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Investor.ge Editorial: the Negative Economic Impact of the Foreign Influence Law

The Law on Foreign Influence has attracted considerable attention in Georgia on the basis that it will be damaging to Georgian NGOs and will undermine the country's democracy and Euro-Atlantic aspirations. Less has been said about the economic impact of this law, but those repercussions will also be negative – and severe.

In the short term, the possibility of the law's passing has impacted the tourism sector, the value of shares in Georgia's internationally listed companies, and it has put notable pressure on the Georgian lari.

Longer term, if the law is passed, it will reduce funding for economic support programs that have been critical to Georgia's economic growth, particularly its infrastructure development. By damaging the prospects for EU integration, it will undermine Georgia's long-term growth and employment prospects and could even lead to reversals, like the withdrawal of Georgia's EU visa-free travel or sanctions on Georgians. Finally, by signaling a rejection of its Western orientation, it will discourage Western investment and make Georgia more economically dependent on a highly problematic and volatile region.

Undermining Georgia's economic growth

As London premium-listed companies, Bank of Georgia and TBC's share prices probably reflect international investor sentiment towards Georgia more than anything else. The Law and what it portends has taken Bank of Georgia's share price from 5510 GBP per share at its peak on May 1 to 4015 GBP at the time of writing on May 27 – a 27% drop. TBC shares are currently 25% down.

As another bellwether of economic confidence, the Georgian lari has become extremely volatile. It lost up to 4% of its value in the days following the first reading of the foreign influence law. In response, the National Bank of Georgia's sold $60 million in reserves. This intervention is large by historic standards, and will probably be unsustainable in the medium term.

On top of this, at a recent press conference, AmCham, the EU-Georgia Business Council, the European Business Association, the German and French business associations, and several others all reported that this law was leading businesses to pause their investment plans and tourists to cancel their travel plans.

Negative impact on development financing

The first long-term impact of the law, will be on foreign economic development projects in a country where development financing is significant. According to the World Bank, net official development assistance was around $400 million in 2022. During Covid, the country received $1.1 billion. This number understates the actual amount of cash available as it only includes the subsidy element of loans. We can therefore say that development financing represents billions of dollars of available cash for government and other spending. This high accessibility of international financing is one of the reasons Georgia's economy made it through Covid relatively intact.

Development financing plays several critical roles. The biggest blocks of resources made available come from international financial institutions (IFIs) like the World Bank, the Asian Development Bank, and the EBRD. This takes the form of loans. However, these loans are made available to governments at far lower rates than would be possible through international markets. This makes possible infrastructure upgrades like the improvements to the East-West Highway; the rehabilitation of city infrastructure, including roads, lighting, and waste management; and, most recently, the upgrade of many Georgian schools.

Other development financing comes through aid agencies, like USAID, the EU, the German GIZ, and many others. This provides grants for a wide range of activities, including considerable financing for economic development. USAID, for example, has been working intensively to improve nut production, including helping with the eradication of the brown marmorated stink bug that nearly destroyed the hazelnut crop - one of the country's top agricultural products. They also have projects that work on tourism, IT, transport and logistics, wine production, investment promotion, and much more.

The Law on Foreign Influence could negatively impact these programs in several ways. If the impact of this legislation makes it harder for development partners to work in the country, it could create practical hurdles for project implementation.

More significantly, since many of these resources come from Western countries, continued harmful rhetoric and actions that undermine those partnerships are likely to reduce the level of assistance offered. As U.S. Secretary of State Antony Blinken recently stated, the passage of the law will trigger a "comprehensive review" of the U.S.-Georgia relationship, including economic support.

Damaging EU orientation

The biggest impact of this law will not be the withdrawal of donor money but a fundamentally negative shift in our relations with our partners in the West, including Western governments, investors, and citizens.

In terms of Western governments, the EU has already made clear that this law significantly reduces the likelihood of Georgia progressing on the EU membership path. As EU Ambassador Pawel Herczyński has clearly stated, this law is "incompatible with European norms and European values."

