

EU BUSINESS CLIMATE REPORT GEORGIA 2022



ევროკავშირი
საქართველოსთვის
Project funded by the European Union





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LIST OF ACRONYMS

ACDA	Former Agricultural Cooperative Development Agency
AEO	Authorized Economic Operator
APMA	Former Agricultural Projects Management Agency
BSOs	Business Support Organizations
Bln	Billion
CEN	The European Committee for Standardization
CEO	Chief Executive Officer
CEPEJ	European Commission for the Efficiency of Justice
CIS	Commonwealth of Independent States
CPR	Construction Products Regulation
DCFTA	The Deep and Comprehensive Free Trade Area
DEP	Donor electronic procurement procedure
DiMMA	State Programme of Dairy Modernization and Market Access Program
EBA	European Business Association
EEN	European Enterprise Network
EFTA	The European Free Trade Association
EG	Enterprise Georgia
EU	The European Union
EUGIPP	The EU-Georgia Intellectual Property Project
EUIPO	European Union Intellectual Property Office
EXBS	Export Control and Border Security Program
FDI	Foreign Direct Investment
FIZ	Free Industrial Zone
FTA	Free Trade Agreement
GCI	World Economic Forum's Global Competitiveness Index
GDP	Gross Domestic Product
GEL	Georgian Lari
GENIE	Georgia National Innovation Ecosystem Project
GI	Geographical Indications
GITA	Georgia's Innovation and Technology Agency
GIZ	German Corporation for International Cooperation
GMP/GDP	Good Manufacturing Practice / Good Distribution Practice
GNCA	Georgian National Competition Agency
GNCA	The Georgian National Competition Agency
GSP	Generalized System of Preferences
GTA	Georgian Tourism Association
GUAM	Organization for Democracy and Economic Development
HCoJ	High Council of Justice in Georgia
HICD	USAID Human and Institutional Capacity Development Project
IBC	International building codes
IDPs	Internally Displaced Persons
ILO	The International Labor Organization
InsolvAid	project by EBRD
IORP	Institutions for occupational retirement provision
IP	Intellectual Property
ISSET	International School of Economics at TSU
IT	Information Technology

LEPL	Legal entity of public law
Ltd	Limited Liability Company
MLN	Million
MoESD	The Ministry of Economy and Sustainable Development
MSMEs	Micro, Small and Medium Sized Enterprises
NCTS	New Computerized Transit System
OECD	The Organization for Economic Co-operation and Development
OSH	Occupational safety and health
PROLoG	Promoting Rule of Law in Georgia (PROLoG) Activity funded by USAID
RDA	Rural Development Agency
RIA	Regulatory Impact Assessment
SME	Small and Medium Size Enterprises
SNiP	Structural design codes designed in Soviet Union and then modified
SPS	Sanitary and Phytosanitary measures
TFP	Total Factor Productivity
TIR	Transports Internationaux Routiers, International Road Transport
TSU	Tbilisi State University
TVET	Technical and Vocational Education and Training
UCITS	Investment funds regulated at European Union level
UNDP	The United Nations Development Program
UNECE	United Nations Economic Commission for Europe
UNIDROIT	The International Institute for the Unification of Private Law
UNWTO	The World Tourism Organization
US	The United States of America
USAID	The United States Agency for International Development
USD	United States Dollar
VAT	Value Added Tax
VC	Venture capital
VET	Vocational Education and Training
WHO	The World Health Organization
WIPO	World Intellectual Property Organization
WTO	The World Trade Organization

FOREWORDS



Carl Hartzell

Ambassador of the European Union to Georgia



John Hugo Freddy Braeckveldt

Chairman of the European Business Association

We live in challenging times. Russia's unprovoked and unjustified war in Ukraine, which has cost thousands of lives and is sending shockwaves throughout the world, further disrupts supply chains already stretched by the impact of the pandemic. This puts a new burden on businesses and households, and adds further uncertainty for investors across the globe.

The new geopolitical reality calls for an acceleration of Georgia's reform agenda and the creation of a resilient economy, which works for the people. I see four main challenges as well as opportunities. First, Georgia needs to get more ambitious on its connectivity agenda, and set out a clear strategy for key infrastructure, transport and digital investments. Second, more work is needed to increase energy efficiency, diversify energy supplies and build up renewable energy production in order to fight climate change and reduce geopolitical risks. Third, Georgia's society needs to make increased use of digitalisation as a force for jobs, growth and inclusivity, while mitigating its risks for democracy. And, fourth, small and medium-sized enterprises need continued support to increase their productivity and competitiveness on the international market. This will also help them make full use of the Deep and Comprehensive Free Trade Agreement (DCFTA) with the EU. The European Union stands behind Georgia in all these endeavours.

In order to successfully address these challenges, we need a strong and unified voice of the business community to assist their involvement in structural reform processes and be an active counterpart to both the Government of Georgia and its international partners; assisting us both to seize new opportunities and to tackle challenges and bottlenecks along the way.

Evidence-based tools such as the EU Business Climate Survey are helpful in putting everyone on the same page when it comes to properly assessing the business environment, to make informed decisions and developing meaningful policies to help improve the business climate in Georgia.

Among its findings, the survey points to the need for a broader and more formalised role of business support organisations and more cooperation between enterprises. The European Union has long been advocating for a stronger voice of European businesses and Georgian businesses engaged in trade with the EU. This has been the basis for our work to create the European Economic Cooperation Platform, together with the European Business Association (EBA). As we are launching this platform, we are taking a qualitative step forward in realising these ambitions.

We are convinced that a closer and more structured dialogue between representatives of the business sector, the European diplomatic corps and policy makers will make a real contribution to advancing common objectives between the European Union and Georgia!

Let me finally take this opportunity to thank the European Business Association (EBA) Georgia for their initiative to publish the first edition of the "EU Business Climate Survey – Georgia 2022". I very much appreciate these efforts and thank all participating companies for their contributions and opinions.

In my capacity as Chairman of the Board of Directors I am pleased to present the EU Business Climate Survey 2022 completed in support of the objective to promote European business and economic interests in Georgia.

The research is fully consistent with the vision of the European Business Association – "doing business in Georgia will become the same as doing business in Europe". The European Business Association is clearly distinguished by its strong and effective public-private dialogue mechanism for advocating European values and core interests of its member organizations. Leading an effective and evidence-based policy dialogue requires complete understanding of the issues that European businesses face in Georgia. Recent developments in the neighborhood and Georgia's application submitted for the EU membership accelerated the relevance of examining overall progress, achievements and challenges towards fostering trade and economic integration with the EU. Amid Russia's War in Ukraine, it is especially important to strengthen cooperation between the "Associated Trio" countries and consolidate all our efforts towards European integration. The crises once again highlighted importance and the need for a strong, powerful and result-oriented business association. Together we are stronger and that is our advantage.

The survey is aimed at determining the most important features of Georgia's business environment as seen by European companies. This is the initial baseline study, and its continuation is essential for improving Georgia's overall business climate. Furthermore, the results and key findings of the survey enable development of the agenda and work of the European Economic Cooperation Platform (EECP) that will facilitate a dialogue between representatives of the business sector, IFIs, European diplomatic community and policy makers to develop a favorable social-economic climate and non-discriminatory, transparent business environment, which would be attractive for investment.

On behalf of the EBA I am pleased to acknowledge the strong support of the European Union Delegation to Georgia that enabled conducting comprehensive research and developing evidence-based strategy for future improvements. The Association gladly continues to act on European values and fulfill the vision, mission and commitments to all of our members and partner organizations.

INTRODUCTION

Evolving political and business environment – tough challenge for EU businesses. As in many emerging economies, businesses in Georgia navigate through a challenging and evolving political and business environment. This dynamism reflects the numerous internal and external drivers. European businesses are part of this ecosystem. Along with external drivers, Georgia’s economic reform agenda compels dynamic approximation to the business climate of the EU. Often, this very process of change causes uncertainties and disruptions of the established status quo and compounds to the existing inefficiencies in the business climate, necessitating high-level of coordination and partnerships among all stakeholders.

EECP – an innovative multi-stakeholder partnership model introduced by EBA Georgia. In 2021, with the EU funded project “Promoting European business and economic interests in Georgia”, EBA established and administers a semiformal platform called the European Economic Cooperation Platform in Georgia (EECP) which will facilitate a dialogue between representatives of the business sector, including BSOs/Bilateral Chambers/NGOs, IFIs, European diplomatic community and policy makers to develop a favorable social-economic climate and non-discriminatory, transparent business environment which would be attractive for investment. This project envisions bringing in cohesion to a multi-stakeholder universe around one platform umbrella and a leading coordinated and evidence-based approach for policy-making.

The EU Business Climate Survey – a means to continuously EECP on what EU businesses need in Georgia. Leading an effective and evidence-based policy dialogue requires complete understanding of the issues that EU businesses face in Georgia. This survey was initiated within the framework of the EECP and will represent a major foundation upon which the agenda and work of the platform will be based. The objective of the survey was to identify the major aspects of the business environment as perceived by European business operating in Georgia. This survey was offered to the participating companies as an opportunity to take their needs to the attention of the policy-makers, better addressed by public and private sector actors involved in the platform. This is the first baseline survey, the continuation of which should be sustained for the better outcomes for the overall business climate in Georgia.

Perceived obstacles and reform evaluation by the EU businesses – the focus of the survey. Important business climate factors when businesses started operations and dynamics of these factors during the last few years, evaluation of the reforms both on the aspect of effectiveness and relevancy, performance and optimism of the EU businesses, general obstacles as well as obstacles in relation to accessing the EU market, role and effectiveness of business support organizations and environmental preparedness were the key blocks covered by the questionnaire and hence represented in this report in separate sections.

Comprehensive factual description of economic reforms agenda – a balancing element. Economic reforms often represent the very causes of changes in the business environment. Largely driven by Georgia’s European future and its EU association reform agenda, the Government of Georgia undertook considerable efforts to reform many aspects of business climate in recent years, with varying speed and intensity. Some of them directly affect the way businesses are run or will be run in the foreseeable future. The effect of other reforms is somewhat indirect but real. Therefore, this report also includes a description of past and planned reforms, with some identifiable influence over the business climate in Georgia.

Three-component approach and tools were used in the study. To address the objectives of the survey, the combination of the desk research, key informant interviews and online interviews were used. The comprehensive desk study included overviewing available materials about obstacles of the business, economic reforms in the country and attitudes of the enterprises towards these economic reforms. The representatives of the responsible state agencies provided invaluable support on providing information related to reforms (past and planned). Key informant interviews were conducted with 35 knowledgeable people in relation to the reforms and obstacles to businesses. Quantitative online survey of businesses was conducted among 176 companies, to assess and validate the findings about the subject.¹

Diverse (by ownership structure, size, sector) group of EU businesses covered. The survey included a convenience sample of companies who were either EU/European-owned (at least partially), or self-associated themselves with the Europe and the EU in some way. 31% of them were fully (100%) EU-owned, whereas another 28% of the companies had at least some ownership in them. Self-association with the EU was expressed in several ways. In some cases this was very explicit and direct (e.g., export, import), in other cases indirect. (e.g. European values). Perception of this affiliation makes Georgia’s European way relevant to them. It should be noted that the inception of the quantitative survey coincided with the war in Ukraine and later - with the formal application of the “Trio” for membership to the EU. Therefore, the pathos triggered by this event could have been a strong source of this self-association by non-EU-owned businesses.²

¹More information about the methodology and survey design is available in the later sections of the report.

²Detailed compassion of the profile of the businesses is provided in the report.



EXECUTIVE SUMMARY OF MAIN FINDINGS

BUSINESS ENVIRONMENTAL FACTORS, BUSINESS PERFORMANCE AND OPTIMISM

Several Important Business Environmental Factors Experience Deterioration.

Understanding what was a major driver for EU businesses *in the begging* (decision factors) and how these important factors *evolved* during the last few years will help policymakers set priorities to increase commitment of the existing business as well as making improvements to attract others. The survey showed that the most important business climate *decision factors* until recently was easy procedures for doing business in Georgia (21.2%), followed by low tax rates (11.6%), low labor costs of production (10.4%), access to local domestic market (10.4%), and diversification of the supply chain (9.6%). In terms of dynamics in the last period, perceptions diverged on whether a particular factor deteriorated or improved. Except for energy costs, in relation to listed factors, most respondents agree that the factor conditions remained the same. Access to the EU market, access to the other export markets and free trade agreements are among the best performing aspects, with a high ratio of respondents who think that the *situation improved* compared to ones who believe that it deteriorated. Labor costs, investment incentives and to doing business procedures (in some sense) - are among the ones with notable portion of respondents who *report deterioration*. Several conditional groups could be distinguished, according to their *importance* and the *recent dynamics*, which require a different policy response.

Despite Mixed Performance and Current Events, Businesses Remain Optimistic about Future.

The majority (43%) of the EU businesses report that their overall business performance *improved*. Business performance remained unchanged for 28% of the surveyed companies and another 28% report that their performance went negative. *Micro* companies were the ones with the *biggest portion of reported deterioration* of performance (33%), followed by large companies (27%). At the same time, 48% of micro enterprises reported improvement – also highest among all sizes companies, indicating the high dynamics and vulnerability of the group compared to other sizes. Despite such a disruptive event in the region, business optimism for the coming year clearly overshadows the past performance - *most of the surveyed businesses (56%) plan expansion* in the coming years. For 19% of the enterprises the development prospects are unclear. 13% of enterprises think they will remain unchanged. The remaining part of the sample plans either downsizing (6%), closure (3%), moving to another country (2%) or suspension of their activities (1%). If they had to, 75% of the surveyed businesses would choose *Georgia again* as a preferred place to do business, 21% would be uncertain and 4% would not choose Georgia again. Not surprisingly, *a bigger portion of micro and small companies consider the likelihood of downsizing*, as opposed to larger ones. *Large companies are more optimistic* as none of them consider likelihood of downsizing and 82% (the biggest among all groups) consider expansion.

There are Major Obstacles to EU Businesses and they Differ in Magnitude across Groups .

Customs regulations, business permits and licenses are *among the lowest obstacles*, since the absolute majority (more than 50%) of the businesses say that this does not represent an obstacle at all. On the other end of the spectrum, political instability, exchange rates and inadequately educated workforce are named as top obstacles to businesses as more than 50% of the surveyed businesses report so. There are notable differences in perceived obstacles between EU-owned and non-EU owned enterprises. The small market and consequent weak demand, combined with the political instability, lack of qualified workforce and exchange rates are reported by EU-owned companies as top obstacles (a major or a minor obstacle, combined). Exchange rates, political instability and lack of qualified workforce are among the top obstacle list among non-EU-owned enterprises. Customs regulations are the lowest obstacle for both groups. Exchange rates represent a top issue for three size groups - small, medium and large. An ineffective court system represents more of an issue for large firms than for other sizes. Smaller firms suffer more from weak market demand than the larger firms.

OTHER OBSTACLES RELATE TO CROSS-SECTORAL (EFFICIENCY OF PUBLIC DECISION-MAKING LACK OF POSITIONING) AND SECTOR-SPECIFIC ISSUES.

Lack of communication in the public sector and limited delegation of decision-making - a cross-cutting issue.

Lack of communication between employees in public institutions and limited delegation of decision-making is a perceived issue and possible root-cause for many of the above-mentioned issues. As the respondents point out, they face the lack of a commonly agreed position among employees of different agencies – a clear result of the lack of coordination. The issue of delegating responsibilities to lower levels is acute and notable. Government officials at lower administrative levels refrain from taking responsibility to resolve issues within their authority. This forces companies to seek solutions with upper-level representatives, resulting in additional time and efforts.

Insufficient positioning of the country as an investment destination. Investments in the country are key drivers of capital as well as technologies and know-how, leading to more added value and income for the economy. However, businesses believe that there is a need for more active work in relation to identifying interesting specific business opportunities to attract business to Georgia from other places, as several successful exporters did (e.g. the case of Georgian products) and communication of the country as an attractive place to do business. Georgia has an attractive product to offer to the outside world but this is not communicated well.

There are sector-specific challenges requiring individual approach. Beyond cross-sectoral issues, there are challenges faced by specific sectors, which were captured by this survey. The challenge related to GMP and GDP standards, absence of statistical information about medication for the pharmaceutical sector, challenges reported by the audit service industry related to the official classification, among others.

REFORMS SNAPSHOT AND EVALUATION

Relative Success and Relevancy with the Reforms – Requiring Differentiated Policy Strategy

According to the analysis, state support programs to business as well as tax, customs, entrepreneurship law and E-commerce reforms are among reforms **Group A** generally accepted as moving towards a *positive direction* and at the same time are *relevant* (affects or somewhat affects) to big part of the business universe. The tourism sector and intellectual property reforms belong to **Group B**, distinguished as a *mostly positive direction*, however perceived as *less relevant* for businesses. The policy response for this group includes better communication strategy to the private sector to win the attention and then buy-in of the companies into the reform process. The judiciary sector, the education system and the capital market reforms are among the most problematic ones (Group C). These are reforms which enjoy *less involvement* and, at the same time, are perceived as going mostly towards a *negative direction*. The policy response for this group is, on the one hand, to understand the root-causes of these negative perceptions and address them. On the other hand, raising the awareness about and involvement in these reforms of the business community remains a critical step.

Businesses Welcome European Approximation, but Indirect Benefits Should be Communicated More

Consequently, the transition to European standards seems generally reasonable for businesses. This does not mean that these reforms are all faultless or perfect. But overall, their importance is clear. Accessing the EU market is relevant now or in the future to majority of businesses, who believe in both direct and indirect benefits of EU integration. However, indirect benefits of EU integration, including the benefits of reforms for overall business environment (not just as a means of accessing the EU market) must be further asserted and communicated.

When it Comes to the Success of the Reforms, Deficiencies are Seen on Both Sides

The international donor community and government complain that businesses are not interested in how reforms go and it is hard to trigger their interest until the very last moment, when certain regulatory requirements enter the force. Businesses complain that they are not well-informed in advance. Another part of businesses believe that a large part of economic reforms do not affect them, hence are not considered relevant. These two perspectives contradict each other and we believe that the truth is in the middle. There is huge room for improvement on both sides. And the role of associations (industry ones, in particular) and BSOs is decisive. Both the intensity and the content (tone) as well as the form of communication with the business should be changed and become more effective.

Perception of Reforms - Costs Vs Investments – Driven by Mostly Inner Business Philosophy

Many businesses in Georgia are established out of necessity, rather than a fully contemplated career choice of their founders. Those businesses are oriented on quick cash-flow and short-term profits. They differ from ones which were created with the underlined vision for growth and long-term development. Perceptions of these two groups towards business-related reforms differ considerably. The businesses with short-term profit goals consider reforms additional unnecessary regulations and related compliance efforts as sunk costs. In contrast, growth-oriented enterprises view these reforms as a means towards better and more competitive business environment, hence as a benefit for them and as an investment for their future.

Legislative Changes Outpace Implementation Causing Dissonance in the Business Climate

Businesses highly acknowledge the progress achieved by the government with the reforms. However, the prevailing opinion is that adopting legislative changes considerably outpaces their effective implementation. Often, during implementation it becomes clear that its execution is an issue and the reform might be end up being an additional formal redundancy for a business rather than a way towards a desired outcome. The technical regulation banning the production of plastic (cellophane) bags is a case in point, as it has not been properly enforced and polyethylene bags are still sold in the consumer market. Such actions are often costly and are affecting the end-users, paying for the increased costs and therefore facing the risk of social discontent.

An Undifferentiated Approach During Implementation is an Important Aspect of the Deficiency

Regardless of their attitudes towards the reforms, businesses differ in terms of capacity to adopt to new changes, including ones driven by the EU approximation agenda. Smaller firms are less flexible and resilient to this end, and not ready to fully implement the commitments made as a result of these changes. Businesses complain that the reform agenda does not consider these differences in the capacity and the regulation does not differentiate among smaller and larger firms

Overdoing the Minimum Standards is Another Issue

The EU directives are general and provide some flexibility for nation states to adapt these regulations to specific national circumstances. They set minimum standards to be considered, and even existing EU members specify them at their discretion. Businesses complained that some of the regulations in Georgia go beyond these minimum standards and are often too restrictive for businesses, even compared to EU members. Timing, phasing and adopting these changes is critically necessary since these are related to large-scale capital investments, often impossible to mobilize even for larger companies (e.g. the case of the Extended Producer Responsibility). A more liberal approach in this regard is desired.

Limited Use of RIAs as a Means of Informing the Reforms Might be One of the Root-causes to This...

Introducing the RIA reform in 2020 was meant to benefit all other reform processes, making them more informed and effective. However, RIAs are not often exercised in practice. According to respondents, regulatory impact assessment is not common and the regulations are not evaluated ex-post. A regulation might be adopted but might be found at fault, not working and may need to be changed or updated. Coupled with the limited interest of businesses towards the reform process, this leads to the faults in the process, avoiding of which might be possible otherwise.

EU MARKET AND DCFTA

Despite the Progress with the Reforms, Direct Impacts of the DCFTA Still Remain Modest

The DCFTA was one of the most important economic achievements in Georgia in recent years. Despite the remarkable progress with the reforms that the GoG undertook, the number of businesses which currently export to the EU reached about thousand companies, but traded volumes are not impressive. Businesses still prefer to sell to more traditional markets, despite the underlying political risks associated with a lack of diversification as well as a lack of awareness and interest about the virtues of the EU market.

Whereas Indirect Positive Effects of the DCFTA Sometimes Outweigh the Direct Ones but Remain Unnoticed

Indirect impact comes along with associated reforms in the economic sector, making the business environment more competitive and favoring more competitive growth and development. These benefits are more long-term, ambiguous, and hence perceived as less relevant. Indirect positive effects of the DCFTA sometimes outweigh the direct ones and often remain unnoticed. For instance, previous research by EBA found that companies who were trade-ready with the DCFTA were more resilient towards the COVID-19 crisis, compared to the ones which were not. Therefore, raising awareness among businesses about the DCFTA and its benefits remains a compelling objective.

Gladly, most of the Businesses Perceive the EU Market as Relevant

The absolute majority (53%) of the EU businesses consider that accessing the EU market is relevant now and another 25% of the surveyed businesses think that it will become relevant in the future. Only 18% of businesses consider the EU market irrelevant to them. It is hard to judge what other, non-EU businesses think about this issue, but for EU businesses, relevancy of the EU market does not come under doubt and it has a high level of legitimacy.

On top of Low Awareness about the EU Market, there are other Obstacles towards Accessing the EU Market

Low qualification and productivity of workforce, insufficient of quality infrastructure and lack of standards and certification lead the rankings. 89%, 74% and 73% of surveyed businesses report that these factors cumulatively represent either somewhat intense or most intense obstacles. The list is followed by market competition (71%), limited access to finance (69%) and high compliance costs for the private sector (67%). The often named issue of absence of a direct land border with the EU is problematic for about 50% of EU businesses. The larger the firm, the more problematic is the low qualification of workforce. Smaller firms are more concerned with lack of standards and poor-quality infrastructure. Fierce competition in the EU market is the second most important obstacle in accessing the EU market for medium-sized firms. Large firms rate low awareness of the DCFTA content as one of the top issues. The key finding is that low qualification of workforce and poor-quality infrastructure were and remain the number one issue for businesses to fully reap the benefits of the DCFTA and EU market.

ROLE OF BSOS

The Role of BSOs in Solving Issues of Businesses is Underpinned

According to usage, the most common ways to solve major issues is through personal contacts. This means of solving issues has also proved to be the most effective among all. Businesses also revert to the responsible state body directly. However, the effectiveness of this channel is not as great. Business associations and chambers come third in terms of usage in such occasions, which has an average effectiveness rate. The institute of business ombudsmen comes next. The remaining channels such as the DCFTA consultative group, Trade Advisory Group under the MoESD and Investors' Council are very rarely used. It should be noted that large firms address the responsible body more than personal contacts. The smaller the firm, the more likely it is that it will address associations and chambers. Clearly there is huge room for improvement for solving these issues for businesses and shifting the burden from personal contacts towards more formalized ways by raising the role of associations and BSOs in this process.

ENVIRONMENTAL ACTIONS

Businesses in the Process of Embracing Green Growth Paradigm

It is pleasantly positive to see that most of the surveyed EU businesses in Georgia are also in the process of embracing at least some actions towards terms of environmental sustainability and green growth. The span of planned activities include: applying energy efficient technology, conducting awareness rising campaigns, adopting the use of renewable energy, using recyclable materials, investing in environmental projects, applying technologies to reduce emissions. Although more non-EU-owned enterprises than EU-owned ones report that they have not taken any action so far in terms environmental governance, there were very few differences found in terms of environmental preparedness.



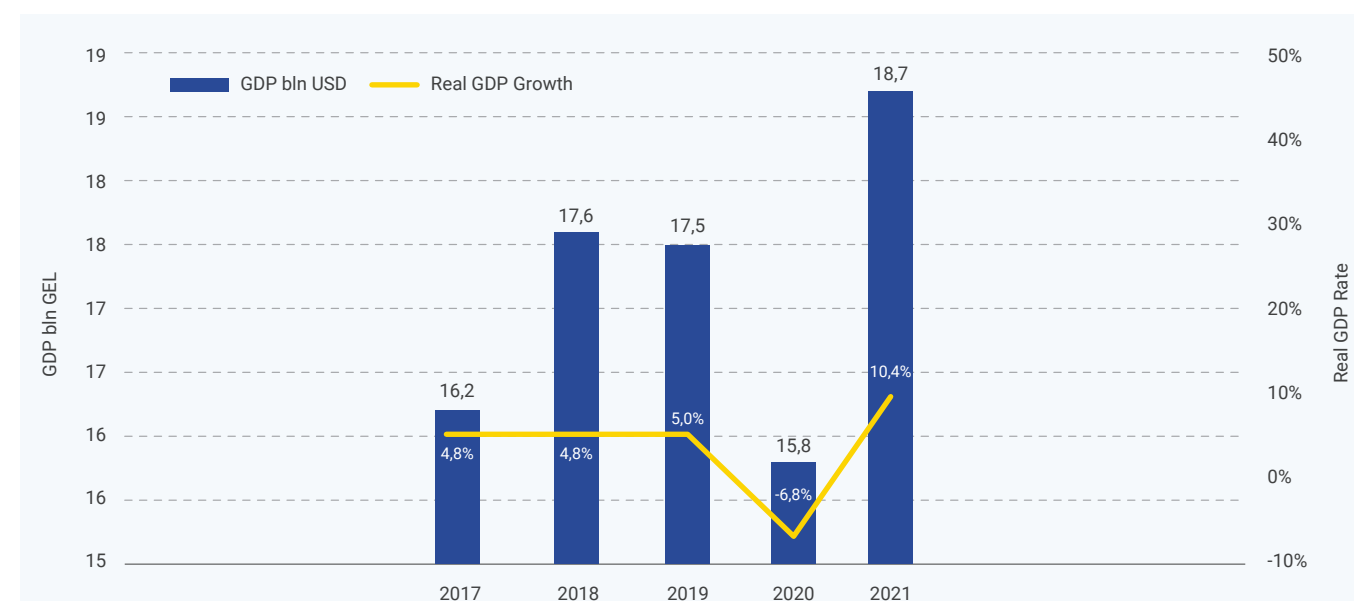
1. GEORGIA AS A DESTINATION FOR EUROPEAN BUSINESSES

1.1. KEY FACTS ABOUT GEORGIA AND ITS ECONOMY

With its economy, Georgia is one of the leaders of the region, and has grown slow and steady. During the pre-COVID period Georgia's economy grew by about 5% annually.

Georgia	2021
Population, million	3.7
GDP, current US\$ billion	18.7
GDP per capita, current US\$	5,015
Unemployment rate	20.6%

In 2020, the GDP declined by 6.8% due to the pandemic. However, the preliminary growth estimates for 2021 point towards a two-digit growth of about 10.4%.



GDP of Georgia

Source: Geostat.

Rapid growth contributed to the halving of the national absolute poverty rate from about 38.8% in 2007 down to 21.3% in 2021. This progress was made possible by responsible macro-economic policies, intensifying global integration, improving governance, advertising the country as a viable business environment, raising public spending and improving the soundness of public investments.

The population of Georgia has a broadly shared a consensus on national priorities, including participation in Euro-Atlantic integration, more efficient government and a better functioning welfare state. The signing of an Association Agreement with the European Union (EU) in 2014, including a Deep and Comprehensive Free Trade Area preferential trade regime was a major breakthrough and a logical course of action. Free trade agreements with major trade partners, such as the EU and China, position Georgia well as a destination for attracting foreign direct investments.

However, evidence suggests that years of sustained growth did not result in high quality job creation. A big part of the population continues to rely on low-productivity employment in agriculture. Informal sector employment remains high. Export volumes have increased but exports remain undiversified and high-value exports are limited. Companies continue to face challenges which impede growth and the survival rates of new startups remain low.

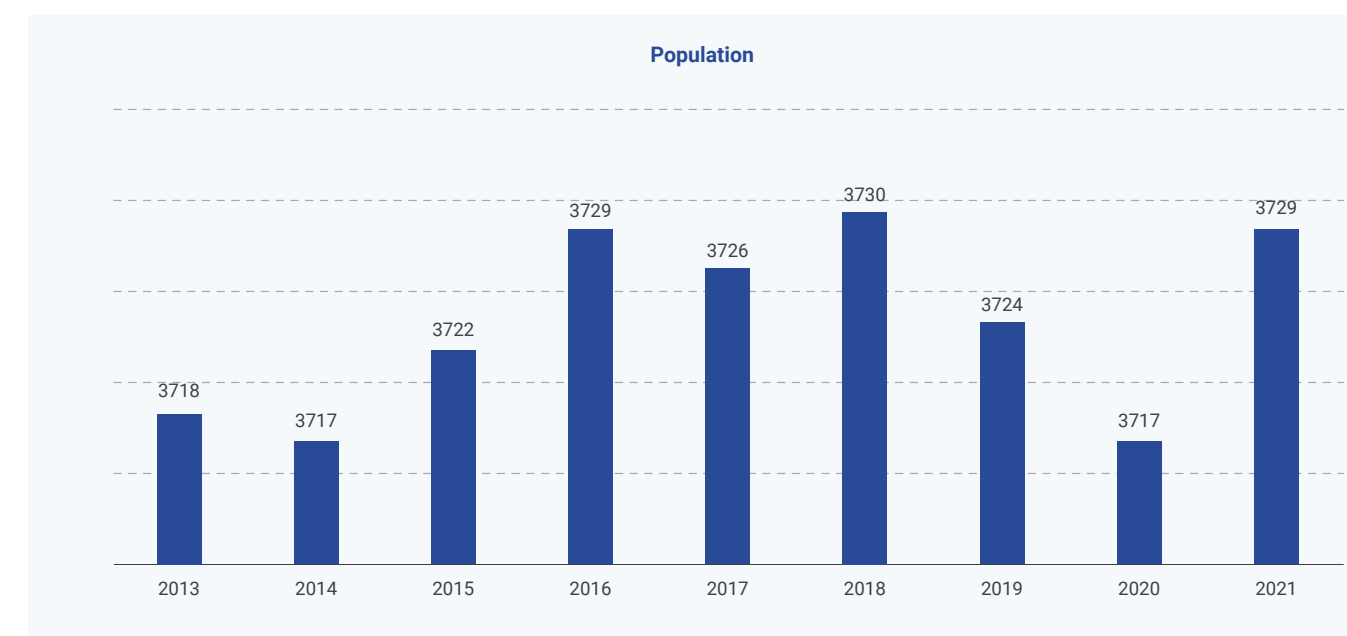
Regional and rural development inequalities remain challenging. Education outcomes remain poor and the skills gap is an unsolved issue for the labour market. Tensions between the political movements lead to uncertainties for the private sector. All of the above combined with a volatility of exchange rates hampers a long-term planning potential.

GEOGRAPHY

Georgia is located at the crossroads of Europe and Asia. Its strategic location makes it a natural logistics and transit hub along the "New Silk Road", linking Asia and Europe via the Caucasus. Georgia represents a bridge connecting several important economic regions, including the European Union, Central Asia, the former Commonwealth of Independent States (CIS), Turkey and the Caucasus. It is a key link in the shortest transit route between Western Europe and Central Asia for the transport of oil and gas, as well as dry cargo. Ports, railway systems and airports are playing an increasingly important role in linking the east and west.

POPULATION

By 2021 Georgia's population stood at 3,7 million. For many years, Georgia has had a declining population, although its current growth rate is estimated at about 0.6% per year. Since the dissolution of the Soviet Union, more than 1.5 million Georgian nationals have left the country. There is an estimate of 1 million Georgian immigrants living in Russia. A collection of economic, social and demographic factors is the major reason behind the stagnation of population growth.

