NEWSLETTER

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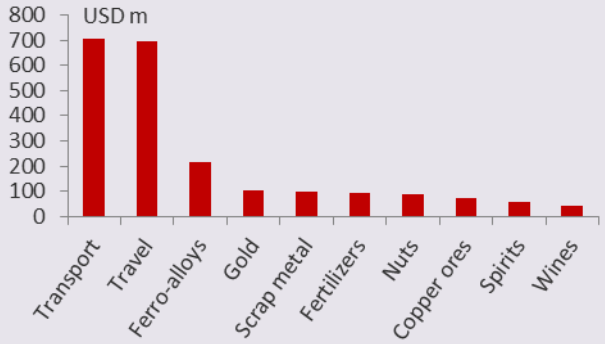
# Georgia's economic specialisation: Present and future

**Georgia's economic development depends on diversifying and upgrading the range of goods and services it can competitively sell on the global market. An empirical approach indicates potential for specialisation in energy-intensive products, the engineering sector, business services and diverse agri-food products. Developing this potential will increase the diversification of Georgia's exports as well as improve the presently low value-added content in Georgia's top exports. In order to realise this potential, it should be actively communicated by the government to help guide investors' decisions. Also, these results on specialisation potential and value added in diverse products should inform necessary allocations of public resources in areas including infrastructure and public education.**

### Specialisation has not changed much in past 10 years

Countries should specialise in the production of goods and services in which they have comparative advantages. Georgia is at present mainly perceived to have comparative advantages in tourism, agriculture and food and as a transit country for energy and goods. Specialisation in these fields can be clearly observed in export data. However, other strengths exist: Metal products such as ferro-alloys, gold, copper ores and some chemical industry products are also among Georgia's largest exports.

**Top 10 export products by volume, 2009-2011 average**




*Source: UN Comtrade and Services Trade databases, own calculations*

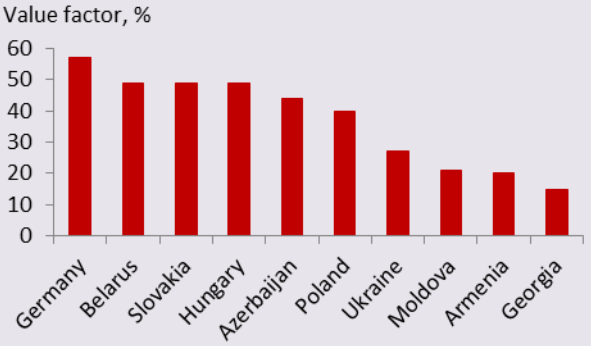
Over the past ten years, Georgia's main exports have not changed significantly. Apart from hazelnuts, no major new specialisation has evolved so far.

### Limited product diversification and value factor

There is, however, a need for an evolution of the specialisation profile. At the moment, the ten largest export products account for 66% of Georgia's total exports. This is less than in Azerbaijan or Armenia, but considerably more than for example in Poland, where the top 10 export products constitute only 32% of total exports, rendering the economy less vulnerable to shocks in individual markets.

Furthermore, Georgia is at present specialised in goods that offer relatively little value added, measured here by the "value factor".

**Value factor* of top 10 exports, weighted average**




*Source: UN Comtrade and Services Trade databases, own calculations*
** The value factor of a product indicates the correlation of export specialisation with the income level of exporting countries. A product with a high value factor is typically exported by higher-income countries*

It is desirable that Georgia gradually climbs up the "ladder" of value added to more technology-intensive, specialised products, building on skills gained in the production of simpler products.

This analysis does not at all imply that current specialisations are wrong and should be abandoned. However, it does indicate that the present specialisations should be complemented with specialisations in other products to increase product diversification and value-added in the future.

### Potential in four categories

We applied an innovative empirical methodology to predict in which products Georgia could develop specialisations in the future. The strategy is broadly that if countries specialised in exporting A and B are often also specialised in exporting C; and if Georgia is specialised in A and B, but not C, there may be potential for future specialisation in C.

