# GEORGIA AT THE CROSSROADS BALANCING VULNERABILITY AND OPPORTUNITY

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It was prepared with the help of AI-generated images and AI assistance to enhance clarity and consistency, while maintaining full human oversight of the research and conclusions.

The Republic of Georgia is undergoing a period of significant economic transformation, driven by shifting regional trade, financial reforms, and new foreign investment. Historically positioned at the crossroads of Europe, Asia, and the Middle East, Georgia has long been a contested fault line where competing empires sought influence. Today, that legacy persists, with Russia, Turkey, and Iran shaping its external environment while newer actors like the EU, US, and China expand their presence in the region.

Despite these complexities, Georgia's geographic centrality offers real economic opportunity. The country's ability to develop peaceful and balanced relations with all major regional actors is increasingly seen as a key enabling condition for its long-term prosperity. With stability, Georgia can fully leverage its role as both an east-west and north-south transit corridor — integrating into global supply chains while acting as a platform for trade, finance and specialized industrial activity.

Three plausible scenarios frame Georgia's medium-term outlook:

- **Managed Expansion** (Base Case): Continued growth driven by reforms, trade flows and foreign investment.
- **Friction & Fragmentation:** Slower growth if geopolitical or governance risks deepen.
- **Strategic Repositioning:** Accelerated growth if Georgia successfully leverages its geography, governance and sectoral opportunities.

The single most critical condition underlying all three scenarios remains regional peace and stability. Georgia's capacity to sustain balanced relations with both its immediate neighbors, as well as competing global powers, will largely determine whether its reform agenda matures into a durable growth platform.

While significant vulnerabilities remain, Georgia currently offers one of the more dynamic growth opportunities within the broader Caucasus–Black Sea region, with growing relevance to international investors, supply chain managers, and regional policymakers alike.

Georgia's strategic advantage lies not in size or strength, but in usefulness. If it can institutionalize peace — not as a pause, but as a platform — and continue serving as a neutral, reliable node in global trade and finance, it may secure something rare in its neighborhood: durable sovereignty backed by relevance, not alignment.

# SECTION 1

## From Collapse to Reform: Georgia's Economic Journey

Georgia's economic journey begins in the shadow of Soviet collapse, marked by institutional disarray, internal conflict, and economic freefall. Like many of its post-Soviet peers, Georgia's GDP contracted sharply, hyperinflation surged, industrial production plummeted, and the command economy that had structured daily life disintegrated almost overnight.

During the 1990s, Georgia struggled to stabilize its economy amid internal conflicts, including civil war and separatist tensions. Infrastructure decayed, energy shortages were frequent, and large portions of the population fell into poverty. The country faced the dual challenges of building entirely new state institutions while simultaneously managing a severe economic contraction. By 1995, Georgia's per capita GDP had fallen to one of the lowest levels in the region.

The early 2000s marked a structural turning point in Georgia trajectory. Under a series of reformist governments, Georgia adopted an aggressive liberalization strategy designed to break from the legacy of Soviet central planning. Key reforms included:

- Privatization of state assets across most sectors;
- Simplification of tax codes and sharp reductions in marginal tax rates;
- Deregulation and ease of doing business reforms, reducing licensing and permitting barriers;
- Criminal justice and anti-corruption campaigns, which dramatically altered Georgia's international image; and
- ·Open capital and trade policies, with a strong emphasis on foreign investment attraction.

These efforts produced significant gains for the country. Throughout the 2010s, Georgia consistently ranked among the global leaders in World Bank Ease of Doing Business rankings. In addition, inflation stabilized, as did the currency (lari) and foreign capital inflows increased. The financial sector, logistics industry and real estate market developed rapidly.

# SECTION 1

By the 2010s, Georgia successfully repositioned itself as one of the most liberal and open economies in the post-Soviet space — distinct both from Russia's resource-driven model and many of its CIS peers. Its geographic location between Europe, the Black Sea, Central Asia and the Middle East, gave it leverage as a regional transit and logistics hub.

Despite these advances, Georgia's transformation remains partial. The country continues to face structural vulnerabilities related to capital dependence, external shocks, demographic pressures and limited domestic industrial capacity. Nonetheless, the country's reform trajectory remains one of the most distinctive in the broader Caucasus-Black Sea region. These reforms did more than modernize the state — they enabled Georgia to position itself as a fast-moving, trusted platform for commerce and diplomacy in a volatile neighborhood.

# SECTION 2

## Structure of the Georgian Economy

Georgia's post-reform economy has taken on a service-oriented character, underpinned by trade, real estate, finance, and logistics, with moderate industrial capacity and a relatively underdeveloped agricultural base. Despite structural vulnerabilities, recent headline growth has been striking: real GDP expanded by 10.6% in 2021, 11.0% in 2022, and 7.8% in 2023 — among the fastest post-pandemic recoveries in the region. A portion of this growth was inflated by hot capital inflows, particularly from Russian private wealth.

