

Industrial potential in Georgia: The engineering sector

Research by the German Economic Team has identified investment potential in four sectors in Georgia, among them the engineering sector. In terms of local factors, Georgia is already well-equipped for labour-intensive production of simpler light goods, i.e. wires and cables for lower supply chain integration as, for example, in the automotive industry.

We verified the potential of the engineering sector by assessing the following competitive factors: labour skills and cost, the business environment and the (cost-efficiency of the) transportation system. Apart from the requirement of essential investments in education, in particular vocational training, and most importantly in transportation, Georgia commends itself due to highly competitive wages, political stability, low profit tax and low administrative burden. This potential needs to be actively communicated to investors. General infrastructure investments need to be promoted as they are the key to unlocking Georgia's industrial and transit potential.

Background

The German Economic Team conducted studies evaluating Georgia's specialisation potential in order to diversify and increase production, exports and the national value-added chain. Major incentives for further specialisation are the currently low level of diversification in its export structure, leaving Georgia highly vulnerable to individual shocks, as well as the inherent low level of value-added. Reliable potential has been predicted in four major sectors, one of them being simple engineering goods. The following goods were considered to bear this potential, ranked from highest to moderate annual export potential:

- *Insulated wires and cables*
- *Pleasure & sport vessels*
- *Derricks, cranes, straddle carriers*
- *Cargo containers*

The global market allows potential

The global market for simple engineering goods does not seem fully saturated and allows growth expectations. Especially the wire and cable market is likely to grow significantly in the future. As Georgia enjoys good access to the EU and to Asian market, which is second after the EU in terms of trade volume, there is a significant chance of successful engagement. Thus, there is unexhausted market volume which validates the argument.

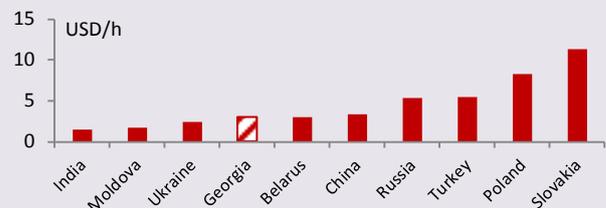
Competitive factors for the engineering industry

A subsequent analysis has been conducted in order to verify the predicted potential, yielding fairly positive results. Thus, three significant competitive factors for the sector of engineering goods of low to moderate complexity were identified upfront and analysed with respect to the status quo in Georgia: labour skills and cost, the business environment and the transportation system with respect to cost-efficiency. For the comparative analysis, other Eastern European and Asian countries specialised in the production of these goods served as benchmarks.

Human capital: Labour skills and cost

Regarding human capital constitution, average wages in Georgia are highly competitive, which is certainly essential as they account for 15-30% of total production cost depending on the technological level. But there also appears to exist a rather low skill base of the workforce as production is – if at all – currently based on outdated technology. Thus, initially, the workforce is rather equipped for “non-high-tech” or “limited skills” production.

Average wage in manufacturing



Source: National statistics bureaus

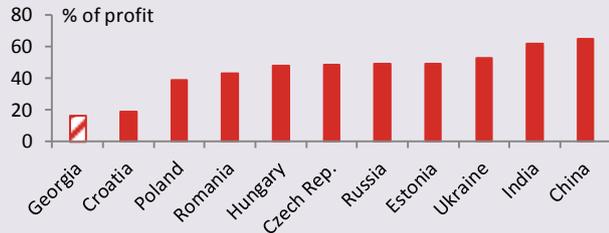
In order to increase the technology level and the skill base of workforce, cooperation with international partners (and potential investors) should be promoted to improve academic and vocational education as well as the communication of already improved graduate schemes.

Business environment: Tax and administration

In terms of the business environment, which is crucial for the attraction of FDI, Georgia has certainly positive location factors. The business environment has received remarkably high rankings by the World Bank's Doing Business report and other studies. It was concluded that the environment has good accessibility and political stability, i.e. a low level of corruption, and that the bureaucratic burden as well as tax burden is comparatively low. There are only few taxes and the total profit tax amounts to only 16.4%. Also, it takes only 2 days to administratively set up a business.

Moreover, the initiative “Produce in Georgia” provides very cheap access to land, infrastructure, finance and consulting services.

Total profit tax rate



Source: World Bank Doing Business 2015

Thus, the business environment can be regarded as being already highly supportive and attractive. Nevertheless, improvements of certain aspects are still necessary, particularly in the quality and constancy of electricity supply to companies.

Infrastructure: transportation cost and system

With respect to infrastructure, the transportation system is the segment that is most in need of promotion, support and investment. Smooth integration into supply chains will only be successful if there is an effective and cost-efficient transportation system, especially for heavier goods, which require more advanced transportation systems. Currently, only lighter goods can be transported quickly, reliably and cost-efficiently using road transport on the main highways.

Cost to Export-Import



Source: World Bank

In order to implement a cost-efficient transportation system for heavier goods, investment into the rail and road systems is necessary. The recent signing of the agreement with investors on constructing a deep-sea port in Anaklia should be seen as very positive news in this context.

Implications

Since the breakdown of the USSR, most of Georgia’s manufacturing sector has been discontinued. Consequently, a technology gap in capital and labour opened up. But Georgia has significant potential to be unlocked. To this end, the constructive dialogue with investors on Georgia’s potential is indispensable.

Any labour-intensive production of relatively simple and light goods and a low-end-integration in respective supply chains, i.e. wires and cables for automotive industry, already finds a favourable business environment. But there is much targeted effort necessary, mostly with respect to infrastructure: Investments ranging from roads, rails and ports to the energy grid and to communication systems as well as the implementation of routine vocational training.

Currently, there are issues regarding the transit of Ukrainian goods through Russia, consequently raising attention to the “New Silk Road”, originally mainly proposed by China as a land route to Europe that passes through Georgia. Increased traffic on, and investments into this route will improve Georgia’s transport link with Europe and Asia at the same time and create the possibility for Georgia to become a trading hub between Eastern Europe and Central Asia. Nevertheless, investments into the domestic transport system will continue to be vital to unlock Georgia’s potential in the engineering sector.

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Note: A more comprehensive analysis of the topic is provided in the Policy Briefing PB/06/2015 – “Engineering goods: Potential in Georgia” available at www.get-georgia.de

German Economic Team Georgia (GET Georgia)

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