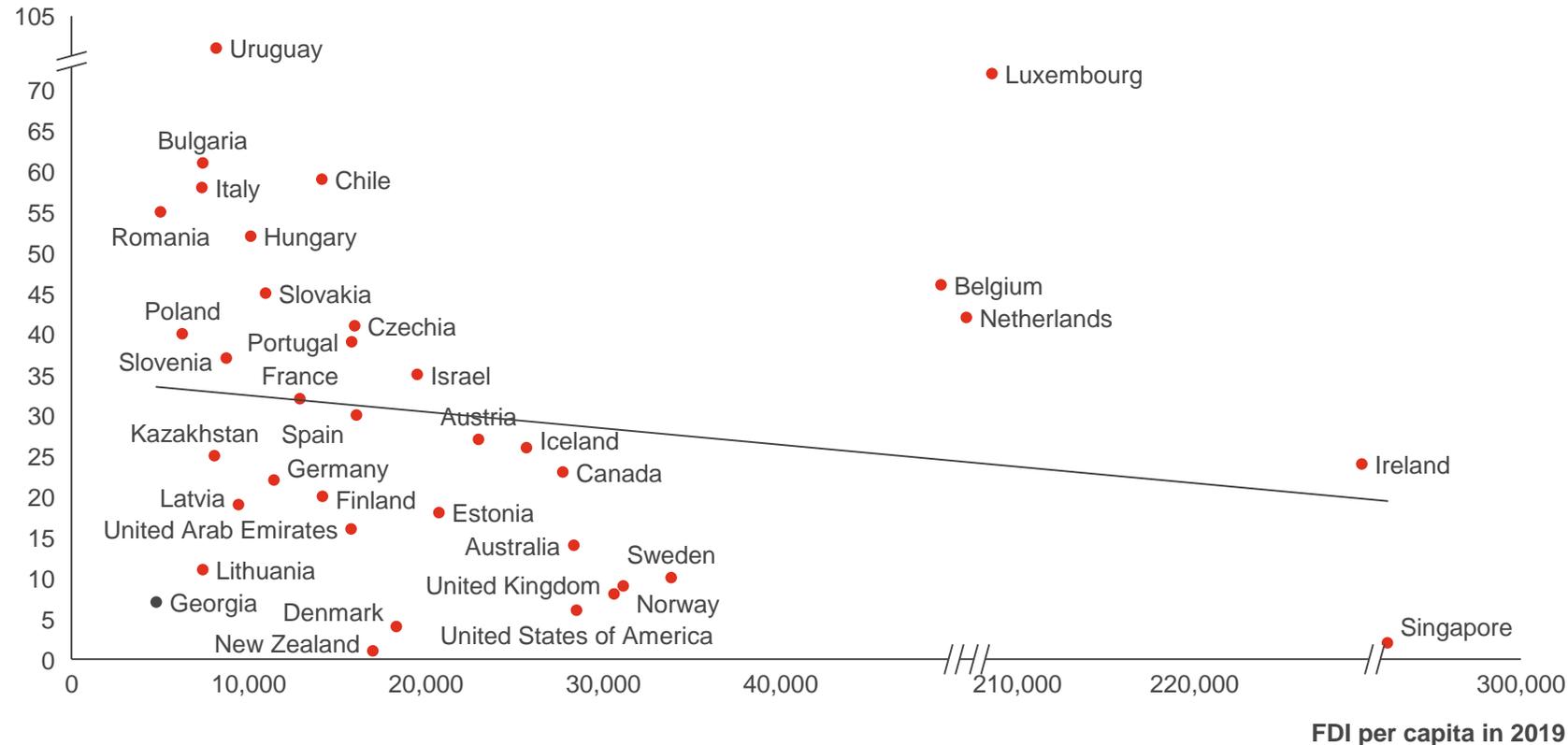
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Key Observations



Doing Business ranking does not seem to be the only factor conditioning FDI inflows around the world

Doing Business rank



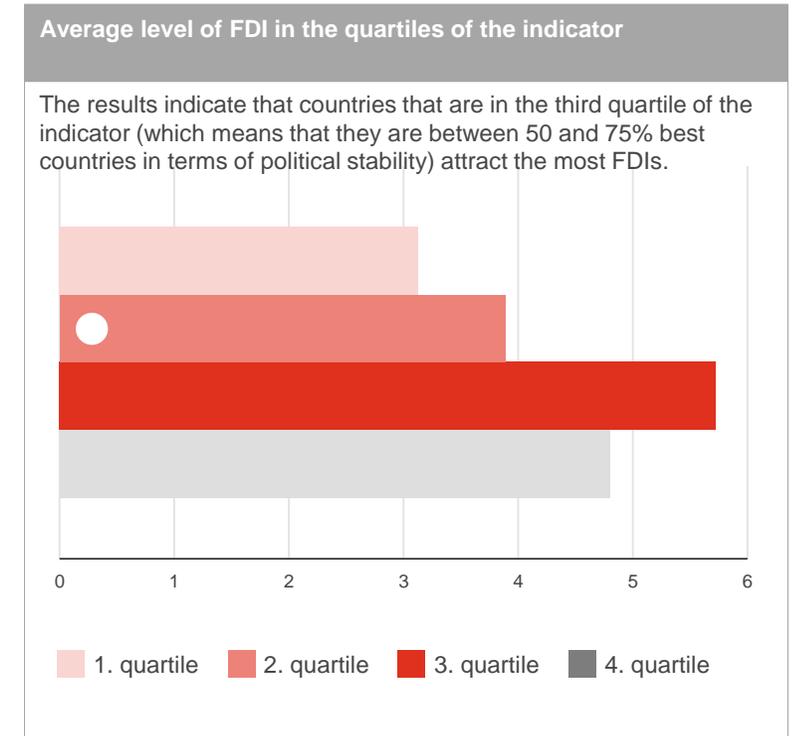
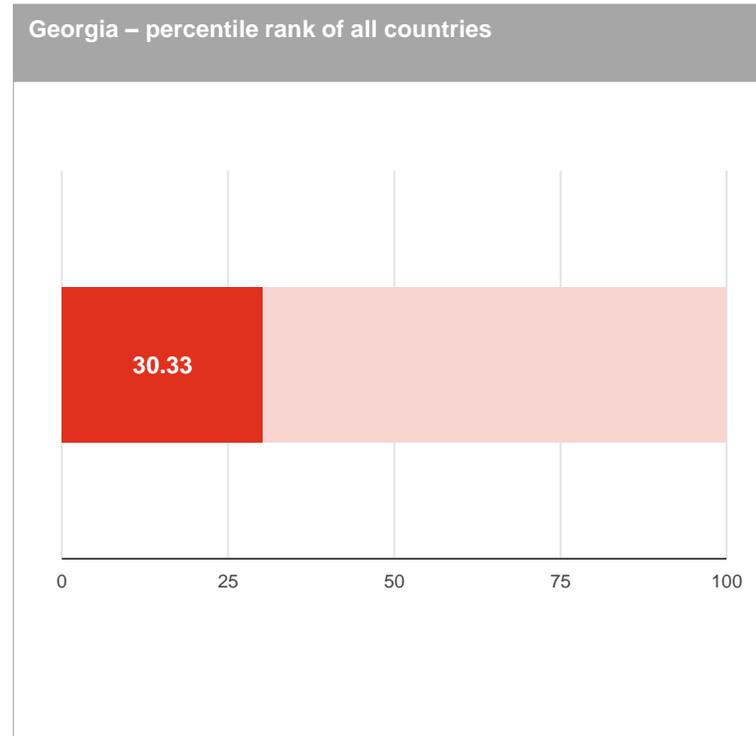
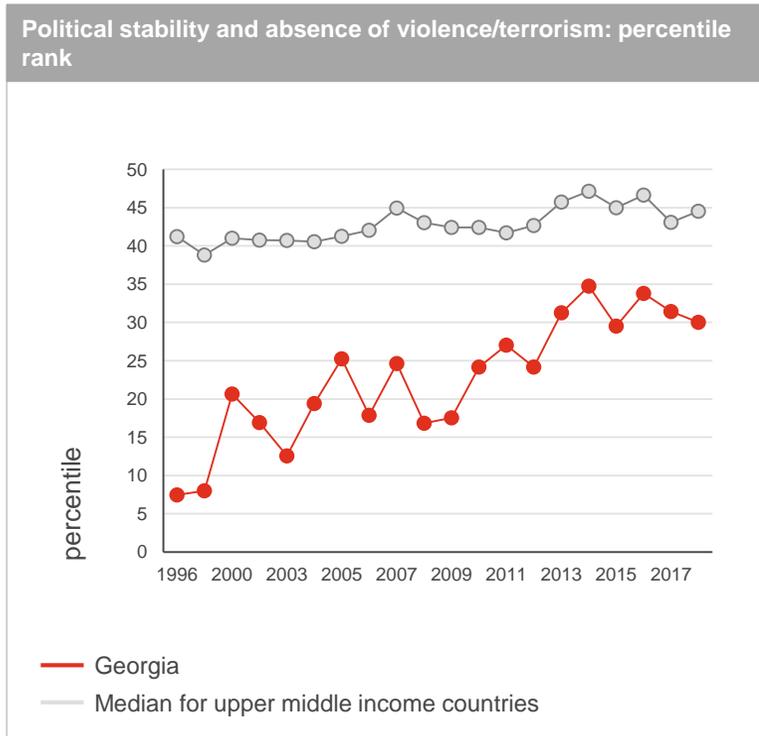
Source: Doing Business 2020, UNCTAD