Between 2021 and 2023, nominal GDP rose from ₾60.7 billion to ₾80.9 billion, and per capita income jumped from $5,083 to $8,284 (USD), reflecting both expansion and inflation. The sectoral composition highlights a consumer-driven model dominated by:

- Wholesale & Retail Trade (16%) — the most consistent driver of value, fueled by urban consumption.
- Real Estate (11%) — buoyed by tourism, diaspora demand, and cross-border capital.
- Manufacturing (10%) — modest in scale, focused on food, beverage, and apparel processing.
- Transportation & Storage (6%) — logistics and transit services tied to Georgia's corridor position.
- Information & Communication (ICT) (6%) — the fastest-growing sector, driven by digital finance, IT outsourcing, and regulatory openness.
- Financial Services (5%) — small in GDP terms but regionally influential.

**Sectoral Shifts & Labor Challenges**

Georgia's consumption-led model has proved resilient, but structural productivity remains limited. While ICT grew by over 120% between 2021 and 2023, and logistics rebounded sharply, value-added industrial output and export competitiveness remain constrained. Real estate growth in nominal terms has recently slowed in real terms, hinting at potential cooling or saturation.

Unemployment has declined (from 20.6% in 2021 to 16.4% in 2023), but youth unemployment remains near 30%. Skills mismatches persist, particularly in ICT, logistics, and manufacturing. Georgia's education system overproduces graduates in law and social sciences while under-supplying technical and trade professionals.

**Summary Insights**

- Georgia's economy is broadly diversified across services, but structurally underweight in high-productivity industry and export agriculture.
- ICT and logistics present the most scalable long-term opportunities.
- The current model relies heavily on consumption and capital inflows — creating momentum, but also fragility.

# SECTION 3

## Trade, Current Account & External Balances

Georgia's growth model remains deeply reliant on foreign trade and external capital. As a small, open economy with limited domestic industrial capacity, Georgia imports far more than it exports, resulting in persistent current account deficits typically ranging from 5–10% of GDP. While the country has so far financed these gaps through a mix of tourism, remittances, and foreign direct investment, the imbalance signals structural economic fragility.

**Exports: Narrow and Volatile**
Merchandise exports grew from $4.2 billion in 2021 to an estimated $6.6 billion in 2024. This growth reflects improved regional integration and favorable currency effects. However, the base remains narrow and unusually reliant on one opportunistic trade niche: the used car re-export business. Georgia imports damaged vehicles — primarily from the U.S., Korea, and Japan — repairs them, and re-exports them to nearby markets. While this generates headline export volume (over $2.8 billion in 2024), the net value-added is modest, and the activity is highly exposed to regulatory or currency shifts in partner countries.

Traditional exports such as wine, mineral water, and copper ores remain competitive but constrained by scale and certification hurdles. Wine, in particular, continues to serve as Georgia's export identity — its deep-rooted cultural value matched by growing niche demand in EU and Gulf markets. Beyond this, traditional exports such as wine, mineral water, and copper ores remain competitive but constrained by scale and production bottlenecks. High-end wine and mineral water show growth potential, particularly in the EU and Gulf markets, but r**equire certification upgrades and marketing investments to scale further.**

**Imports and Trade Deficit**
Imports remain highly diversified—spanning fuel, capital goods, pharmaceuticals, vehicles, and industrial inputs—highlighting Georgia's structural reliance on external supply for both consumption and production. As a result, the goods trade deficit remains large, persistent, and unlikely to close in the medium term.

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**Capital-Financed Balance**
Georgia's trade imbalance is financed through three primary channels:

- **Remittances** — Roughly 10% of GDP in peak years, driven by labor migration to Russia, the EU, and the Gulf.
- Tourism — Over 5 million annual visitors post-COVID, generating critical service exports.
- Foreign Direct Investment — Averaging 5–7% of GDP annually, concentrated in real estate, infrastructure, and finance.

This model has allowed Georgia to avoid balance-of-payments crises, but it creates exposure to exogenous shocks: geopolitical instability, global interest rate shifts, or disruptions to labor or tourist flows could trigger financing stress.

**Summary Insights**

- Georgia's export base is growing but remains narrow, opportunistic, and scale-constrained.
- The economy is structurally import-dependent —particularly for fuel, capital equipment, and pharmaceuticals.
- Persistent current account deficits are manageable in stable periods but leave Georgia vulnerable during capital tightening cycles.
- Long-term sustainability will require deeper industrial capability, export diversification, and resilient service income.

**Tbilisi as a Financial & Tech Platform**

Tbilisi has quietly emerged as one of the region's most dynamic hubs for financial and digital experimentation. Regulatory simplicity, competitive wages, and capital openness have enabled a flourishing fintech and software ecosystem. The city now hosts cross-border fintech pilots, crypto-enabled payment platforms, and sandbox-tested regulatory frameworks.