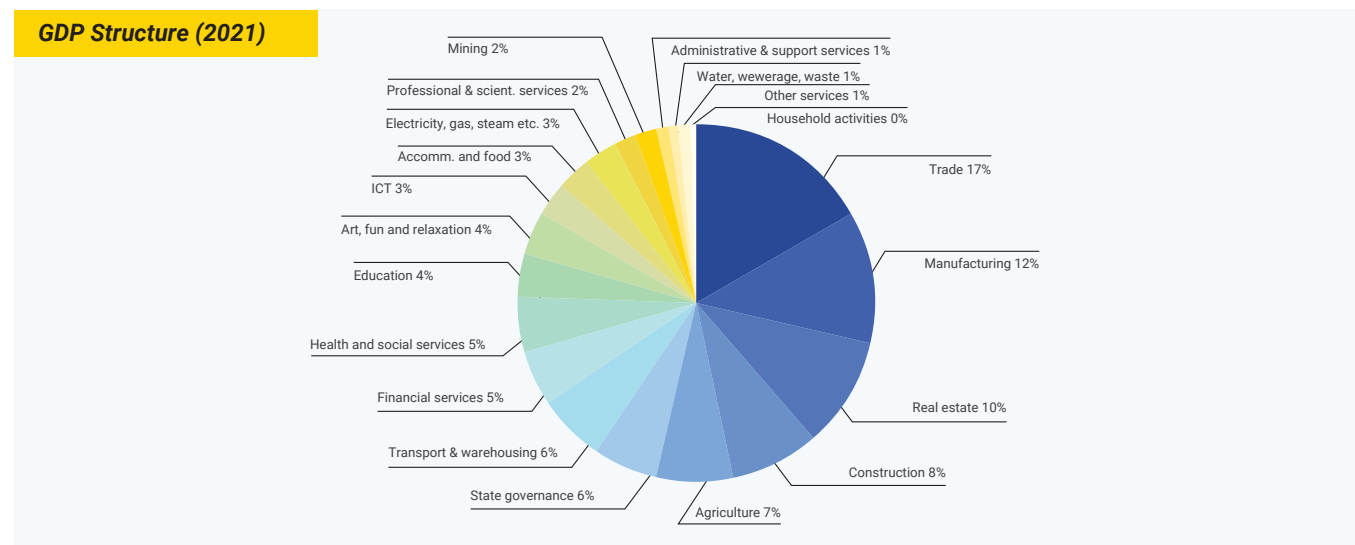


Population of Georgia

Source: Geostat.

ECONOMY AND SECTORS

Georgia's economic structure is relatively diversified, with trade, manufacturing, construction and real estate activities representing the lion's share of the Georgian economy. Before the COVID-19 outbreak, Georgia saw a remarkable tourism boom, which became a key driving force for the economy. Tourism reached a volume of about 7.3 million visitors in 2019 and its incomes had positive spillover effects on several segments of the economy, including the retail and trade sectors as well as construction. Agriculture represents roughly 7% of the GDP, accounting for a large part of total employment and a significant contribution to Georgian exports.



Source: Geostat.

POLITICAL SYSTEM

Politics in Georgia involve a parliamentary representative democratic republic with a multi-party system. The President of Georgia is the ceremonial head of state and the Prime Minister of Georgia is the head of government. The Prime Minister and the Government both hold executive power. Legislative power is vested in both the Government and the unicameral Parliament of Georgia.

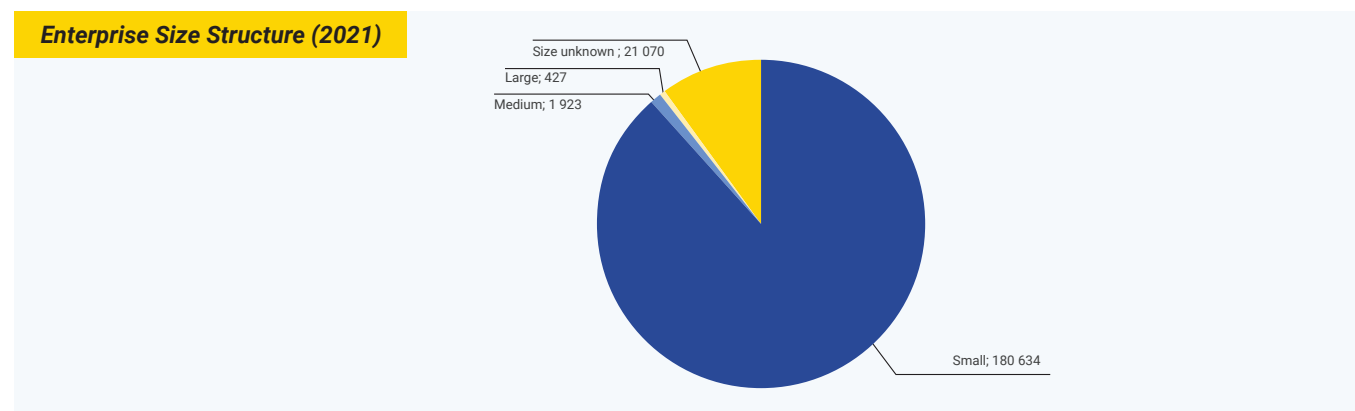
COVID-19 FACTS

The COVID-19 pandemic reversed some of Georgia's gains. After the country achieved early success in containing the spread of the disease, infections surged in late 2020, and by the summer of 2021 Georgia had one of the world's highest infection rates per capita. Vaccination coverage has risen, but only a tiny portion of the adult population had been fully vaccinated. Economic output fell, contracting by 6.2% in 2020, as mobility restrictions were implemented and tourist arrivals collapsed. Despite a robust fiscal response, estimated at 7.5% of GDP, close to the regional average for Europe and Central Asia, the poverty rate at the international upper-middle-income poverty line (\$5.50 per capita per day) rose from 42% in 2019 to an estimated 46.6% in 2020.

SME SECTOR

In highly competitive economies SMEs are considered key drivers of economy. Georgia is characterised by a large number of SMEs, but the SME sector is underrepresented in employment, added value and contributions to GDP. Small and micro enterprises represent the biggest number of firms in Georgia. However, despite a widespread and robust number of firm registrations, total employment growth is low on account of a smaller company scale, with most employment being concentrated in larger and relatively older firms.

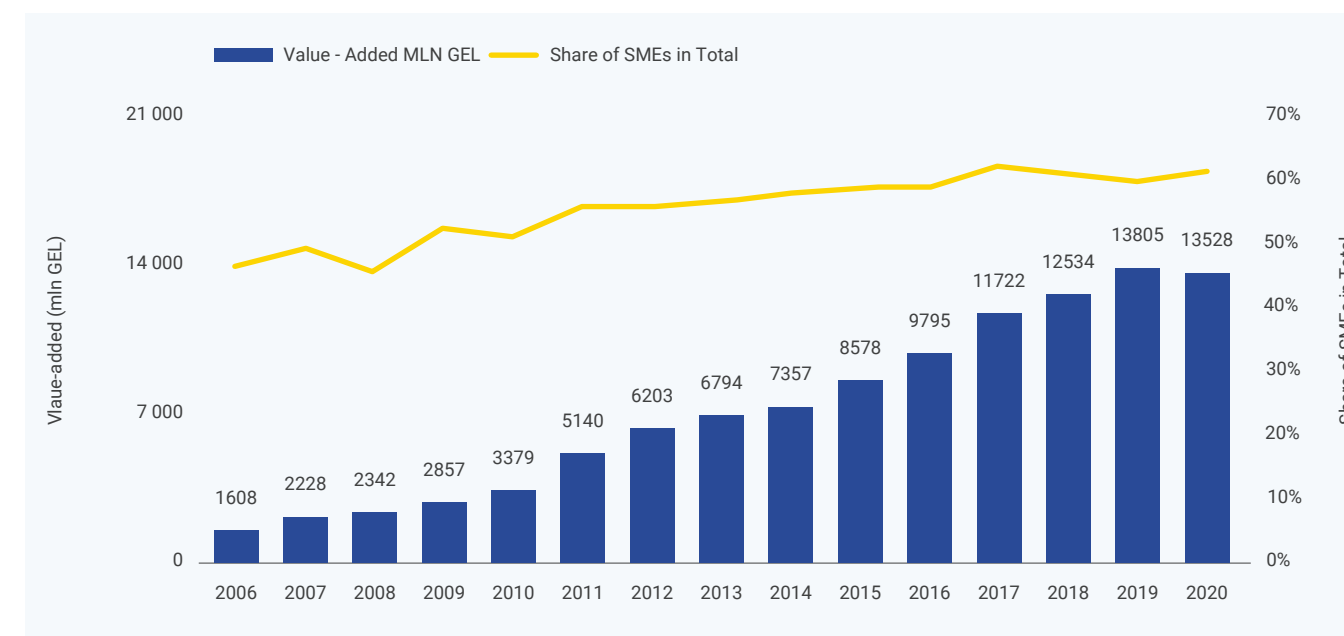
As of April 2022, according to official figures, there were 821,654 registered enterprises in Georgia, of which there were 204,054 active business enterprises, 180,634 of which (or about 89%) were small and medium enterprises. Additionally, there are 21,070 (or 10% of the total) active enterprises of which the size is unknown. Assuming that most of them are either small or medium, the share of SME sector goes up to about 99%.



Source: Geostat.



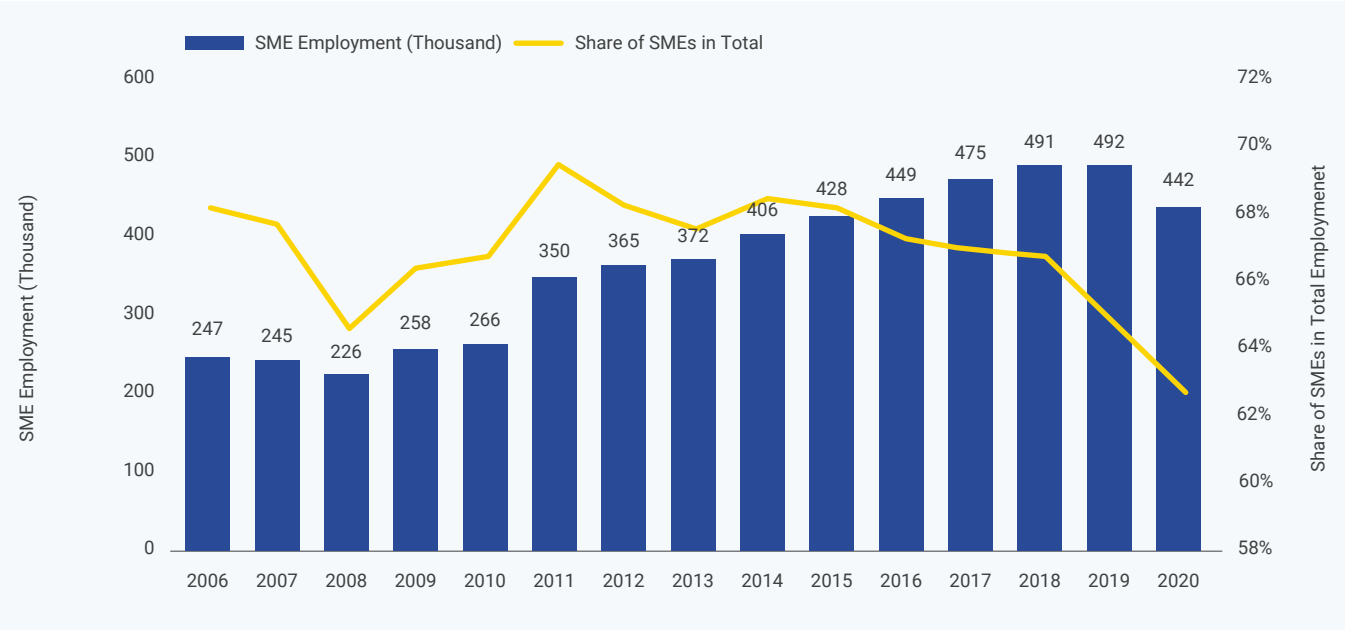
Notwithstanding the relatively large SME proportion of overall registered enterprises, the SME contribution to the overall economic value creation at a national level is low. Despite growing revenues of SMEs over the last decade, as a share of overall business revenue, SME turnover has been consistently decreasing, indicating that larger enterprises were growing faster, and SMEs were not reaping the full benefits of an improved business environment. By 2021, the share of value added by SMEs in the country was about 61% (or about 13.5Bn GEL), which is a result of a slow but sustained growth over the last decade.



SME value added (MLN GEL)

Source: Geostat.

Share of employment in SME sector has been declining from about 70% of the total employment in 2014, down to 65% or about 442 thousand people.



Employment by SMEs (thousand people) Source: Geostat.

Over the last few years Georgia has undertaken significant economic reforms resulting in impressive growth rates and improved business climate as repeatedly reported by the World Bank’s Doing Business indicators. Nevertheless, a range of critical constraints such as low productivity and export rates, low adherence to international standards, and poor competitiveness continues to impede SME growth. Georgian SMEs are still not taking full advantage of the market opportunities provided by the European Union. Lack of adequate entrepreneurial adaptability and institutional infrastructure to develop foreign trade-oriented sectors are some of the root-causes to this issue.

Despite regulatory improvements, most SMEs in Georgia predominantly operate in low added value segments and demonstrate minimal export activities with low levels of product and market diversification and refinement. Despite new business opportunities in view of the Deep and Comprehensive Free Trade Area with the EU, SMEs in Georgia face considerable challenges costs in complying with EU standards and enhancing sectoral competitiveness.

One of the key issues identified by economic studies is a size discrepancy among enterprises, which indicates a high concentration towards smaller and larger firms, whereas medium-sized operations remain underrepresented. This might imply institutional constraints impeding the growth of small firms into medium-sized firms. Another important observation related to the enterprise sector in Georgia is that there appear to be numerous market distortions — as shown by the high variation in Total Factor Productivity (TFP) — within sectors and low correlation between firm size and productivity. According to World Bank estimates, eliminating allocation distortions could increase TFP by up to 70%.³

In 2021, the government of Georgia approved a renewed SME Development Strategy for 2021-2025, which represents a key policy document with the intent of promoting the SME sector in Georgia. Priorities within this strategy include: improving legislation, institutional and operational environment; improving the skills and entrepreneurship culture of the SMEs; improving access to finances; promoting internationalization and export orientation and market access of SMEs; promoting electronic and ICT communications, innovations and R&D for SMEs; promoting female entrepreneurship; promoting a green economy.

TRADE WITH THE EU

Signing the DCFTA between Georgia and the EU was meant to remove tariff and non-tariff barriers to trade and expand trade between the parties. To facilitate this objective, Georgia embarked on a comprehensive strategy to align with EU practice, including in the areas of sanitary and phytosanitary regulations, institutional infrastructure, better farming practices and implementation of the EU industrial product standards. However, trade analysis shows that these reforms did not yet translate into tangible outcomes in terms of trade volume.

In general terms, although trade with the EU expanded, the share of the trade with the EU relative to other markets did not grow. In 2014, the trade turnover with the EU (in value terms) was about USD 2.9 Bln, reaching more than USD 3 Bln in 2021 (about 5.4% growth). The largest growth in export statistics was between 2017 and 2018, when exports to the EU grew by 30% and 25% respectively. By 2021 the EU was one of the largest export markets for Georgia at about 17%, also sourcing about 23% of its import from there.

³Georgia at Work: Assessing the Jobs Landscape, the World Bank Group, 2018.

	2014	2015	2016	2017	2018	2019	2020	2021
Total turnover	11,463	9,508	9,459	10,803	12,742	13,318	11,396	14,346
Growth (%)		-17%	-1%	14%	18%	5%	-14%	26%
Turnover EU-GE	2,877	2,614	2,635	2,768	3,166	3,110	2,547	3,031
Growth (%)		-9%	1%	5%	14%	-2%	-18%	19%
Share (%)	25%	27%	28%	26%	25%	23%	22%	21%
Total exports	2,861	2,204	2,117	2,746	3,380	3,798	3,343	4,242
Exports to EU	599	623	550	642	713	806	697	717
Growth (%)		-23%	-4%	30%	23%	12%	-12%	27%
Share (%)	21%	28%	26%	23%	21%	21%	21%	17%
Total imports	8,602	7,304	7,342	8,057	9,362	9,519	8,053	10,104
Imports from EU	2,277	1,991	2,084	2,126	2,453	2,304	1,850	2,314
Growth (%)		-13%	5%	2%	15%	-6%	-20%	25%
Share (%)	26%	27%	28%	26%	26%	24%	23%	23%
Balance with the EU	-1,678	-1,368	-1,534	-1,484	-1,740	-1,499	-1,153	-1,597

Trade between Georgia and EU countries (\$ million) 2014-2021 Source: Geostat.

The commodity structure of Georgia’s trade with the EU in 2021 was dominated by industrial minerals (44% in the total export to the EU), followed by fruits, nuts and beverages with 12% and 10% share in total EU exports, respectively. Other commodity groups take up a limited share. Overall, the top 10 products in the export structure comprise up to 87% of overall imports from the EU.

HS	Name of the group	\$ million	Share in total export
26	Ores, slag and ash	314.95	44%
8	Edible fruits and nuts; The bark and skin of citrus or cultivated crops	82.62	12%
22	Alcoholic and non-alcoholic beverages and vinegar	73.06	10%
31	Fertilisers	47.36	7%
72	Ferrous metals	26.49	4%
87	Land vehicles, their parts and properties	21.99	3%
71	Pearls, stones, precious metals and articles thereof; Bijouterie; Coins	21.19	3%
44	Wood and articles thereof; Charcoal	15.58	2%
63	Other textiles; Kits; Worn clothing and textiles	11.56	2%
20	Processed products of vegetables, fruits, nuts or other parts of plants	10.95	2%
Total top 10 to EU		625.74	87%
Total export to EU		717.14	

EU–Georgia trade structure by commodity (top 10 products by value), exports to the EU, 2021 (\$ million) Source: Geostat.

Imports from the EU to Georgia is less concentrated have been dominated by petroleum products (comprising 14% of the imports from the EU), motor cars, medicaments and medical equipment (each holding a 12% share). Overall, the top 10 products in the import structure represent about 68% of the total imports from the EU.

HS	Name of the group	\$ million	Share in total export
27	Mineral fuels, oil and petroleum products; Bituminous substances; Waxes	327.92	14%
87	Land vehicles, their parts and properties	277.69	12%
30	Pharmaceutical products	270.41	12%
84	Nuclear reactors, installations and mechanical equipment; Their parts	267.62	12%
85	Electric machines and equipment, parts and accessories thereof	121.21	5%
33	essential oils and resinoids; Perfume, cosmetics and toiletries	98.19	4%
90	Optical, photographic, measuring, control, medical instruments and apparatus	76.10	3%
38	Other Chemical Products	48.24	2%
39	Plastics and articles thereof	44.58	2%
22	Alcoholic and non-alcoholic beverages and vinegar	39.12	2%
Total top 10 to EU		1571.09	68%
Total export to EU		2,314.16	

EU–Georgia trade structure by commodity (top 10 products by value), imports, 2021 t *Source: Geostat.*

Despite the limited quantities and volume of exports in the EU, the number of exporting companies to the EU grew to about 1,000 by 2021. In recent years, there has been a systemic attempt to diversify export commodity groups to the EU. This included several new products (pet furniture, honey, dried fruit, blueberry, kiwi, fruit jams, glass bottles). However, their quantities remain notably limited.

To unlock the full potential of the DCFTA in terms of growing exports to the EU, a number of challenges remain, proved by numerous studies and additionally confirmed by our survey. Along with reducing the number of obstacles that business face, other initiatives such as the activation of ‘diagonal cumulation’ rules of origin with Turkey, as well as promoting already active diagonal cumulation rules with Ukraine and Moldova, a progressive approximation of EU legislation on SPS measures and technical trade barriers, quality infrastructure investments, and promoting opportunities stemming from Georgia’s growing base of other free trade agreements, in order to enable international businesses to move their locations to Georgia and export to the EU from here.

1.2. MACRO-ECONOMIC OUTLOOK

ECONOMIC GROWTH AND OUTLOOK

Georgia’s economy expanded rapidly during the pre-COVID period, growing at a robust annual average rate of 5% from 2005 to 2019. This expansion halved the national poverty rate between 2007 and 2019. This amount of progress was largely sustained by responsible macro policies, intensifying global integration, sound public investments, an attractive business environment, improving governance and a rise in public spending.

The Georgian economy grew faster than expected in 2021, with output increasing by 10.40% year-on-year (y-o-y) over the years, as pandemic-related restrictions were gradually eased. Economic acceleration - due to rising mobility, trade volumes, tax collection, credit growth, and tourism revenues - returned the GDP to pre-COVID levels. However, the labor market has been slow to recover; the unemployment rate remained high at 22.0% in the first half of 2021 in comparison to 18.3% in the first half of 2020 and 17.3% in 2019.

Driven by rising global food and oil prices and pass-through from the earlier depreciation of the Lari, the inflation rate spiked to 9.6 % y-o-y in 2021, its highest level in over 10 years. In response, the central bank has increased its policy rate by a cumulative 200 basis points since March 2021 to 10%. The current account deficit remained high at 9.8% of GDP in 2021, as weak services exports, particularly from tourism, were only partially offset by strong remittances and an improved trade balance in goods. Outflow of portfolio investments completely offset FDI inflow, and public borrowing fully covered the external gap, enabling the accumulation of international reserves. The latter remained adequate at USD 4.3 billion by the end of 2021.

The fiscal deficit narrowed down to 6% of the GDP in 2021, compared to 9.3% in 2020, as did the government foreign debt, which went down to 42.5% of the GDP in 2021, compared to almost 47% of GDP in 2020.

ECONOMIC OUTLOOK

According to the World Bank estimates,⁴ the war in Ukraine is likely to impact the Georgian economy adversely through trade, tourism, and remittances, as well as through elevated commodity prices. These effects will likely cause a slowdown in growth, higher inflation, and widening external balances. Georgia’s growth forecast for 2022 has been downgraded to 2.5% (from the 5.5% projected before the war began). The baseline outlook envisions growth recovery from 2023 onward, as easing monetary policy, the recovery of tourism, and the restoration of economic links are partly offset by the gradual withdrawal of the fiscal stimulus. Georgia is well placed to manage the economic impacts of the external shock caused by the war. The credible macro-financial framework, sufficient buffers and reliable banking sector provide a strong foundation for a reliable outlook.

1.3. KEY ADVANTAGES TO INVEST FOR THE EU BUSINESS

DOING BUSINESS

Georgia’s successful economic reforms are reflected in its rankings by reputable international organisations. Georgia ranks 7th in the World Bank’s 2020 Ease of Doing Business index, 12th in the 2020 Economic Freedom Index, and 74th out of 141 economies in the 2019 Global Competitiveness Report. According to Transparency International, Georgia has the lowest corruption rate in the region and international credit rating agencies (Fitch, Moody’s Investors Service and Standard and Poor’s) rate Georgia as a stable country.

The "one-stop shop" principle created by the LEPL "National Agency of Public Registry" operates in the country and is widely accessible to the general public. Anyone interested in registration services can apply to the LEPL National Agency of Public Registry territorial offices, houses of justice, community centres and other authorised users of the Public Registry. In order to further support businesses, from 2018 onwards all the services required for business registration have become available on a unified portal of electronic services - my.gov.ge – entrepreneurs can register a business without leaving their home or office, make a change in the registered data without a visit to the Revenue Service, on a one-stop-shop basis, register as a value-added taxpayer, etc. Business-related procedures have been further simplified by the introduction of an innovative e-congregation service.

Ltd. Partners have the opportunity to save time and meetings of governing bodies from anywhere in the world, to invite, conduct, make decisions and send electronically signed documents for registration. Since 2020, 184 public registry services have been remotely available on the my.gov.ge portal. The applicant can take out a mortgage, rent, etc. without leaving home, engage in economic activities (registration, extension and termination), access all restrictions on public services and address registers, request information and copies of documents, etc. In addition, standard electronic documentation forms to be submitted for registration were now posted on the same portal, which simplified the document filling procedure and minimised the risk of mistakes while filling out forms. Some remote services are also provided by e-mail. However, although significant steps have been taken in recent years to develop online services, including the unified portal my.gov.ge, this is a field with further room for improvement in terms of simplicity and accessibility.

FREE TRADE AGREEMENTS

Liberal foreign trade policy is one of the major economic policy principles in Georgia. Georgia places no quantitative restrictions (quotas) on trade, except on ozone-depleting substances. Only medical products, firearms, explosives, radioactive substances, dual-use goods, industrial waste and a few types of agricultural chemical products are subject to import/export licensing. In 2005, the number of permits required for import and export was reduced from 14 to 8, where it has remained until the present. Excise taxes and value added tax (VAT) apply equally on to imported and domestic products.

As a member of the WTO, Georgia has most-favoured-nation trading relationships with all WTO member countries. Georgia benefits from Generalized System of Preferences (GSP) tariff reductions on a wide range of products with Canada, Japan, Norway and Switzerland. The EU grants Georgia GSP+ treatment, with duty-free treatment for more than 7,000 products. Georgia has free trade regimes with countries of the former CIS and with Turkey. In June 2014, Georgia signed an Association Agreement with the EU and the DCFTA was established. Georgia signed a free trade agreement (FTA) with China in 2017, and in 2018, it signed an FTA with Hong Kong, China. In addition, negotiations with India on an FTA are under way. Table 3 provides the summary list of Georgia’s free trade agreements.

⁴www.worldbank.org

NAME OF THE AGREEMENT	BILATERAL / PLURILATERAL	COVERAGE	ENTRY INTO FORCE
CIS Agreement on the Establishment of a Free Trade Area (Azerbaijan, Armenia, Belarus, Georgia, Republic of Moldova, Kazakhstan, Ukraine, Uzbekistan, Tajikistan, Turkmenistan and Kyrgyzstan)	P	Goods	6 December 2002
Agreement between GUAM Countries on Establishment of Free Trade Area (members: Azerbaijan, Georgia, Republic of Moldova, Ukraine)	P	Goods	10 December 2003
Free Trade Agreement Between Government of Republic of Georgia and Government of Russian Federation	B	Goods	10 May 1994
Free Trade Agreement Between Government of Republic of Georgia and Government of Ukraine	B	Goods	4 June 1996
Free Trade Agreement Between Government of Georgia and Government of Republic of Azerbaijan	B	Goods	10 July 1996
Free Trade Agreement Between Government of Georgia and Government of Republic of Kazakhstan	B	Goods	16 July 1999
Free Trade Agreement Between Government of Georgia and Government of Turkmenistan	B	Goods	1 January 2000
Free Trade Agreement Between Government of Georgia and Government of Republic of Moldova	B	Goods	19 May 2007
Free Trade Agreement Between Government of Georgia and of Government of Republic of Armenia	B	Goods	11 November 1998
Free Trade Agreement Between Government of Republic of Georgia and Government of Republic of Uzbekistan	B	Goods	15 October 2010
Free Trade Agreement Between Georgia and Republic of Turkey	B	Goods	1 November 2008
Deep and Comprehensive Free Trade Area Agreement between Georgia and EU	B	Goods and Services	1 September 2014
Free Trade Agreement Between Georgia and the EFTA States	B	Goods and Services	1 September 2017 (for Georgia, Norway and Iceland) 1 June 2018 - full
Free Trade Agreement Between the Government of Georgia and the Government of the People's Republic of China	B	Goods and Services	1 January 2018
FTA Between Georgia and Hong Kong, China	B	Goods and Services	13 February 2019

Georgia's Free Trade Agreements

Source: Ministry of Sustainable Economic Development of Georgia.

FREE ZONES AND TAX REGIMES

Specialised tax rates and procedures have been adopted for four types of tax-free regimes in Georgia: free industrial zones (FIZs); free warehouse enterprises; entities designated as international finance companies; entities designated as international companies (for information and communication technology and for maritime services). These innovations are intended to establish new international institutions within the country, to attract inward investment and to encourage economic growth and sustainable development. The introduction of free warehouses and international enterprises into the tax and legal systems is intended to promote the trade-transit function within Georgia.

Free Industrial Zone legislation was introduced in Georgia in 2007 for the purpose of encouraging foreign investment, as well as stimulating exports and transit activities. In order to provide incentives for international firms to develop their production bases within FIZs, a favourable tax and customs framework has been introduced. At the time of writing, there were four FIZs in Georgia, which entitle FIZ-incorporated international companies to operate in a tax-free environment. In FIZs, firms can process, produce and export goods with minimal tax burden and export goods free from trade barriers to global markets.

Free Warehouse Enterprises are intended as an integral part of international transit companies, benefitting from income tax exemptions when re-exporting goods from an independent warehouse, through the usage of a free warehouse enterprise. The VAT rate on the supply of goods using this process is 0%.

In order to further improve the country's business environment, to strengthen Georgia's potential as a regional hub, and to increase the interest of international companies, the Georgian government is allowing companies to obtain **international company status** and enjoy tax breaks. Profit and income taxes for enterprises with this status will be 5% instead of 15% and 20%. These benefits apply to information technology and maritime services. In order to receive the status an international enterprise, the company must meet certain conditions.

STARTING A BUSINESS AND BUSINESS SERVICES

Reforms implemented in Georgia led to the creation of an effective business registration and service system and made Georgia one of the leading countries in the world in terms of ease of starting a business. This is also confirmed by international studies. According to the Doing Business 2020 report by the World Bank⁵, Georgia ranks second among 190 countries in the world in terms of starting a business. The "one-stop shop" principle introduced by the LEPL National Agency of Public Registry ensures that anyone interested in registration services can apply to the LEPL National Agency of Public Registry territorial offices, houses of justice, community centres and other authorised users of the Public Registry.

In addition, in order to further support the business, with the introduction of a unified portal of electronic services (my.gov.ge), all services required for business registration have become available, and entrepreneurs can register a business without leaving their home or office, as well as making changes in the registered data. Since 2020, 184 public registry services have been made remotely available on the my.gov.ge portal. In addition, standard electronic forms of documentation to be submitted for registration were posted on the portal, which simplified the procedure for filling out the document and minimised the risk of making mistakes during document completion. Some remote services are also provided by e-mail. The "one-stop shop" principle also applies to the services provided by the revenue service, through which entrepreneurs can be registered as a VAT payer and so forth without leaving their home or place of business. Introduction of an innovative e-meeting service allows founders and governing bodies to conduct online meetings from anywhere in the world, to invite, conduct, make decisions and send electronically signed documents for registration.

However, although significant steps have been taken in recent years to develop online services, including the unified portal my.gov.ge, this area needs further refinements in terms of simplicity and accessibility.

GOVERNMENT SUPPORT PROGRAMS

The state budget for entrepreneurship development has substantially increased over the last few years. Enterprise Georgia, Georgia's Innovation and Technology Agency, Rural Development Agency continued provide their programs accordingly over the last few years.

Programs by Enterprise Georgia (EG): EG has several support programs and activities for improving overall level of entrepreneurship. There are three main directions that EG focuses on: 1) Development of businesses; 2) Investment promotion; 3) Export support.

Program	Description
Universal Component	Interest rate subsidy (the national refinancing rate minus 5% for the full term of the Bank's loan and in case of leasing, the national refinancing rate minus 3%). Within the framework of the loan, the Agency guarantees no more than 60% of the loan principal amount for a maximum period of 10 years.
Credit Guarantee Scheme	Guarantees provided by EG for up to 80% of the principal amount, in priority areas and the maximum loan warranty period is 10 years
Produce For Better Future (implemented during 2019)	Grant financing from GEL 7,000 to 35,000 for people living across conflict lines
HORECA Component	Interest rate subsidy (the national refinancing rate minus 5% for the full term of the Bank's loan and in case of leasing - the national refinancing rate minus 3%). Within the framework of the loan, the Agency guarantees no more than 60% of the loan principal amount for a maximum period of 10 years). Co-financing the International Brand within 36 months, no more than 600,000 GEL.
Micro and Small Business Support	Co-sharing grant financing maximum 30,000 GEL for individuals, as well as technical assistance.
Film in Georgia	Specialised financial and tax incentives for international film productions.
Small and Medium Hotel Industry Financial Support (implemented in 2020-2021)	Interest rate subsidy for small hotels and guesthouses

Table: EG support programs implemented in the last few years

Source: Enterprise Georgia.

⁵Doing Business 2020, The World Bank Group, 2020

Investment Promotion includes identifying sectors with attractive investment opportunities, conducting feasibility studies and preparing investment proposals. In addition, EG also provides support in export promotion and development by organising international exhibitions and trade missions, trade facilitation through www.tradewithgeorgia.com website, training for export managers, and networking through EEN (European Enterprise Network).

Programs by GITA: GITA is an agency set up within the Ministry of Economy and Sustainable Development. Its mandate is to coordinate and mediate innovation and technology development within the country. Objectives include:

- Coordinating the establishment and development of an innovation ecosystem in Georgia
- Stimulating innovation, research and development, and adoption of new technologies
- Supporting commercialisation and application of innovation
- Connecting businesses with scientific research institutions to conduct R&D
- Supporting the creation of start-up companies and enhancing their competitiveness
- Developing broadband internet throughout the country and increasing connectivity
- Developing skills required for innovation and technology transfer
- Creating relevant infrastructure for the development of innovation and technology

There are number of initiatives, implemented by GITA to achieve these objectives, including development, running technoparks, fablabs, ILabs, Innovation Centers (including in the regions) and business incubators, conducting workshops and training in several regions (e.g., internet literacy trainings, programming), mentoring and coaching programs.