- Low correlation between Doing Business ranking and inflows of FDIs per capita implicates more variables conditioning FDIs.
- Our study explored the key conditions relevant to investor including political stability, quality of infrastructure or availability of skilled workforce.

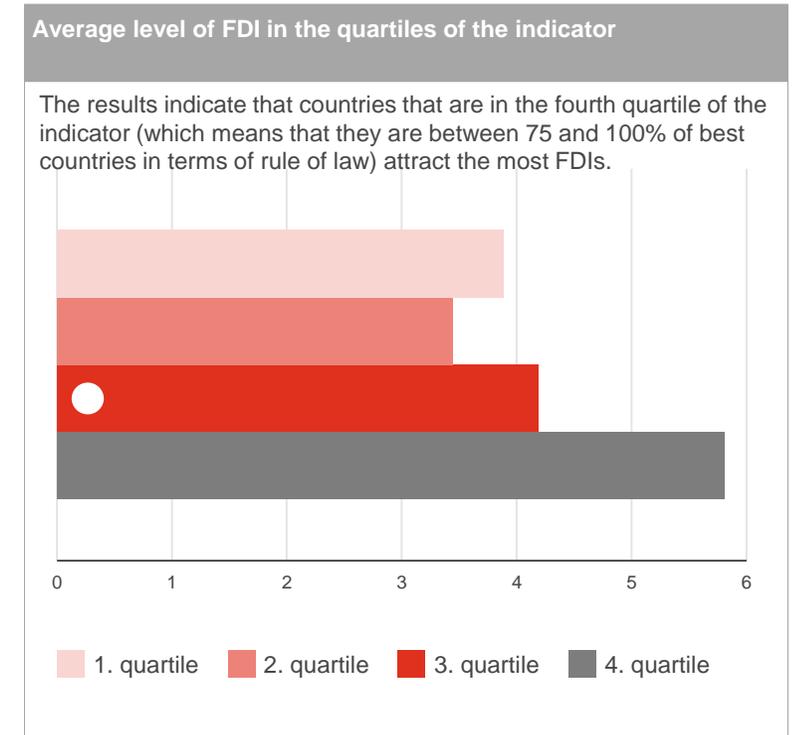
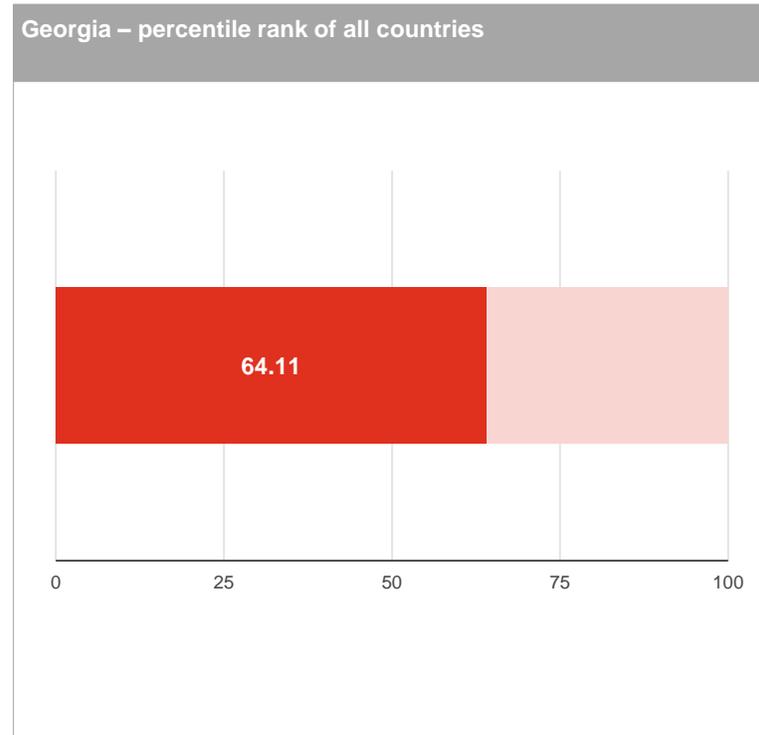
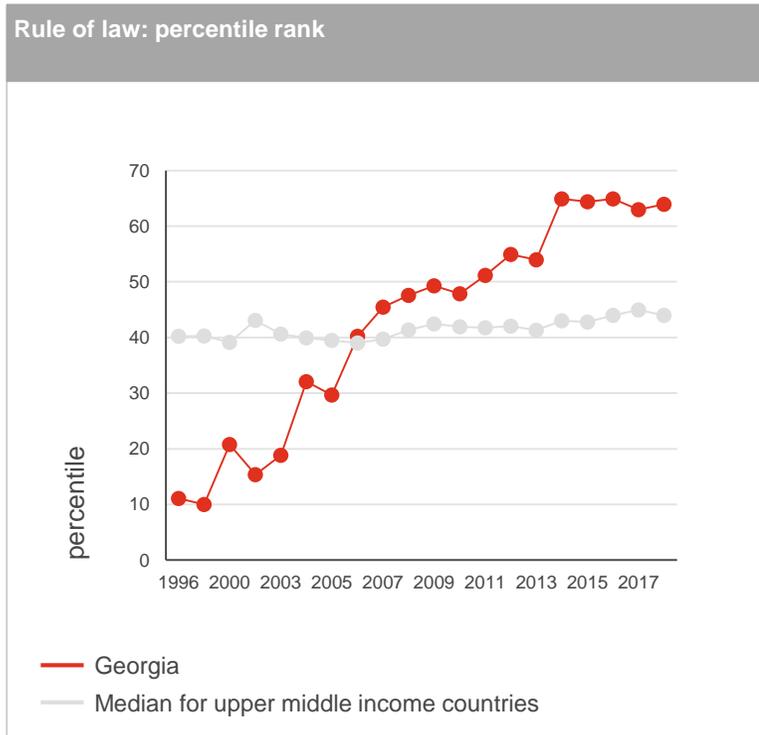
Political stability (World Governance Indicators)