Despite challenges with AI talent and cybersecurity depth, the sector's trajectory suggests a potential leapfrog into higher-value services—especially if Georgia can retain talent and scale venture financing.

# SECTION 4

## Foreign Investment: Capital Sources and Patterns

Foreign direct investment (FDI) has long served as one of Georgia's core economic pillars, enabling infrastructure expansion, sector development, and macroeconomic stability. Since liberalizing its economy in the early 2000s, Georgia has consistently maintained one of the highest FDI-to-GDP ratios in the region—averaging 5–7% annually—even during periods of regional volatility.

**Why Investors Choose Georgia**

Several structural advantages underpin Georgia's sustained investment appeal:

- Liberal capital controls and full foreign ownership rights;
- Transparent, low-friction tax policies (including 0% tax on reinvested corporate earnings);
- A relatively predictable macroeconomic framework and convertible currency;
- Competitive labor costs and streamlined business registration;
- A strategic location linking Europe, Central Asia, and the Middle East.

These features allow Georgia to attract capital far beyond what might be expected for a country of its size and population.

**Investment Patterns by Sector**

FDI has concentrated in a few high-visibility sectors:

- Real Estate and Tourism — Hospitality, residential development, and boutique tourism have attracted capital from Gulf, EU, and CIS investors.
- Logistics and Transport — Port upgrades, dry ports, highways, and planned rail corridors reflect Georgia's ambition to serve as a regional trade bridge.

- Energy — Focused on small-to-medium hydropower projects and electricity transmission infrastructure.
- Finance and Technology — Georgia's liberal digital finance regulations have drawn fintech pilots, digital banking startups, and early-stage venture capital.
- Agribusiness and Cold Chain Logistics — Export-oriented agri-processing (especially nuts, berries, and wine grapes) has modest but rising investor interest.

Despite strong flows, the investment profile remains skewed toward real estate and short-cycle capital. Long-term industrial and export-linked FDI is still limited, reflecting Georgia's small domestic market and labor force constraints.

**Geopolitical Balancing in Capital Sources**

Georgia's FDI inflows come from a remarkably diverse mix of partners:

- **Turkey & Azerbaijan** dominate energy and construction.
- **EU investors** focus on infrastructure, agriculture, and real estate.
- **Gulf states** fund high-end real estate and select fintech projects.
- **China** plays a niche role in logistics and warehousing, with limited strategic footprint.
- **The U.S.** is present in tourism, fintech, and financial institutions, though often indirectly.

This diversification gives Georgia resilience. Georgia's appeal to diverse investors is no accident—it reflects a deliberate posture of neutrality, credibility, and openness. If sustained, this balancing act could prove to be its most strategic asset.

**Summary Insights**

- FDI remains a foundational anchor of Georgia's growth model.
- The country's investment appeal rests on openness, predictability, and geographic leverage.
- A strategic shift toward export-generating and productivity-enhancing FDI is needed to reduce dependence on short-cycle capital.
- Georgia's geopolitical balancing act—between East and West—remains a critical enabler of investment inflows and long-term development optionality.

# SECTION 5

## Sectoral Opportunity Zones

Georgia's growth potential is not evenly distributed across its economy. While services remain dominant, certain other sectors offer stronger export potential, higher value-add or special relevance for foreign investors. Based on extensive quantitative assessment from the ISET High Growth Sectors study, Georgia's sectoral landscape can be segmented into three distinct investment opportunity zones:

1

### Established Export Performers

These sectors already contribute meaningfully to Georgia's export performance with demonstrated durable competitiveness in foreign markets:

**Beverages (Wine, Spirits, Mineral Waters)**

- Georgia's leading export identity — deeply rooted cultural asset and mature international market presence.
- Dominates SME export turnover (35% of sector turnover).
- Solid export competitiveness with demonstrated demand across Russia, the EU, China and Gulf States.
- EU DCFTA agreement offers further market access, but scaling production remains a constraint.

**Apparel & Light Textiles**

- Quiet export success story with growing presence in EU markets, particularly for knitwear and lightweight garments.
- Production cost advantages compared to Eastern EU and Turkey.
- SMEs contribute 29% of sector turnover.
- Room for further expansion under preferential trade terms.

**Metal Ores & Basic Metals**

- Export competitiveness is driven largely by copper ores (92% of metal ores export volume).
- Ferro-silico-manganese dominates basic metal exports; Georgia utilizes only 20% of its EU export potential in this category.
- Exposure to global commodity cycles makes the sector highly volatile, but still relevant for selective long-term investment.