Program	Description
The Matching Grants (MGs) Program (approx. USD 50 K)	The goal of this program is to stimulate innovation and the creation of innovative enterprises in the Georgian economy through the development/adoption and monetisation of innovative products and services with a potential for internationalization.
Innovation Matching Grants Program (approx. USD 250K)	The grant is a dollar-to-dollar co-investment in private equity financing. Its aim is to further facilitate access to finance in the formation of globally scalable startups. The project aims to stimulate innovation and creation of innovative enterprises in the Georgian economy.
Small grants for Prototype Development (approx. USD 5K).	Grants are awarded for designing, testing, and refining prototypes in the field of innovation and technology. Project deliverables should be the application of new technologies or the development of existing ones, available to promote locally or globally.
Regional Grants Programme	Financed by the EU grant funding within the framework of the "Pilot Integrated Regional Development Programme 2020-2022", dedicated to 4 regions of Georgia. In line with the latest regional development policies and approaches to EU territorial planning, the project aims to develop a regional entrepreneurial innovative ecosystem, stimulate the creation of innovative enterprises and integrate them into the country's economy.

GITA support programsSource: GITA.

GITA is currently implementing the Georgia National Innovation Ecosystem (GENIE) Project – a USD40mln project financed by the World Bank. The main objective of the GENIE project is to support development of innovation by MSMEs and promote their participation in the digital economy.

By 2019 there were 129 startups, 358 events held, and with more than GEL 2 million provided to start-ups. In 2020, 500 Startups, a leading global start-up accelerator, entered Georgia and began accepting applications. To raise the scale and quality of entrepreneurial skills, in 2020 GITA signed an agreement with 500 Startups – a top world-class accelerator, which has established a fund with the local private sector. Herewith, for stimulating innovation services, GITA is running bootcamps, a pre-accelerator and internship programs, helping early-stage startups transform their ideas into business projects.

In 2021, GITA and Catapult Georgia VC formed a partnership agreement, according to which Catapult Georgia will invest USD 50 million in Georgian technology and innovation startups. GITA will allocate USD 5 million to the fund.

Programs by the Agriculture and Rural Development Agency: The Rural Development Agency (RDA) was established in 2019 by the Ministry of Environmental Protection and Agriculture by merging the former APMA (Agricultural Projects Management Agency) and ACDA (Agricultural Cooperative Development Agency) in order to promote rural development in Georgia. The main purpose of the Agency is to promote and stimulate development of production-oriented agriculture in rural areas, and to take over the projects initiated by APMA with the intent of supporting the establishment and expansion of agricultural enterprises.

Program	Description
Integrated Development Program for the Pilot Regions (2022)	The program is being implemented in 4 pilot regions: Imereti, Kakheti, Guria, Racha-Lechkhumi and Kvemo Svaneti. The goal of the program is to promote the competitiveness of the country and its regions, balanced socio-economic development, the improvement of the living conditions of the population living in the region, reducing regional inequalities and territorial development.
Plant The Future	Co-financing will be carried out in four separate components of the program: a) The component of co-financing perennial gardens (hereinafter referred to as ‘gardens’ component’); b) Co-financing component of the nursery gardens (hereinafter referred to as ‘nursery gardens’ component’); c) Co-financing component for the installation of anti-hail systems and/or arrangement of a well/borehole pumping station. d) Co-Financing component of damaged seedlings as a result of natural disasters (hereinafter referred to as the seedlings component).
State Program of Dairy Modernisation and Market Access (DiMMA)	The goal of this program is to develop the rural economy by promoting the establishment of a competitive, diversified and sustainable dairy industry. The aim of the program is to promote sustainability and flexibility for small dairy producers.

RDA support programsSource: RDA.

ASSESSMENT OF THE BUSINESS ENVIRONMENT IN INTERNATIONAL RANKINGS

Ongoing reforms in Georgia are positively recognised by international research organisations and the international community. It is the successful and effective implementation of systemic reforms that has led to a significant improvement in Georgia's position in the World Economic Forum's Global Competitiveness Index (GCI). According to the 2020-2021 Global Competitiveness Index report, out of 12 indicators, Georgia's rating improved in 6 areas, including the financial system, business dynamism and innovative opportunities.⁶

Georgia ranks 26th in the Heritage Foundation's 2022 Economic Freedom Index. The index rates countries in terms of the rule of law, government size, regulation effectiveness and market openness. It is worth noting that Georgia is ranked 18th among 45 countries in the region of Europe, and its overall score is above the regional and world averages.⁷

In the Fraser Institute's 2021 "World Economic Freedom" ranking report, Georgia ranked 5th out of 165 countries (based on 2019 data).⁸ The improvement of the country's rank was determined by a number of factors, such as: positive growth of the country's GDP in recent years, correct and targeted state policy of transfers and subsidies, reduction of government consumption in total consumption, effective tax reform and favourable business environment.

The World Bank's World Governance Indicators assess countries around the world in several areas of governance, including governance effectiveness, quality of regulation and more. It should be noted that in 2020Georgia's score in the improved in two dimensions compared to the previous year: Political Stability and Absence of Violations and Regulatory Quality, whereas in other areas its position slightly worsened.⁹

According to the SME Policy Index 2020 by OECD¹⁰, Georgia has achieved unprecedented success in the 2020 ranking. According to the report, Georgia's rating and corresponding score (compared to the previous 2016 rating) improved in all 12 rating components, while in 9 out of 12 components the country was rated the highest among the Eastern Partnership countries. According to the OECD report, Georgia has made further progress and achieved significant success with a more strategic approach to the development of small and medium-sized enterprises and the implementation of relevant targeted initiatives. At the same time, according to the study, Georgia has taken particularly impressive steps in the areas of entrepreneurship training, as well as improving the operating environment of small and medium-sized enterprises. However, according to the report further improvement could be used in areas such as: insolvency, small and medium enterprises in the green economy, innovation in small and medium enterprises and internationalization.

In addition, according to the OECD Investment Policy Review of Georgia¹¹ in the FDI Regulatory Restrictiveness Index, Georgia ranks 8th among more than 80 countries as one of the most open economies in the world in terms of attracting foreign investment.

As for gender equality, according to the Global Gender Gap Report 2021 by the World Economic Forum¹², Georgia has made great progress and ranked 49th out of 156 countries in 2021 (improvement by 25 positions compared to 2017).

⁶SME Development Strategy of Georgia, 2021-2025
⁷Index of Economic Freedom 2022, heritage.org
⁸Economic Freedom of the World, 2021 Annual Report, Frazer Institute
⁹World Governance Indicators - Georgia in the World Bank Ranking 2021
¹⁰The SME Policy Index: Eastern Partner Countries 2020
¹¹OECD Investment Policy Reviews: Georgia, 2020
¹²Global Gender Gap Report 2021, Weforum.org



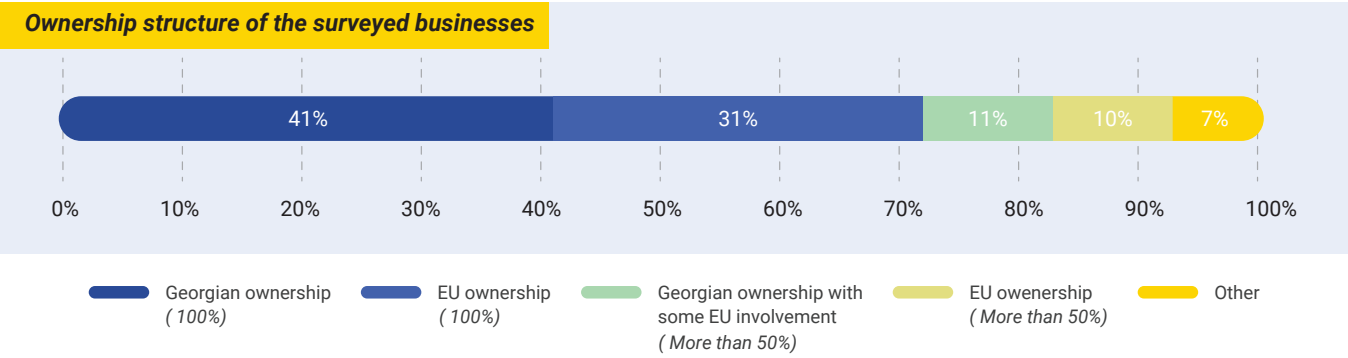
SURVEY RESULTS

1. PROFILE OF SURVEY PARTICIPANT COMPANIES

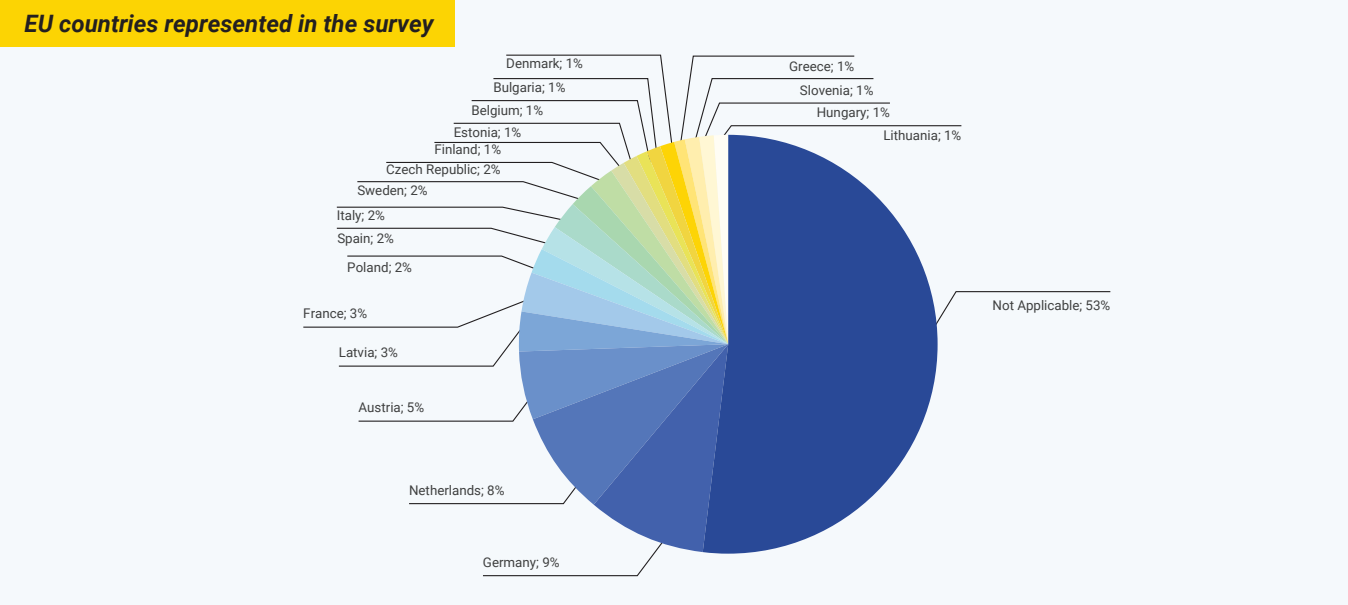
EBA survey primarily aimed at capturing the opinion of EU companies in relation to topics of the business climate in Georgia. Defining an EU business is difficult, but certain rules were used to identify and reach EU businesses for purposes of survey participation. One of the primary indicators was the existence of EU-based company shareholders (both individual as well as corporate). Beyond ownership of EU resident legal entities and individuals in a company, other used criteria included business links with the EU, such as export and imports, European management, and self-association of businesses as such.

According to Geostat, by the end of 2021 there were more than 1,200 active companies operated in Georgia with at least some European ownership interests, in diverse economic and geographic sectors. Reaching some of those was possible, and impossible - for others. For survey purposes, companies were welcome to participate if they had any connections or relation to the EU, as well as sharing European values, regardless of whether or not they were EU owned. Among them were members of EBA Georgia. Throughout this report, these companies are referred to as “EU enterprises”. Detailed methodology of the survey is provided in the annex of this report.

In total, 176 companies responded to the survey. 31% of these were purely EU-owned, with full ownership. In another 10% of responding companies, EU ownership comprised a controlling majority of more than 50% in the shareholding. In about 11%, EU ownership was a minority fraction. About 41% of enterprises were 100% Georgian-owned, but otherwise related to EU. For analytic purposes, later in the report, we differentiate between “EU-Owned” companies (the ones with at least partial ownership from entities from the EU) and “Non-EU-Owned” companies (the ones with no ownership from EU individuals or legal entities but otherwise associated with the EU and Europe).

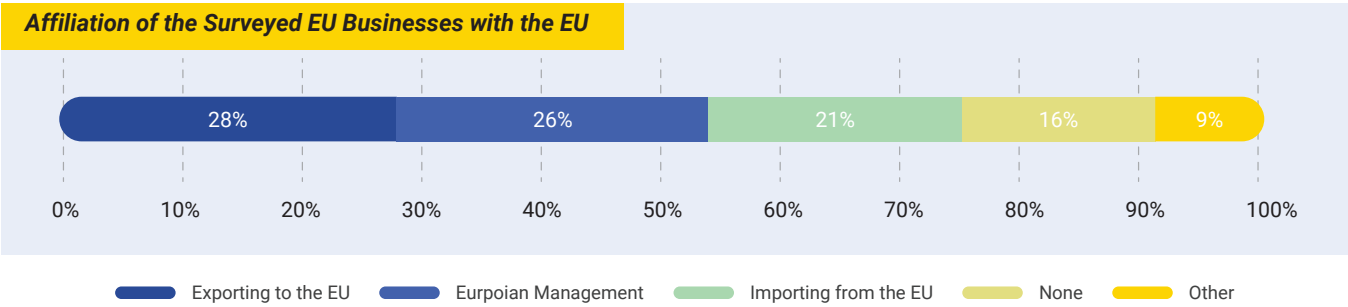


In about 47% of cases, there were at least partial EU ownership (18 EU countries in total) in the surveyed company. The biggest representation in the survey was from companies with German ownership (9%), followed by the Netherlands (8%), Austria (5%), Latvia (3%), France (3%). Other EU countries represented in the surveyed sample were Italy, Poland, Czech Republic, Spain, Sweden, Estonia, Denmark, Bulgaria, Belgium, Greece, Finland, Hungary, Lithuania, Slovenia.

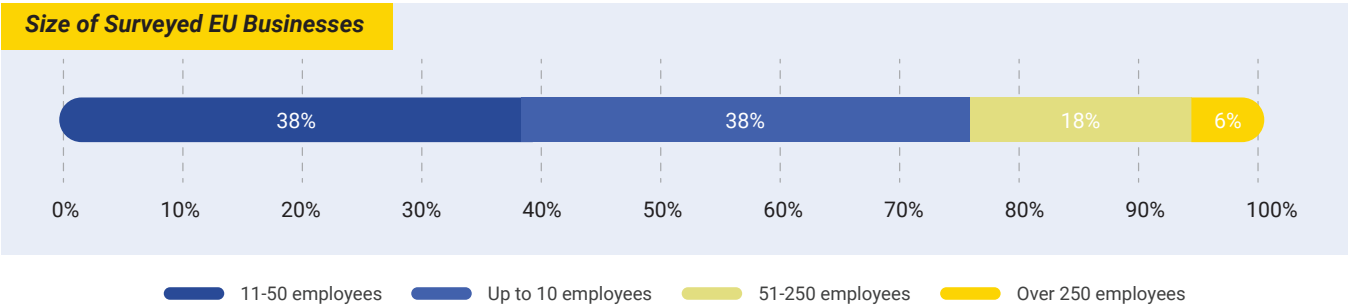


Beyond ownership interests, businesses have perceived themselves to be somewhat affiliated with the EU in several ways. This affiliation in some cases is very explicit and direct, though indirect in other cases. Businesses could have a completely non-European ownership but perception of this affiliation makes Georgia’s European way relevant to them.

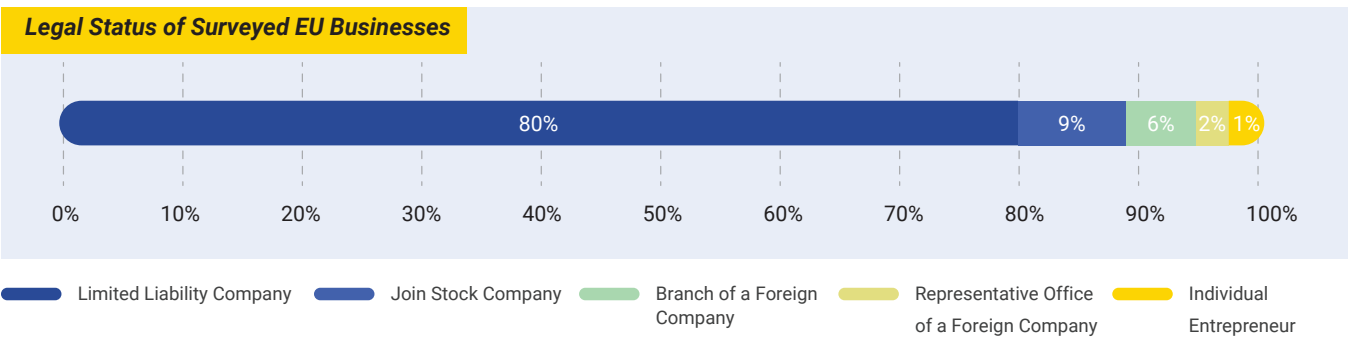
It is interesting that 28% of surveyed companies report that they export to the EU. Clearly these are among the 1,000 Georgian companies who export to the EU. About 26% of other companies are run by European management, making them directly connected to the EU. 21% of companies report that their affiliation is through imports from the EU. Other links with the EU are reported by 9% of the surveyed companies, specified as: buying equipment and services from the EU, EU standards and business approach, the EU as a source of knowledge and know-how, partnership networks and so forth. Only 16% of companies report that they do not have any affiliation with the EU. We believe that European values make them a perfect candidate to such an affiliation in the future. Overall, the reported affiliation, combined with the ownership, make this a valid sample when it comes to the airing the voice of European businesses in Georgia.



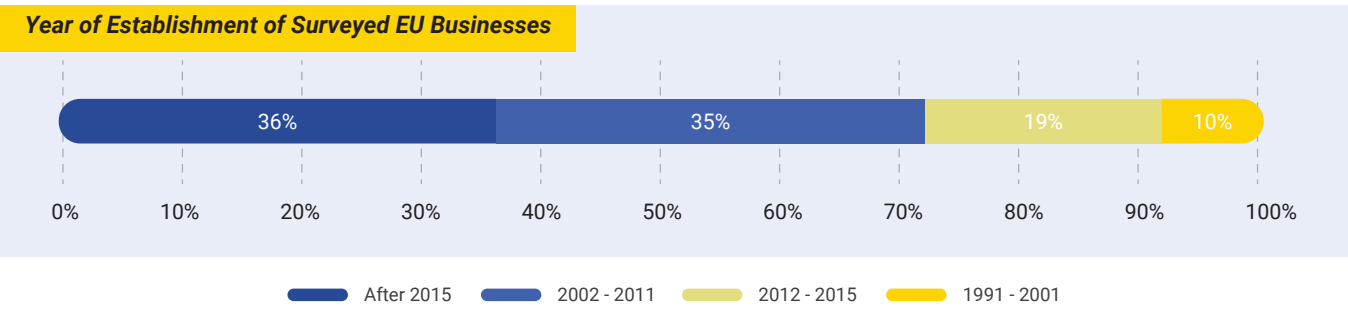
A diverse picture emerged in terms of company sizes. Most surveyed companies were either micro-sized (up to 10 people) or small (11-50 employees), each consisting of a 38% share. 18% of responding companies were medium-sized with 51-250 employees and 6% of them were large companies with over 250 employees.¹³



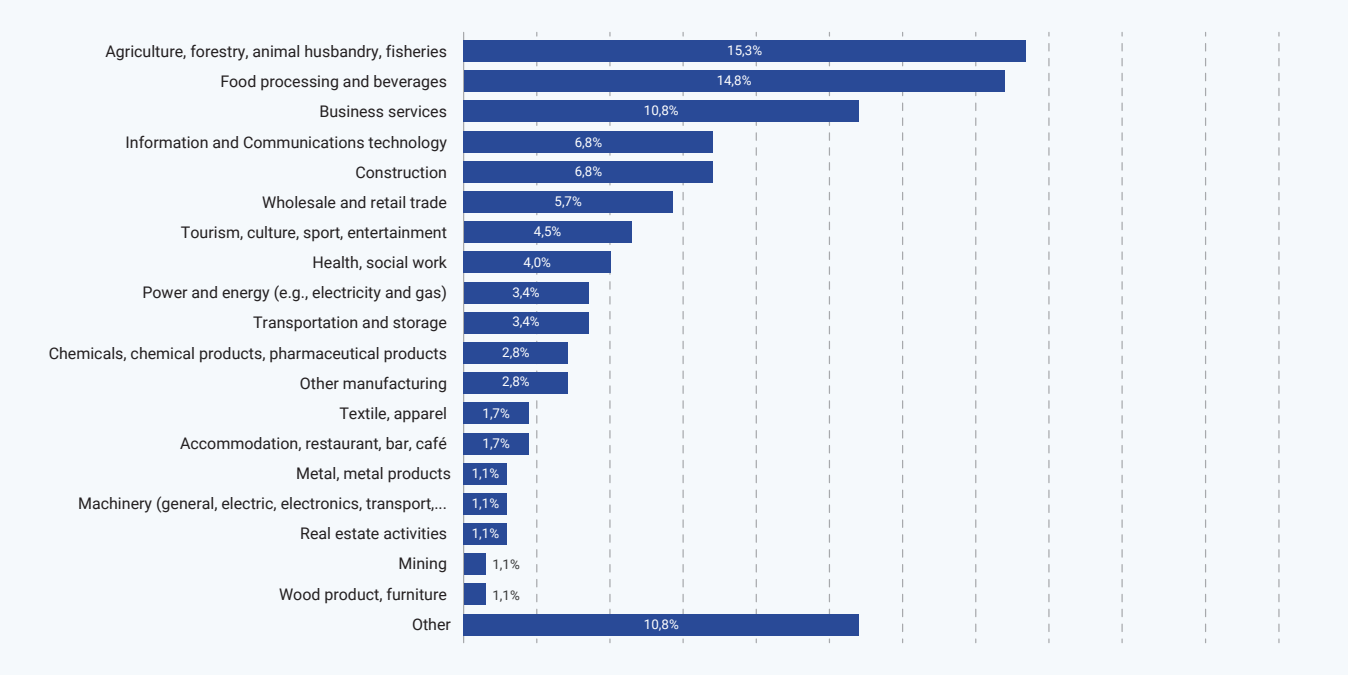
In terms of the legal structure, most European companies (80%) have legal status of a Limited Liability Company, followed by Joint Stock Companies (about 9%). Interestingly, 6% of the respondents were a Branch of a Foreign (mostly European) Company and another 3% were Representative Office offices. Only 2% among the respondents were Individual Entrepreneurs.



European companies in Georgia are relatively young, as more than 36% of the firms were established after 2015 and another 19% were established in the period of 2012-2015. Another large segment was made up of companies established in the period of 2002-2011, which comprised 35% of the pool. Only 10% of the companies were old businesses established before 2001.

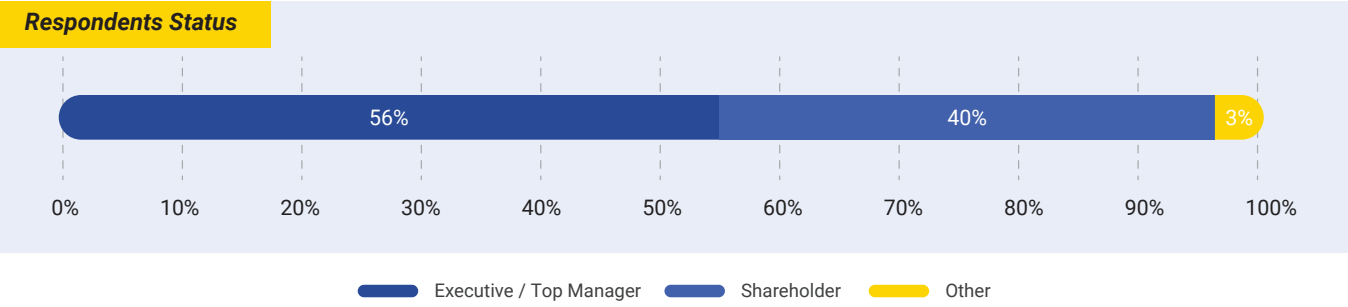


A wide variety of sectors were covered by the survey. The agricultural sector is the least formalised sector in the economy. Despite this, most of the responding enterprises (about 15%) were in the agricultural sector, followed by food processing and beverages (14.8%). Combined, these two sectors make up about 30% of the total pool of enterprises. Clearly, affiliation with the EU is relevant to this sector to its furthest extent, and the sector also has important things to say in terms of the business climate in Georgia.



Sectors Represented by Surveyed EU Businesses

This survey was about strategic issues related to business and its environment. Therefore, surveying the most informed and responsible person interviewed was a critically validating element to the survey’s legitimacy. 96% of respondents were either top executives (56%) or owners (40%) of the businesses.



Considering the sizeable share of the large and medium firms represented in the sample, interviewed companies do represent a meaningful chunk of the national economy and their voices should be taken seriously.

¹³For simplicity reasons, we use only one criterion (employment), instead of two, for classifying the companies by size. Therefore, our denotations of micro, small, medium and large are no way equivalent to the official classification. The definition of size buckets is based on the EU definition of the sizes of SMEs and therefore could not be matched to Georgia’s definition and could not be verified whether our sample is similar to the Georgian SME universe.



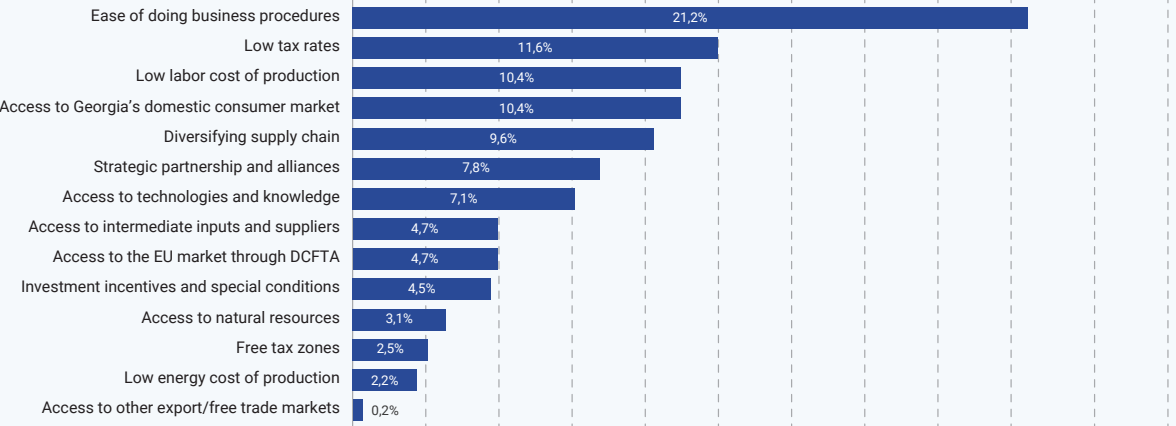
2. BUSINESSES CLIMATE CHALLENGES AND OPPORTUNITES FOR EU BUSINESSES

Businesses in Georgia navigate through quite challenging and evolving political and business environment, reflecting the dynamics of internal and external drivers. European businesses also are part of this ecosystem. Economic reform agenda compels dynamic approximation of the business climate in Georgia to the business climate of the EU. However, often, this very process of change causes uncertainties and disruptions of the established status quo, often not welcome by the businesses. Sometimes, the end in itself - a better business environment - is not also clear to businesses and opinions diverge on that subject. This section overviews perceptions of the EU businesses towards some of the key elements of the ecosystem, such as key dynamics of the key business climate factors, major obstacles to do business, recent performance and future optimism of the enterprises, attitude towards economic reforms, the DCFTA and key obstacles to its implementation, established ways to solve issues in relation to the state, environmental dimension.

2.1. MOST IMPORTANT BUSINESS ENVIRONMENTAL FACTORS (BEFORE AND NOW)

For the last few years Georgia was among top performers in terms of critical ingredients of doing business climate. These factors were often main decision factors to invest or do business in an otherwise small domestic market of Georgia. Understanding such major drivers and for EU businesses in the begging and how these important factors evolved will help policy-makers set priorities to increase commitment of the existing business as well as making improvements to attract others.

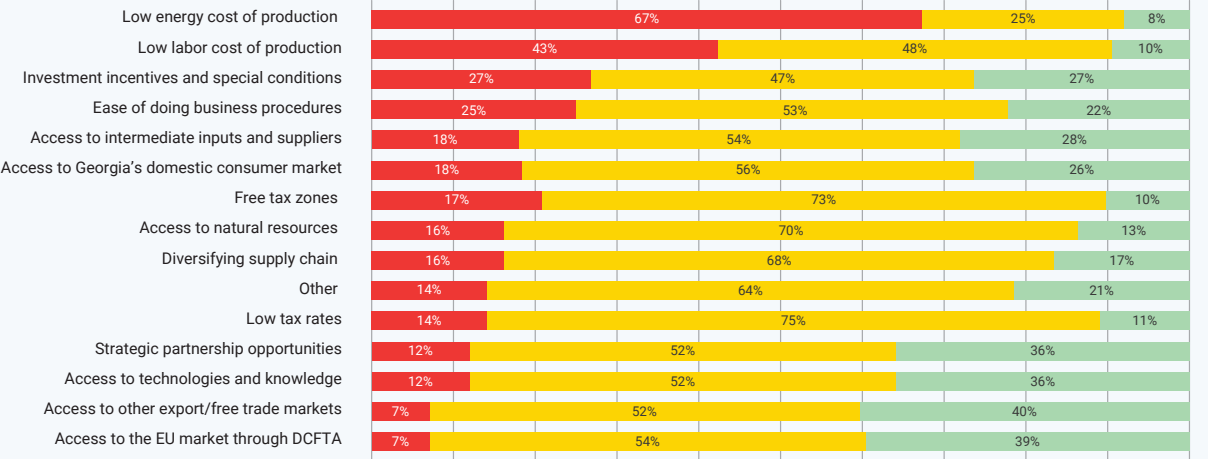
The survey showed that the most important business climate factors until recently was easy procedures of doing business in Georgia (21.2%), followed by low tax rates (11.6%), low labor costs of production (10.4%), access to local domestic market (10.4%), and diversification of the supply chain (9.6%).



Important business climate factors while entry or until recently

There are not so many differences among the EU-Owned and Non-EU-Owned enterprises participating in the survey, and the top-ranked factors remain the same for these two groups. Differences are more visible as we move down in terms of importance of the factors.

Business factors change over time, independent to how important they are to individual businesses. Businesses were asked to evaluate whether this dynamic was positive or negative in relation to each of the factors. Several findings emerge. First, there is some divergence of perceptions (or a level of consensus) on whether a particular factor deteriorated or improved. Except for the energy costs, in relation to listed factors, most respondents agree that the factor conditions remained the same. Access to the EU market, access to the other export markets and free trade agreements are among the best performing aspects, with high ratio of respondents who think that the situation improved compared to the ones who believe that it was deteriorated. Labor costs, investment incentives and to doing business procedures (in some sense) - are among the ones with notable portion of respondents who report deterioration.