Almost 70% countries in the World are perceived as more stable than Georgia in terms of political processes and absence of violence. Although Georgia has made substantial progress in this area, it is still rated much lower on this indicator than the average upper middle-income country. This has a clear and negative impact on country's ability to attract FDIs.



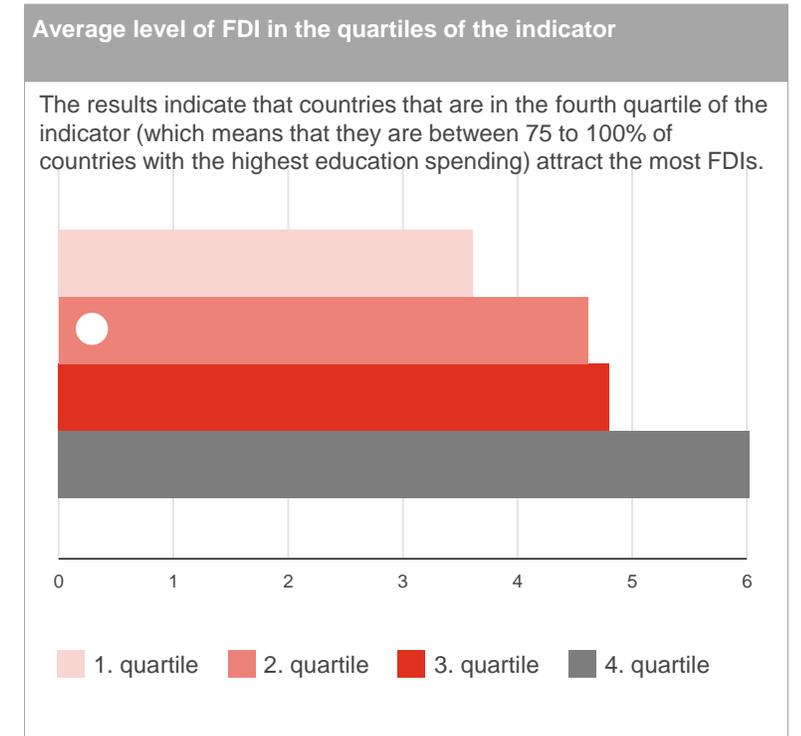
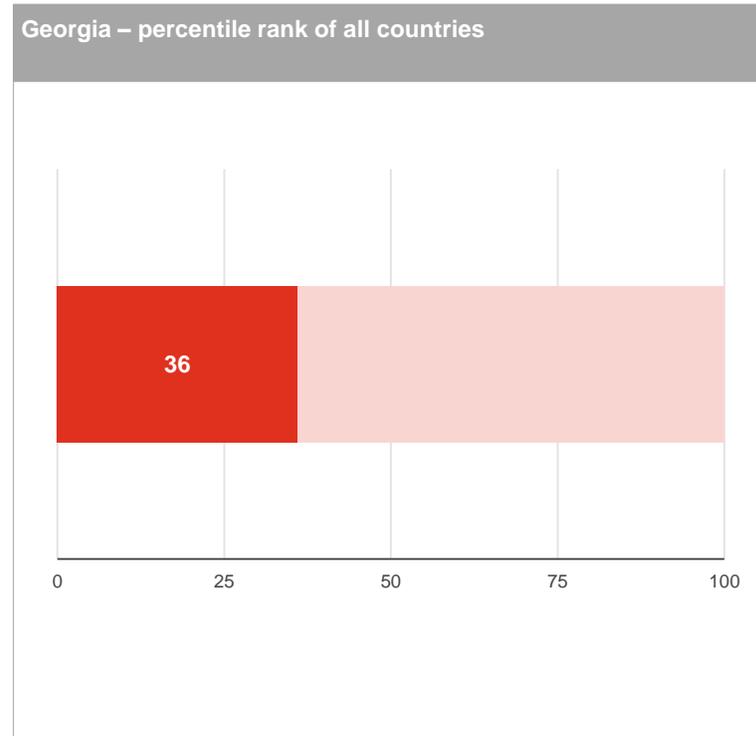
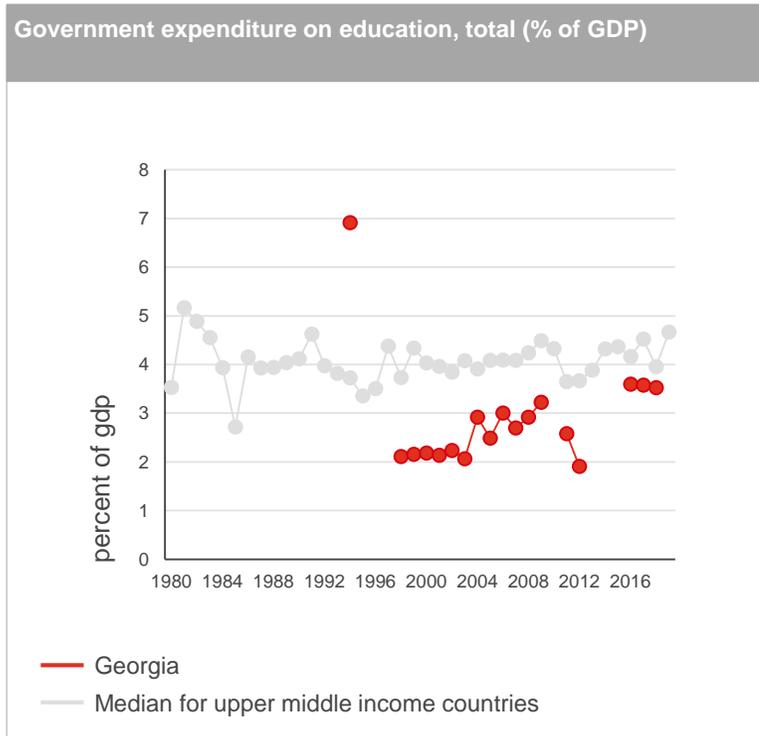
Rule of Law (World Governance Indicators)