€80,9

0%

7,8%

2

### Emerging High-Growth Sectors

Emerging high-growth sectors demonstrate strong growth dynamics and increasing foreign investor interest, often leveraging Georgia's transit and technology advantages:

**Transport & Logistics**

- Georgia's geographic leverage as a Middle Corridor transit hub makes this sector central to its regional integration strategy.
- Significant capital investment is flowing into rail, dry ports, East-West highways and pipeline connectivity.
- Pipeline transport, electricity transmission and air transport form the backbone of the sector.
- SMEs account for 44% of turnover — unusually high SME participation for an infrastructure-heavy sector.

**Information & Communication Technologies (ICT)**

- One of the fastest growing sectors with 58% growth in 2022 and 27% in 2023.
- Exports primarily driven by computer services (69% of ICT exports), followed by telecommunications (20%).
- High SME participation (84% of turnover in computer services) makes this sector highly flexible and scalable.
- EU market accounts for 42% of sector exports, with room for further expansion.

**Financial & Fintech Services**

- While modest in GDP share (5%), Georgia's financial sector has become a regional testbed for fintech innovation.
- Regulatory flexibility, open capital controls and digital ID infrastructure allow pilot projects not easily conducted in larger regulatory systems.
- Domestic banks remain highly profitable and attractive to international investors.

**Summary Insights**

- Georgia's sectoral growth map reflects a healthy balance of traditional strengths (wine, logistics) and new growth engines (ICT, fintech, creative industries).
- High SME participation is a consistent feature across many sectors — an advantage for investors seeking local partnerships.
- The most scalable export opportunities are emerging in technology, logistics and select manufacturing niches.
- Continued FDI inflows into infrastructure and services remain the most important macro-level driver of near-term growth.

# SECTION 6

## Georgia's Geostrategic Role and the Middle Corridor

Georgia's geographic positioning offers it a rare advantage in Eurasian trade dynamics. As a critical node in the evolving Middle Corridor — a trans-Caspian logistics route connecting Central Asia to Europe via the Caucasus — Georgia has the potential to shift from periphery to a pivot point. Its deepwater Black Sea ports, overland transit links, and relatively open regulatory environment position it as a bridge between systems: between the EU and China, Central Asia and Turkey, the Caspian and the Mediterranean.

**The Middle Corridor: From Vision to Implementation**

The Middle Corridor has gained momentum as a strategic alternative to Russia-dominated routes, especially after the Ukraine invasion. Georgia's Black Sea ports (Poti, Batumi, and the new Anaklia project) form the linchpin of this corridor, connecting rail and road freight from Azerbaijan and Central Asia to Europe via Turkey.

Investments in rail capacity, customs digitization, and dry port development (e.g., Tbilisi and Rustavi logistics zones) are already underway. While current volumes remain modest, partly due to infrastructure gaps in Kazakhstan and Azerbaijan, the long-term vision is credible: a decentralized, multi-modal corridor that reduces dependency on any single geopolitical actor. Georgia's main constraint is scale. The country is not a major production center and will not become one in the foreseeable future. Its opportunity lies instead in platform economics — offering reliable transit, storage, financial, and digital services that amplify the productivity of others..

**Peace as Strategy — Georgia's Geopolitical Posture**

Peace is not merely a passive condition to be hoped for — it is Georgia's most valuable national asset. In a region shaped by historical conflict and ongoing great power rivalry, Georgia must treat peace as an active strategic position.

Unlike larger neighbors, Georgia cannot afford direct confrontation. Instead, it can secure its sovereignty and relevance by moving first into new spheres of influence — ones that do not provoke traditional anxieties. This means investing in corridors, not contests. Logistics, renewable energy, fintech, and digital governance offer asymmetric leverage: sectors where agility and credibility matter more than size or hard power.

The strategic play is not to resist pressure through force, but to reframe the game — by becoming indispensable in emerging ecosystems where Georgia writes the rules. This posture demands institutional agility and constant recalibration, but it offers the best chance at durable sovereignty. In this frame, peace is not a pause in conflict, but a deliberate platform for national agency.

**The Platform Model: A Different Kind of Power**

Georgia's strategic edge will not come from dominating production or controlling hard infrastructure. It will come from being the place where transactions happen smoothly, where cargo clears quickly, where digital platforms comply and scale, and where financial capital is welcomed and repurposed with efficiency.

This model — a transaction-oriented zone embedded in global supply and service chains — is already emerging. The expansion of Tbilisi's fintech sandbox, the growing B2B warehousing sector, and the development of integrated cold-chain logistics for agri-exports all point to Georgia's evolving role as a facilitator of high-trust exchange.

To deepen this role, Georgia must maintain credible neutrality, avoid regulatory overreach, and skillfully balance its relationships with all major regional powers. Its real power lies in being useful to all — and threatening to none.

**Summary Insights**

- Georgia's geographic leverage is real but must be earned through infrastructure reliability and regulatory predictability.
- The Middle Corridor offers long-term potential, but is constrained by upstream and downstream execution challenges.
- Georgia's best strategic posture is one of active peace—advancing through usefulness, not confrontation.
- Becoming a trusted platform for exchange—rather than a contested prize—is Georgia's path to durable relevance.