1 - Deteriorated 2 - Remained same 3 - Improved

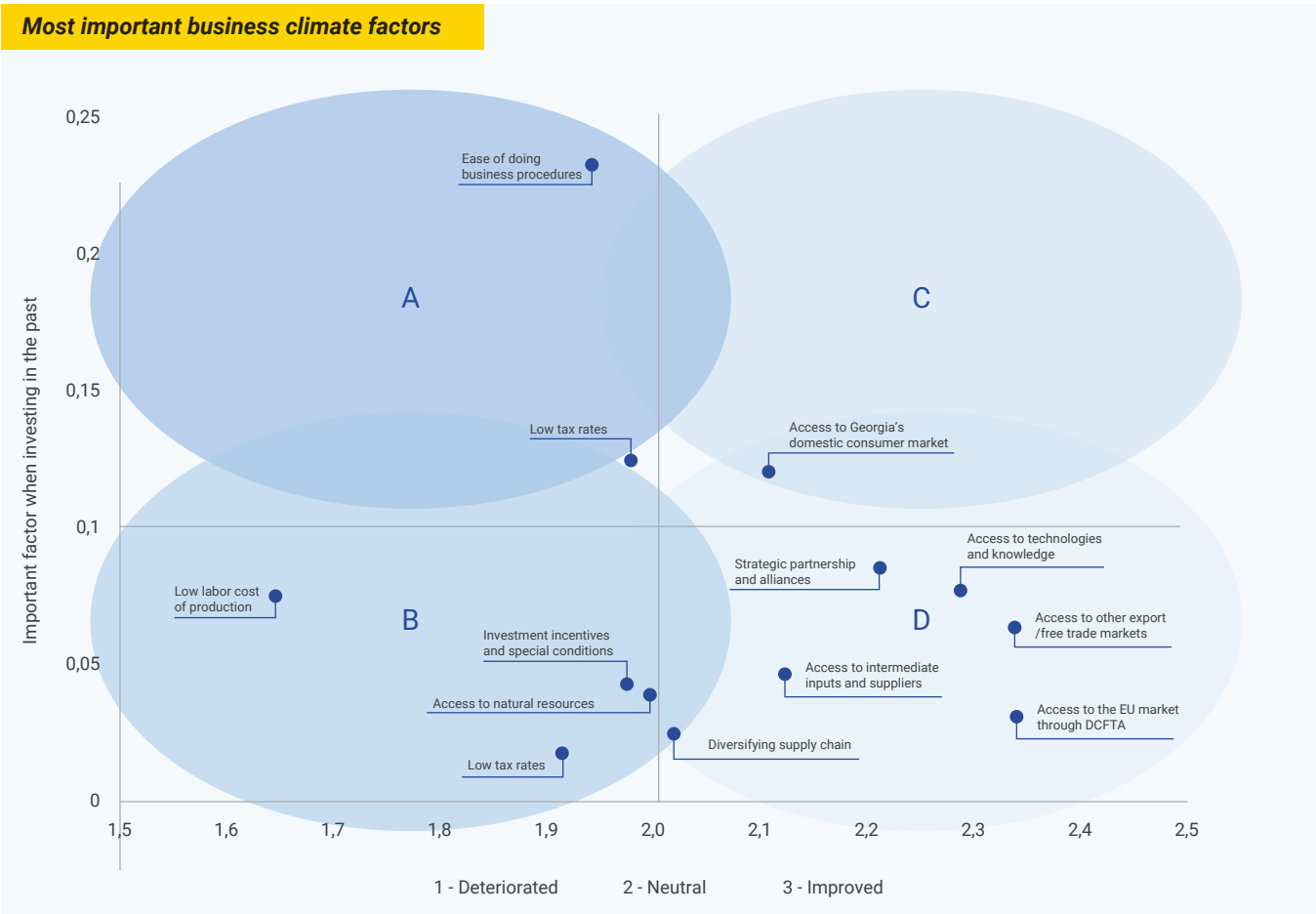
Recent dynamics in business climate factors

Evidence-based policy making ensures that priorities are set in the right order. Addressing the challenges will require making a trade-off between important and what has gone wrong in recent year and less important business climate factors. These factors could be grouped into several different segments, according to their *importance* and the *recent dynamics* (positive or negative direction). Four conditional groups were distinguished, which require different policy response and level of attention:

Group A: the business climate factors with *high importance* for making business in Georgia and *negative direction* in the recent years. This is the most problematic area, which requires urgent attention in order to maintain or improve business climate in the country. Ease of doing business procedures and low tax rates fall in this group. Policy response for this group is understanding the root-causes of this perceptions and mitigate the risks. These could be meaningful reasons but also could be a matter of wrong perceptions of the businesses, which could be solved through the right level of communication.

Group B: Second priority group, with *less than average level of importance* for doing business, with *negative dynamics*. The policy measure to this group might be same as for Group A, but as a second priority, if there is a need to make a tradeoff between resources. According to the EU businesses, four aspects of the business environment such as low labor costs, free tax zones, access to natural resources and investment incentives - fall in this group.

Group C and Group D: These factors are the ones in which Georgia’s *positioning improved* according to the EU businesses. They only *differ in terms of importance* to do business and priorities must be set according to their perceived importance (first C and then D). The policy response for these groups include: capitalizing on these strong perceptions, learning from successful cases and building the communication to the potential investors about these factors more profoundly.

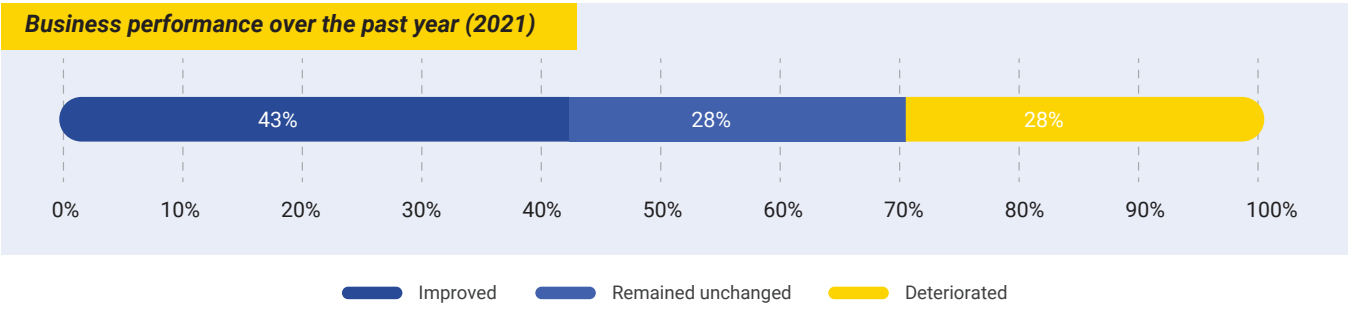


A common assumption in this consideration is that these numbers are generalized and averaged, which means that despite an overall positive perception about a particular factor, individual businesses might face certain problems, and vice-versa, an average negative perception does not exclude many individual enterprises who positively assess the progress. Therefore, an individualized, customized approach, especially when it comes to the important international companies, still applies as a desirable policy.

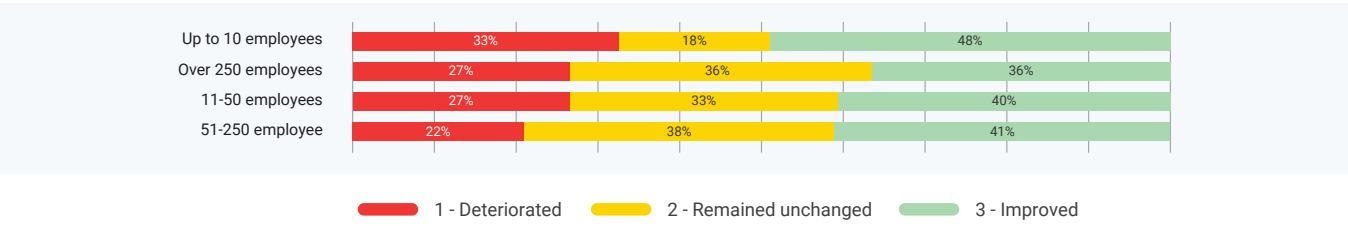
2.2. BUSINESS PERFORMANCE AND OPTIMISM

The COVID-19 pandemic – which spread in Georgia in 2020 – significantly distorted the “business as usual” way and forced the private sector to revert to previously unheard of measures. The measures provided by the government with the support of the international strategic partners, strengthened resilience of the private sector to crises and Georgia’s private sector navigated through these rough waters during the 2020 and some part of 2021. Although, it is hard to measure an exact attribution of the impact to the pandemic, business performance over the last year might indicate the overall direction of the business performance.

A majority (43%) of EU businesses report that their overall business performance *improved*. Business performance remained unchanged for 28% of the surveyed companies and another 28% report that their performance went negative. Although hard to measure the business health of these enterprises, this indicator may serve as a baseline for coming years.

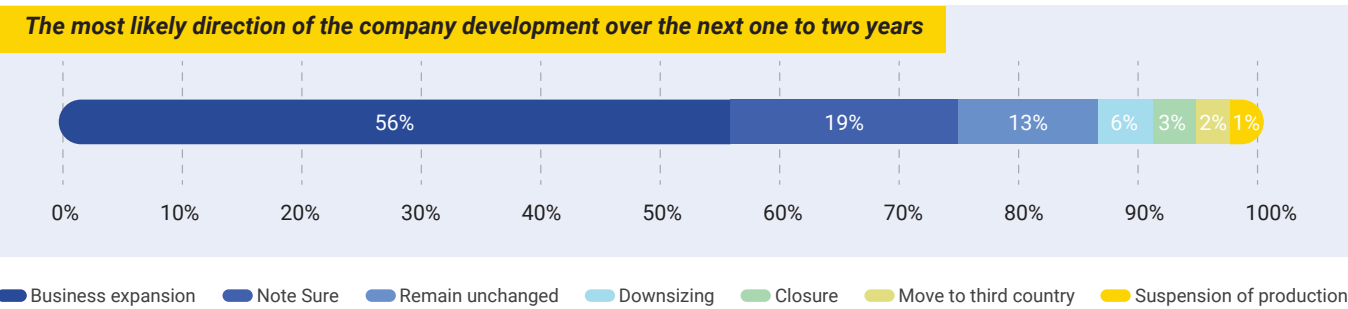


Among all size groups, *micro* companies were the ones with the *biggest portion of reported deterioration* of performance (33%), followed by large companies (27%). At the same time, 48% of micro enterprises reported improvement – also the highest among all sizes companies, indicating the high dynamics and vulnerability of the group, compared to other sizes.

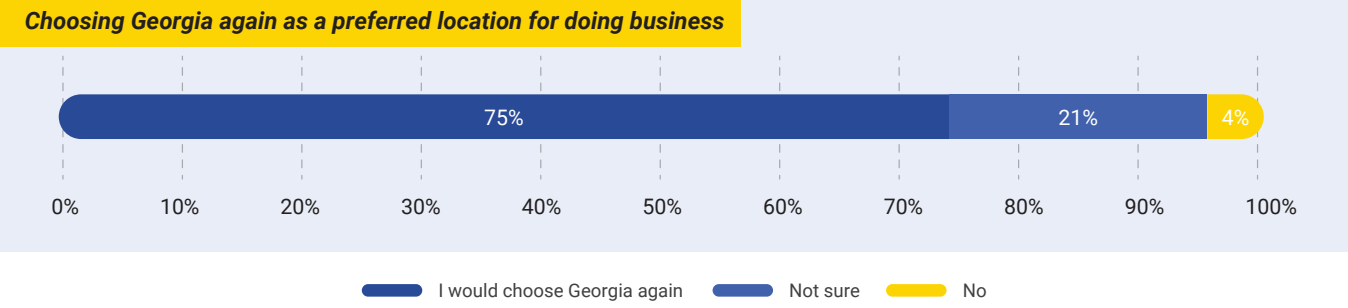


Business performance over the past year (2021) (by company sizes)

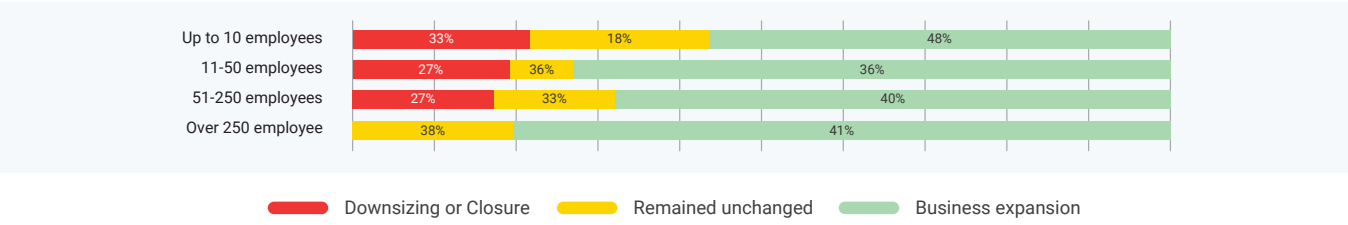
The survey was carried out as a full-scale Russian invasion advanced in Ukraine. Despite such a disruptive event in the region, business optimism for the coming year clearly overshadows past performance – *most of the surveyed businesses (56%) plan expansion* in the coming years. For 19% of enterprises, development prospects are unclear. 13% of enterprises estimate they will remain unchanged. The remaining part of respondents plans either downsizing (6%), closure (3%), move to other country (2%) or suspension of their activities (1%). Although small in numbers, it is interesting to understand the reasons of the pessimistic outlook of this group, to take measures to prevent this from happening. Some of them might represent a source of high-value employment and added value in the economy.¹⁴



The aggregation of environmental business factors may result in a particular opinion about an economy as a preferred location of doing business. In an integrated global economy, with free flow of capital, it is not difficult to relocate businesses, as conditions change. It is interesting to see how many EU firms are committed to doing business in Georgia. If they had to, 75% of the surveyed businesses would choose Georgia again as a preferred place to do business, 21% would be uncertain and 4% would not choose Georgia again. Again, this very 4% of the enterprises are an interesting segment to explore, since retaining an investor is more economically reasonable than finding a new one.



Not surprisingly, a *bigger portion of micro and small companies consider the likelihood of downsizing*, as opposed to larger ones. *Large companies are more optimistic* as none of them consider a likelihood of downsizing and 82% (the biggest among all groups) consider expansion.



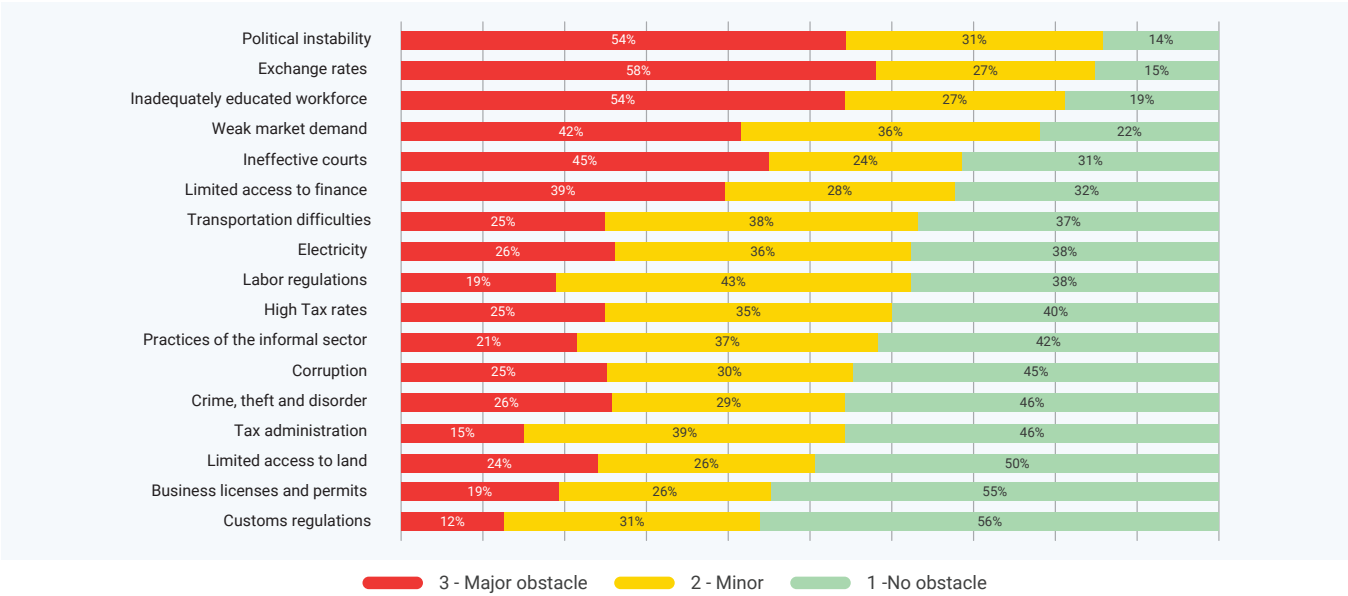
The most likely direction of the company development over the next one to two years (by company sizes)

¹⁴EBA stands ready to take steps towards exploring more these root-causes from individual companies and individual cases, if these companies made themselves identifiable during the survey or they will do so during the discussions of the results.

2.3. MAJOR OBSTACLES TO EU BUSINESSES

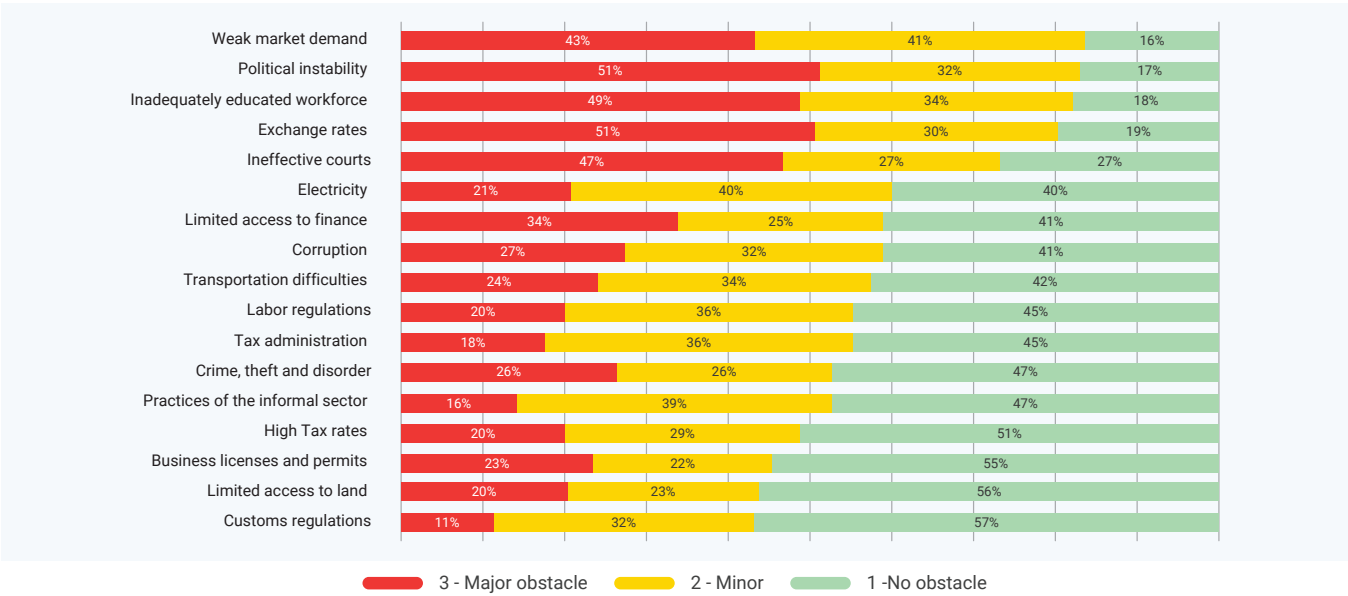
Exploring obstacles to businesses in Georgia has often been addressed by many reputable parties in the past, with various findings and lists of factors, often undermining the importance of truly fundamental obstacles. Our study revealed some of those.

Customs regulations, business permits and licenses are *among the smallest obstacles*, since an absolute majority (more than 50%) of the businesses say that these do not represent an obstacle at all. On the other end of the spectrum, political instability, exchange rates and inadequately educated workforce are named as top obstacles to businesses, as more than 50% of the surveyed businesses have reported. The rankings reflect the relative magnitude of obstacle impacts on business operations of the surveyed businesses.



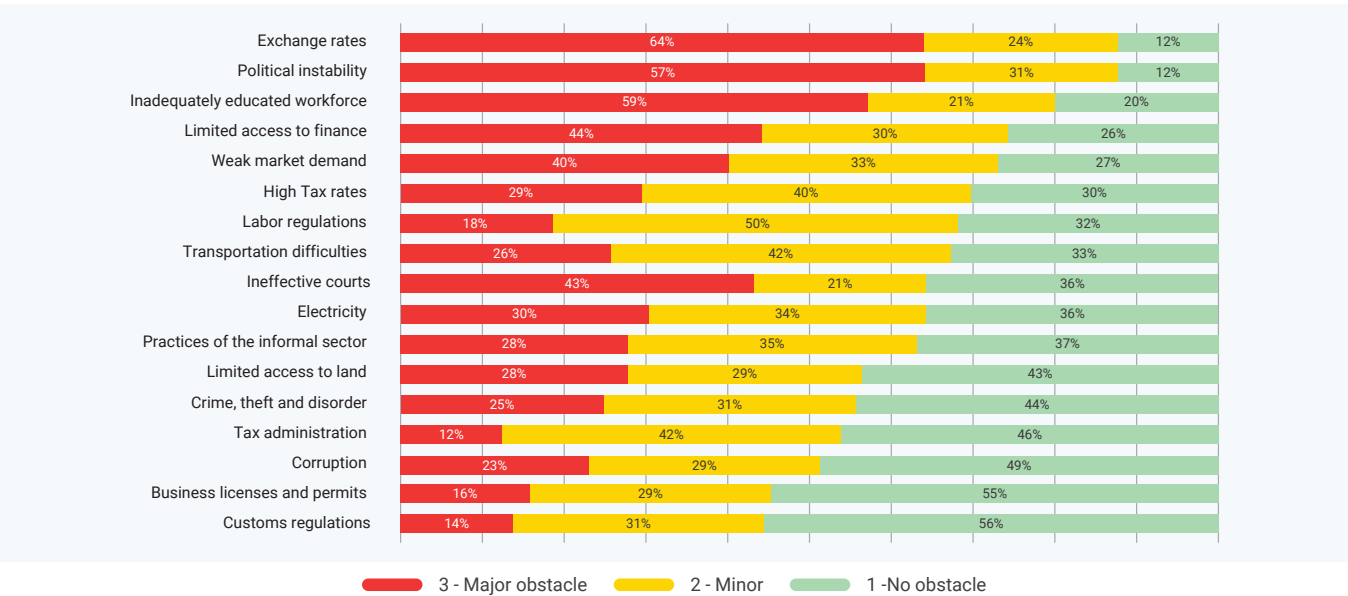
Major obstacles to businesses

There are notable differences in perceived obstacles between EU-owned and non-EU owned enterprises. The small market and consequent weak demand, combined with political instability, lack of qualified workforce and exchange rates are reported by EU-owned enterprises as top obstacles (a major or a minor obstacle, combined).



Major obstacles to businesses (EU-Owned)

Exchange rates, political instability and lack of a qualified workforce are among the top obstacles among non-EU-owned enterprises. Customs regulations are the smallest obstacle for both groups.



Major obstacles to businesses (Non-EU-Owned)

Different size companies face different obstacles and concerns. Although slight, there are some differences. Exchange rates represent a top issue for three size groups – small, medium and large. An ineffective court system represents more of an issue for large firms than for the rest of the firms. Smaller firms suffer more from weak market demand than the larger firms.

#	Micro (up to 10 Employees)	Small (11-50 Employees)	Medium (51- 250 Employees)	Large (Over 250 Employees)
1	Political instability	Exchange rates	Exchange rates	Exchange rates
2	Weak market demand	Political instability	Inadequately educated workforce	Ineffective courts
3	Exchange rates	Inadequately educated workforce	Political instability	Political instability
4	Inadequately educated workforce	Weak market demand	Electricity	Inadequately educated workforce
5	Limited access to finance	Limited access to finance	Weak market demand	Weak market demand
6	Corruption	Ineffective courts	Transportation difficulties	Electricity
7	Ineffective courts	Transportation difficulties	Labor regulations	Labor regulations
8	Electricity	Labor regulations	Practices of the informal sector	Tax administration
9	Practices of the informal sector	Crime, theft and disorder	High Tax rates	Crime, theft and disorder
10	Transportation difficulties	High Tax rates	Ineffective courts	Business licenses and permits
11	Labor regulations	Electricity	Limited access to finance	High Tax rates
12	High Tax rates	Practices of the informal sector	Tax administration	Transportation difficulties
13	Tax administration	Corruption	Limited access to land	Corruption
14	Limited access to land	Tax administration	Customs regulations	Limited access to finance
15	Crime, theft and disorder	Business licenses and permits	Business licenses and permits	Limited access to land
16	Customs regulations	Customs regulations	Crime, theft and disorder	Practices of the informal sector
17	Business licenses and permits	Limited access to land	Corruption	Customs regulations

Rankings of the perceived obstacles among by firm size

Different size companies face different obstacles and concerns. Although slight, there are some differences. Exchange rates represent a top issue for three size groups – small, medium and large. An ineffective court system represents more of an issue for large firms than for the rest of the firms. Smaller firms suffer more from weak market demand than the larger firms.

POLITICAL INSTABILITY

Future uncertainty is the number one challenge businesses seek to avoid and EU businesses consider political instability as a top contributor to this uncertainty. Political instability becomes a major obstacle to plan the future of a company.

Political instability has two dimensions in the judgements provided by the surveyed enterprises – internal and external. The Internal dimension is related to the notable polarization of political parties. Tensions related to such polarization as well as frequent changes in the economic policy vector translate into the risks for businesses. Businesses mentioned that frequent change in decision -making positions among state agencies makes doing business difficult. Instability is also related to the change of the government’s vision towards various strategic economic projects.

External political moves and specifically the war in Ukraine considerably shook an already shallow political background for the enterprises in Georgia. Some of the enterprises consider this as an obstacle for them, since it directly affects the perceptions of risks by clients (often foreigners), investors and trade partners, causes disruptions in the supply chains and spikes in input prices. Especially enterprises which made investments in infrastructure reported that they need stability and predictability. During the survey, specific cases were mentioned about the political instability leading to cancelations of specific investment leads and transactions.

<i>“Russian aggression in Ukraine is the biggest obstacle right now.”</i>	[Food and Beverage]
<i>“In our opinion, the current geopolitical situation is the biggest obstacle, because there is a feeling of instability.”</i>	[Machinery]
<i>“50% of our customers are foreigners, an unstable political environment may be an excuse for them to leave the country, which in turn will lead to a decrease in our customers”</i>	[Real Estate]
<i>“Current war conditions severely affect not only our business as consulting entity, but also manufacturers and producers, since we directly work in waste elimination and business process optimization”</i>	[Professional Services]
<i>“Political instability is hurting the tourism industry even more, as safety is the first and foremost criterion for tourism development in the country”</i>	[Tourism]

From donors’ and international strategic partners’ perspectives, this aspect of the business environment has usually been considered outside the immediate impact area for a business environment. As a result, most of the efforts were directed to other aspects of the business environment such as access to finance, access to labor and so forth. The survey of EU businesses again proved the importance of this factor in the everyday life of businesses. Therefore, stakeholders should realize that any steps to mitigate political risks (i.e. avoid uncertainties related to frequent changes in the environment), will have a marginally more profound impact on business environment than efforts in relation to other factors.

EXCHANGE RATES

Fluctuation of exchange rates was rated as one of the top obstacles for EU businesses. This factor was often mentioned in combination with political instability. Under exchange rates, businesses imply volatility and unpredictability of exchange rates, making planning and business operations challenging. Unstable environment, combined with currency devaluation and a decline in the purchasing power of customers cause price fluctuations on inputs and significantly hurt entire sectors. Weak exchange rates also have a negative implication on EU businesses that work with state projects funded in Lari. This fluctuation makes it difficult for businesses to make long-term commitments.

<i>“Exchange rates significantly hinder the influx of tourists to the country.”</i>	[Tourism industry]
<i>“Exchange rate fluctuations have a significant impact on the development of business.”</i>	[Machinery industry]
<i>“Frequent and significant devaluation of the national currency increases the prices of imported medicines and decreases the financial access of the population to medicines and decreases sales”</i>	[Medical industry]



The fact that exchange rate is a top-rated severe obstacle should have some consequences in terms of policymaking. Macro-financial policy rather than institutional environment is the most obvious area to look into, should the country decide to significantly improve the perception of businesses regarding these obstacles, letting them plan ahead and grow.

INADEQUATELY EDUCATED WORKFORCE

The skills mismatch on the labor market is not a novelty. This mismatch translates into important practical issues of doing business in Georgia and EU enterprises consider this the third most important obstacle, after exchange rates and political instability. In the background of high unemployment rates in the country, businesses consider finding adequately educated workforce an issue, especially for low and middle management positions. Respondents believe that the lack of qualified staff is particularly an issue for businesses operating in regions where, unlike in the capital, finding professional staff is almost impossible. That is why strengthening vocational education should be one of the country’s top priorities.

<i>“We lack professional education”</i>	[Agriculture]
<i>“Inadequately educated workforce is a problem not just for our company, but for all the businesses in Georgia. This is the most important issue we shall address as a country”</i>	[Unidentified sector]
<i>“Inadequate knowledge and experience of the workforce is an important impediment to both the effective management of the business and its development”</i>	[Real Estate]
<i>“The main obstacle is to find adequate workforce with qualifications and experience</i>	[Construction sub-contracting]

According to the surveyed respondents, there is no culture of professional education in the country, its reputation is very poor and this component of the education system does not function properly. The vocational education system should respond quickly and efficiently to the changing demands of the labor market, which it does not. And this, in their view, represents one of the root-causes of a shortage of existing skills.

There is no link between higher education and the employability of graduates. Georgian higher education institutions fail to equip students with critical thinking skills. Respondents believe that Georgian universities do not focus on practical components of the learning process, critical for developing employable skills among students.

Stemming from the magnitude of this issue, some businesses are taking on this challenge and try to handle staff training themselves, although more involvement from the state in this area is important. Collaboration between the private sector, educational institutions and the state remains a priority.

WEAK MARKET DEMAND

Georgia is a small country, with a small internal market. Consumer businesses suffer from weak purchasing power of the population, due to weak exchange rates and high unemployment. Business-to-businesses are concerned that, despite the economic growth in the last year, after the pandemic slowdown, business sectors did not grow to generate demand for goods and services.

<i>“Georgia is a small land country and there is no way to expand actively”</i>	[Agriculture]
<i>“Market is small, hence the weakness of demand”</i>	[Agriculture]
<i>“EU-market demand significantly decreased”</i>	[Unidentified Sector]
<i>“Most of our products are designed for business development and advancement. Unfortunately, in recent years, a large part of businesses in Georgia have not moved to the stage of development and growth, which is reflected in the activity of our business.”</i>	[Business services]

Part of the weak demand could be attributed to purely company-related competitive factors, growing pressure from competitors and overall competitiveness of a company and its products and services. However, 79% of surveyed firms report the weak market demand as an obstacle (major or minor). Therefore, it is highly likely that overall weak market demand might be real and should be taken seriously. If not considered in the context of wider free trade areas, regional partnerships, and export markets, naturally Georgia’s domestic market could not be sufficient for a growing company. More internationalization strategy should be universally adopted.

INEFFECTIVE COURTS

An ineffective court system is reported as the fifth important obstacle in rank. According to the surveyed businesses, lack of qualifications of the judges in business-related issues significantly reduces trust towards the system. Protracted decisions by the court, which take several years, make doing business impossible, influences both Georgian companies and foreign investors, inflicting the damage to the reputation of Georgia as an investment destination.

Apart from the business-to-business litigation, time-consuming processes also hinder the enforcement of the decisions of the Georgian National Competition Agency, which impacts the competitive environment.

<i>“The court is very unqualified in business disputes, and if the business dispute is between private and public organizations - it is significantly biased and unpredictable.”</i>	[Insurance]
<i>“I think the biggest problem of the country is the courts, including in relation to disputes on labor relations.”</i>	[Agriculture]

Businesses report that in cases of disputes with the state, the court usually upholds the position of the state party.

Insufficient progress of the court system reform and weak alternative dispute resolution mechanisms (e.g., mediation and arbitration) are at the root of this issue. Proper distribution of the case and the introduction of the institute of so-called “writer assistants” will shorten the time required for litigation.

LIMITED ACCESS TO FINANCE

Limited access to finance is reported as number six in the obstacles ranking. According to the surveyed businesses, extremely high interest rates on short-term borrowings, cumbersome procedures to arrange any type of loan with a bank, limited financing products for startup entrepreneurship and collateral requirements impede the growth of the businesses. There are very limited leasing opportunities. Absence of a stock market leads to the domination of expensive bank financing.

<i>“Extremely high interest rates for short-term borrowing for a cash flow and very cumbersome procedures to arrange any type of loan with bank.”</i>	[Agriculture]
<i>“Our company is actively working to develop entrepreneurs and startup ecosystems in Georgia. It is by observing our programs and projects that we can say that limited access to finance is hindering the development of this field to some extent. Banks issue loans at high interest rates, and the investment environment is only now, slowly starting to develop.”</i>	[Unidentified sector]
<i>“I would like to buy machinery for my factory with leasing, but there is limited access to leasing opportunities in Georgia.”</i>	[Real Estate]
<i>“Limited access to finance leads to dependence on inflexible and expensive services in the banking sector - alternative investment opportunities are needed, including the existence of a stock exchange that is not dependent on banks.”</i>	[Construction sub-contracting]

The study found that access to finance for the beneficiaries of the "Produce in Georgia" program has been somewhat resolved. For others who do not have access to these programs, access to finance remains a significant challenge. This problem is especially true for small and medium enterprises, for whom accessing preferential credit is related to the difficulty of procedures and requirements.

Finally, the study found that there is an issue of limited awareness about available state financial support. Many businesses do not yet have a proper idea of what type of support they can receive from the state. In some cases, the private sector has unrealistic perceptions of financial support. It is clear that additional efforts are needed both in terms of increasing the supply of the programs as well as raising awareness of the existing programs and instruments.

