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Time to build factories – again

Georgia's neoliberal development model has failed. Now, it's time to re-industrialise the economy

Read this article in Russian.

Though hard to determine whether it happened naturally or was politically imposed, it is clear the Georgian people have experienced massive socio-economic change since gaining independence in 1991. Through neoliberal experimentation, the state has enacted the basics of market-fundamentalism: a massive privatisation of publicly owned assets, deregulation, a decrease in taxes for the rich, and a liberalisation of trade and finance.

These changes made Georgia a success story within the international community. In 2018, Georgia was ranked seventh on the Fraser Institute's Economic Freedom of the World Index, appearing just after the United States. Georgia also outperformed all its immediate neighbours on the Heritage Foundation's Index of Economic Freedom, where it placed ninth in Europe and 16th in the world.

Besides ranking highly in various international indices, Georgia has successfully integrated commercial banks. Georgia's banks have the highest profitability rate among Europe's banks and are among the top 20 most profitable banks worldwide.

Georgia also has one of the most liberalised trade regimes in the region. It has Free Trade Agreements (FTA) with all of the countries of the Commonwealth of Independent States (a post-Soviet bloc) excluding Russia, as well as with Turkey and China. Georgia has also been a part of the EU Deep and Comprehensive Free Trade Area (DCFTA) since 2016.

While all of the above may read as a success story, it does not tell the whole story. The population of Georgia has decreased by a third since 1991, mainly due to rampant migration. According to Georgia's National Statistics Office, every fifth Georgian lives in poverty; UNICEF says that 6.8 per cent of Georgian children live below the extreme poverty line.

Georgia's middle class has been demolished — the monthly income of around 80 per cent of earners is less than $370.

The Georgian public sector has also suffered, mainly due to chronic underfunding. For instance, the position of school teacher has become one of the least paid jobs; the situation in pre-school education is even worse. Massive de-industrialisation and the underdevelopment of outlying regions has forced people to move to the capital – Tbilisi is now inhabited by one-third of the entire Georgian population.

An embryonic response

One of the key reasons for these negative side-effects was the massive de-industrialisation of the country that occurred after 1991. According to Soviet statistics, around 643,000 people were employed in the industrial sector in 1987. In 2015, just 116,000 people worked in manufacturing, according to a study by the Georgian Foundation for Strategic and International Studies.

Over time, Georgia has gradually transformed into an agrarian economy with a subsistence-based income. In what seems to be a step backwards, the agricultural sector now employs almost half the population, yet only makes up around 8 per cent of Georgia's GDP.

Georgian political elites are not blind to this issue but have tried to deal with the problem by further liberalising the economy, including through the expansion of free trade. The logic behind this neoliberal economic policy is that by setting up free trade deals with industrialised nations, as well as maintaining low taxes and poor labour conditions, Georgia would receive a huge flow of foreign direct investment (FDI). The rate of FDI was indeed high during the last decade, the biggest share however went to sectors such as finance and construction, which created less employment and more precarious jobs.

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The manufacturing sector received only 5 per cent of the total FDI, even though it is better able to strengthen the economy and create more stable jobs. In other words, while the FDI did indeed make Georgia richer, it achieved this by giving money to the already wealthy, rather than helping to create stable jobs for the rest of the population.

The current Georgian Dream government tried to change the situation through the introduction of embryonic forms of industrial policy. These

efforts included establishing the government's Produce in Georgia programme, which aims to support Georgian businesses through subsidised credit, partial collateral guarantee schemes, and organising exhibitions to promote exports.

But the positive results of these activities have been minuscule due to the lack of finances provided and inconsistencies regarding priorities on the part of the government. Another financial mechanism, the Partnership Fund, also did not work out as planned; rather than supporting the Georgian manufacturing sector, it assisted the energy sector and hotel industry.

There are a number of reasons why both Produce in Georgia and the Partnership Fund have not been successful. First, both are investing in projects that are already commercially attractive. Both theoretical research and empirical evidence in the field of industrial policy have shown that governments should support only those economic activities where market forces are unable to operate.

For instance, the German development bank KfW invests in cutting-edge technologies, such as renewable energy, industrial development, and big infrastructure projects. By doing so, KfW's successful industrial policies have helped fix market failures, create new markets and jobs, and enforce spillover effects in other sectors.

Market forces alone have not been enough to cure the problems caused by de-industrialisation in Georgia. In addition, no Georgian government has been able to re-industrialise the nation because their policies have not addressed the key economic bottlenecks that hamper economic development.

What has to be done?

First and foremost, the Georgian political elite should renounce the fake promise of laissez-faire economic doctrine. A free market alone will not bring about economic prosperity.

The current neoliberal doctrine must be replaced with a developmental agenda that would put people first through the creation of more stable and well-paid jobs. To achieve this goal, the Georgian government needs an industrial policy, something countries such as South Korea and Taiwan used when gradually transitioning from agricultural economies to industrial ones.

Industrial planning creates a road-map of economic development for businesses, the government, public institutions, and local government. This road-map determines the goals and directions of the project and also sets indicators for measuring the results. It is based on sectoral research and is directed through incentives like grants, subsidies, tax incentives, and technical assistance.

This preferential treatment for local, infant industries stops foreign competitors undermining their development and helps local firms feel secure in their new investments. Another way of incentivising local firms is to attract foreign investors specialising in that particular sector and create joint ventures. These ventures could be expanded upon by connecting a local producer with a local university; the latter can provide research in addition to qualified workers, creating more employment and solidifying a spillover into other sectors. Supporting local business is crucial when creating an independent, industrial economy that can sustain itself.

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Georgia also urgently needs to create an export promotion strategy. Currently, the Georgian government's only approach to this issue is to organise export exhibitions in different countries. But exhibitions should not be the only method to promote an increase in export goods.

A key instrument for promoting exports is through export discipline. This method has been used vigorously by the South Korea since the 1960s, whereby the government actively supports Korean business conglomerates with the condition that they concentrate on exporting goods.

Thus, the government uses state support, whether through subsidies or tax incentives, to promote the export of goods. The Georgian government should do similarly, using incentives such as subsidies, tax incentives, research and development benefits, and political support to reward companies that concentrate on exports and organise their production process in local regions.

If the government follows this path, it could kill several birds with one stone. First, companies would be forced to be competitive and efficient because they would be operating in international markets that require a high degree of competitiveness.

Second, the Georgian government would be able to use the development

of economically depressed regions as a pretext for granting subsidies to local enterprises, which would allow the country to avoid sanctions from the World Trade Organisation (WTO). This is a tactic used by numerous other countries as the WTO has banned blanket export subsidies.

Finally, the Georgian government would address the economic imbalances and underdevelopment of Georgia's depressed regions by incentivising firms to set up manufacturing facilities there.

A lack of political will

The tragedy of underdevelopment in capitalist societies is not an economic issue, it is a political one. The virtues of industrial policy are more or less known in academic and policy-making circles, but political elites in developing countries are often too weak, too corrupt, and prone to short-term thinking.

This short-term thinking is driven by interest groups who work on behalf of importers, big banks, and international vested interests to the detriment of the country. The key challenge for Georgian society, as well as for other developing nations, is how to create a political elite who will defend the economic interests of the many, rather than the wealthy few.

Economic development is not an easy task. In the last 200 years, only a couple dozen countries have achieved a high standard of living. Economic development is gradual; it is impossible to turn from a less-developed, agrarian economy into an industrial nation overnight.

Active industrial policy, however, can help challenge the modus operandi of importers, who are financed by banks and supported by international rentiers, and create a platform for local businesses to kickstart a more industrialised economy.

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