# PEACE AS STRATEGY: GEORGIA'S ASYMMETRIC ADVANTAGE

In the Caucasus, peace is not the natural state of things. It is an active stance, a political posture, and a strategic resource. For Georgia, a small country flanked by larger, more assertive powers, peace is not simply a moral preference—it is the most effective form of leverage available.

Across history, great powers have treated the Caucasus as a frontier of influence, a corridor of contest. In such an environment, small states are often reduced to proxies or pawns. But Georgia's recent trajectory suggests a more original path: rather than becoming a client of any single bloc, it has attempted to function as a connector, a facilitator, and a neutral platform. This strategy is not passive. It demands agility, constraint, and consistent strategic messaging.

The key insight is this: Georgia's most defensible strength is its usefulness. It is valuable to others not because of what it can extract, but because of what it can enable—connectivity, commerce, energy transit, digital infrastructure, and capital flows. Each of these depends on one condition: predictable peace.

In a world shaped by exponential technological change, Georgia's neutrality becomes even more valuable.

As global systems fragment and new economic corridors emerge, those who can guarantee legal clarity, platform access, and geopolitical restraint will command influence far out of proportion to their size. This is Georgia's asymmetric advantage.

To succeed, peace must be institutionalized—not just hoped for. It requires credible defense, yes, but also diplomatic professionalism, consistent investment in multilateral partnerships, and a national commitment to soft power tools: infrastructure, legal credibility, education, and digital openness.

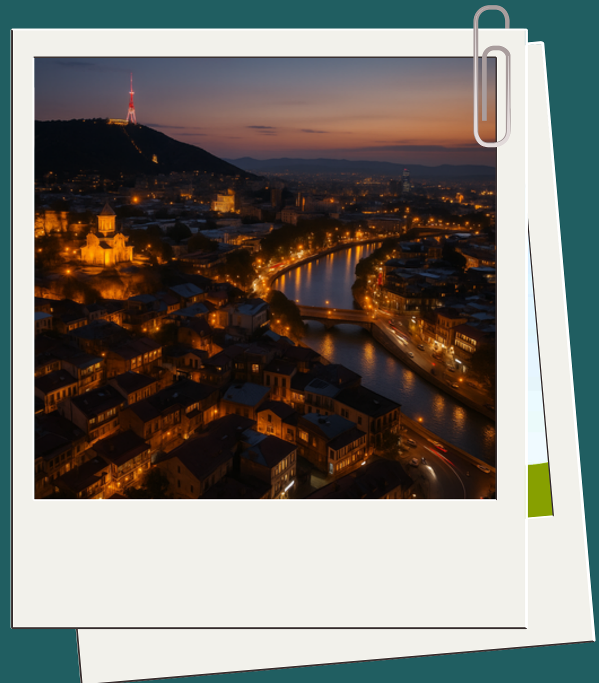
Peace, for Georgia, is not a pause between conflicts. It is the core of its national offer. If sustained, it can transform Georgia from a former battleground into a future node—where systems meet, deals happen, and friction is low. If compromised, everything else—FDI, logistics, tech—unravels with it.

This is the strategic imperative: treat peace not as a condition, but as an asset to be cultivated, protected, and deployed. In doing so, Georgia does not merely survive the great power game. It changes the rules.

# SECTION 7

## Structural Economic Vulnerabilities

Georgia's economic success over the past two decades reflects real achievements in reform, foreign investment attraction and regional integration. However, several structural vulnerabilities continue to constrain Georgia's long-term resilience. These risks are not unique to Georgia but are important for investors to weigh when evaluating exposure to the Georgian market.



**Capital Flow Dependence**

Georgia's open capital account has allowed sustained foreign investment inflows but simultaneously renders the economy highly sensitive to global capital market conditions. Increases in U.S. or EU interest rates, changes in global risk appetite or deteriorating regional investor sentiment could trigger rapid shifts in capital availability. Further, the lari historically experienced periodic bouts of depreciation during external capital tightening cycles. (for a detailed discussion of the lari in capital tightening cycles see Appendix C)

**Current Account Deficit**

Persistent current account deficits, typically ranging from 5 to 10 percent of GDP, reflect Georgia's reliance on: imports, limited scale of industrial exports, dependence on remittances and tourism to stabilize external balances.

While Georgia has successfully financed these deficits with stable FDI inflows, any sustained slowdown in capital or remittance inflows could create external financing pressures. (See external financing pressures in Appendix D).

**Tourism and Remittance Exposure**

Tourism receipts and remittances account for a substantial share of Georgia's foreign currency inflows. Global shocks such as pandemics, geopolitical disruptions or economic slowdowns in source countries could rapidly depress both sectors. The pandemic period demonstrated the speed and severity with which tourism can evaporate under crisis conditions.