TAX RATES AND TAX ADMINISTRATION

Under obstacles, tax rates were rated the ninth most important business obstacle (58% evaluated as a minor or a major obstacle). Comments received from the surveyed respondents were related both tax rates and tax administration. Major issues named were: high tax rates (in relation to VAT, income tax, tax on agricultural inputs), unclear law interpretation, no guidance in relation to the tax zones, huge unjustified fines, retrospective decisions and lack of staff qualifications.

<i>“I think taxes in Georgia are high and corresponding reforms should be carried out. I would emphasize VAT and income tax.”</i>	[Unidentified Sector]
<i>“Import taxes on agricultural input as seeds and breeding cows remain a concern. If Georgia wants to improve in agriculture, there should not be barriers to the access of basic material.”</i>	[Agriculture]
<i>“As the Company has been implementing projects, having international and national importance and involving various international and local experts – proper tax administration shall be applied in order to meet local tax regulations of Revenue Service.”</i>	[Construction and Engineering Services]
<i>“We started business in Georgia because of special tax zones investing in training workforce in Georgia. Now the interpretation of some tax laws suddenly changed and we are being fined for past 3 years retrospectively despite previously it was accepted how we work. Appeal procedure seems to not work. Seems that court agrees with RS interpretation without getting even involved.”</i>	[ICT]

Tax disputes were mentioned as one of the most problematic issues under this topic. Protracted resolutions of the tax disputes affect many critical aspects of the surveyed businesses, their assets get frozen, banks refrain to provide credit, they become cautious with regards to expansion and growth. Time is wasted during the process. Internal dispute resolutions are not effective. In practice, the Ministry of Finance never changes a decision made by the Revenue Service, so the same issue is formally discussed twice. There should be an opportunity to appeal the decision directly in court.

Georgia is a small country, with a small internal market. Consumer businesses suffer from weak purchasing power of the population, due to weak exchange rates and high unemployment. Business-to-businesses are concerned that, despite the economic growth in the last year, after the pandemic slowdown, business sectors did not grow to generate demand for goods and services.

The practice of tax audits also is subject to criticism. This relates to the frequency of tax audits and the duration of the process. In Georgia, tax audits may take years, while in the worst case, the process should be completed in a few months.

Frequent and unanticipated changes in certain procedures or records in the legislation adds to business uncertainties. When inaccurate record in the legislation is specified, business decisions are reviewed retrospectively, which makes the business responsible for actions taken in the past. More advance consultations with the affected sectors and other stakeholders are needed in this regard. The issue related to special tax zones was the most serious one.

Companies also mentioned that sometimes it is difficult to get information about taxes from the responsible body, including from the Revenue Service and Tax Inspectorate.

As mentioned in the investment climate section, low tax rates were one of the key determinants of starting a business in Georgia for many surveyed firms. Therefore, any such cases should be carefully examined and solved. This is to avoid losing the established image of a low tax economy, incentivize growth of enterprises and prevent, in severe cases, business closures or moving to other countries.

ELECTRICITY

This is the seventh most important obstacle for EU business. Many agricultural lands do not have access to electricity, which makes it impossible to implement modern draining and irrigation technologies. Increasing frequent shuts of the electricity becomes an issue for industries where an uninterrupted supply of it is critical. In many cases, growing prices on electricity becomes a notable issue for businesses and directly threatens their operations. The enterprises suggest introducing financial benefits for alternative energy projects and long-term contracts for take-off as is the case in Europe.

“Increased energy prices directly threaten our business.”

[Insurance]

LICENSES AND PERMITS

As a result of the reforms implemented, the number of areas regulated by licenses and permits in the country has been reduced by almost 85%, excluding only a very limited list of organized activities, characterized by increased risk to human life or health or involving particularly important state or public interests or related to the use of state resources. An exhaustive list of types of licenses and permits is defined by one law, and introduction of new licenses and permits by another legislative or sub-legislative act is not allowed.

At the same time, the system of licenses and permits has been procedurally simplified as a result of the reforms implemented in the country and is subject to the "one-stop shop" principle. This implies an administrative procedure when the licensor or permit issuer facilitates provision of additional licensing or permits by another administrative body. The system of licenses and permits is also based on the principle of "silence is a sign of consent", which means that the license / permit is considered issued if the decision or refusal to issue a license has not been made within the prescribed period.

Despite the above-mentioned reform progress in the areas of license / permit system, it is important to further refine it, increasing and improving electronic access.

According to several comments, mostly from the agriculture sector, there is a noticeable increase in licenses and permits, which makes doing business difficult. The details or specifics of this issue are not mentioned, but could be a subject of exploration.

LAND OWNERSHIP

Ownership limitation of agricultural land is complicated and makes expansion impossible for EU companies with non-resident shareholders (a major part of the surveyed sample). Generally, limited agricultural land represents an issue for the agricultural industry. A considerable part of land in the country is unused, but most of it comes in small plots, which are not attractive to investors. Land registration issues are also problematic.



CORRUPTION

Reforms towards liberalization, democratic development of state institutions and the enhanced electronic access to public services lead to significant drop of corruption rates in the country. According to the Corruption Perceptions Index¹⁵ by Transparency International, Georgia ranks 45th in the world and is a leader in the region.

Despite the results achieved, it is important to maintain the fight against corruption as a priority and to continue reforms in this regard, including increasing online access to public services and further simplifying administration.

Corruption cases were mentioned by a noticeable number of respondents. Lack of transparency and corruption kills fair competition. Corruption practices used by competitors, which often are often illegal, distort fair competition in the sector and prevent the EU enterprises from growing. Such cases were mentioned both in relation to public procurement, government support programs as well as private sector transactions. For instance, some of the respondents from the Pharma sector complained that the agreement between certain pharmaceutical companies and doctors is not acceptable and the responsible ministry should take measures to eliminate such practices. It should be elaborated that corruption among middle and lower levels of management remains eliminated and the cases of elite corruption are more common.

Corruption in public procurement is one of the key areas of concern. Tender requirements are often reported as being tailor-made to only one company, which in turn excludes the possibility of fair competition. The evaluation and decision-making process is not always transparent, directly violates the Competition Law and restricts competition. Small businesses suffer from this most of all. The lack of awareness of the procuring organizations themselves regarding competition issues is one of the root causes.

LABOR REGULATIONS

According to respondents, the changes in the Labor Code are positive. However, labor regulations seem to favor the employed more than the employer. To the detriment of the employer, the reform added liabilities which do not yield real results and only increase costs, so that the effect does not improve. Electronic accounting of work hours is one example. Large companies already had this system in place, whereas for small and medium ones complying to these requirements is related to capital costs and often unnecessary formalities. Therefore, in many cases these regulations are exercised as a formality and miss the desired outcome.

According to respondents, the issue of labor safety is problematic. Occupational safety issues should not only be declared, but should also be properly monitored. This is to make sure that rules are commonly adopted by the industry and not to become a cost disadvantage to only certain companies who follow them.

Disproportionate rights of the parties in relation to termination of the agreement is another aspect of inequality. Employers spend huge efforts on staff training, who might leave to competitors or clients, and this damages the employer significantly, whereas dismissing an employee is not easy.

INFORMAL SECTOR PRACTICES

The informal sector competes with the formal one, being price-competitive by not paying taxes. Despite the quality differences, this inflicts damage on the commercial performance of EU businesses, who run the business in compliance to all regulations.

¹⁵Corruption Perceptions Index by Transparency International, 2021.

TRANSPORT INFRASTRUCTURE

The logistics industry complains that rail infrastructure is inadequately invested. Rail infrastructure (accessing loading territories) is obsolete and requiring care. Sea terminals are overloaded and companies have to wait unexpectedly long (often several days) before the cargo is loaded. Services are infrequent and expensive. Delays in vessel schedule might take weeks, affecting the supply times and ultimately - relations with the client. Access road to the agricultural farmlands is in poor conditions and the state does not take responsibility to improve it, directly affecting the costs and possibility to run the farms.

CRIME AND DISORDER

Crime and unrest directly damage the image of the country, which reduces the inflow of capital and tourists. Organized theft of minors is problematic. A lax attitude on the part of the state towards organized crime by minors encourages similar cases. Police investigations are ineffective and the interests of businesses and their foreign investors are not duly respected.

FINANCIAL OVER-REGULATION

Opening a bank account for foreign business is reported to be difficult and sometimes impossible in certain banks. The financial system is over-regulated, which increases compliance burden and regulatory impact assessments are not usually carried out.

CUSTOMS SERVICES

Although customs services were mentioned as one of the least problematic areas, several comments related to taking a certification on origin, due to long queues, impreciseness of the working and details (often discarded by the target country customs and returned back to the sender). Minor comments were also mentioned in relation to delays, incorrect interpretation of the nomenclature, suggesting some room for further improvement.

OTHER GENERAL FINDINGS

Lack of communication in the public sector and limited delegation of decision-making - a cross-cutting issue

Lack of communication between employees in public institutions and limited delegation of decision-making is a perceived issue and possible root-cause for many of the above-mentioned issues. As the respondents point out, they face lack of a commonly agreed position among employees of different agencies – a clear result of a lack of coordination. The issue of delegating responsibilities to lower levels is acute and notable. Government officials at lower administrative levels refrain from taking responsibility to resolve issues within their authority. This forces companies to seek solutions with upper-level representatives, resulting in wasted time and efforts.

Insufficient positioning of the country as an investment destination

Investments in the country are a key driver of capital as well as technologies and know-how, leading to more added-value and income for the economy. However, businesses believe that there is a need for more active work in relation to identifying specific and interesting business opportunities to attract business to Georgia from other places, as several successful exporters did (e.g. in the case of Georgian products) and communication of the country as an attractive place to do business. Georgia has an attractive product to offer to the outside world but this is not communicated well.

There are sector-specific challenges requiring individual approach

The challenge for the pharmaceutical sector is that GMP and GDP standards are not translated into Georgian. However, as respondents point out, the lack of statistical information and its transparency are problematic. Information about medication specifically is posted on the website of the Ministry of Health, although this information is not detailed, but very general. There are no reliable statistics in the country.

A specific reported challenge by the audit service industry is that the official classification currently in use, provides too many categories of audit firms. There are 5-6 categories and the criteria used to group them are not clear. A regulation is needed which further specifies the how the categories should be assigned.

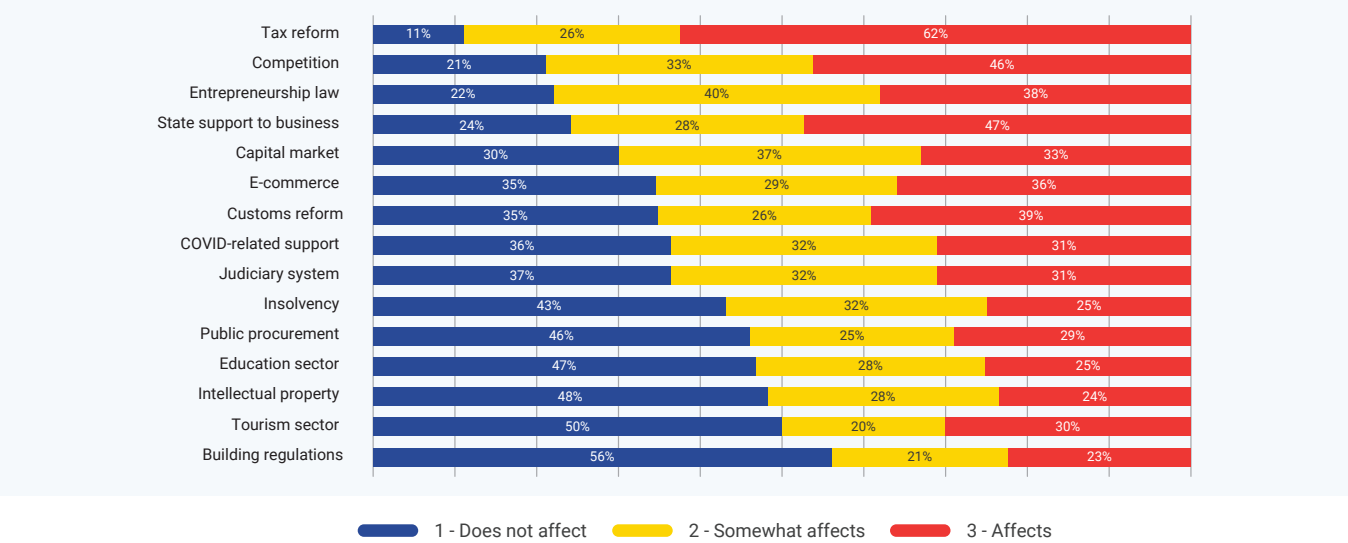
2.4. REFORMS SNAPSHOT

Changing business environment often comes down to economic reforms undertaken by the Government of Georgia in recent years. Largely driven by Georgia’s European future and its EU association reform agenda, the flow of reforms often gets criticized by the private sector on being too fast or negligent of the interest of the business sector. In this regard, attitudes among businesses widely diverge and are often driven by business vision and mission. Businesses established with a long-term vision and mission, aimed at growth and development, view these reforms as a way towards a healthier and more competitive business environment. Other, more short-term oriented firms view these reforms as additional costs to running business, hence unproductive. A predominant view is that the general awareness and involvement of the private sector is low. Recent studies proved this fact.

For this purpose, we set to evaluate two important dimensions: a) *how relevant* these reforms are for businesses as they perceived them; b) *which direction* these reforms head to positive or negative.

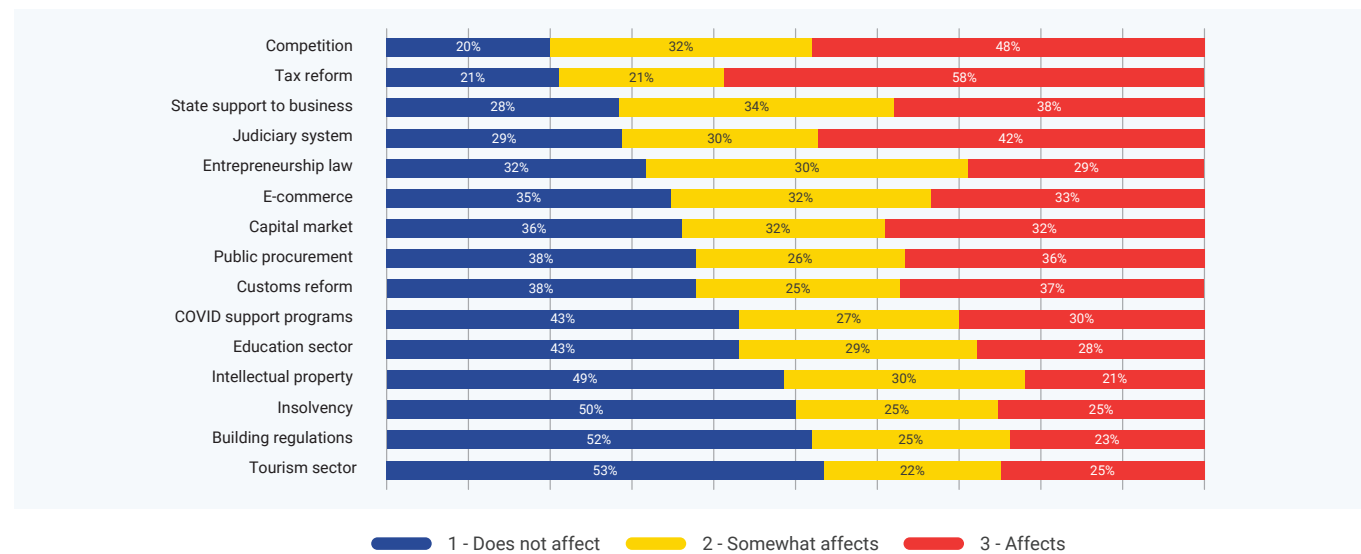
It should be noted that both questions are subjective and might have little to do with true relevancy or perceived success of a particular reform. For instance, the fact that 32% of surveyed businesses state that an e-commerce reform does not affect them is more of an opinion – perhaps baseless – than a fact, since e-commerce will probably affect all industries in some way in the future. The same could be said in relation to other reforms such as the judiciary system (36% report as not affecting) reform, the insolvency (40% report as not affecting their business) reform or the intellectual property reform. We believe that such perceptions are at the very root of the limited involvement of the private sector in the reform process.

The survey shows that the tax reform is the most relevant cross-sectoral reform affecting businesses, as 62% of respondents report this reform as affecting and another 26% as somewhat affecting their business. At the other extreme, sectoral reforms such as budling regulations are the least relevant for the sample. For instance, the building regulations reform does not affect the work of 55% of the surveyed companies, followed by the tourism sector reform (49% correspondingly).

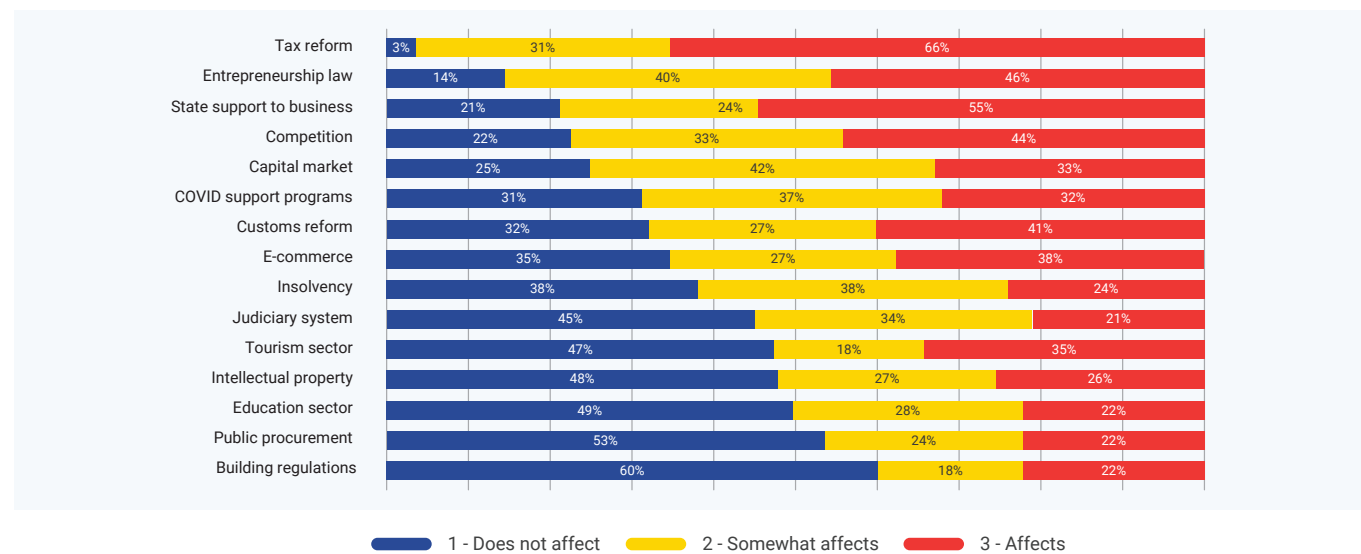


Relevancy of economic reforms

There are notable differences in perceived relevancy of different reforms among the enterprises with EU and non-EU ownership. This reflects the culture and approach of making business. For instance, EU-owned enterprises rate competition as the number one relevant reform, affecting or somewhat affecting their operations, whereas for non-EU-owned companies the competition reform is not that relevant in comparison to other reforms. Clearly, free market principles are foundational to the European way of doing business. Clearer differences are, for instance, relevant to the judiciary system reform, which affects EU-owned businesses more (71% affecting or somewhat affecting) compared to non-EU-Owned businesses (55% - affecting or somewhat affecting). Fair, fast and transparent court system is also fundamental to doing business the European way.



Relevancy of economic reforms (EU-owned enterprises)



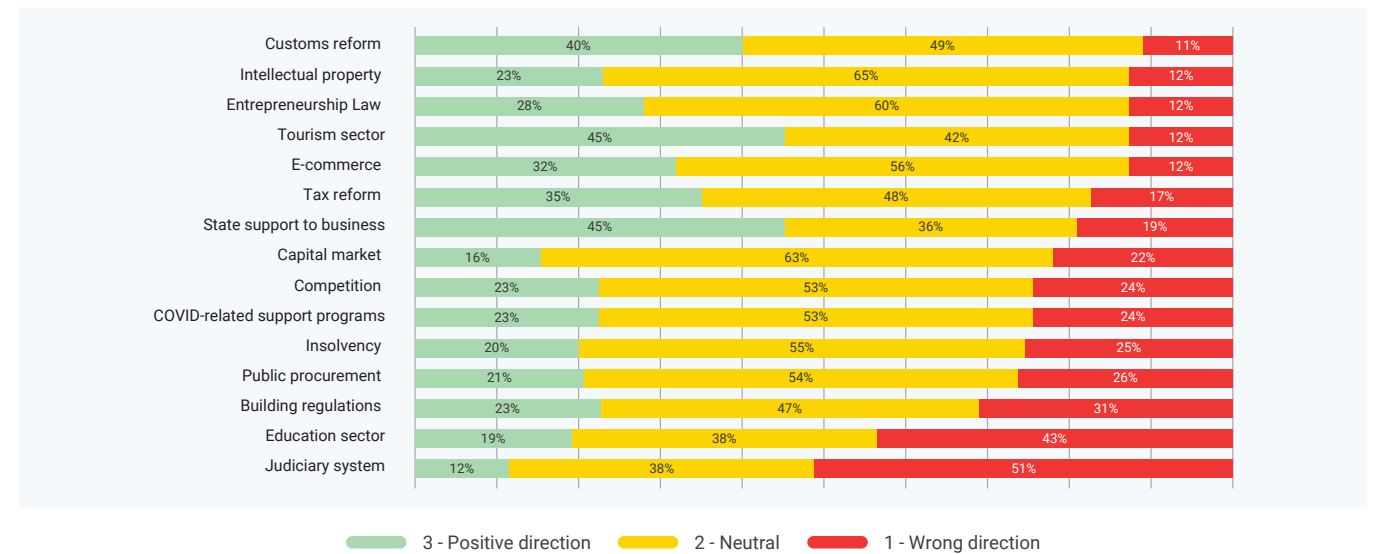
Relevancy of economic reforms (non-EU ownership)

Perception of relevancy might be driven by the size of the companies. It seems that the state support to companies during the pandemic was more relevant for medium size firms. Other state support programs by Produce in Georgia, Rural Development Agency and GITA are more or less relevant and affect the work of the smaller firms. For large firms, reforms in competition and judiciary systems are more relevant.

#	Micro (up to 10 Employees)	Small (11-50 Employees)	Medium (51- 250 Employees)	Large (Over 250 Employees)
1	Tax reform	Tax reform	Tax reform	Competition
2	Competition	New Law on Entrepreneurship	New Law on Entrepreneurship	Tax reform
3	State support to business	State support to business	COVID support by the GoG	Customs reform
4	New Law on Entrepreneurship	Competition	Competition	Judiciary system
5	Capital market	Customs reform	Customs reform	Capital market
6	E-commerce	Capital market	State support to business	E-commerce
7	Judiciary system	COVID support by the GoG	Capital market	COVID support by the GoG
8	Education sector	E-commerce	Judiciary system	State support to business
9	Customs reform	Judiciary system	Insolvency	Public procurement
10	COVID support by the GoG	Insolvency	Intellectual property	Intellectual property
11	Insolvency	Public procurement	E-commerce	New Law on Entrepreneurship
12	Public procurement	Education sector	Building regulations	Tourism sector
13	Intellectual property	Tourism sector	Tourism sector	Education sector
14	Tourism sector	Intellectual property	Public procurement	Insolvency
15	Building regulations	Building regulations	Education sector	Building regulations

Ranking of the relevancy of economic reforms by firm size

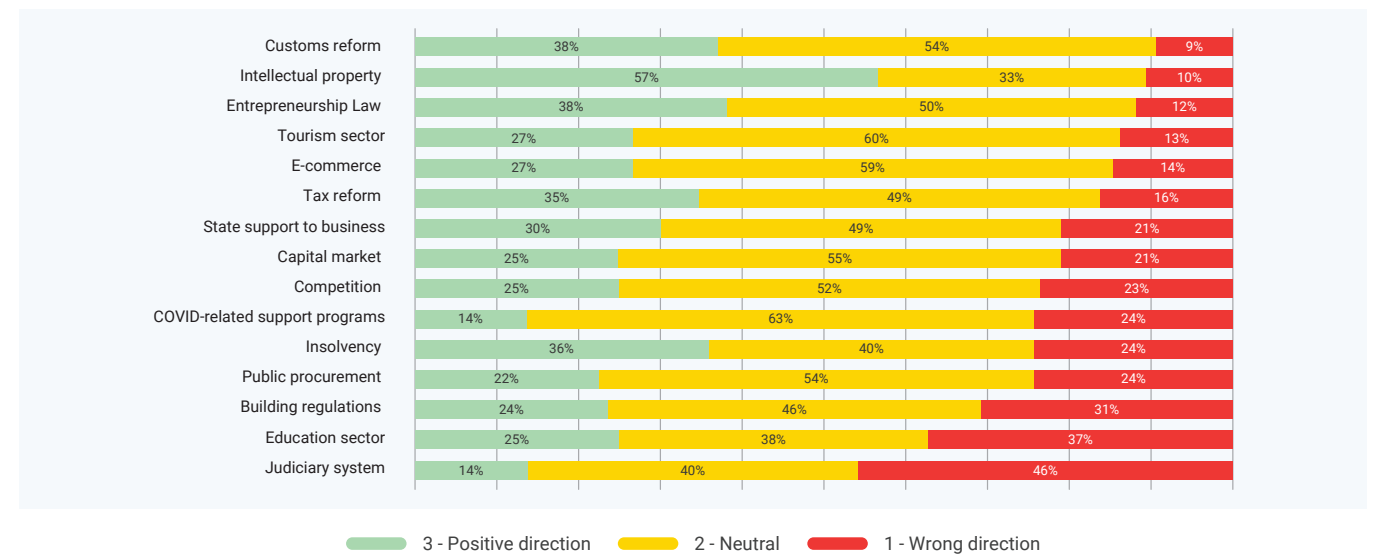
When it comes to the perceived direction of the reforms, among the positively perceived reforms were the customs reform, the intellectual property reform, the entrepreneurship law reform, the tourism sector reform are leading the list. Almost 90% of the respondents evaluate the flow of these reforms as either positive or neutral. It comes as no surprise that the judiciary system reform is the leader among reforms which are perceived to be going the wrong direction, followed by the education sector reform. 54% and 46% of respondents, correspondingly, report that the reforms are going the wrong direction.



Perceptions of economic reforms

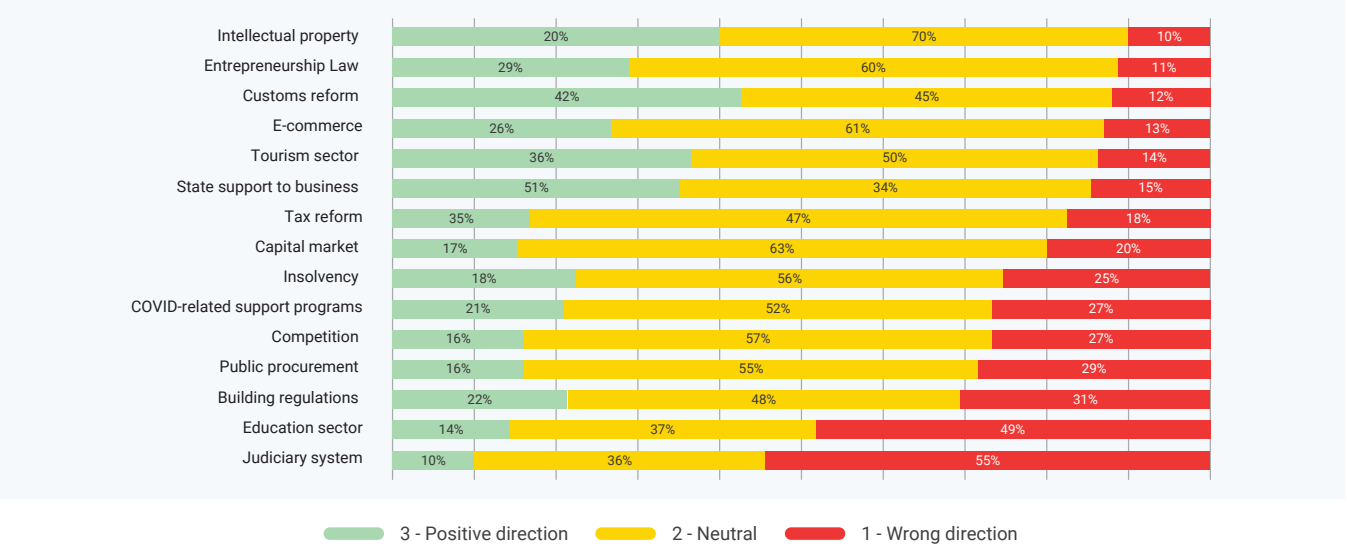
Some differences emerge in evaluation patterns as well. The customs reform, the tourism sector and the E-commerce reform are leading the ranks of the reforms, which are going to an either positive or neutral direction (or with the least portion of respondents reporting as going the wrong direction), whereas the Judiciary and the education system reforms are at the bottom of the rankings.

It should be mentioned that state support to business, the tourism sector reform and the customs services reform are the ones with the most positive evaluations (if ranked only by the criterion of Positive direction), with 45%, 45% and 40% of the respondents indicating that these reforms are going in a positive direction.



Perceptions of economic reforms (EU ownership)

Non-EU companies also share the same opinion on the bottom ranked reforms, but in terms of the best performers, intellectual property, the entrepreneurship law and customs services reforms were leading the list.



Perceptions of economic reforms (non-EU ownership)

Overall, these evaluations mostly paint the same picture and they clearly indicate the best and worst performers among the ongoing economic profile reforms of the country.

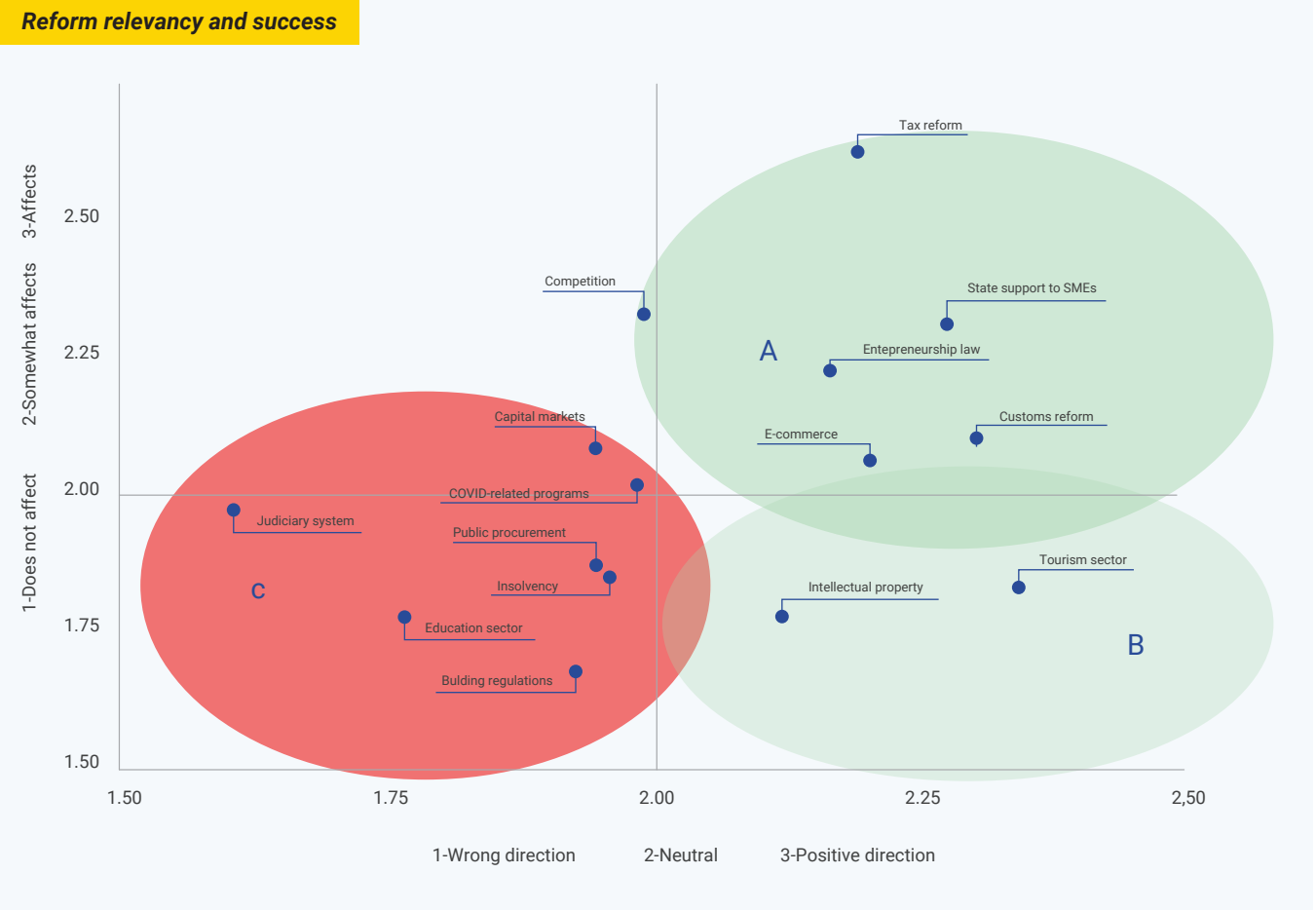
The smaller the firm, the more successfully it evaluates the intellectual property reform. The customs reform is considered more successful for medium-sized and large firms. The e-commerce reform is considered successful for small firms. Firms of all sizes agree that the education and judiciary reforms are the least successful.