Georgia has made an enormous progress in terms of improving the rule of law over the last three decades, but since the mid 2010s it has somewhat stalled. Should it continue on strengthening the effectiveness of its judicial system, it might increase its attractiveness to investors.



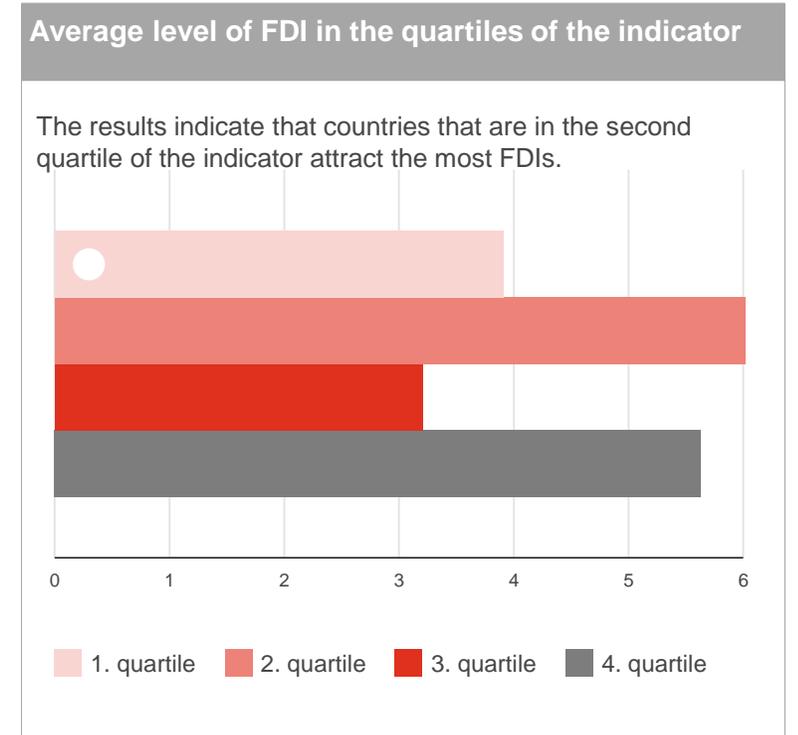
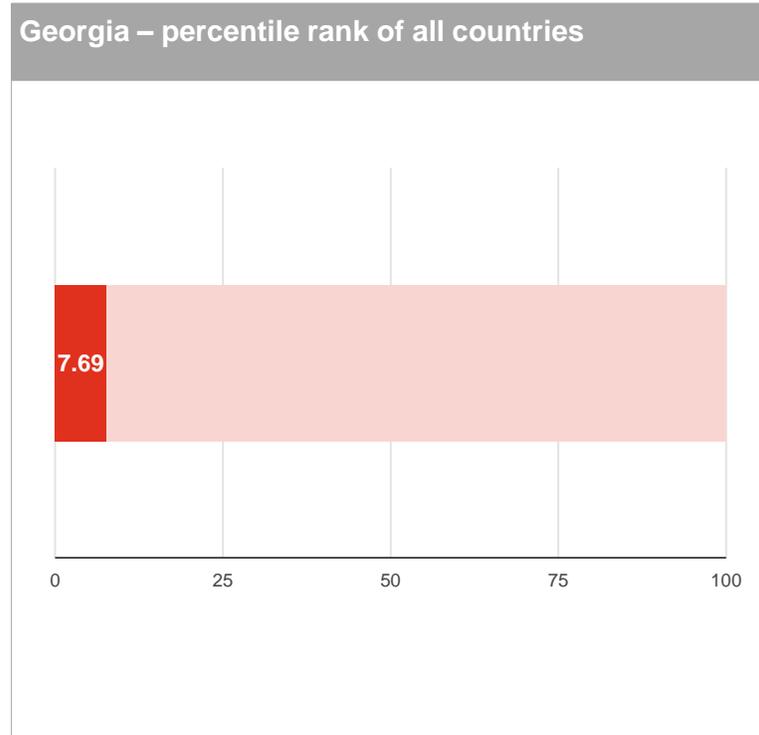
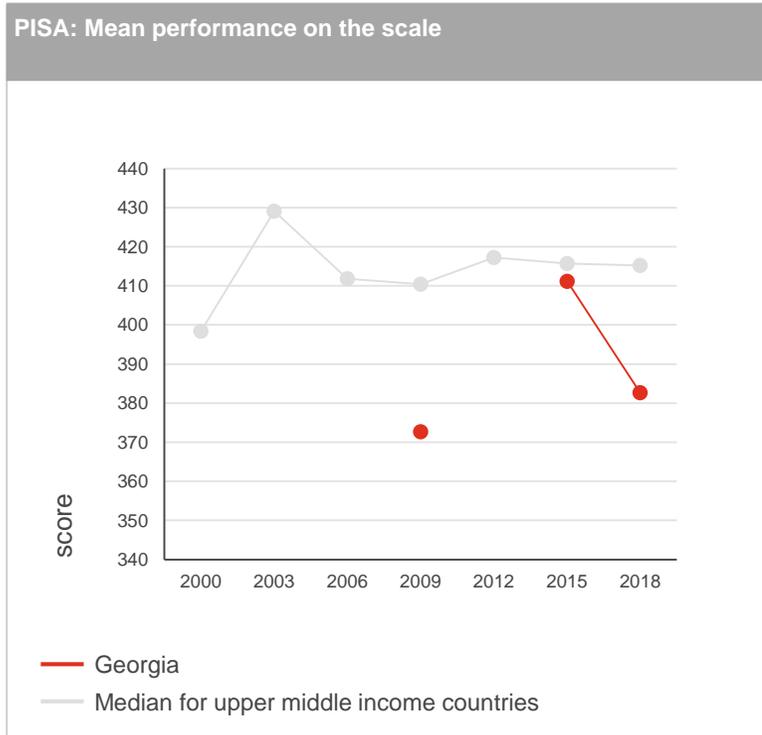
Education spending (World Bank)

Well educated workforce is one of the most important assets determining the FDI flows. This is especially true in the era when investments are more than in the past concentrated in the business services sector. That is why education spending correlates clearly with FDI inflows. In this area Georgia lags its peers.