**Demographic and Labor Market Constraints**
Despite improvements in labor market participation, Georgia faces challenges with youth unemployment (estimated at approximately 30 percent) as well as skills' mismatches. High emigration rates, especially among skilled young professionals, limit the depth of Georgia's domestic labor pool. In addition, the education system produces high graduation rates in law and social sciences, while shortages persist in trades, applied technical fields and STEM disciplines.

**Industrial Diversification Limitations**
Georgia's industrial base remains relatively narrow, with limited depth in advanced manufacturing, high-tech production or complex value chains. Agriculture remains fragmented, and much of the export sector is still focused on a small number of products. Building deeper industrial diversification will likely require sustained investment in technical capacity, infrastructure and export capability.

**Geopolitical Neighborhood**
Georgia's location offers both opportunity and exposure. While the country has pursued a balanced foreign policy approach, unresolved regional conflicts, tensions between major powers and volatility in neighboring markets create a background level of geopolitical risk that investors cannot entirely avoid.

**Summary Insights**

- Georgia remains structurally vulnerable to global capital movements and shifts in investor sentiment.
- External shocks affecting tourism, remittances or regional stability could rapidly disrupt growth trajectories.
- Long-term competitiveness depends on closing the skills' gaps, diversifying the industrial base and maintaining investor confidence in Georgia's legal and regulatory stability.

# SECTION 8

## Strategic Outlook and Scenarios

Georgia stands at a structural crossroads. New trade flows, financial sector reforms, foreign capital inflows, and targeted infrastructure investments are reshaping its economic landscape. While the near-term growth trajectory is encouraging, longer-term outcomes will depend on how skillfully Georgia navigates intersecting vulnerabilities and opportunities. Three plausible national scenarios help frame the range of potential futures over the next 5–10 years.

**Scenario A: Managed Expansion (Base Case)**
In this scenario, Georgia sustains steady reform momentum and capitalizes on regional trade shifts:

- The Middle Corridor strengthens gradually, improving customs processes and logistics capacity.
- Light industrial, agro-processing, and ICT sectors expand in tandem with FDI and infrastructure upgrades.
- Financial sector reforms increase SME access to GEL-denominated credit.
- Georgia manages Russian capital inflows without triggering international regulatory backlash.

**Outcome:**
Georgia grows at a moderate pace, consolidates its position as a regional trade and finance platform, and preserves macroeconomic stability. The reform agenda progresses, but deeper structural transformation remains partial.

**Scenario B: Friction & Fragmentation**
Here, political or external shocks erode the reform trajectory:

- Regional conflicts or geopolitical tensions increase risk aversion.
- Regulatory inconsistencies and institutional backsliding discourage long-term capital.

- Delays in logistics or energy infrastructure slow integration into Eurasian trade flows.
- Russian capital inflows become more politically sensitive.

**Outcome:**
Growth slows, external financing becomes more fragile, and Georgia risks becoming overly dependent on short-cycle capital and remittances. Its role in the region narrows to basic transit and real estate functions.

**Scenario C: Selective Leapfrogging**
Under this more ambitious path, Georgia focuses narrowly but effectively on high-potential sectors:

- It leverages its regulatory flexibility and competitive costs to develop fintech, remote IT services, and light manufacturing clusters.
- Financial markets deepen, cross-border pilots scale, and a niche ecosystem of digital and logistics service firms gains international relevance.
- Select agro-processing and value-added re-export businesses emerge around the Middle Corridor.

**Outcome:**
Georgia leapfrogs some traditional stages of industrialization by scaling selectively in high-margin service and logistics niches. It builds a reputation as a transaction-oriented zone—an agile, externally connected platform where capital, goods, and digital services move efficiently across borders.

**What Is a Transaction-Oriented Zone?**
A transaction-oriented zone is not defined by industrial heft or population scale, but by strategic fluidity, regulatory openness, and logistical efficiency. It serves as a node in global value chains where activity is driven by the movement, exchange, and processing of capital, information, and goods—rather than large-scale domestic production. Georgia's role as a customs bridge, financial sandbox, and re-export hub embodies this model.

**Summary Perspective**
Georgia currently aligns most closely with the Managed Expansion scenario, showing credible reform progress and early-stage industrial diversification. Elements of Selective Leapfrogging are visible—particularly in fintech, ICT, and transit-based value chains—but require further depth, capital, and policy discipline.

To move decisively toward a higher-value trajectory, Georgia must maintain regional peace, deepen institutional reforms, and skillfully manage external partnerships. If successful, it may not become a traditional economic engine—but it can thrive as a strategically positioned, transaction-oriented zone linking Europe, Central Asia, and the Middle East.

# CONCLUSION

In the end, Georgia's greatest strength lies not in its size, its industrial capacity, or even its growth metrics — but in its strategic clarity. By choosing to be useful rather than dominant, and stable rather than provocative, Georgia is rewriting the rules of small state engagement. If it can institutionalize peace, deepen institutional capacity, and maintain its role as a trusted node in global transactions, it may chart a development path uniquely its own — one defined not by what it controls, but by what it enables. This is Georgia's opportunity. The task now is to make it durable.