#	Micro (up to 10 Employees)	Small (11-50 Employees)	Medium (51- 250 Employees)	Large (Over 250 Employees)
1	Intellectual property	E-commerce	Tax reform	Customs reform
2	Customs reform	Tourism sector	Customs reform	E-commerce
3	New Law on Entrepreneurship	Intellectual property	New Law on Entrepreneurship	Insolvency
4	Tourism sector	Customs reform	E-commerce	State support to business
5	E-commerce	New Law on Entrepreneurship	Intellectual property	Tax reform
6	Tax reform	State support to business	State support to business	Tourism sector
7	Capital market	Public procurement	Capital market	Capital market
8	COVID support by the GoG	Tax reform	Tourism sector	New Law on Entrepreneurship
9	Competition	COVID support by the GoG	Competition	Intellectual property
10	State support to business	Insolvency	Public procurement	Competition
11	Insolvency	Competition	COVID support by the GoG	Building regulations
12	Building regulations	Capital market	Insolvency	COVID support by the GoG
13	Public procurement	Building regulations	Building regulations	Public procurement
14	Education sector	Education sector	Judiciary system	Education sector
15	Judiciary system	Judiciary system	Education sector	Judiciary system

Rankings of perceptions of economic reforms by firm size (positive to negative)

REFORM PRIORITIZATION

Overall, evidence-based policymaking should ensure that priorities are set in the right order. Addressing challenges will require making a trade-off between relevancy of the reforms and whether the reform is on the right or wrong track. These factors could be grouped into several different segments according to their *relevancy* and *recent dynamics* (positive or negative direction).



If these two aspects (perceived relevancy and reform direction) are combined, several conditional groups can be analyzed. Of these, two will require special policy response and level of attention to make the reform implementation successful and widely accepted.

Group A: This group includes reforms which are generally accepted as moving towards a positive direction and at the same time are relevant (affects or somewhat affects) to a large part of the business universe. This group includes state support programs to business as well as tax, customs, entrepreneurship law and e-commerce reforms. This is the least problematic area – since both involvements in these reforms are high, the positive progress is validated by the business.

Group B: Distinguished as a mostly positive direction, however perceived as less relevant for businesses. This group includes the tourism sector and intellectual property reforms. The policy response towards such reforms includes a better communication strategy to the private sector to win the attention and then buy-in of the companies into the reform process. Without a widely participatory approach, no reforms can be considered truly successful.

Group C: These are the reforms which enjoy less involvement (very few businesses think that these reforms affect them) and at the same time are perceived as going mostly towards a negative direction. The judiciary sector, the education system and the capital market reforms are among the most problematic ones. The policy response for this group is, on the one hand, to understand the root causes of these negative perceptions and address them. On the other hand, raising the awareness about and involvement in these reforms of the business community remains a critical step.



CUSTOMS REFORM

The surveyed businesses evaluate the customs reform as one of the most successful reforms in terms of positive direction. This reform also belongs to the Group A reforms (classified above), which are perceived as mostly positive or neutral, and its perceived relevancy is high both for EU-owned and non-EU owned enterprises, requiring a consequent policy response.

Efficient, simplified and streamlined customs procedures are key to businesses who are involved in international trade. The relevant chapter of the DCFTA envisions facilitating operational cooperation between the customs services of the EU and Georgia. According to the Association Agenda between the European Union and Georgia, parties should cooperate in preparing for the approximation of Georgia's legislation to EU acquis and international standards, listed in the relevant Annex to the Association Agreement and be based on the Union Customs Code.

In order to fulfill obligations under the Association Agenda, Georgia has implemented a number of customs reforms in recent years. The specific steps included increasing transparency and the set-up of e-services with full automatization of all customs operations; the establishment of modern customs-clearance zones significantly simplified the clearance of goods at the border and covered the whole chain of customs clearance.

In 2019 the Parliament of Georgia had adopted the new Customs Code, which brought it in line with the Union Customs Code. The new code includes a number of novelties and simplifications for all stakeholders. All customs procedures, declarations, and functions used by economic operators have been simplified. In 2020, corresponding procedural norms were developed to make customs processes more business-oriented and properly administered.

The EU technical assistance twinning project - "Supporting the Accession of Georgia to the Conventions on Transit Area and Launching of the New Computerized Transit System (NCTS)" was completed in 2020. The project was funded by the European Union and envisaged the creation of a new electronic transit module. It should be highlighted that as a result of the project, a single transit document and guarantee issued by the Customs Department is sufficient for continuous transit through the European Union, the European Free Trade Association (EFTA), the United Kingdom, Turkey, Serbia, and Macedonia.

The system of an Authorized Economic Operator (AEO) has been introduced. The concept of an Authorized Economic Operator is based on the partnership between customs and business. A taxpayer who voluntarily meets the requirements will continue to work closely with customs to ensure the safety of the international supply chain and will benefit from various simplifications.

In order to simplify the formalities of registration and release of goods, changes have been made in the customs legislation, according to which, from December 15, 2021, taxpayers have new, accelerated opportunities for the registration of goods.

The new legal framework for the full digitalization of the TIR system (eTIR) entered into force in May 2021, with the support of the United Nations Economic Commission for Europe -UNECE TIR Secretariat. This landmark change allows for completely paperless cross-border transit of goods, under the customs guarantee of the TIR system. Within the framework of this initiative, in 2020-2021, the Revenue Service was involved in the implementation of the eTIR project, which involves the electronic exchange of TIR information between Georgia and the United Nations Server.

Significant simplification happened in 2021 through the introduction of a one-window principle for issuing licenses related to electronic licensing. The interested party can submit an electronic application to the relevant licensing, permit and/or certification bodies via the Revenue Service website (eservices.rs.ge), using the one-window principle, and then receive electronic information about the decision made on their application via the same system.

The modern electronic licensing information system STRATLINK was transferred to the Revenue Service with the assistance of the US Embassy Export Control and Border Security Program (EXBS). By logging on to the Revenue Service website www.rs.ge, various business operators will be able to fill out an application in order to obtain a permit for dual-use products, as well as determine the need for a permit.

The project of an automated custom declaration using AI is being actively developed. Instead of a customs officer, this software based on cutting-edge technology is supposed to carry out a variety of critical procedures related to the completion of the customs declaration.

The customs information systems modernization project is currently underway, with the assistance of the US Export Control and Border Security Program (EXBS) and the participation of NU Borders, a leading US analytics firm (Memorandum was signed on January 26, 2022). The project aims for the modernization of the customs data system.

The Strategy of the Revenue Service for 2021-2024, which has been adopted in 2021, among others, includes customs-related objectives: development of customs risk management and advance information exchange system; strengthening mechanisms to detect, prevent and avoid violations of customs legislation; in addition, promoting the concept of Authorized Economic Operators, which entails strengthening cooperation between customs and the business sector, improving supply chain security and introducing mutual recognition mechanisms.

As a result of the implemented reforms, Georgian customs services in essence are considered to be fast, efficient and de-corrupted. Georgia outperforms or is close to its best performance in Europe and Central Asia.

"In the direction of customs, export documentation and procedures are very easy and at a high level in Georgia, very much the same procedures as European countries."

[Insurance]

Despite the measures Georgia has implemented in the field of customs services, there are still some issues that must be addressed. The New Computerized Transit System and the mechanism of Authorized Economic Operator are not yet activated. The recent simplification of the registration of goods only covered the owners of goods and did not include freight forwarders. In addition, under the current reform, customs liabilities for large companies have been reduced from 30 days to 5 days, which became a cash-flow related challenge for large companies. Small and mid-size enterprises especially are not well informed about the advantages of the reform in this field. Besides, in atypical cases problem-solving is protracted and not effective, caused by a lack of qualification and experience and limited delegation of responsibility. Because of this, delays could happen.

INTELLECTUAL PROPERTY REFORM

Overall, the surveyed businesses evaluate the intellectual property reform as number two in terms of positive or neutral direction. This reform also belongs to Group B reforms (classified above), which are perceived mostly as positive or neutral, but its perceived relevancy is considered low and needs more work to increase the awareness of the private sector on its relevancy.

Without a proper level of protection of intellectual property, businesses would not reap full benefits of their inventions and would devote less time to research and development. According to the Association Agenda between the European Union and Georgia, the Parties should cooperate to ensure Georgia's compliance with the EU acquis and international standards for the protection of intellectual property (IP) rights, including geographical indications. The DCFTA requires Georgia to modernize its system on intellectual property rights (IPRs).

Regarding the protection of intellectual property rights and the corresponding enforcement system, Georgia has advanced its reforms in order to bring Georgian intellectual property legislation in line with the Association Agenda. In 2020, the Intellectual Property Center of Georgia Sakpatenti prepared a draft law "On Amendments to the Patent Law of Georgia" and active work on the amendments is underway, its goals being analyzing existing legislative gaps, as well as preparing relevant recommendations to facilitate legislation and the process of maximum harmonization with EU legislation.

The EU-Georgia Intellectual Property Project (EUGIPP), funded by the European Union, was launched on January 1, 2020, and was implemented by the European Union Intellectual Property Office (EUIPO). The main beneficiary of the Project is the National Intellectual Property Centre of Georgia Sakpatenti. EUGIPP is a three-year project with a budget of 1.2 million Euros, and it is aimed to support the intellectual property system in Georgia. The following crosscutting challenges are to be addressed by the project in 2022: the continuous building of skills of IP officials, rights holders, creators and designers with a Train of Trainers approach; a continued support of registration procedures by leveraging on information technology tools; raising awareness of the business community, especially SMEs and local communities on the benefits of efficient IP systems to them.

In 2021, the EU-funded Twinning Project for institutional cooperation between Public Administrations - "Establishing Efficient Protection and Control System of Geographical Indications (GIs) in Georgia", was implemented. The main beneficiary of the Project was the National Intellectual Property Center of Georgia Sakpatenti, which was given the opportunity to create administrative and institutional mechanisms by sharing the experience and knowledge of leading countries in this field. In 2021, in order to ensure effective functioning of the geographical indications system, draft amendments to the "Law of Georgia on Appellations of Origin of Goods and Geographical Indications" were prepared according to the experts' recommendations. Based on the draft Law, by-laws, guidelines, and instructions were developed.

A draft law also envisions establishing the National Commission on Geographical Indications. The Commission shall ensure the use of the so-called two-stage system of the registration procedure, namely the participation of the Commission in the examination process and full study of an item marked with a geographical indication.

To eliminate the facts of counterfeiting of Georgian geographical indication products in the digital world, experts studied the mechanisms of control and rights enforcement and developed a plan, which includes signing agreements of cooperation with the Internet platforms Amazon, Ebay, Alibaba and Rakuten.

The intellectual property system is evolving gradually. Sakpatenti introduced a new e-filing system and database, which made the process of filing applications easier. In the framework of bilateral cooperation with the EU Intellectual Property Office (EUIPO), Sakpatenti has incorporated into its system three tools, TMView, TMclass and Designview. Integration of Georgian databases enables foreign users to receive information on marks/designs registered in Georgia. Alongside this, by means

of adding the Georgian language to the EUIPO system, it is possible to search using the Georgian interface. As of 13 July 2020, up to 60,000 terms of goods and services were translated into Georgian and integrated into the TMclass harmonized database (HDB). Georgian-speaking users can now search and select almost 60,000 goods and services in their own language for their trademark applications.

Sakpatenti established an intellectual property education center in collaboration with the WIPO, which implements a variety of educational initiatives and is involved in several capacity building activities in the field. Georgia is the first country in the EU neighborhood region where, according to the decision of the WIPO Academy, a professional development course was held.

Sakpatenti is working on the institutional Strategy Document. Work on the document is being implemented with the support of the United Nations Development Programme Governance Reform Fund. The main objective of the development strategy is the organizational strengthening of Sakpatenti and ensuring the efficiency of its functioning through elaboration of the existing governance processes and development of new management mechanisms and services.

With the help of WIPO, Sakpatenti plans to translate and adapt WIPO publication "Enterprising Ideas: Guide to IP for Startups" into Georgian and adapt to the local legal, regulatory and business context.

Despite the measures Georgia has implemented, there are still some issues that must be addressed. One of the main challenges is the fact that products marked with Georgian geographical indications are being counterfeited in the Internet space. Online user protection requires new approaches and administrative mechanisms. Georgia is improving enforcement, but some problems persist, including the widespread use of unlicensed software and the availability of pirated video and audio recordings and other unlicensed content online. During the survey, several comments were made by EU businesses that mentioned the absence of defense mechanisms against preventing other companies from copying their ideas and intellectual property, such as technical solutions.



ENTREPRENEURSHIP LAW REFORM

Surveyed businesses evaluate the entrepreneurship law reform as the third reform in terms of positive or neutral direction and 26% of the surveyed businesses consider this a positive move. This reform also belongs to Group A reforms, according to our classification (provided above), which are perceived both positive or neutral, and their perceived relevancy is high.

To further support Georgia’s transition into a fully functioning market economy and to create a stable environment for investment and trade, the Association Agreement includes a brief chapter on company law, corporate governance and accounting and auditing. This includes only a short and soft provision stating that Georgia aims to cooperate with the EU in these areas. In view of this aim, the EU and Georgia commit to set up a regular dialogue to share information and expertise on both existing systems and developments in these three areas. Georgia undertakes approximating a selection of EU law and international standards (Annex XXVIII).

Law of Georgia on Entrepreneurs entered into force on 1st January 2022. The Law aims to create a uniform and transparent legal framework for corporations, their shareholders, directors, creditors, and other stakeholders. The new rules are adapted to the requirements of modern corporate relations. The law has undergone changes and innovations in several directions, such as the concept of a director, a regulation related to the company name and so forth. The law will further improve the business climate and continue promoting entrepreneurial freedom.

The new law was elaborated together with changes to other normative acts, such as the Law on Securities Market, the Law on Accounting, Financial Reporting and Auditing, etc.

TOURISM SECTOR REFORM

The surveyed businesses evaluate the Tourism Reform as one of the successful reforms (third in terms of positive or neutral direction) and one of the first in terms of positive evaluation (45% of the surveyed businesses consider the tourism reform is going in a positive direction). This reform belongs to Group B reforms, according to our classification (provided above). This is a group of reforms perceived as positive but their relevancy remains limited to a large part of enterprises, due to its sectoral nature.

Tourism boosts the revenue of the economy, creates jobs and represents one of the main instruments of the SME sector development. According to the Association Agenda between the European Union and Georgia, parties should exchange information on the development of tourism in Georgia and the EU, including relevant events and best practices, through the dedicated Subcommittee.

Before the COVID-19 pandemic, tourism in Georgia bombed, driven by a combination of the growing international demand as well as a new supply of accommodation and tourism offer. Between 2016 and 2019 Georgia achieved tremendous results in tourism growth, with international traveler trips increasing by more than 139%, from 6.7 million to exceeding the mark of 9 million. In the same period, international travel receipts increased by 54.9%, reaching 3.3 bn dollars.

COVID-19 has significantly distorted the national economies, through shutting the movement of goods, services and people, consequences of which still lingers. Of all sectors of economy, the tourism sector was affected the most and this effect extended to rural areas as well. According to various ex-post estimates, the COVID pandemic inflicted a huge blow to tourism in the past two years (2020 and 2021). In 2020, in total 1.7 MLN people visited Georgia (compared to 9.4 MLN in 2019 or 81% less) and tourism lost 2.7 bn USD (which was 83% less).

In 2021, Georgia received 1.8 MLN visitors, representing a 7.7% growth in comparison to the previous year, contributing to the Georgian economy with 1.2 B dollars. The recovery rate of flight frequencies compared to 2019 reached 88%, recovery for the destinations reached 96%. In 2021, Georgia was named the world's leading country by Eurocontrol with the fastest dynamics of recovery in the aviation industry.

Georgia was one of the first countries to host the 112th Session of the Executive Council of UNWTO online during September 2020, in the framework of which the Tbilisi Declaration on Actions for a Sustainable Recovery of Tourism was adopted by the Member States of the Executive Council. Important events for the sector in 2021 included participating in international tourism exhibitions such as ITB Berlin (online) and FITUR (offline); the election of Georgia to the Executive Council of the World Tourism Organization (UNWTO) for the 2021-2025 term, which attests Georgia’s gained significant international recognition as a tourist country; the project "Digital Days in Georgia" aimed at the promotion of country's tourism potential.

To keep up the pace with the current demand of the preferences of international travelers towards ecotourism, agrotourism and adventure tourism, Georgia is actively working in this direction. To ensure the provision of high-quality ecotourism-related products and services to international visitors, with the active involvement of the private and public sector and support of international organizations, the Eco-Tourism Development Strategy 2020-2030 was adopted and entered into force in 2021. Development of an agrotourism roadmap and the corresponding action plan is underway.

One of the most important initiatives in this regard was initiation of the new draft Georgian Tourism Law, by the Georgian National Tourism Administration together with the Parliament of Georgia and in close cooperation with the private sector and essential support from the USAID. The law will implement two of the following EU directives: protection of consumers in respect of certain aspects of timeshare, long-term holiday product, resale and exchange contracts (DIRECTIVE 2008/122/EC) and DIRECTIVE (EU) 2015/2302 on package travel and linked travel arrangements, amending Regulation (EC) No 2006/2004. Drafting of the new law was initiated to guarantee its compliance with the new trends and demands of Georgia's tourism industry.

Taking into consideration the fact that tourism is one of the industries most affected by the COVID-19 pandemic, the Government of Georgia focuses its efforts in the coming years on addressing the efficient recovery and further development of the tourism sector. To this end, to further aid the development of the tourism industry in the post-Covid period, the tailor-made Tourism Recovery Plan is being elaborated in the framework of the Georgia Tourism Strategy 2025. Georgia supports local businesses to establish and provide highly competitive services and products at the same time as practicing responsible travel behavior. Furthermore, the country is making considerable emphasis on attracting world-renowned airlines to commence operations in our country in order to further boost direct flights to the new destinations as well as on intensifying country popularization and conducting various promotional activities in order to promote the tourism potential of Georgia. To this end, it is worth highlighting that Georgia represents a Convention and Culture Partner of ITB Berlin 2022. In 2023, Georgia will be showcased as a Host Country at ITB Berlin 2023, the world’s largest and most influential tourism fair.

Challenges that existed before the pandemic included the lack of a qualified workforce and limited infrastructure. The COVID-19 pandemic amplified some of the existing challenges and introduced new ones. The new pandemic reality introduced challenges such as a lack of information of the operators on new regulations, high dependence on international tourism, lack of financial means to cope with regulations and lack of predictability of operations. All of this made Georgian tourism related enterprises more vulnerable during the pandemic period.

E-COMMERCE REFORM

The surveyed EU businesses evaluate the e-commerce reform as one of the successful reforms (fourth in terms of positive or neutral direction), leading in terms of positive evaluation (32% of the surveyed businesses consider this reform is going in a positive direction). This reform also belongs to the Group A reforms, according to our classification (provided above), which include reforms perceived as both positive and relevant to the private sector.

E-commerce played an important role in overcoming the impacts of the COVID-19 crisis and fostering economic development as well as promoting international trade and exports. The pandemic has boosted Georgia’s e-commerce market, as lockdowns encouraged many to purchase online for the first time or increase the frequency of online purchases. The lockdowns also forced Georgian companies to expand their online offerings. The size of the local e-commerce market increased 3.2x y/y and reached GEL 137.9 MLN in 2020 (according to Galt and Taggart). So did the number of postal operators, which grew from about 80 to up to 600. However, compared to other mature markets (about 12% in the EU), the size of e-commerce (about 1,1% of total retail sales) lags significantly behind. Anecdotal evidence suggests that, after the pandemic, there has been significant slide back, with consumers switching back to traditional offline channels.

Georgia significantly advanced its e-commerce reform in recent years in order to ensure its obligations under the Association Agenda. However, the most important reform package yet needs to be implemented. The Ministry of Economy and Sustainable Development of Georgia developed the draft Law of Georgia on Electronic Commerce based on the EU Directive on Electronic Commerce (2000/31/EC), mainly driven by the approximation of the rights and responsibilities of the Intermediary Service Providers.

In a broader sense, beyond the protection of the right of the Intermediary Service Provides, the law aims to put the sector under the legal framework, promoting internal market development through free flow of information society services, protecting consumers' rights and exempting intermediary service providers from general monitoring obligation. The law creates a legal foundation for monitoring the sector, often subject to self-regulation, and does not provide detailed guidance and regulations by the state. The only state control area envisioned will be limited surveillance by the Georgian National Competition Agency, to protect the rights of the service recipients and to provide minimum information of the service providers to their customers on the e-commerce platforms. The service recipient can submit their complaint to the Agency in case the service provider does not provide the recipient with minimum information defined by the law, if there is non-compliance of commercial notification with the established requirements, also when there is a failure to provide the information required for concluding an electronic contract or violation of e-ordering rules by the provider. Once it is adopted, then there will be a 6 months grace period for the agency to start preparing to execute its functions.

The draft Law of Georgia on Electronic Commerce has not been registered yet in the Parliament of Georgia. It is worth noting that in February, in order to review and discuss the draft law, a meeting was held with the representatives of the public sector where, along with the interested public agencies, representatives from the Parliament of Georgia participated. The meeting was also attended by private sector representatives of small and medium-sized enterprises and several e-commerce associations.

E-commerce is a complex sphere and is inexplicably connected, among others, with consumers rights, intellectual property, personal information, payment systems and postal services. The Parliament of Georgia adopting the Law on Protection of

Consumer Rights is a relevant milestone. Consumer rights will be protected by the National Competition Agency on the territory of Georgia. The law will have entered into force on June 1 2022 and the review of complaints will begin on November 1. The purpose of the law is to ensure a high degree of consumer protection in the country. Sakpatenti is working on a new legislative package of related intellectual property rights. The National Bank of Georgia has also prepared a legislative package related to payment systems to address alternative dispute resolution mechanisms. The Ministry of the Economy and Sustainable Development of Georgia has also initiated a new law on postal services, which will regulate the quality of postal services. Although work in all these important directions has been started, they are in early stage and there is a long way to go before the appropriate changes are practically implemented and support the development of a favorable legal and institutional ecosystem for e-commerce to flourish.

Meanwhile, the sector experiences difficulties on both sides of supply and demand. Consumer digital literacy as well as trust in online platforms remain low. The legal base does not provide minimal standards of what information needs to be put online. Protecting property remains a challenge. The execution of disputes as well as personal information and cyber security remain open issues, influencing consumer trust.

On the supply side, digital literacy of business operators is also a challenge. Many entrepreneurs start online stores and then, due to difficulties related to limited technical skills, close them down. One of the issues from the business sector side is limited postal services, especially affecting international transactions. Shipment of goods abroad is difficult and expensive, driven by the high airfare transport rates. Payment methods remain an issue. The acceptance of payments by international cards is complicated and very much avoided by local banks, making it an obstacle for merchants in Georgia to accept international orders. Prohibitive costs of shipping make the returning of goods uneconomic. Limited knowledge of international markets and import procedures also remain an issue. Other challenges include an undefined liability and obligations for intermediary service providers and insufficient enforcement mechanisms to protect consumers' rights.

Responsibilities of Intermediary service providers are not yet defined and hence are not indemnified. As witnessed by the multiple stakeholder and responsible agencies involved, e-commerce is a complex area of interconnected elements, with many stakeholders, both public and private, making a case for public and private cooperation. This is also connected to payment systems, postal and customs services. All these sectors need to function properly for e-commerce to function properly. It is important that any planned legislative changes address most of the needs of the sectors.

TAX REFORM

The surveyed EU businesses evaluate the tax reform as a successful reform (fourth in terms of positive or neutral direction) and in the lead in terms of positive evaluation (35% of the surveyed businesses consider this reform going to the positive direction). This reform also belongs to the Group A reforms, according to our classification (provided above), which include the reforms perceived as both positive and relevant to the private sector.

As trade globalizes, managing taxes and understanding opportunities becomes increasingly important for all businesses. According to the Association Agenda between the European Union and Georgia, the parties should enhance and strengthen cooperation in order to improve and develop Georgia's tax system and administration in accordance with EU and international standards.

Georgia has implemented comprehensive tax reforms in recent years in order to ensure its alignment with international standards. For example, in January 2021, for the purpose of approximation of tax legislation with EU VAT Directive (2006/112/EC), amendments were made to the Tax Code of Georgia. As a result of the reform, all simplified procedures that previously existed regarding VAT are maintained. In addition, the list of services, provision of which takes place outside Georgia and which are not subject to VAT taxation, was expanded; list of the operations related to goods transportation and exempted from VAT with the right to deduction was expanded and clarified; temporary admission of goods is no longer deemed as a taxable operation; regulations related to VAT taxation of transfer of goods free of charge was simplified.

The new VAT reform will improve the process of tax administration. It will also establish the best EU practice supporting the cooperation between registered entrepreneurs of Georgia and the EU. Moreover, approximation of Georgian and European VAT legislation will improve investment environment, while number of disputes will be reduced as a result of a simplification of tax obligations.

In 2019 an Automatic VAT refund system was introduced by Georgia Revenue Service, which provides simplified and fast VAT refund procedures. Starting in November 2020 the refund system became fully automatic, where surplus calculated by the automatic VAT refund program is reflected in the taxpayer's personal bank account automatically, without any additional request. An automatic VAT refund system gained even greater importance in the event of the COVID-19 pandemic. In 2020, using the automatic VAT refund program, more than a billion GEL were returned, which is GEL 466 million more than the amount of VAT returned in 2019. In 2021, the total VAT amount refunded was over 1,9 billion GEL

The Code of Ethics for Auditors was approved in 2020. It represents a set of general rules and basic principles that define auditors' conduct while exercising their official powers. In 2021, the Revenue Service continued working on an electronic audit case management system. The purpose of the system is to digitalize the audit case management process and enhance audit efficiency. The system also provides an opportunity for electronic control of the tax examination process.

In 2020, the rule on writing off commodity-material values was simplified and a new tax audit document was developed, which significantly streamlined the administration of tax audit records. For the purpose of improvement of e-services, the remote format for handling tax disputes should also be highlighted which, despite the pandemic, proceeded smoothly in its usual mode.

The Code of Ethics for Auditors was approved in 2020. It represents a set of general rules and basic principles that define In 2020 "International Company Status" was introduced by Georgia. The status grants the opportunity for certain types of companies providing services to nonresidents in the IT Sector & Maritime sector to qualify for tax breaks if they base their companies in Georgia. Income from employment in an international company shall be taxed at 5% instead of 20%. The corporate income tax rate of an international company shall be 5% as well instead of 15%.

Starting in October 2021, Revenue Service of Georgia introduced a special platform, VAT Portal on Digital Services, where foreign taxable persons can undergo a simplified registration procedure and conduct reporting. VAT Portal on Digital Services is intended for those foreign taxable persons who provide digital services to people natural to Georgia.

Large taxpayers make a significant contribution to the formation of the country's budget. Because of this, in line with international best practices, a large taxpayer office has been set up to provide highly qualified services and timely response to tax risks in 2021. The website www.rs.ge has been updated with a new design and additional features. Its use has been greatly simplified and adapted to the requirements of taxpayers.

In 2021, a new mechanism related to registration as a VAT taxpayer was launched – "Status of a Qualified VAT Taxpayer", which aims to improve the tax administration process, manage the risks of fraudulent schemes, as well as reduce false VAT registration and misappropriation of relevant documents.

The Strategy of the Revenue Service for 2021-2024 which has been adopted in 2021 among others, includes tax-related objectives: strengthening the tax compliance risk management process, improving tax arrears management system and introducing modern systems for controlling the accuracy of tax returns in all core taxes. To meet the objectives of the above strategy, sub-strategies such as Strategy on Taxpayers Awareness-raising, Service Development Strategy, Large Taxpayers Administration Strategy as well as operational plans have been developed and published on the Revenue Service webpage.

Notwithstanding the above, it is important to continue the reforms, including the need to continue the process of further digitization of tax administration, as well as to continue the reforms in order to introduce an effective system for resolving tax disputes.

There are still gaps in the tax auditing practices that allow the Georgian Revenue Service and the Ministry of Finance of Georgia to exert pressure on businesses. Periodicity of tax audits also represents an issue. The state tries to simplify certain procedures regarding accounting, but in some cases gaps in legislation allow for an incorrect interpretation.

Within the broad tax reform, reforming the tax dispute resolution system remains one of the main directions relevant to business, especially to small and medium companies. Delays and uncertainty related to dispute resolutions frequently result in severe consequences for the companies involved. A transparent and efficient process of resolving tax disputes is especially important to raise the trust of the private sector towards the system. However, the existing two-stage (through the Tax Dispute Resolution Board of the Revenue Service of Georgia and Tax Appeals Council under the Ministry of Finances of Georgia) mechanism for tax dispute resolutions remains insufficient. The number of tax dispute cases increases over time, but the system does not follow. The identified key root-causes of this are: absence of a fully dedicated and qualified independent body and efficient and fair decision-making process. Limited qualifications of the courts to deal with complex tax cases also contribute to the system overload. A new methodological approach to the reform which will address the identified root-causes and their drivers becomes a necessity. There is a need to support efforts to build a strong political commitment to the reform, which would result in the creation of an effective, efficient and fair TDR body. This commitment is seen as an important pre-condition for the success of the reform.



GOVERNMENT SUPPORT TO SMES

The surveyed EU businesses evaluate the government support programs for SMEs as very positive, as 45% of the surveyed businesses consider that this aspect of the state policy is going towards a positive direction and another 36% evaluate it as neutral. With this, state support to SMEs is among Group A reforms. These are both highly relevant as well as successful reforms.

State support programs are vital for the business sector. Some surveyed respondents stated that they are highly active in collaboration with GITA, implementing various initiatives and projects targeted at developing a startup environment in Georgia. In addition, as part of the future and preferential agro-project introduced during the cultivation of gardens, some companies received significant subsidies in the form of grants and loans. Continued state assistance for micro and small businesses is critical, and more targeted loans to minority groups and women-owned businesses are also notable.

<i>“With GITA support, our company was able to complete a training course in International Startup Accelerator and create a local startup pre-accelerator for startups at an early stage.”</i>	[ITC]
<i>“For local farmers, state programs are critical. Reinvestment is motivated at the expense of existing programs.”</i>	[Food processing and beverages]

As the survey showed, during the pandemic period, many of the surveyed companies participated in the "Produce in Georgia" program, through which some of them were able to expand production despite the pandemic’s challenges. Respondents positively assess the purpose of this program and the opportunities it provides. However, not all firms have equal capacity to access these programs, which limits their prospects. However, respondents believe that these programs should be focused on quality rather than quantity. Successful projects should also be expanded to include other regions (e.g. Plant the future should cover grapes outside of Kakheti).

CAPITAL MARKET REFORM

Overall, only 16% of the surveyed businesses evaluate the capital market reform as going in a positive direction and another 53% as going in a neutral direction. This reform belongs to the Group C reforms (classified above), which are evaluated below average both in terms of perceived relevancy and reform success (i.e. going in the right or wrong direction), requiring corresponding policy measures to increase its relevancy as well as improve its effectiveness.

Well-developed domestic capital market contributes to a more effective mobilization of domestic savings, diversification in sources of financing and in general it contributes to Georgia’s sustainable economic growth. When both the supply and demand sides are equally developed and armed with proper tools and instruments, capital market can increase capital allocation and contribute to progressive growth.

A notable step in the capital market development included the adoption of the Law of Georgia on Investment Funds by the Parliament of Georgia in 2020. The development of investment funds is one of the most important aspects of capital market development, since it provides a wider range of alternative funding sources to the private sector. The Law of Georgia on Investment Funds is based on international principles and regulatory models. Certain requirements of the Alternative Investment Fund Managers Directive and full compliance with UCITS (Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009) were achieved when drafting the investment funds legislation. In addition, significant amendments have been ratified in the Tax Code of Georgia. Special tax regime for investment funds is included in the Tax Code of Georgia.

Significant amendments have been made in the law of Georgia on Securities Market in 2020. The aim of these amendments was to ensure a high-level investor protection by establishing transparency requirements and prohibiting market abuse. The mentioned amendments are based on international best practice (Directive 2004/109/EC of The European Parliament and of The Council and Regulation (EU) No 596/2014 of The European Parliament and of The Council). Legislative amendments improve the level of transparency among issuers of public securities by setting requirements regarding submission and reporting of periodic financial/non-financial and insider information.