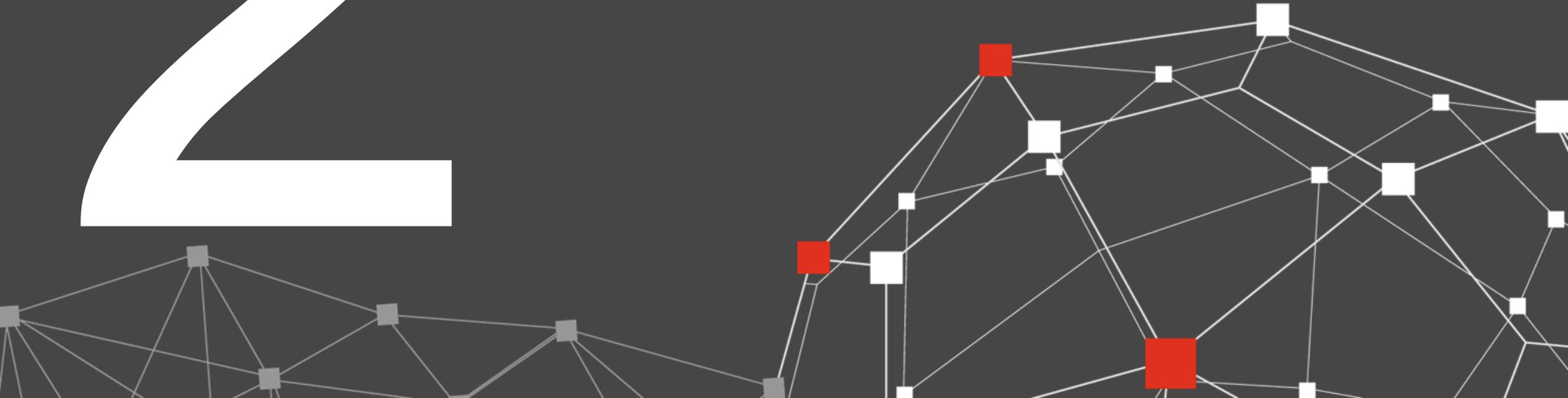
Education outcomes (PISA)

Georgia's lower results in the PISA test (Program for International Student Assessment, run by OECD) than its peer group may impact FDIs and country's growth prospects.



2

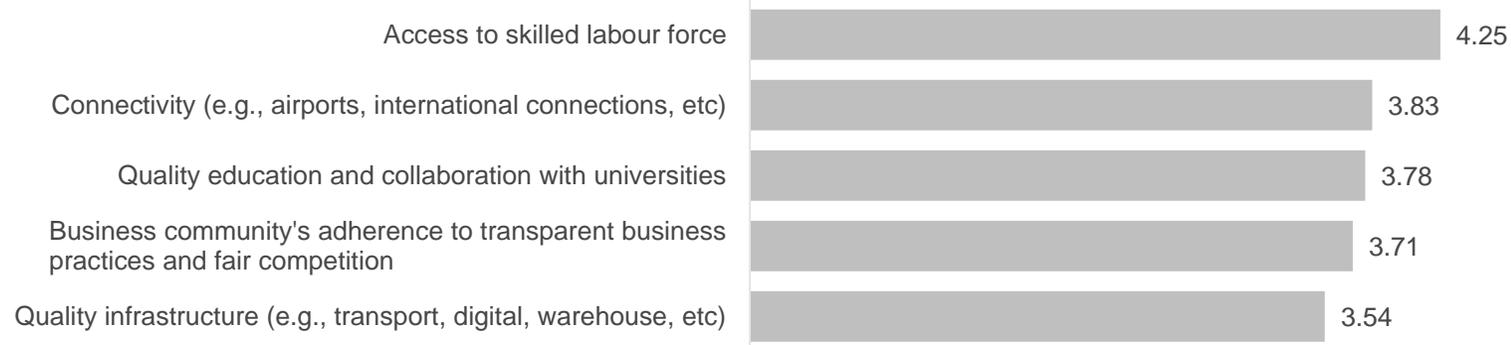
Key findings and
policy
recommendations



Key criteria for investors identified in the survey

Q: Which elements are critical for you when selecting a location for a new investment project in the post-pandemic reality?

Key criteria as seen by all respondents (n*=93)



Key criteria as seen by the targeted group** (n=52)



Access to talent, quality education, connectivity and transparent business practices and fair competition are top criteria selected by respondents.

Targeted respondents favor ESG practices.

* n - represents the number of responses to each question.

**Targeted group were companies operating in the industries that Georgia considers as priority sectors for investment attraction.

Human capital is the most important foundation that Georgia should build upon

1. Continue enhancing the private sector engagement in the field of General Education

2. Pay attention to STEM disciplines, digital and media literacy, development of entrepreneurial and basic labour skills

3. Tackle skills mismatch by further supporting the development of vocational education

4. Develop mechanisms for facilitating private sector and Higher Education partnerships

“

„Languages are a vital skill to develop. They should be speaking fluent English. Education is absolutely vital. Georgia hasn't invested enough in education. It is necessary to give people skills, because it is their competitive advantage.” **CEO of Gazelle Finance**

”

0.7 p.p.

According to our economic model, reforming the education outcomes could add 0.7 pp to the growth rate in the long-term.

Focusing on **education** and alignment of offered skills with needs of business, such as e.g. knowledge of foreign languages and technical upskilling

Findings:

- Online survey – access to quality labour (#1) and quality education are both among top 5 criteria for investors
- In-depth interviews - technical and language skills are crucial for international investors while choosing their investment location, especially in BPO and manufacturing industries
- Sectoral assessment – Lack of coordination of sectoral priorities with the universities, limited capacity of STEM skills and migration of employees that affect BPO, logistics and manufacturing related industries