# APPENDIX A

Georgia's Current Model: Consumption-Driven Services Economy

In Georgia's case, **household spending** (especially urban consumption) and **real estate activity** are key drivers of GDP. This is reflected in:

- Large GDP shares from wholesale & retail trade and real estate;
- Capital inflows fueling housing and banking activity; and
- Modest industrial and export contributions.

This structure is typical in **small, open, emerging markets** which attract capital and enjoy liberal trade and finance rules, but have limited scale in production or innovation.

Alternative Economic Models

Here are four major alternative growth models, with real-world examples:

| Model Type | Key Drivers | Typical Economies | Notes |
|---|---|---|---|
| Export-Driven | Trade surplus from manufactured goods and services | **China**, Germany, Vietnam | Requires high production capacity, competitiveness, and foreign demand. |
| Investment-Led | Government or private investment in infrastructure/industry | China (early 2000s), Gulf states | Often includes large-scale public spending and industrial policy. |
| Resource-Driven | Commodities exports: oil, gas, metals, agriculture | Russia, Saudi Arabia, Nigeria | Subject to price volatility; often capital-intensive;not labor-intensive. |
| Innovation-Led | High-tech exports, R&D, intellectual property | U.S., South Korea, Israel | Requires strong education, IP protection and venture ecosystems. |

# APPENDIX B

What's Behind the $2.8 Billion Export Figure?

The report lists **"Machinery & Transport Equipment"** as Georgia's **largest merchandise export category** in 2024, valued at approximately **$2.8 billion**. This is a broad category, and in Georgia's case, it is **heavily dominated by one very specific and unusual business model:**

***Importing used (and often damaged) vehicles, repairing them in Georgia, and re-exporting them to other markets.***

This activity scaled significantly in recent years and now accounts for a **major share of both exports and import activity.**

Georgia's Used Vehicle Trade Model

Here's how the model works:

**1. Import Source:**

- Georgia imports tens of thousands of used and damaged vehicles (including wrecked cars) from the **United States**, **South Korea**, **Germany**, and **Japan**.
- Many of these are sourced from salvage auctions (e.g., Copart, IAAI in the U.S.).

**2. Repair and Processing:**

- Vehicles are shipped (mostly to Poti and Batumi), brought to repair hubs — especially around **Rustavi**, **Tbilisi**, and **Kutaisi** — where they are refurbished or partially stripped.

3. **Re-export**:

The repaired (or rebuilt) vehicles are exported primarily to:

- **Armenia**
- **Kazakhstan**
- **Kyrgyzstan**
- **Azerbaijan**
- **Ukraine** (before the war)

These countries have demand for affordable, used vehicles and often lower import restrictions.

4. **Logistics Advantage:**
   - Georgia acts as a logistics hub because of its **open customs regime**, **strategic location** and **free trade agreements**.

5. **Classification:**
   - These re-exports are recorded under **“Machinery and Transport Equipment”**, inflating Georgia’s headline merchandise export figures.

**How Big is this Business?**

- According to government trade data and various customs reports (outside the doc), over 60% of Georgia’s Machinery & Transport Equipment exports are used cars.
- It is estimated that hundreds of thousands of vehicles pass through this pipeline annually, generating billions in trade turnover.
- This also contributes significantly to employment in logistics, repair shops, customs brokerage and local services.

**Key Characteristics**

| Aspect | Description |
| --- | --- |
| Not Domestic Production | Georgia is not manufacturing cars or machinery at scale — it is almost entirely trade processing. |
| Low Value-Add per Unit | While revenue is large, much of the value is from **imported goods**; Georgia’s net value-add (repair, services, logistics margin) is **relatively modest**. |
| Regulatory Arbitrage | Georgia’s **customs policies** and **low registration barriers** make it a good place to manage inventory and repurpose vehicles. |
| Vulnerability | Changes in **partner country import rules** (e.g., when Kazakhstan raised standards), or **USD exchange rates**, can sharply disrupt trade flows. |

**Risks and Limitations**

- Environmental and safety concerns: Many re-exported cars are older, less efficient or damaged, raising questions about long-term sustainability.

- Policy changes: Neighboring countries occasionally tighten vehicle import regulations, which could cut demand overnight.
- Not industrial capacity: While this looks like a big export number, it does not indicate structural strength — no deep supply chain or local production base exists behind it.

**Summary**

The $2.8 billion export figure is real, but is heavily dependent on a single trade model: the used car re-export business, which is more akin to a logistics and repair arbitrage strategy than a traditional export-driven industrial base

# APPENDIX C

**What is a "Capital Tightening Cycle"?**

This refers to periods when **global capital becomes more expensive, scarce, or risk-averse** — usually because:

- The U.S. Federal Reserve or European Central Bank **raises interest rates**;
- Global investors shift out of **risky/emerging markets** into safer assets; or
- There's a **geopolitical or financial crisis** (like COVID, 2008, or the Ukraine war).