One of the main reforms in past several years is related to the local financial market regulations. The Law of Georgia on Financial Collateral Arrangements, Netting and Derivatives was adopted on December 20, 2019. It is a foundation for the enforceability of derivatives transactions, including netting, close-out netting and financial collateral. Certain requirements of the financial collateral arrangements directive (Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements) are included in the law.

The Law of Georgia on Funded Pensions adopted in June, 2018 is one of the main achievements for ensuring older people have a decent standard of living in retirement. Added to this, Pension Agency became the first institutional player holding long-term local capital as well creating further pressure on the market to supply instruments, so that capital is properly deployed. As of today, the value of total pension assets is about 2 billion GEL and the accrued interest on investment activities is nearly 292 million GEL.

Currently, the law on dematerialized securities holding and the law on covered bonds are initiated at the Parliament of Georgia. The law on dematerialized securities holding creates safe and more efficient infrastructure for securities holding and securities transactions and their settlement. The law on securities holding is based on international best practice (CSDR Regulation (EU) No 909/2014 and UNIDROIT principles). The adoption of the law on dematerialized securities holding creates a more efficient securities market, improves its infrastructure and therefore ensures the development of capital market in Georgia.

Ministry of Economy and Sustainable Development of Georgia – along with the relevant stakeholders and with the support of donor organizations – is working on the draft laws on securitization and private pensions. The law on Securitization will provide a financing technique by which predictable income-generating assets – which on their own may be difficult to trade – are pooled and sold to a specially created third party, which uses them as collateral to issue securities and sell them in financial markets. Developing a framework for private pensions has been identified as important, as the law on funded pensions is already enacted and further development of pension framework needs an additional flexible tool for creating a complete and thorough environment for pension systems. Furthermore, under the Association Agreement between EU and Georgia, Georgia has an obligation to approximate its laws to the IORP directive (Directive (EU) 2016/2341 of the European Parliament and of the Council), therefore the law will be based on international best practice. The law on Securitization and the law on private pensions are planned to be submitted to the parliament by the end of the year.

The Ministry of Economy and Sustainable Development of Georgia is working with relevant stakeholders on the renewed capital market strategy, which will identify possible gaps as well as challenges, propose all the necessary policy approaches and relevant actions for capital market development and act as fundament for future capital market reforms.

The actively discussed planned actions for the capital market further development include the development of Private Equity Funds and VCs, factoring, Crowdfunding, Trust, Real Estate Investment Trust, Commodity Trading and Financial Centers. All mentioned fields are perceived as crucial and essential elements for capital market development and are perceived as successive to the current reforms under capital market agenda.

With the small size of the economy and a small number of large companies on the capital market, Georgia is facing some inherent constraints and challenges. On the supply side, capital markets in Georgia are mostly comprised of government bonds, with a largely inactive secondary market. The absence of a secondary debt market is a main challenge, since such a market is a crucial element of capital market environment. Benchmark bond issuance program and others are helpful in addressing it. The dominance of large banks in the capital market, through direct and indirect ownership of investment banks/brokers and market infrastructure and their concentration on the saving and borrowing market appears to be one of the main challenges for capital market development. The general level of awareness and competence of the private sector in novel financial instruments also remains a challenge.

The identified challenges for the sector, among others, include an absence of a secondary debt market in Georgia, which, in its turn, requires developing asset securitization regulations. Securitization will help businesses capitalize on their income-generating loaned assets and raise funds against these assets through issuing securities. Absence of the equity market is another major missing element of the Georgian capital market ecosystem, including the absence of such traditional instruments as REITs, the availability of which would create the first model for creation of a modern investment fund instrument in Georgia, provide incentives for growing companies to go public, offer opportunities to local savings holders and pension schemes on the one hand and international institutional investors on the other. Reforming this sector will require a significant modification of the relevant legal framework, including amendments to the Civil Code of Georgia, the legislation related to tax, enforcement, and bankruptcy. The USAID Economic Governance Program actively works with the Government of Georgia and the National Bank of Georgia on these reform lines.

On top of the deficient legislative frame and incomplete supervisory functionality, a major missing element of the ecosystem for securitization is the system of credit assessment in Georgia, which has yet to be established, which will assign credit ratings to issued securities. Technical infrastructure of the market needs to be improved. The general level of awareness and competence of the private sector in the novel financial instruments remains a challenge, not to mention the associated costs of securitization and going public. For this purpose, state policy of incentive could play an important role. As stated by the surveyed respondents, the capital market reform has been significantly delayed, which resulted in an excessive concentration of financial power in the hands of main commercial banks. Companies also mentioned that access to equity and traditional financial mechanisms, as well as public funding opportunities, are limited.

<i>‘Capital market reform has not taken place properly in Georgia. Re-planning and implementation is necessary’.</i>	[Unidentified sector]
<i>“It will be extremely important to improve access to the international capital markets by further developing the local capital market.”</i>	[Business Services]

COMPETITION REFORM

Overall, the surveyed businesses evaluate the competition reform in second place in terms of positive or neutral direction. This reform also belong to Group B reforms (classified above), which are perceived as mostly positive, but its perceived relevancy is below average for businesses, requiring more work to increase awareness of the businesses about its importance.

Fair competition is an indispensable part of a healthy business environment. According to the Association Agenda between the European Union and Georgia, Parties should cooperate on the implementation of the Competition Chapter of the Association Agreement and its related reforms, as well as enhancing dialogue on legislative enforcement in the competition area and related legislations.

In September 2020, after almost two years of discussions by the Parliament of Georgia, the Law on Competition and related secondary legislation were substantially amended. The main reason to amend the law was to approximate national competition legislation to EU standards. On an administrative level, independence of the Georgian National Competition Agency (GNCA) was further strengthened. The GNCA's enforcement (investigatory and fining) powers have also improved. The amendments equip market players with additional tools to effectively exercise their right to defense and enhance procedural justice. Legislative changes also include improved procedures for concentration control, enhancements to the enforcement system of competition rules in regulated sectors, changes to the GNCA's institutional set-up as well as new functions and enforcement tools. These amendments covered investigative powers of the agency (such as an extended investigation period;

the GNCA's right to conduct unannounced inspections; the right to request information from undertakings during any administrative procedure; the right to make commitment decisions, the obligation to send draft decisions to the parties and allow them to comment and present additional evidence, etc.) and merger control (a new two-phase merger review procedure; the possibility of imposing structural or behavioral remedies; more effective information gathering powers; the right to impose fines for unnotified concentrations). These changes significantly improved the foundation for improved efficiency of the agency.

Moreover, to identify unnotified concentrations, the GNCA introduced a new cooperation mechanism with the Public Registry of Georgia, which allows the agency to effectively monitor registered mergers and acquisitions.

After the amendments, the Law on Competition is set to be enforced in all regulated sectors of the economy (such as financial services, energy, telecoms) by relevant sector regulators. In certain cases, and upon certain conditions, the GNCA has enforcement powers. Before the amendments, the legal gap made enforcement of the competition law in regulated sectors very difficult. The updated law establishes a cooperation procedure for cases where the GNCA investigates a potential infringement involving undertakings operating in the regulated sectors, and vice-versa. In practice, the GNCA has already been involved in ongoing investigations by all three sectoral regulators by providing non-binding opinions and participating in oral hearings, etc.

In 2021, the Office of the Public Procurement Dispute Resolution Council started operating under the structure of the National Competition Agency. Also, on January 1 2021, the anti-dumping legislation came into force and the relevant department started functioning in the Agency.

The EU funded project “Support to the Georgian Competition Agency”, which was implemented from 2017 through 2020, aimed to support institutional capacity building, improve the legal framework, and promote a competitive culture in the country. With this project, the law enforcement capacity and professional skills of the Competition Agency of Georgia were significantly enhanced. In 2021, the Memorandum of Understanding between the USAID Human and Institutional Capacity Development Project (HICD) and the Competition Agency was signed, under which the Agency is working on a long-term organizational strategy, action plan, and communication strategy.

In 2022, Parliament of Georgia adopted the Law on “Protection of Consumer Rights”. Consumer rights will be protected by the National Competition Agency on the territory of Georgia. The law will enter into force on June 1 2022, and the review of complaints will begin on November 1. The purpose of the law is to ensure a high degree of consumer protection in the country. It is part of the obligation of the Association Agreement between Georgia and the European Union. The law reflects the best international practice prepared in full compliance with the European directives and serves to improve the standard of protection of consumer rights.

The National Competition Agency has already conducted several activities involving mergers and acquisitions, abuse of a dominant position, restrictive agreements and concerted practices, and violations of state aid provisions. In 2019-2021 the agency conducted 9 investigations on different competition cases and established violations in 7 cases; received 8 notifications on concentrations; carried out 7 market monitoring activities; 3 impact assessments of the decision of the agency were carried out.

One of the most notable recent cases, was releasing the results of its pharmaceutical market monitoring in the beginning of 2022. According to findings, the pharmaceutical market in Georgia is characterized by limited regulations and high concentration when compared to other European countries. The prescription policy doesn’t ensure a competitive environment in the market and does not suit the best interests of the patient.

According to the Agency’s analysis, it is important to strengthen legislative regulation and effective enforcement, to ensure maximum competition between substitute products and increase the share of generic drugs, leading to a significant reduction in consumer expenditure on medication. The Agency considered issuing 13 recommendations in this regard.

Georgia's legislation has moved one step closer to EU directives as a result of the reforms. However, businesses are concerned about a variety of issues, including those related to effective enforcement of developed rules. Lack of awareness of competition law by the private and public sectors and by civil society remains a challenge. In addition, long-term concessional projects are frequently awarded without a competitive process. The size and structure of the economy also have an impact on competition, as dominance is often more difficult to avoid in a small market with fewer players.

The comments received from EU businesses related to the absence of specific requirements to examine the quality standards. The advantages of local companies regarding government connections and language barriers were also highlighted as well as sector-specific concerns.

<i>‘Sometimes competitors use government connections to make obstacles. Also, competitors did not exist until they copied our business exactly’</i>	[Food processing and beverages]
<i>“Improving the competitive environment built on the quality / price ratio of medicines is very important in the field of sale of pharmaceutical products”</i>	[Health, social work]

COVID-RELATED SUPPORT PROGRAMS

Overall, 23% of the surveyed businesses evaluate COVID-related programs, as going in a positive direction and another 53% as going in a neutral direction. This reform belongs to the Group C reforms (classified above), which are evaluated as below average both in terms of perceived relevancy and reform success (i.e. going in a right or wrong direction), requiring corresponding policy measures to increase its relevancy as well as improve its effectiveness.

Georgia’s response to the COVID-19 virus pandemic was considered successful, especially during the first phase of the pandemic in early 2020. By introducing a lockdown in early 2020 and limitations on the movement of people across borders, Georgia was able to protect itself from the massive virus outbreak in the most critical early moments. With uncertainties related to virus management, at the background of an unrestrained virus spread in Europe, Georgia's case was considered exemplary. The anti-crisis plan followed with some delays, which included tax reliefs for enterprises, specifically for the most affected sectors such as tourism.

The second phase of the pandemic management, which started in the fall of 2020 and coincided with the lifting of lockdown measures, experienced several waves and corresponding peaks of the virus spread, reaching a number of new infections over 5,000 per day, and 50 deaths per day. By the end of January 2021, the number of daily infections had fallen to around 700 per day, and deaths to 20 a day. Mass vaccination experienced some delays and despite massive public efforts (including the availability of vaccines as well as public campaigning), the overall process of mass vaccination proved to be difficult.

The Government of Georgia was also quite successful in mobilizing external resources to handle the crisis. In this, the role of the European Commission was instrumental and included several tens of millions of grant and debt financing for budget support and macro-financial assistance, as well as through WHO’s Covax platform, which the EU made available for its Eastern European neighbors.

Economic and social consequences of the pandemic to the state, both direct and indirect, have yet to be measured. The most obvious of which was the loss of real GDP in 2020 at 6.8%, the highest negative growth record since 1994. The state debt increased considerably from about 20.6 bln GEL up to about 30.7 bln GEL by January 2022, close to the 60% boundaries of the country's GDP.

The state business support programs also responded to the pandemic in various ways:

EG	Enterprise Georgia introduced several new mechanisms to respond to pandemic challenges. These were loan and leasing project subsidy mechanisms for event organizers; co-financing mechanisms to support the small, medium and family hotel industry; co-financing mechanisms to promote the restaurant industry; subsidy mechanisms for the promotion of sports facilities and kindergartens. All these instruments were targeted mechanisms to mitigate the impacts of the pandemic on these vulnerable sectors of economy.
GITA	The skills have to be in place to adjust to the needs and challenges of the pandemic situation. Access to finance, especially for risky businesses and innovation. In response to new challenges, the amount of prototype grants in the field of innovation has increased. An e-service component has been added to prototype grants, which will help Georgian businesses develop remote services in response to Covid-19; An online hackathon was conducted against COVID-19; thematic startup groups were strengthened; ideation was initiated to mobilize the startups around the government challenges; free online courses for entrepreneurs were launched, and more.

INSOLVENCY REFORM

Overall, 20% of the surveyed businesses evaluate the insolvency reform as going towards a positive direction and another 55% as going towards a neutral direction. This reform belong to Group C reforms (classified above), which are evaluated as below average both in terms of perceived relevancy and reform success (i.e. going towards a right or wrong direction), requiring corresponding policy measures to increase its relevancy as well as improve its effectiveness.

Efficient and business-friendly insolvency processes in the country provide a high level of flexibility and efficiency to businesses and add significant attractiveness to the business environment. Recent years have been very productive in terms of reforming the sphere. The Parliament of Georgia adopted the Law on Rehabilitation and Collective Satisfaction of Creditors in September 2020. The new law entered into force in April 2021. This new law was drafted with a completely different philosophy, which aims at the rehabilitation of a company in trouble rather than allowing it to go bankrupt.

The insolvency process includes the element of heavy involvement of the outside parties into the management of a company. Therefore, the new law makes it possible to discard unfounded requests by creditors to start insolvency cases and disrupt the operations of a business. Such a scenario is in the best interest of all stakeholders and creditors alike – since the rehabilitation plan is supposed to save the company first, so that creditors get more than it would have been the case otherwise. One significant change in terms of execution has been the introduction of the possibility of reaching a regulated agreement outside of court. The procedure also allows for a mechanism of realization of the property at the highest value, as well as a strong bankruptcy manager and so forth.

The new law introduces a new profession of licensed insolvency practitioners and creates incentives to use other restructuring possibilities at an early stage, even before getting to the point of bankruptcy liquidation. Before, the National Bureau of Execution had the function of trustee, which was a controversial issue both from the side of the business and international community. The new profession of insolvency practitioners makes it possible to diminish this exclusive role of the state in the process.

The reform has been accompanied by RIA. The process includes involvement of the outside parties into management, therefore the case of starting insolvency cases has been solved (unfounded requests by creditors to start the insolvency case).

The Ministry of Justice introduced the rule of authorizing (certification and interview with the execution bureau) and appointing the insolvency practitioners (random selection) and created a special register. The process involves BRIPA – the Business Rehabilitation and Insolvency Practitioners Association. The system of selecting practitioners was linked with the electronic selection system of court cases and functions without issues. The Training Center of the Justice house is the responsible agency for the certification. The first wave of authorizations finished in 2021. The electronic system of insolvency processes has been re-launched, enabling all parties involved to follow the process and inform the parties about the process. There is room for improving the content of this platform. Up to 20 practitioners were registered in the system.

According to World Bank business rankings, the indicator of insolvency has shown notable improvement in 2018, jumping from 106th position up to 57th position. In 2020, Georgia’s rank has gone down to 64th position, which was driven only by improvements of its only one sub index out of the two major sub-indices of which are a) index of the legal framework and b) level of creditors satisfaction, of which nothing has changed in the last few years.

According to ISET, in 2020 there were about 189 insolvency cases in the supreme court with 22 being completed, and the ratio of completed cases in total during the year comprised about 12% in 2020, without too much improvement in the recent years. Since 2019, 244 cases have been registered in the E-court system, of which 162 were adopted under process, 89 were adopted under bankruptcy and 20 under rehabilitation. In total 30 cases were completed, of which only 2 were rehabilitation cases. In total, 52 cases were not adopted in the process. Average time for 162 cases ranges from 3.1 to 4.8 years, depending on the starting time (time from status definition or from the point of definition of the rehabilitation regime).

Despite changes and new possibilities for business, challenges remain. Firstly, the utilization of the new mechanisms remains low. According to Business Rehabilitation and Insolvency Practitioners Association, 15 applications have been received according to the new law, but not all of them have been adopted and the numbers are not high. This is due to the existing stigma of businesses, seeing this process in a negative context of bankruptcy rather than rehabilitation. Therefore, it is important to raise public awareness among the business community about the benefits of the new opportunity.

Initiatives in this regard include the project by EBRD to provide support to small and medium businesses, which is supported through a specially created platform and manual for companies who can’t afford to hire expensive consultants (InsolvAid).

Since the National Enforcement Bureau is indirectly involved but has a significant role to play, it is important to maintain the high reputation of certified practitioners. The challenge is the absence of the statistics and indicators or the sphere to assess whether the reform goes successfully, regarding the workload of existing practitioners. Capacity building of the profession as well as utilization of the interpretation of the law remains in the agenda. The court only receives and formalizes the decision.

SMEs are more susceptible to a lack of awareness and capabilities. Big businesses have more capabilities. Individual entrepreneurs are not yet covered by the current law and another parallel legislative process is in place in the Parliament of Georgia to regulate along with physical persons. During rehabilitation it is impossible for a company to mobilize cash-flow and hence is not in the position to use rehabilitaion services. The issue is also the reporting liability of the companies to provide financial reporting, even if they are almost bankrupt. Repositioning of the law needs to be done, providing a more favorable rehabilitation context to the companies, rather than bankruptcy.

PUBLIC PROCUREMENT REFORM

Overall, only 21% of the surveyed businesses evaluate the public procurement reform as going in a positive direction and another 54% as going in a neutral direction. This reform belongs to Group C reforms (classified above), which are evaluated below average both in terms of perceived relevancy and reform success (i.e. going in a right or wrong direction), requiring corresponding policy measures to increase its relevancy as well as improve its effectiveness.

Public procurement in Georgia is of great economic importance, especially considering EU integration. Public procurement accounts for around 18% of GDP in the EU and offers an enormous potential market for Georgian companies. In relation to public procurement, the Association Agenda of 2017-2020 refers to the implementation of the roadmap adopted in 2016 by the Government of Georgia for the period of 2016-2022, in view of ensuring the approximation of the Georgian public procurement legislation to the EU public procurement acquis as foreseen in the Association Agreement. It also provides the obligation of Georgia to provide timely and precise information on the implementation process.

In order to improve the legal framework, to fine-tune public procurement procedures and fulfill international obligations, in 2019 numerous amendments were made to the legal framework regulating public procurement.

In 2020, a total of 25,598 tenders was announced through various electronic procedures. In comparison, a total of 34,216 different types of electronic procurement procedures were announced in 2019. Respectively, the total amount of electronic procurement announced in 2020 reduced by approximately 25% as compared to the previous year. A significant decline in the number of announced tenders was largely caused by the reduction of economic activities in the country caused by the pandemic.

In 2020, procurement contracts were awarded for 26 completed DEP (donor electronic procurement procedure) tenders and net contract value accounted for approximately 87 million GEL. Procurement carried out through DEP tenders was funded by the World Bank, European Investment Bank, Nordic Environment Finance Corp., Asian Development Bank and European Union.

A notable recent step in public procurement was the amendment of the Law of Georgia on Public Procurement in July 2020, which aimed at implementing in the national legislation the two Euro directives envisioned by the Association Agreement in the area of public procurement [2014/24/EU; 89/665/EEC]. As a result of the amendment, the Dispute Resolution Council was established. Necessary draft amendments entailed by the law were elaborated. The draft amendments were reflected in the respective subordinate normative acts of the Chairperson of the State Procurement Agency. According to the amendments, the Council set up for reviewing public procurement-related disputes or the Court will be authorized to review the disputes related to public procurement. Moreover, the amendments increased the list of disputable issues subject to being appealed to the Council; in particular, decisions related to the award of simplified procurement contracts will also be appealed to the Council where the estimated value of goods, services or works to be procured equals to or exceeds the monetary thresholds established by EU Directives in the field of public procurement.

Over the year 2020, 1,044 complaints were filed to the Dispute Resolution Council set up on the bases of the Law of Georgia on Public Procurement, which is 201 complaints less compared to the previous year. The majority of complaints filed in 2020, 559 complaints in total, were adjudicated in favor of business (partially or fully granted by the Council), which made up 54% of the total number of submitted complaints. This fact verifies the impartiality of the Dispute Resolution Council, as well as a high level of trust of business to the Council

The State Procurement Agency completed elaboration of new Draft Legislation in the scope of public procurement complex reform. The Draft Legislation reflects remarks and recommendations made by governmental entities. The new Draft reflects almost all the phases of approximation envisaged by DCFTA, gradual implementation of each phase in compliance with relevant obligations and agreed terms. The Draft received positive evaluation at EU Commission Session that took place on 28 May 2021.

Currently, the process of distribution of competencies within primary and secondary Legislation regulating Public Procurement is underway. In the scope of the EU Twinning program, for strengthening Public Procurement Practices in Georgia, international experts of the project elaborated seven sub-legislative normative acts based on Public Procurement new Legislation. Sub-normative acts are currently in the process of translation and adaptation due to Georgian Legislative norms. Furthermore, the State Procurement Agency continues various activities for the modernization of e-Procurement system, including information exchange with other public entities.

As a result of the reforms, Georgia's legislation got one step closer to the EU directives. However, businesses have concerns in relation to numerous issues, including those related to blacklisting and unbalanced agreements between the companies and procuring parties. The affected businesses complain that some EU Directives are automatically copied without adaptation. Certain norms allow for broad interpretations, and as a result businesses often encounter unfair and inadequate sanctions and norms. Faulty public procurement system, not oriented on high quality (but on prices), discourages offering high quality products and services.

“Four areas are important for improving problems in public procurement: policy, international standards, legislation, and skills. It is crucial to start with the policy and to determine what criteria should be used in the tenders to decide.”

[Construction industry]

The draft law on public procurement is considered progressive, although it has some shortcomings. In the terminology section, it is noticeable that some terms have been translated, which contains content inaccuracies. The bill still does not address the imbalance of contracts concluded between the buyer and the supplier. It does not provide a price indexation possibility that is used worldwide.

Overall, there is a room for further improvement of the regulatory base and approximation with the best international practices, coordination of the state procurement centrally, adding new electronic services and raising awareness and trust of the civil society and business towards public procurement.



BUILDING REGULATIONS REFORM

Overall, only 23% of the surveyed businesses evaluate building regulation reform as going in a positive direction and another 47% towards a neutral direction. This reform belongs to Group C reforms, according to our classification (provided above). These are the reforms which are rated below average both in terms of perceived relevancy and success (i.e. perceived to positive or negative direction), requiring corresponding policy measure.

Among the sectoral reforms, the building regulation reform has been one of the late runners. The obligation to bring specific construction norms in line with European standards in Georgia derives from the Association Agreement. According to the agreement, Directive 305/2011 (Construction Products Regulation, or CPR) and Directive 2010/31/EU (on the energy performance of buildings) of the European Parliament and of the Council should be introduced in Georgia. These regulations, in turn, would also indirectly imply an obligation to transpose European construction standards for creating the harmonized standards developed by CEN for the European single internal market.

For a long time, the existence of multiple standards in use was one of the obstacles of the sector. The main reason for this was the conflicting grounds on which these norms were based. International (American) building codes (IBC), European codes in force in the construction part and the so-called Soviet "SNIPs" (SNIp) create systemic incompatibilities. Such circumstances lead to an unpredictable environment for all stakeholders involved – developers, architects, structural engineers and permit issuing authorities. Therefore, there is a need for structural reform in this direction, which will solve these problems.

The Ministry of Economy and Sustainable Development of Georgia is working on the Eurocodes implementation process. The Ministry has translated all 10 Eurocodes and translation of euro norms necessary for Eurocodes is still undergoing. Eurocode 0 – Basis of structural design – has already been sent to the Georgian National Agency for Standards and Metrology to be registered as a national standard. This year the respective procedures will be carried out in order to register all remaining Eurocodes as national standards. At the initial stage, it will be voluntary to use Eurocodes and gradually (depending on the readiness of the market) they will become mandatory. Eurocodes will replace not only the so-called SNIpS (structural design codes designed in Soviet Union and then modified) but also the government resolution N50 (which allows the operation of technical regulations of various countries in Georgia).

In 2018 the Parliament of Georgia adopted the Spatial Planning, Architectural and Construction Activities Code of Georgia, which entered into force on June 3, 2019. The new construction code creates an appropriate platform for the fundamental reform of the current construction standards and norms in the country. The Code provides a systematic framework and generally regulates spatial planning and urban planning matters, as well as the issuance of construction permits and other important issues. It also regulates the supervision of the construction process and sets construction offenses and the appropriate sanctions. One of the most important novelties of the Code is the obligatory certification of architects and engineers. Starting at the end of the year, certified architects and engineers will be able to draft projects. The permit issuing body should also have certified specialists. The Code also envisages that the Government of Georgia should establish the minimum sunlight penetration requirements in buildings.

The Code explicitly requires that European standards developed by the European Committee for Standardization (CEN) on the design, construction and operation of buildings be considered in the development of construction norms and standards. In practical terms, this includes the Structural (Constructive) Eurocodes (CEN / TC 250), Building Fire Safety (CEN / TC 127), Barrier-Free Construction / Planning (CEN / CLC / JWG 6), and Energy Efficiency of Buildings (CEN / TC 371), "Building Insulation/Lighting" (CEN 17037) and other standards in the Georgian legal system, which are relevant when concretizing the requirements of the Code.

EDUCATION SECTOR REFORM

Overall, only 19% of the surveyed businesses evaluate the education sector reform as going in a positive direction and another 38% – towards a neutral direction. 43% of the businesses consider that it is going in the wrong direction. This reform belongs to Group C reforms, according to our classification (provided above). These are the reforms which are rated below average both in terms of perceived relevancy and success (i.e. perceived to positive or negative direction), requiring corresponding policy measure.

Limited access to a well-educated workforce has been one of the main challenges of businesses operating in Georgia. According to the Association Agenda between the European Union and Georgia the Parties should cooperate on the overall modernization and reform of Georgia's education, training and youth systems, particularly by encouraging a strategic approach to all levels of education – general, vocational, and higher education and research, in order to bring Georgia's education and science systems in line with EU standards.

This field was marked by several important strategic policy documents and legislative changes, as well as significant financing of the sector, with the support of international donors. The policy documents included Vocational Education Reform Strategy (2013-2020) and United Strategy of Education and Science (2017-2021) as well as the legislative changes related to introduction of a new law of Georgia on Vocational Education, adopted in 2018. Development of new Unified National Strategy of Education and Science for 2022-2030 started in 2020 and is in its final stage of development. The process was assisted by EU-funded Public Administration Reform project and the World Bank project Innovation Inclusion and Quality (I2Q Georgia). The Strategy dwells on three pillars – equity, quality and governance – in order to ensure long-term sustainable results.

Vocational education system has undergone fundamental changes in recent years since it plays a most critical role in addressing the skills gap established on the labor market. Georgia's TVET system faces several challenges at the sectoral level. These include a need to make the system more demand-led and responsive to industry needs. So far, there is a mismatch between the industry's skill needs and existing TVET provision, which needs a development of the mechanism to involve industry representatives in initiatives, intended to ensure that labor market needs are met. Despite significant attention to the sector, involvement of the private sector in designing the programs and cooperation between the private sector, education and public sector remains limited. To better address this limitation and the existing skills gap on the labor market, in 2021 the Georgian Ministry of Education and Science, in collaboration with the Chamber of Commerce and Trade, established a Professional Skills Agency. It aims to facilitate the introduction of vocational programs in the labor market, support innovative training, increase competition and provide better employment opportunities. The agency provides the basis for the country's public-private partnerships and human capital development.

Further development of vocational education as an important tool for addressing the skills gap in the labor market, continues to be one of the country's priorities. According to the Georgia Government Program 2021-2024, access to vocational education and training/retraining programs will be enhanced and mechanisms will be developed for identifying vulnerable groups outside vocational education and engaging them in vocational education.

The Government of Georgia has plans that prioritize significantly improving the quality of general education, developing the system in accordance with international standards, and attracting young quality human resources into the system. In 2021 the government of Georgia presented a ten-year plan for the development of education and science. According to the plan, there will be exchange and joint programs with foreign vocational schools. Multilingual education is being introduced in the education system, which will help create an educational environment tailored to the needs of pre-school ethnic minorities. A new school management model is being developed, with the goal of strengthening general educational institutions and giving them greater autonomy.

With the emergence of the novel coronavirus pandemic in late 2019, Georgia had to urgently convert the school education system into a functional distance learning mechanism as soon as possible. Most public schools lacked any previous experience in remote education. The majority of public schools had no prior experience with remote education. The challenge was made even more difficult by a lack of resources, trained teachers and necessary equipment.

The Ministry has been implementing the EU flagship project "Eastern Partnership European School" since 2018. The school offers high quality European education in a multicultural environment and based on fundamental values to students of 6 partner countries (Azerbaijan, Belarus, Moldova, Georgia, Armenia and Ukraine) aged 16-17, which will enhance their employment opportunities.

In the higher education sphere, the new model for financing, which includes basic funding for state universities, will be introduced. The also project aims to facilitate the implementation of a new model of performance-based funding by creating a HEIs information management database system, to measure the institutional effectiveness of HEIs and statistical processing of all relevant information, for a new funding formula.

Significant progress was made in terms of quality assurance as a part of an ongoing wave of higher education reforms including the membership to European Association for Quality Assurance in Higher Education in 2019, that was followed by securing the registration in European Quality Assurance Register for Higher Education. In terms of success in higher education, it is important to mention Georgia's successful participation in the Erasmus+ higher education component over the years.

The Ministry, through its Agency - Shota Rustaveli National Science Foundation of Georgia is the beneficiary organization of the EU Twinning project "Supporting Inter -sectoral Collaboration Perspectives Between Research and Industry", which aims at bridging science and industry. Georgia has achieved tangible progress in research by being fully associated to large-scale EU framework programs such as "Horizon 2020" and "Horizon Europe" by aligning its policy and program framework to European standards.

Despite the measures Georgia has implemented, there are still some issues that must be addressed. The vocational education system currently does not meet all the demands that the labor market places on job seekers. Lack of relevance of VET program to the current and future labor needs of Georgia's growing and diversifying economy; the low and variable quality of awarded VET qualifications and their lack of recognition by employers and education institutions both locally and internationally. The initial framework of recognition of informal education is worked out but the results remain weak, and the scope of recognition needs to be significantly expanded.

JUDICIARY SYSTEM REFORM

Overall, only 12% of the surveyed businesses evaluate the judiciary system reform as going in a positive direction and another 38% in a neutral direction. 51% of the businesses consider that it is going in the wrong direction. This reform belongs to Group C reforms, according to our classification (provided above). These are the reforms which are rated below average both in terms of perceived relevancy and success (i.e. perceived to positive or negative direction), requiring corresponding policy measure.

Highly trustworthy, competent and effective courts have proved to be one of the most critical elements of the business sector. According to the surveyed businesses, when state bodies are on one side, the court is biased and not independent. The language barrier for foreigners is also mentioned, as companies stated, and the justice system should give assistance to foreigners with facilitated pathways owing to the language barrier.

Large-scale reform has been under way since 2012 to meet the commitments made to the European Community and its citizens, to ensure compliance with international standards and international best practice of the judiciary.

As part of the third wave of reform starting in 2016, the most important changes made in the systems were the introduction of the institution of an independent inspector, the introduction of the rule of electronic distribution of cases in the court system on a random basis, as well as steps made for improving the degree of transparency in the work of the High Council of Justice.

The fourth wave started in the middle of 2017, with several key priorities: streamlining the principles of disciplinary liability and disciplinary proceedings, solving the problem of overcrowding of courts, improvement of regulatory norms of the HCoJ, and reform of the High School of Justice. At the end of December 2019, the task force completed its work on legislative changes, and amendments to the Law on Common Courts were adopted by the Parliament. The circle of issues to which the High Council of Justice must, in its decision-making, apply the norms of the Organic Law of Georgia on Common Courts (which regulate conflicts of interest) was expanded and, accordingly, the norms on recusal of a member of the Council in the process of taking these decisions were improved. Despite criticisms, most reforms that aimed to increase the independence and transparency of the judiciary system were considered positive by the civil society. However, in practice, they have not succeeded in making the judiciary independent and free of political influence.

During the fourth wave of reforms, important changes were made. In particular: the duration of studies at the High School of Justice was increased from 10 months to 16 months; the High Council of Justice was made accountable for publishing "the reasoning behind appointments of judges to regional/city courts and appeals courts for an indefinite term"; the right to elect judge members of the Independent Council of the High School of Justice was given to the Conference of Judges; the Chairperson of the High Council of Justice was made to submit annual reports on the Council's activities to the Conference of Judges; important steps were taken to ensure the openness of sessions of the High Council of Justice.