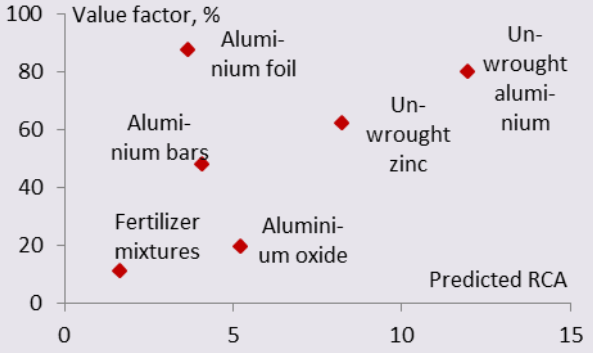
Our analysis predicts potential for new specialisation in four broad categories:

- Energy intensive products
- Some manufactured products
- Business services
- Various agricultural and food products

The predicted potential should be verified using qualitative, sector-specific information. Nevertheless, the four categories appear credible at first sight.

Key condition for the production of energy-intensive products such as aluminium is the availability of cheap energy. Georgia has excellent hydro power potential and has successfully exported electricity in past years. It also has sea access for importing raw materials and exporting processed goods. Products in this category on average also exhibit significant value factors and thus seem conducive to the qualitative development of Georgia's specialisation profile.

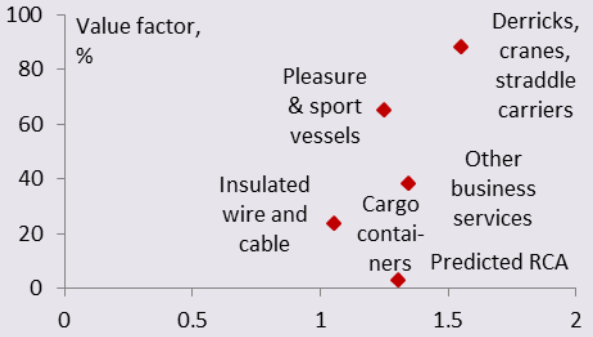
**Energy-intensive products: Predicted potential* and value factors**




*Source: UN Comtrade and Services Trade databases, own calculations*
*We measure and predict specialisation in a product using "revealed comparative advantages" (RCA). An RCA >1 means that a country exports a larger share of a product than other countries and has a comparative advantage in this product.*

Specialisation in other goods of the manufacturing sector also seems feasible. A metal and engineering industry (e.g. railway locomotive production) exists in Georgia. Developing this expertise contributes to growing the role of the industrial sector. Value factors in these products, as well as business services, are largely above the average of the current top 10 exports.

**Manufacturing and business services: Predicted potential and value factors**




*Source: UN Comtrade and Services Trade databases, own calculations*

The range of predicted potential in agricultural and food products is too large to present here. However, two considerations contribute to the credibility of this potential: Firstly, Georgia already is specialised in several products in this category and secondly, as Georgia clearly has a comparative advantage in agricultural and food production, its present net deficit in agricultural trade indicates unexploited potential.

**Policy implications**

Successful economic specialisation is the outcome of market processes, not of government planning. However, a vision of the potential of Georgia is a vital ingredient to the government's communication with investors. This is particularly relevant for developing the manufacturing sector, in which real and valuable potential seems to exist, yet the sector is often disregarded as a comparative advantage of the country.

Furthermore, in some cases (e.g. infrastructure investments) government policy cannot be fully neutral towards all economic sectors. Such decisions should be informed by objective potential as well as figures about the value-added (value factor) of the respective products.

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Note: The results presented here are based on the forthcoming Policy Paper PP/01/2015 "Georgia's economic specialisation: Present and future" and PB/02/2015 "Georgia's economic specialisation: Summary of Results"
Download at: www.get-georgia.de

**German Economic Team Georgia (GET Georgia)**
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