In such periods, investors **reduce exposure to small emerging markets**, causing a drop in capital inflows.

**Why Does the Lari Depreciate?**

**1. Georgia Runs a Persistent Current Account Deficit:**

- Georgia **imports more than it exports** annually;
- This trade imbalance must be financed by **foreign capital inflows** (FDI, remittances, tourism, etc.);
- If capital inflows **slow down or reverse**, **demand for the lari decreases** — leading to depreciation.

**2. The Lari is a Floating Currency:**

- The National Bank of Georgia allows the lari to float. That is, it is **not tightly pegged to the dollar or euro**.
- Thus, when **capital leaves or dries up**, the exchange rate adjusts — often rapidly — **downward**.

**3. Investor Sentiment Shifts Quickly:**

- During capital tightening, investors **pull money from small, illiquid markets first**.
- Georgia, as a small frontier market, is often a **first out, last in** location for global funds.
- This dynamic reduces **demand for GEL assets**, increasing supply of GEL as investors **convert to foreign currency**, pushing the lari lower.

**4. Dollar Debt and Dollarization:**

- Many Georgians and businesses borrow or save in **foreign currency (USD or EUR)**.
- When GEL weakens, their **repayment burden rises**, putting further pressure on demand for foreign exchange.

**Real-World Examples of Lari Depreciation**

| Year | Trigger Event | Result |
|---|---|---|
| **2008** | Global Financial Crisis | Sudden capital outflows |
| **2014–2015** | Russia's economic downturn + Fed rate hikes | Regional stress + dollar strength hurt GEL |
| **2020** | COVID-19 shutdown (collapse in tourism) | Major depreciation |
| **2022** | Russia-Ukraine War (briefly reversed by inflows) | GEL rallied due to Russian capital inflow, then normalized |

**Summary**

The Lari depreciates during capital tightening cycles because Georgia is highly dependent on external capital to balance its trade and finance its economy. When global investors retreat, capital inflows drop, currency demand weakens, and the exchange rate absorbs the shock. This is not unique to Georgia; it is a classic emerging market pattern. However, Georgia's small scale, open capital account, and high dollarization make it especially vulnerable to these shifts.

# APPENDIX D

**What Does "External Financing Pressures" Mean?**

In essence, it refers to **a country's difficulty in attracting enough foreign capital** to:

- **Pay for imports** (goods, fuel, pharmaceuticals, machinery);
- **Service foreign debt** (interest and principal);
- **Fund the current account** deficit (the gap between what it earns from exports vs. what it spends on imports); and
- **Maintain exchange rate stability** and **foreign reserves**.

So, when we say Georgia might face "external financing pressures," it means:
***It could struggle in attracting sufficient foreign capital so as to keep the system running smoothly.***

**Why Might these Pressures Arise?**
External financing pressures emerge from:

| Trigger | Effect |
| --- | --- |
| **Global interest rate hikes** | Foreign investors pull capital out (chasing higher returns elsewhere). |
| **Drop in tourism or remittances** | Fewer hard currency inflows. |
| **Geopolitical instability** | Capital flight, rising risk premiums. |
| **Reduced FDI or donor flows** | Less stable long-term funding |
| **Rising import costs (e.g. energy shocks)** | Increases need for FX without offsetting earnings |

**What Happens When a Country Faces These Pressures?**

If Georgia cannot finance its external needs through normal inflows (FDI, tourism, remittances, debt rollover), several challenges could emerge:

| Response | Implication |
| --- | --- |
| Currency depreciation | GEL weakens, making imports more expensive (imported inflation) |
| Reserve depletion | The central bank uses foreign reserves to prop up the lari |
| Emergency borrowing | IMF programs or foreign loans, often with policy conditions |
| Interest rate hikes | To defend the currency or attract capital, at the cost of growth |
| Capital controls **(rare but possible)** | Limits on currency exchange or transfers — undermines investor confidence |

**Georgia's Specific Exposure**

Georgia is **more exposed than most** countries because of its:

- **Persistent current account deficit** (imports > exports);
- **High reliance on tourism and remittances** (volatile sources of FX);
- **Open capital account** (money flows in and out freely);
- **Limited industrial export base** (low structural self-sufficiency); and
- **Moderate but real external debt obligations**.

In the event **foreign inflows slow**, Georgia could face real **pressure in financing its basic needs and maintaining stability.**

**Bottom Line**

**External financing pressures** are a stress test for how well a country can meet its **foreign currency needs** in the event capital inflows dry up.

In Georgia's case, it is a key vulnerability — and a central reason why macro stability, investor confidence and diversified exports are so heavily emphasized in the report.