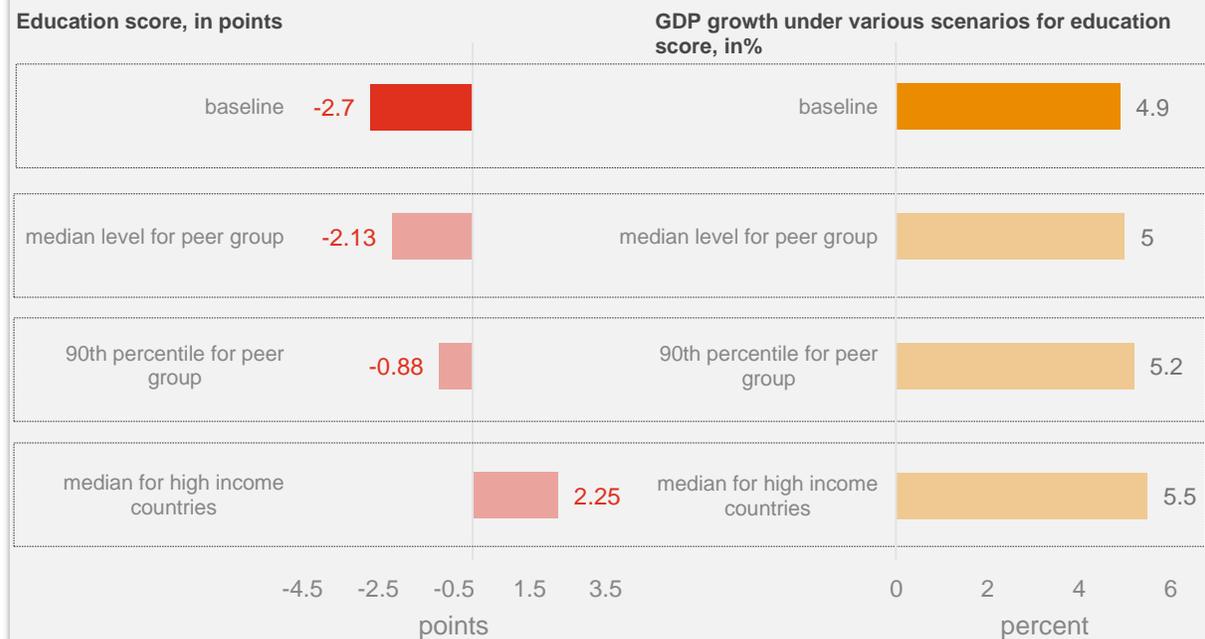
Actions:

- Define and prepare an action plan of VET state spending increase for 5-year period
- Aggressively promote rebranding of VET education
- Replace some of the bachelor programmes with shorter, modern and labour oriented VET programmes
- Significantly revise curricula for the bachelor level programmes where necessary and conduct retraining of teachers / professors

Testing results:

Average GDP growth over the 10-year period

LTGM simulation under various scenarios for the score for education inputs and outputs



Connectivity and quality infrastructure is a key to exist on a global FDI market

“

„Georgia needs infrastructure. That’s a game changer. Tying the country together.” **CEO, Gazelle Finance**

„Infrastructure is crucial, road infrastructure, airport infrastructure, connectivity. We see it in Central Europe where infrastructure was growing for years, how locations are being transformed.” **CEO, Panattoni Europe**

”

5. Improve digital infrastructure

6. Develop and promote public investment strategies – infrastructure programs and Trans-European Transport (TEN-T) Network

Developing country's **infrastructure** in order to provide connectivity and build on country's strategic position on a getaway between Europe and Asia

Findings:

- Online survey – connectivity and quality infrastructure are among top 5 criteria for investors
- In-depth interviews - quality of transportation within country is very important criteria for foreign investors
- Sectoral assessment - Insufficient quality of transport infrastructure throughout the country for tourism/hospitality, logistics and electric/electronic product industries

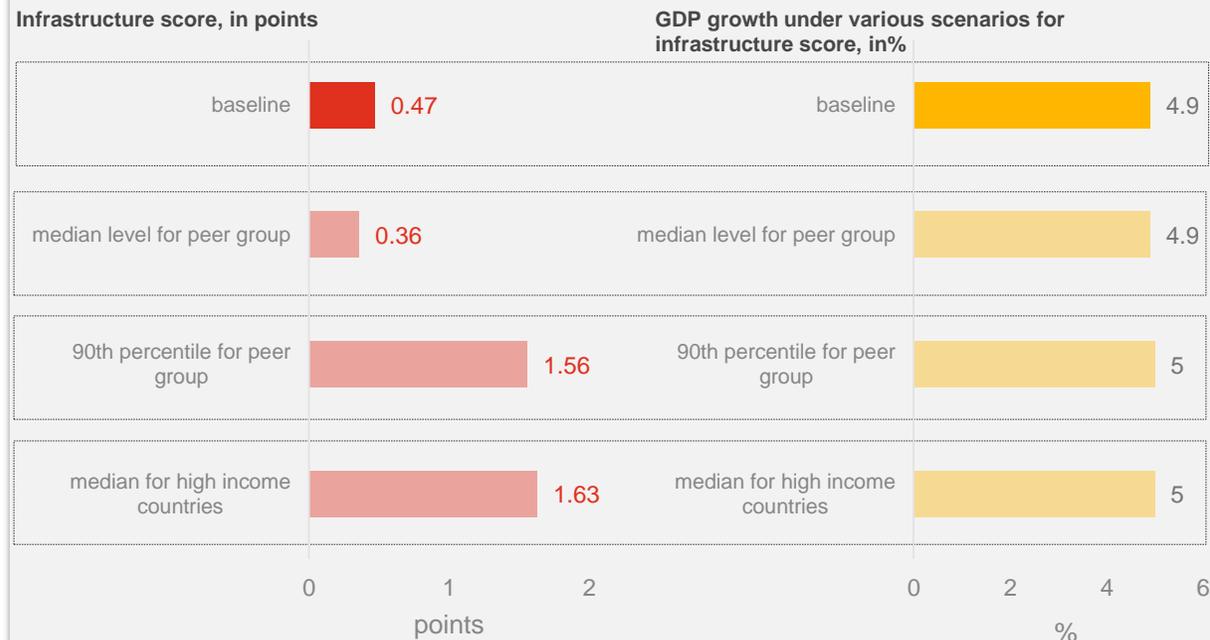
Actions:

- Develop a comprehensive roadmap for transport and logistics infrastructure network
- Support collaboration between the public and private sector on design and delivery models to increase efficiency
- Raise awareness of the private sector about new services and current and planned infrastructure development projects in the region
- Enhance digitalization and alignment of document flows and procedures, increase cooperation with the countries on the transit route from China to Europe

Testing results: Effects of growth in infrastructure availability score

Average GDP growth over the 10-year period

LTGM simulation under various scenarios for the score for infrastructure availability



Upskilling civil servants and supporting business networking and entrepreneurship are important in developing FDI attraction policies

9. Upskilling civil servants and further development of e-government services (digital government)*

10. Support formation of business clusters and business networking and entrepreneurship

11. Expand the data collected by national agencies and promote data distribution

“

„To promote foreign investment is a long-term cycle... it's about big business decisions, which means that somewhere an individual is putting their head on the block by recommending 'let's go to Georgia'” **Colliers**

”

* In the latest 2020 [edition](#), where Georgia is ranked 65th, it is underlined that e-government development continues to advance and progress is evident even in countries in special situations and limited resources.