Furthermore, within the framework of the reform, a platform has been created which unites the representatives of the Parliament of Georgia, the Ministry of Justice and the High Council of Justice. The working group has already completed the work on drafting legislative changes related to the grounds of disciplinary responsibility. A unified draft law on the grounds of disciplinary liability has been prepared for this stage.

Effective judicial reform would also require reforming the Prosecutor's Office, which has been persistently criticized for being politically biased. A new Organic Law on the Prosecutor's Office was adopted in 2018. The Law aimed to establish a depoliticized and independent Prosecutor's Office, and thus implied a new rule for the selection/appointment and dismissal of the prosecutor general. One of the main focuses of prosecutorial reforms in 2020 continued to be the separation of functions between investigators and prosecutors.

A new High Council of Justice website (<http://hcoj.gov.ge/ka/>) was launched in test mode on February 5 2021, with the support of USAID / PROLoG, to improve the efficiency and accountability of the High Council of Justice.

As part of a Council of Europe project, a strategy document on the organizational development of the Supreme Court has been prepared in order to continue the progress of judicial and legal reform. Experts from the Council of Europe briefed Supreme Court judges on the Court's strategy and action plan.

However, important challenges remain regarding the independence and accountability of the judiciary system. In particular, public trust in the High Council of Justice remains low. The Parliament elected four Supreme Court judges for lifetime tenure on December 1 2021, continuing the process of top court appointments despite coming under criticism of the civil society, the international community and strategic partners. The existing rule does not allow for reflecting the interests of the judges who are in the minority in the composition of the High Council of Justice. Reflecting on setbacks, the Freedom House report on Nations in Transit 2018 rated Georgia a 3 (7 being the best possible score), a decline compared with 2017 and 2016 (3.25). In 2020 Georgia’s rating has further declined to 2.75 because of the contentious appointment of new judges of the Supreme Court.

Time-consuming business disputes and court proceedings have been identified as one of the main challenges to the Georgian business environment. One of the reasons for this problem is the incorrect functioning of alternative dispute resolution mechanisms (Mediation and Arbitration) in the country. The development of Mediation and Arbitration institutes will ensure access to justice for businesses and help the country to fulfill its obligations under the Association Agreement with the European Union. Mediation and arbitration release courts from excessive caseloads and bring justice closer to businesses.

<i>“The judiciary system is crucial for the country, because if it does not work, doing business in Georgia does not make sense.”</i>	[Unidentified sector]
<i>“The reforms need to be further advanced in the Judiciary Sector”.</i>	[Business Services]

OTHER REFORMS

In addition to the list of reforms that were evaluated quantitatively, other important economic reforms in Georgia includes labor regulations and enforcement law, overviewed in this section.

Labor relations. The Association Agreement provides the broad obligation for Georgia to approximate its employment and social policy framework to the EU in the areas of anti-discrimination and gender equality and health and safety at work. According to the Association Agenda, medium-term priorities include: continuing to work on establishing an effective labor inspection system, with adequate competencies and capacities for inspections of all working conditions and labor relations in accordance with ILO standards, ensuring the effective functioning of the Tripartite Social Partnership Commission and improving social dialogue through cooperation with the ILO.

Relative to the labor relations, significant moves have been made recently. The Tripartite Social Partnership Commission as a consultative body accountable to the Chairperson, the Prime Minister of Georgia facilitates the development of social partnership and social dialogue at all levels in Georgia between employees, employers and the Government. It holds consultations with the Government of Georgia on issues of common interest related to labor, economic and social policy, drafts proposals and recommendations on other issues related to labor and social policy that are important for the members of the Tripartite Commission. The Tripartite Social Partnership Commission at a regional level is also operational, specifically in the Autonomous Republic of Adjara.

Georgia has taken several significant steps toward labor market development in recent years. Before 2019 the Organic Law of Georgia on Occupational Health and Safety applied only to high-risk and hazardous jobs. In 2019, Georgia adopted the Organic Law on Occupational Safety, reflecting the main principles and requirements of the EU occupational safety and health (OSH) framework directive. The new law extended the mandate of labor inspectors, implying that labor inspectors are entitled to conduct unannounced inspections in enterprises in all economic sectors and impose sanctions on identified violations, which entered into force on September 1 2019, and applies to all workers including public sector and public officials. The new law required employers to have in-house labor safety specialists.

A labor mediation mechanism has been introduced to resolve collective disputes involving at least 20 employees, be they connected to the negotiation of collective agreements or the violation of human rights and freedoms, labor standards, employment contracts or collective agreements. There is a roster of mediators consisting of 17 neutral, independent and qualified labor mediators.

The law of Georgia on Employment Promotion was approved by Parliament in July 2020, filling some legislative gaps and defining public employment service provision in Georgia. The Law regulates the work of state institutions related to employment promotion, responsible institutions, forms of employment and employment promotion measures, etc.

In order to promote employment of Georgian citizens, The LEPL State Employment Promotion Agency, separating social services from employment services has been operational since the beginning of 2020. Active Labor Market Policy has been implemented since 2015 through state programs. Vulnerable groups including disabled people are on a priority list, and various activities are being implemented in this regard, for instance, wage subsidy, supportive employment, protected workplaces, etc.

In September 2020, the Parliament of Georgia passed a new package of reforms in labor regulations, including updates in the Labor Code. The new labor code introduced significant changes that further advanced labor standards such as limits on work hours, mandatory weekly rest time, breaks between shifts and better protections for interns, part-time employees, and night-shift workers. It also addressed the issue of eliminating discrimination between male and female employees and better protecting the rights of working mothers.

The Code defines that state supervision over labor legislation is ensured by the LEPL Labor Inspection Service. The Law on the Labor Inspection was approved, extending the Labor Inspectorate’s mandate to include labor rights and conditions (in addition to health and safety issues) and transforming it into an independent agency under the Ministry of IDPs, Labor, Health and Social Affairs of Georgia. Following the reform, the Inspectorate is now authorized to inspect and supervise execution of a full range of labor rights prescribed under the Labor Code of Georgia. Therefore, the current mandate of the Labor Inspection Service covers both labor rights (prohibition of discrimination, equal pay, overtime pay, etc.) and occupational health and safety. In addition, the Labor Inspection Service is authorized to commence inspection activities without giving any prior notice to employers.

While approximation is the only perceived way forward, compliance costs for the implementation of obligations for the private sector, especially for SMEs will be high. Compliance might require additional investments for companies to purchase new technologies, setting up new infrastructure, ensure protective equipment for their staff and provide relevant training to their employees.

The Government of Georgia further plans to continue working towards upgrading and implementing a legislative framework in the areas of labor rights and workplace safety to promote the effective execution of the mandate of labor inspection and the practical implementation of workplace safety regulations. Although in general these steps were very positive in terms of improving labor standards that ensure worker safety, problems emerged in the execution of requirements by businesses – the issue being an undifferentiated approach to all companies, despite their sectors, sizes and business profiles, which sometimes impose unreasonable and unnecessary burdens to SMEs, often evaluated by them as too restrictive and not practical. Improving the effectiveness of functioning of the Tripartite Social Partnership Commission remains a challenge.

Enforcement law reform. Fast and efficient enforcement is an integral part of the business environment. In the recent past, Georgia’s enforcement system has been reformed several times. In 2021, the Parliament of Georgia approved the new bill on Enforcement Code in the first reading, which envisages the transition of the state to a new system of enforcement. The bill was created because there is currently no unified and systematic legal document in the field of enforcement. The old Law of Georgia on Enforcement Proceedings enacted in 1999 is out of date and can no longer meet modern challenges. The new bill sets forth the terms and circumstances for the establishment and operation of the Executors’ Chamber, as well as the National Enforcement Bureau’s service provision. The Bill determines the action territory for certain executors and establishes an e-system for the automated distribution of cases on these territories.

The new bill introduces the position of Inspector, who represents a person employed by the National Bureau of Enforcement and ensures the execution of specific types of cases. The Inspector will enforce cases against the state budget, budgets of autonomous republics or local self-governing units, and cases classified as secret in accordance with Georgian legislation, as well as manage the amount of bail and diversion defined by the Criminal Procedure Code. The National Bureau of Enforcement will maintain the status of the LEPL at the Ministry of Justice, and the inspector shall ensure the enforcement of cases of certain categories in the Bureau. Furthermore, the bill dissociates the competencies of the Bureau and the Notary.



GENERAL FINDINGS

These are the general findings and conclusions based on interviews with key informants and the survey of enterprises. These general, high-level ideas in relation to reforms are mostly captured during these interviews. Some but not all of them are backed with quantitative evidence, but makes lot of sense for improving overall success of economic reforms in the country.

Businesses Welcome European Approximation, but Indirect Benefits Should be Communicated More

Consequently, the transition to European standards seems generally reasonable for businesses. This does not mean that these reforms are all faultless or perfect. But overall, their importance is clear. Accessing the EU market is relevant now or in the future to majority of businesses, who believe in both direct and indirect benefits of EU integration. However, indirect benefits of EU integration, including the benefits of reforms for overall business environment (not just as a means of accessing the EU market) must be further asserted and communicated.

When it Comes to the Success of the Reforms, Deficiencies are Seen on Both Sides

The international donor community and government complain that businesses are not interested in how reforms go and it is hard to trigger their interest until the very last moment, when certain regulatory requirements enter the force. Businesses complain that they are not well-informed in advance. Another part of businesses believe that a large part of economic reforms do not affect them, hence are not considered relevant. These two perspectives contradict each other and we believe that the truth is in the middle. There is huge room for improvement on both sides. And the role of associations (industry ones, in particular) and BSOs is decisive. Both the intensity and the content (tone) as well as the form of communication with the business should be changed and become more effective.

Perception of Reforms - Costs Vs Investments – Driven by Mostly Inner Business Philosophy

Many businesses in Georgia are established out of necessity, rather than a fully contemplated career choice of their founders. Those businesses are oriented on quick cash-flow and short-term profits. They differ from ones which were created with the underlined vision for growth and long-term development. Perceptions of these two groups towards business-related reforms differ considerably. The businesses with short-term profit goals consider reforms additional unnecessary regulations and related compliance efforts as sunk costs. In contrast, growth-orientated enterprises view these reforms as a means towards better and more competitive business environment, hence as a benefit for them and as an investment for their future.

Legislative Changes Outpace Implementation Causing Dissonance in the Business Climate

Businesses highly acknowledge the progress achieved by the government with the reforms. However, the prevailing opinion is that adopting legislative changes considerably outpaces their effective implementation. Often, during implementation it becomes clear that its execution is an issue and the reform might be end up being an additional formal redundancy for a business rather than a way towards a desired outcome. The technical regulation banning the production of plastic (cellophane) bags is a case in point, as it has not been properly enforced and polyethylene bags are still sold in the consumer market. Such actions are often costly and are affecting the end-users, paying for the increased costs and therefore facing the risk of social discontent.

An Undifferentiated Approach During Implementation is an Important Aspect of the Deficiency

Regardless of their attitudes towards the reforms, businesses differ in terms of capacity to adopt to new changes, including ones driven by the EU approximation agenda. Smaller firms are less flexible and resilient to this end, and not ready to fully implement the commitments made as a result of these changes. Businesses complain that the reform agenda does not consider these differences in the capacity and the regulation does not differentiate among smaller and larger firms.

Overdoing the Minimum Standards is Another Issue

The EU directives are general and provide some flexibility for nation states to adapt these regulations to specific national circumstances. They set minimum standards to be considered, and even existing EU members specify them at their discretion. Businesses complained that some of the regulations in Georgia go beyond these minimum standards and are often too restrictive for businesses, even compared to EU members. Timing, phasing and adopting these changes is critically necessary since these are related to large-scale capital investments, often impossible to mobilize even for larger companies (e.g. the case of the Extended Producer Responsibility). A more liberal approach in this regard is desired.

Limited Use of RIAs as a Means of Informing the Reforms Might be One of the Root-causes to This...

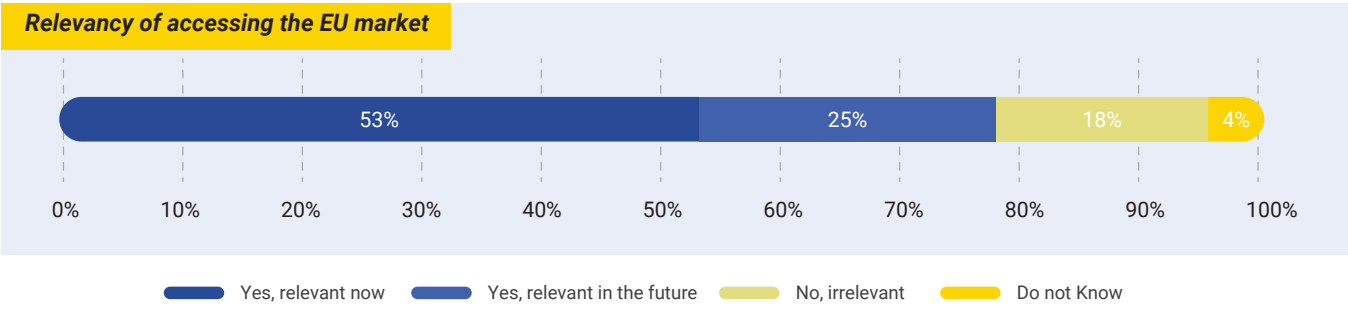
Introducing the RIA reform in 2020 was meant to benefit all other reform processes, making them more informed and effective. However, RIAs are not often exercised in practice. According to respondents, regulatory impact assessment is not common and the regulations are not evaluated ex-post. A regulation might be adopted but might be found at fault, not working and may need to be changed or updated. Coupled with the limited interest of businesses towards the reform process, this leads to the faults in the process, avoiding of which might be possible otherwise.

2.5. EU MARKET AND DCFTA

The DCFTA was one of the most important economic achievements in Georgia in recent years. However, after almost eight years from the signing the DCFTA between the EU and Georgia, its benefits are not fully utilized and a question among businesses in Georgia – whether it counts as a “pain” or “gain” remains at the forefront.

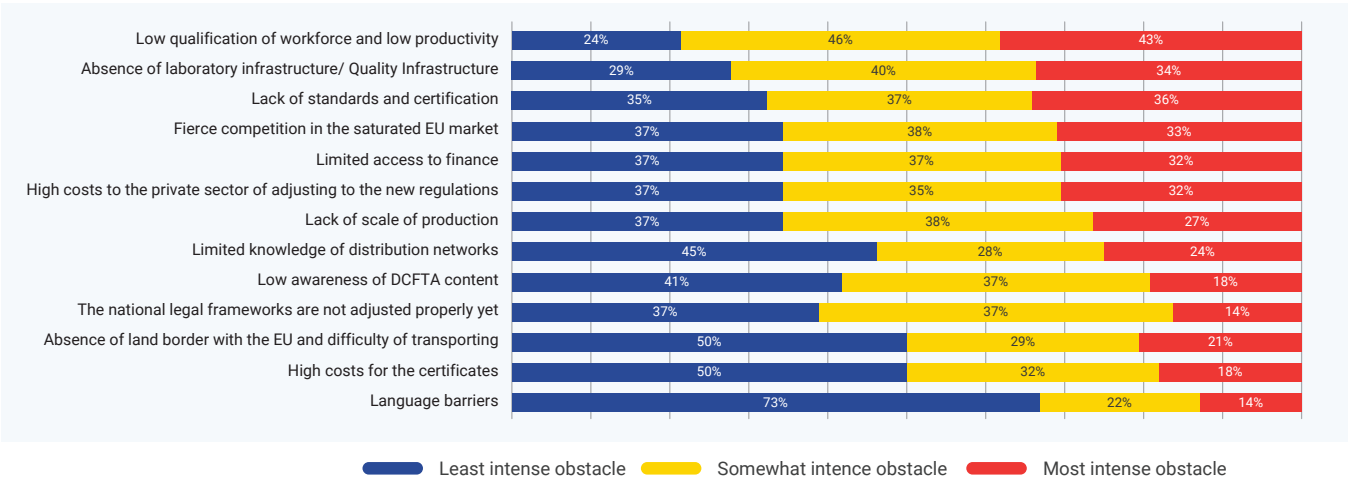
Despite the remarkable progress with the reforms that the GoG undertook, the number of businesses which currently export to the EU reached about 1,000, but the traded volumes are not impressive. Businesses still prefer to sell to more traditional markets, despite the underlying political risks associated with the lack of diversification. Part of the reason for this could be a lack of awareness and interest of businesses in Georgia about the virtues of the EU market. Some of the direct impacts of the DCFTA such as the instant access to the EU markets is clear. Other indirect impacts come along with the associated reforms in the economic sector, making business environment more competitive and favoring more competitive growth and development. These benefits are more long-term, ambiguous, and hence perceived as less relevant.

Indirect positive effects of the DCFTA sometimes outweigh direct ones and often remain unnoticed. For instance, previous research by EBA found that the companies who were trade-ready with the DCFTA were more resilient toward the COVID-19 crisis., Therefore, raising awareness among businesses about the DCFTA and its benefits remains a compelling objective. It is interesting to check whether businesses perceive the DCFTA as an advantage to long-term competitiveness and a path to more organized, sustainable and high added-value markets for enterprises. The absolute majority (53%) of the EU businesses consider that accessing the EU market is relevant now and another 25% of the surveyed businesses think that it will become relevant in the future. Only 18% of the businesses consider the EU market irrelevant to them. It is hard to judge what other, non-EU businesses think about this issue, but for EU businesses, relevancy of the EU market does not come under doubt and has a high level of legitimacy.



On top of the awareness and perceptions about the EU market, there might be objective obstacles that hinder implementation of the DCFTA and prevent companies from accessing the EU market, despite their willingness to do so. The responses are listed according to their rankings and led by low qualification and productivity of workforce, as well as insufficient quality infrastructure and lack of standards and certification. 89%, 74% and 73% of the surveyed businesses report that these factors cumulatively represent either somewhat intense or most intense obstacles. The list is followed by market competition (71%), limited access to finance (69%) and high compliance costs for private sector (67%).

It should be noted that the issue of absence of a direct land border with the EU is often named. Although, compared to other factors it comes below in terms of acuteness, it is still problematic, since 50% of the EU businesses report this as either a somewhat intense or the most intense obstacle.



Barriers towards accessing the EU market

EBA has explored this subject before. In 2020 within the framework of GIZ-funded regional project, related to eastern partnership “Trio” and the similar question was addressed.¹⁶

Rank	Micro (up to 10 Employees)
1	Low qualification of workforce
2	Absence of laboratory infrastructure/ Quality Infrastructure
3	Access to finance
4	High costs to the private sector of adjusting to the new regulations
5	Lack of scale
6	Tax reform
7	High costs for the certificates
8	The national legal frameworks are not adjusted properly yet
9	Difficulties in understanding the EU Regulations
10	Language barriers

Barriers towards implementation of the DCFTA (EBA 2020)

The larger the firm, the more problematic is the low qualification of workforce. Smaller firms are more concerned with a lack of standards and poor-quality infrastructure. Fierce competition in the EU market is the second most important obstacle in accessing the EU market for medium-sized firms. Large firms rate low awareness of the DCFTA content as one of the top issues.

#	Micro (up to 10 Employees)	Small (11-50 Employees)	Medium (51- 250 Employees)	Large (Over 250 Employees)
1	Lack of standards and certification	Low qualification of workforce and low productivity	Low qualification of workforce and low productivity	Low qualification of workforce and low productivity
2	Absence of laboratory infrastructure/Quality Infrastructure	High costs to the private sector of adjusting to the new regulations	Fierce competition in the saturated EU market	Low awareness of DCFTA content
3	Low qualification of workforce and low productivity	Absence of laboratory infrastructure/Quality Infrastructure	Absence of laboratory infrastructure/Quality Infrastructure	Lack of standards and certification
4	Limited access to finance	Lack of scale of production	Lack of standards and certification	Absence of laboratory infrastructure/Quality Infrastructure
5	Fierce competition in the saturated EU market	Low awareness of DCFTA content	Limited knowledge of distribution networks	High costs to the private sector of adjusting to the new regulations
6	Lack of scale of production	Fierce competition in the saturated EU market	Limited access to finance	The national legal frameworks are not adjusted properly yet
7	The national legal frameworks are not adjusted properly yet	Limited access to finance	High costs to the private sector of adjusting to the new regulations	Lack of scale of production
8	High costs to the private sector of adjusting to the new regulations	Lack of standards and certification	Lack of scale of production	Limited access to finance
9	Limited knowledge of distribution networks	The national legal frameworks are not adjusted properly yet	The national legal frameworks are not adjusted properly yet	Language barriers
10	Absence of land border with the EU and difficulty of transporting	Absence of land border with the EU and difficulty of transporting	Low awareness of DCFTA content	Absence of land border with the EU and difficulty of transporting
11	High costs of certificates	High costs of certificates	High costs of certificates	High costs of certificates
12	Low awareness of DCFTA content	Limited knowledge of distribution networks	Absence of land border with the EU and difficulty of transporting	Limited knowledge of distribution networks
13	Language barriers	Language barriers	Language barriers	Fierce competition in the saturated EU market

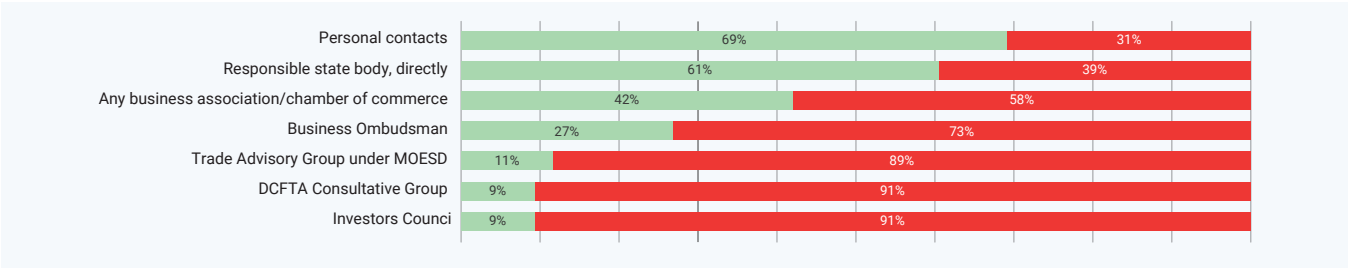
Rankings of barriers towards accessing the EU market by firm size

The key finding is that low qualification of workforce and poor-quality infrastructure were and remain the number one issue for the businesses to fully reap the benefits of the DCFTA and EU market. Respondents believe that overcoming technical barriers requires large financial resources. Among the mentioned technical obstacles is the requirement of laboratory testing, which is not developed in Georgia. Sending samples abroad to obtain appropriate laboratory certificates is costly. Enhancing quality infrastructure, including establishing an appropriate laboratory cluster provided by the state or subsidizing laboratory expenses abroad seem necessary to enhance traceability and normal quality accreditation.

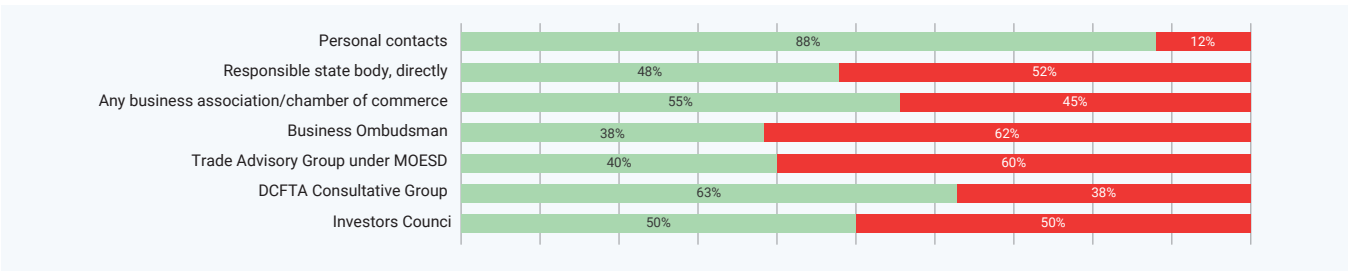
¹⁶The report and the related position paper could be found on the website of the European Business Association - www.EBA.ge

2.6. WAYS TO SOLVE BUSINESS ISSUES

In a healthy business environment, business associations are the first places resorted to carry out advocacy and to solve business issues that are beyond the capacities of the individual business. Additionally, there are several consultative bodies established with the government of Georgia to address the issues the business face. It is interesting to see whether associations and other consultative bodies duly perform this function.



Usage of different ways to solve business issues



Effectiveness of ways to solve business issues

According to usage, the most common ways to solve the major issues is through personal contacts, as cumulatively about 70% of the respondents used this source before. This means of solving the issues is also proved to be the most effective in 88% of the cases.

Businesses also revert to the responsible state body directly. Cumulatively about 61% of the respondents used this channel. However, the effectiveness of this channel is not as great, as with 48% of cases. Business associations and chambers come as third in terms of usage in such occasions (42%), which has about 55% of effectiveness rate. The institute of business ombudsmen was used in 27% of the cases, with the effectiveness rate of 38%. The remaining channels such as the DCFTA consultative group, Trade Advisory Group under the MoESD and Investors' Council are very rarely used (11%, 9% and 9% of incidence, correspondingly), but have certain effectiveness (40%, 63% and 50%, correspondingly).

Clearly there is huge room for improvement for solving the issues for businesses and shifting the burden from personal contacts towards the more formalized ways, by raising the role of the associations and BSOs in this process.

Personal contacts and responsible state body are the two most widespread ways to address the issue among all size firms, whereas large firms address the responsible body more so than personal contacts. The smaller the firm, the more likely that it will address to associations and chambers.

#	Micro (up to 10 Employees)	Small (11-50 Employees)	Medium (51- 250 Employees)	Large (Over 250 Employees)
1	Personal contacts	Personal contacts	Personal contacts	Responsible state body, directly
2	Responsible state body, directly	Responsible state body, directly	Responsible state body, directly	Personal contacts
3	Any business association/ chamber of commerce	Any business association/ chamber of commerce	Any business association/ chamber of commerce	Business Ombudsman
4	Business Ombudsman	Business Ombudsman	Business Ombudsman	Any business association/ chamber of commerce
5	Trade Advisory Group under MOESD	Investors Council	Trade Advisory Group under MOESD	Investors Council
6	DCFTA Consultative Group	Trade Advisory Group under MOESD	DCFTA Consultative Group	Trade Advisory Group under MOESD
7	Investors Council	DCFTA Consultative Group	Investors Council	DCFTA Consultative Group

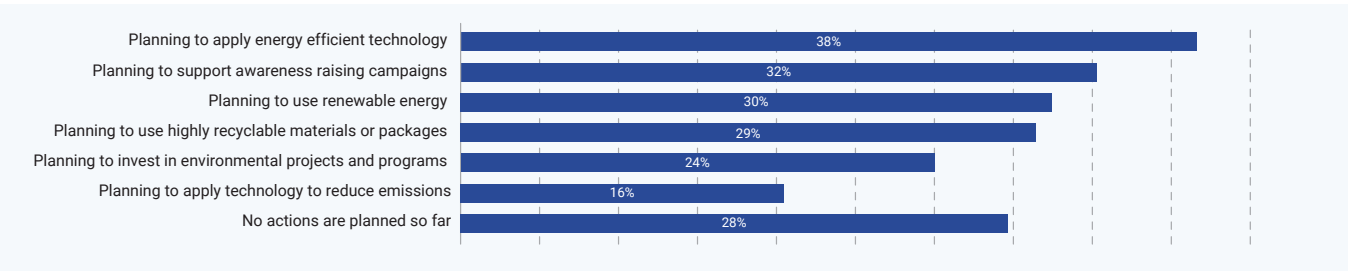
Usage of different ways to solve business issues by firm size

Respondents view the role of associations more as a means of business development rather than solving a major issue with the state. Promoting investment and business development is a major purpose when joining the association. This could include connecting the businesses with financial organizations or initiative groups, foreign partners, organizing meetings related to the expansion of companies. The functions of an associations as a means of advocacy with state bodies, promotion of competition and support in terms of licenses come as a secondary function. Smaller businesses use the associations more for this purpose, rather than large ones, who have direct access to the responsible state bodies and decision-makers.

2.7. ENVIRONMENTAL ACTIONS

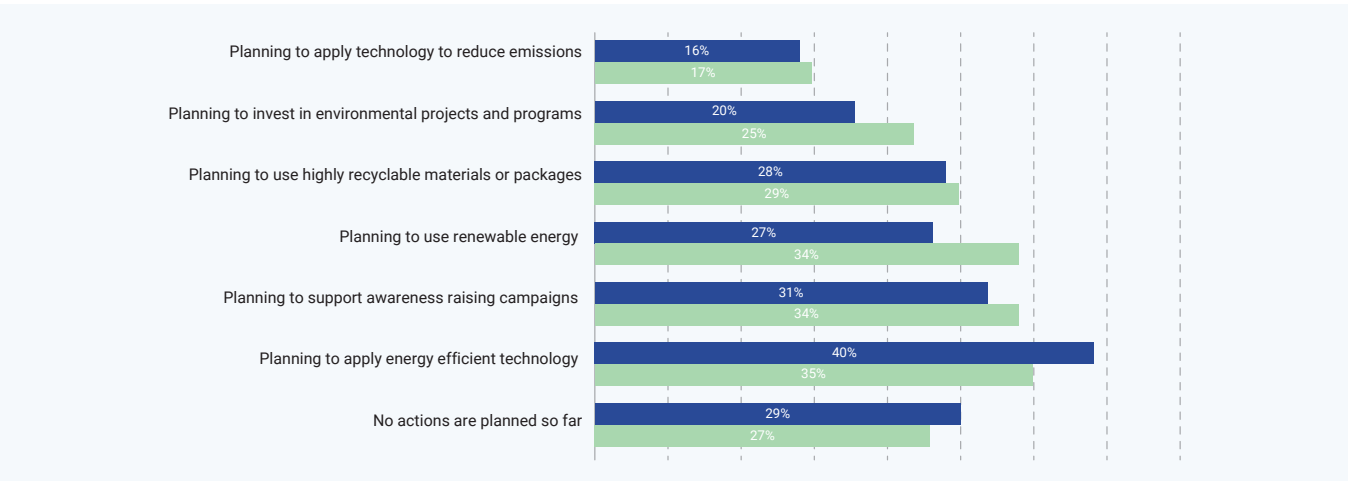
Green growth represents a new paradigm that European companies are embracing at the background of the global climate change concerns. It is also a declared priority of the EU delegation in Georgia and its assistance to the private sector in the country.

It is a pleasant surprise to see that most of the surveyed EU businesses in Georgia are also in the processes of embracing at least some actions towards terms of environmental sustainability and green growth. 28% of the companies say they have no plans so far in this regard. The span of the planned activities include: applying energy efficient technology (planned by 38% of the surveyed companies), conducting awareness rising campaigns (32% of the enterprises), adopting the use of renewable energy (30%), using recyclable materials (29%), investing in environmental projects (24%), applying technologies to reduce emissions (16%).



Planned environmental actions of the EU companies in the nearest future (1-2 years)

Although more non-EU owned than EU-owned enterprises report that they have not taken any action so far in terms environmental governance, there were very few differences found in terms of environmental preparedness. Overall, this difference is not meaningful and it could be assumed that other factors (outside ownership) define whether a company is taking steps towards environmental responsibility.



Planned environmental actions of the companies in the near future (1-2 years) – Comparison (EU and Non-EU Firms)

METHODOLOGY

A three-stage approach was used in the study.

Desk Research. The first stage was conducting a comprehensive desk study of the available materials on the subject of the obstacles of businesses, economic reforms in the country, attitudes of enterprises towards these economic reforms and other topics covered by the research. This included secondary reports, statistics and descriptive texts from responsible state agencies. Special gratitude is owed to the state agency representatives who provided up to date descriptions of the status of the reforms – both recent and future. A huge amount of material was collected during this study, which was used for drafting the factual description of texts in the report related to several economic sections.

Interviews with key informants. Many knowledgeable people and organizations in Georgia have carried out meaningful work in relation to these reforms in the past and are very much knowledgeable about them. We approached and interviewed several of them. This included the representatives of the donor projects, working in various reform directions, who provided valuable insights and input on the subject. We also approached different sectoral associations to understand the industry-specific concerns of their members. We also interviewed one or two representatives of each major business sector.

Quantitative online survey of businesses. Desk study and key informant interviews helped us to elaborate the quantitative questionnaire, which gave us the possibility to approach the wider private sector, assess and test different subjects and validate findings about the subject. The questionnaire was a semi-structured instrument, which was distributed online and primarily targeted to a convenience sample of EU-owned enterprises, EBA members, or companies which associated themselves with Europe and European values. It should be noted that the inception of the quantitative survey coincided with the war in Ukraine, and later with the application of the “Trio” for membership to the EU. Therefore, some of the responses might reflect the pathos triggered by this event.

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