5G is crucial for the IT and BPO sector

Infrastructure Digitalisation Recommendation: Improve digital infrastructure, upskill civil servants and further develop the e-government services (digital government)

Findings:

- Online survey – quality digital infrastructure is among top 5 criteria for investors
- In-depth interviews – In addition to the benefits of greater efficiency and effectiveness, it is suggested that the development of digital government services should be a top priority for countries who want to attract FDIs.
- Sectoral assessment – comparably low broadband internet speed that is mostly affecting the BPO sector

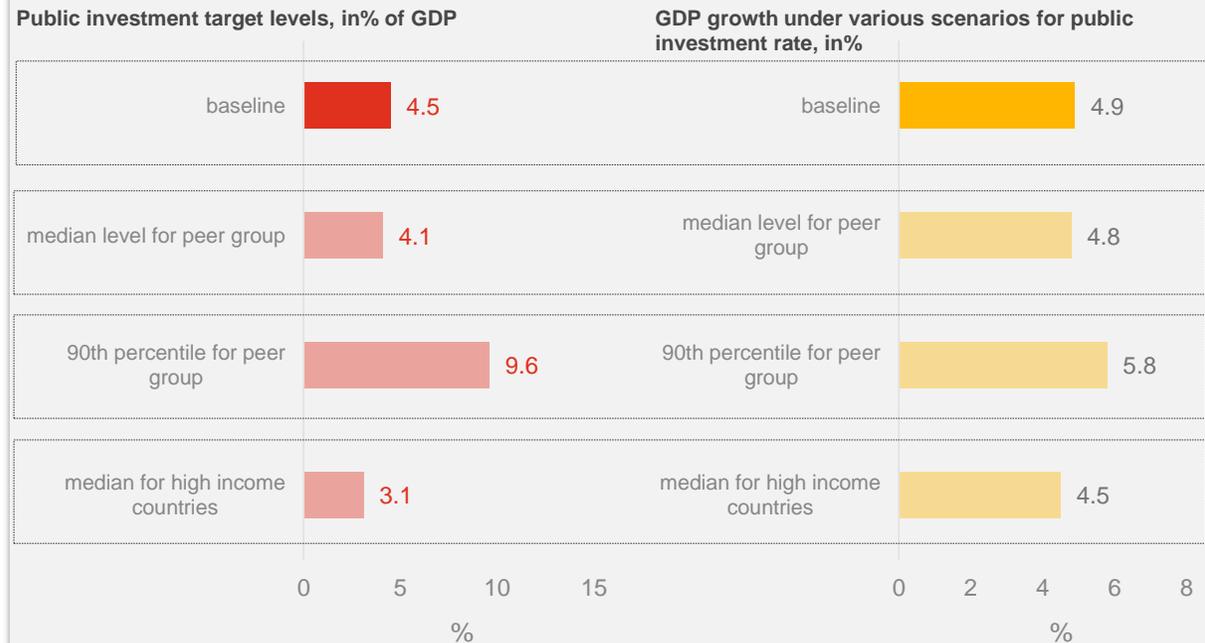
Actions:

- Promote development of 5G
- Increase of broadband internet speed
- Review the development of e-government services by: 1) enhancement of online services via various government websites; 2). further development of telecommunications infrastructure; 3). Upskill civil servants in e-governance and 4). continue investment in human capital to educate population on use of new technologies.

Testing results: Effects of enhanced infrastructure investments

Average GDP growth over the 10-year period

LTGM simulation under various scenarios for the public investment rate



It's about communication – Georgia should promote itself where the investors are looking

7. Launch promotional campaign to increase country awareness



8. Strengthen country's presence in Social Media channels



„In business we are fundamentally on LinkedIn 24 hours a day, so if we don't see stuff about Georgia on LinkedIn, it shouldn't be surprising we haven't heard all the good things about Georgia”. **Director of Market Engagement**



Georgia should target changing perceptions and improving country's **image** and identifying channels relevant to potential investors

Image Building Recommendation: Launch promotional campaign to increase country awareness and strengthen country's presence in Social Media

Findings:

- Online survey – Almost 95% of respondents have no experience of working with or in Georgia, 50% did not have information about Georgia. Online media is main information source for 68% of respondents
- In-depth interviews - the awareness of Georgia as an investment destination is low among foreign investors. Investors assume that Georgia as being surrounded by difficult neighbors and have similar public administration or governance or judiciary system.
- Sectoral assessment – lack of country awareness that is significantly affecting the tourism/hospitality sector

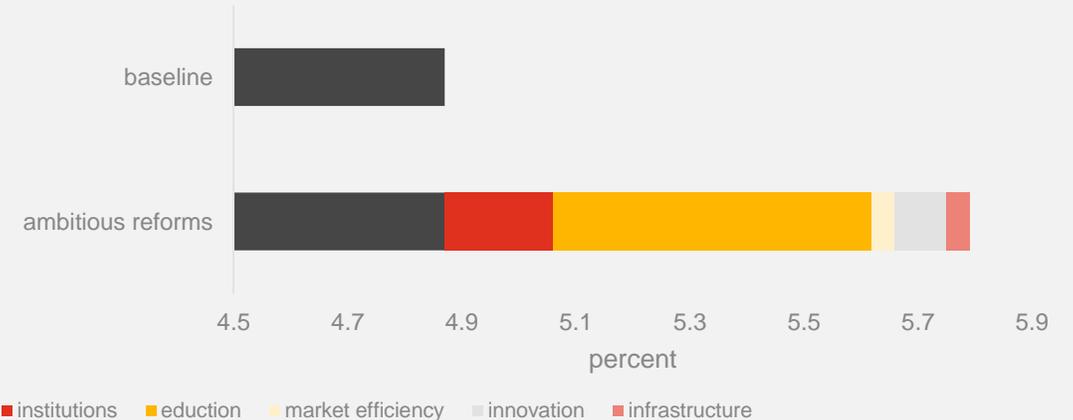
Actions:

- Develop a unified national brand development strategy
- Launch effective promotion strategy that will promote the country and be targeted at investors
- Launch a sector driven communications campaign
- Further develop usage of Social Media to target foreign investors and promote country
- Approach investors directly

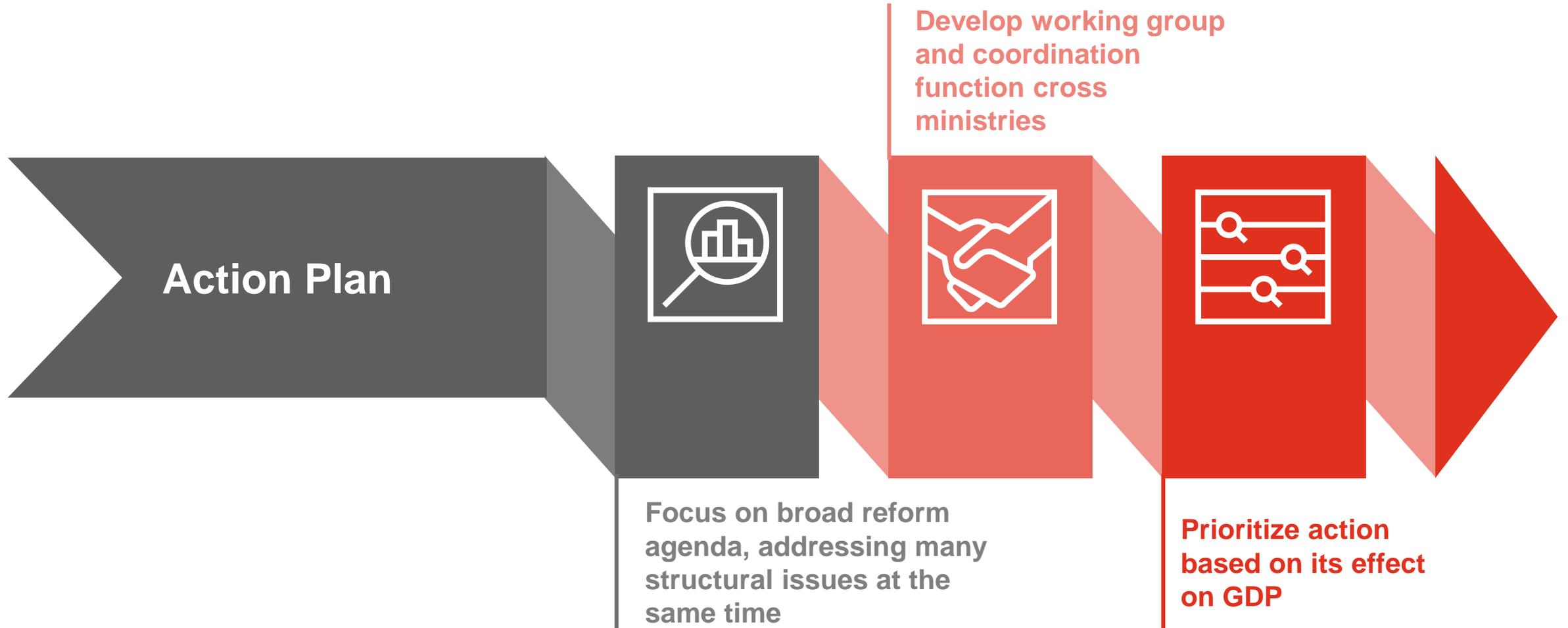
Testing results: all recommendations

GDP growth rate

% yoy



Key takeaways and action plan



Testing results of the potential tax measures show the potential effect that such changes has on the economy

VAT	Net effect on tax revenues in %*	Effect on GVA in all sectors in %*
Reduce VAT rate from 18% to 16%	-0,31%	0.312%
Reduce VAT rate from 18% to 14%	-0,62%	0.625%
Reduce VAT rate from 18% to 10%	-1,24%	1.249%
Increase VAT threshold from 100 000 GEL to 200 000 GEL	-0,04%	0.064%
Increase VAT threshold from 100 000 GEL to 300 000 GEL	-0,06%	0.118%
Increase VAT threshold from 100 000 GEL to 500 000 GEL	-0,12%	0.225%
Reduce VAT rate for SMEs from 18% to 10% for persons with turnover under GEL 500 000	-0,06%	0.118%
Reduce VAT rate for SMEs from 18% to 10% for persons with turnover under GEL 1 000 000	-0,11%	0.198%
Reduce VAT rate from 18% to 10% for restaurants	-0,03%	0.027%
Reduce VAT rate from 18% to 4% for restaurants	-0,05%	0.046%
Exempt hotel services from VAT	-0,06%	0.06%
Reduce VAT rate from 18% to 10% for hotel services	-0,03%	0.027%
Reduce VAT rate from 18% to 4% for hotel services	-0,05%	0.046%
Exempt internal tourism services from VAT	-0,04%	0.041%
Reduce VAT rate from 18% to 10% for tourism services	-0,02%	0.018%
Reduce VAT rate from 18% to 4% for tourism services	-0,03%	0.032%
Art, entertainment and recreation sector - exempt from VAT	-0,03%	0.033%
Exempt from VAT all education services	-0,02%	0.015%
PIT	Net effect on tax revenues in %	Effect on GVA in all sectors in %
Decrease PIT rate from 20% to 18%	-0,65%	0.673%
Decrease PIT rate from 20% to 15%	-1,63%	1.684%
Decrease PIT rate from 20% to 12%	-2,60%	2.694%
Exempt staff of restaurants from PIT	-0,10%	0.104%
Exempt staff from hotels from PIT	-0,10%	0.104%
Exempt staff in other tourism services from PIT	-0,21%	0.231%
Exempt private entrepreneurs in tourism services from PIT	-0,06%	0.062%
Decrease PIT rate for hospitality staff from 20% to 15%	-0,04%	0.041%
Decrease PIT rate for hospitality staff from 20% to 12%	-0,07%	0.066%
Decrease PIT rate for hospitality staff from 20% to 5%	-0,13%	0.124%
Other	Net effect on tax revenues in %	Effect on GVA in all sectors in %
Exempt restaurants from property tax	-0,03%	0.026%
Exempt hotels from property tax	-0,03%	0.026%
Exempt real estate from property tax	-0,13%	0.146%

Net effect on tax revenues and GVA in all sectors for baseline scenario

The measures with general targeting and the biggest tax rate reduction respectively results in proportional reduction in tax revenue, however should have a bigger stimulus effect on the recovery of the economy in post COVID era. For example, in baseline scenario economic growth might reach 2,7% in case PIT rate reduction to 12% while the growth would be smaller, i.e. - 1,7% if the rate is reduced to 15%.

On the other hand, fiscal measures with lower tax reduction bring moderate effect on growth of economy and subsequently the negative effect on fiscal policy is smaller. For example, 2% VAT rate cut would lead only to 0,3% growth of economy.

Because of the higher portion of the PIT in the Georgian state budget, its reduction leads to more than twice bigger effect in comparison to VAT rate reduction.

Sectoral targeted measures tend to cause smaller reduction in tax revenue, but the overall effect on economy is smaller. However, the effect on the specific sector is considerably higher.

Our study shows that within one year period, the economic growth is nearly equivalent to the tax cut. However, if increasing VAT threshold, this leads to significantly higher economic growth in comparison with rest of the fiscal measure types.

Dear Sir/Madam

Assessment of the Impact of Covid-19 on the Georgian Economy and preparation of a Medium-term Strategy for recovery

This report has been prepared only for the EBRD and solely for the purpose and on the terms agreed with EBRD in our Agreement (#2021.001672) dated 20 January 2021.

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As described in the Agreement or as expressly agreed by us in writing, we accept no liability (including for negligence) to anyone else or for any other purpose in connection with this report and it may not be provided to anyone else.

Should you have any questions concerning this report, please contact Nino Cholokashvili at +995 599 933311 or nino.cholokashvili@pwc.com.

Yours sincerely,

Agnieszka Gajewska