At the end of 2023 when Georgia gained EU candidate status, the country was unified in its enthusiasm for what that this would mean. From an economic point of view, this excitement was premised on the opportunity created by access to the 450 million person and $19.4 trillion EU market.

The opportunity that this presents is borne out by history. All EU candidate countries saw significant improvements in investment, trade, and growth during the build-up to EU membership - and in its immediate aftermath. This is significantly driven by increases in national and international business confidence that comes from integrating into the EU. As a developed economy, the EU market is not only very large but is incredibly stable and reliable with longstanding institutions to ensure that member countries apply rules consistently. This provides a certainty about the nature of a business environment that transcends any particular government, and so gives the level of confidence needed for long-term investments.

In the EU, for example, if a country passes legislation that violates EU law, it can be taken to the European Court of Justice and effectively forced to withdraw it. In this system, laws which will allow breaches of data protection or advantage one company over another are struck down by the court and cannot come into force.

To join this EU "club," a government therefore must demonstrate that it is prepared to follow these kinds of rules; the passage of the Law on Foreign Influence demonstrates the exact opposite. Don't follow the rules and you don't get to join the club. It's as simple as that.

This would be a historic missed opportunity. EU membership offers the greatest chance in a generation for improvements in Georgia's prosperity, security, and democracy. Missing out on that would undoubtedly leave us poorer and more vulnerable.

But the results could also be far more damaging. If Georgia is not part of the EU club, it may start to see other benefits of close EU association withdrawn. Beyond immediate financing of development projects, Georgia's biggest EU alignment perk is visa-free travel. This is hugely popular. It also brings significant economic benefits as it allows Georgians to come and go easily for work and the development of business relations in the EU.

Georgia has seen expansion in wine, agricultural products, and light manufacturing to the EU. It has also seen huge growth in employment within the business process outsourcing sector with EU companies. All of this is hugely helped by the ability of Georgian people and companies to easily go to the EU for marketing, training, and networking. Losing this benefit would be a huge blow to these growing businesses and to Georgian pride.

Signaling a rejection of Western orientation

If the West decides to sanction prominent Georgians who were involved in passing the law, the impact of this will not end with them. Financial institutions at home and abroad may be nervous to provide debt or equity to any company whose ownership is in any way uncertain in case it turns out that they have financed a sanctioned individual by accident. This could have a broad impact and will, at minimum, damage the country's reputation and risk profile.

A Georgia that does not head towards the West can expect to stop attracting investment from pro-Western sources, both at home and abroad. It might also see a national credit rating downgrade or negative assessments from the IMF, which would have other negative economic impacts.

The reduction of investments that AmCham members and other business associations have already reported in the last month reflect a concern about the direction of the country. The foreign influence law demonstrates a fundamental distrust in outside financing, no matter where it comes from or what it finances. The law does not distinguish friendly states from its foes or helpful action from the harmful. Worse than that, the rhetoric around the law has suggested that Western sources might be the most suspicious.

Business-people from the West or with strong ties to the West are reasonable to feel that their business investment might also be seen negatively by the state. This is extremely problematic for a country that has grown quickly, in part thanks to its strong ties with the West. From banking to tourism, to IT, to retail, the Georgian market-place has modernized thanks to partnerships between foreign expertise and local talent.

Disconnecting these ties would inevitably mean that Georgia would increasingly fall into the economic arena of Russia. This not only flies in the face of the EU aspirations of 80% of the population but would also undermine the corporate sector more broadly, since Russian finance tends to be based on patronage rather than legal due-process. Furthermore, it will make the country less secure as market access is used as a geopolitical weapon - a common feature of Russian statecraft.

Of course, in the end, the impact of the foreign influence law on the business environment cannot be disentangled from its impact on Georgia's democracy and international standing. Whichever way one looks at it, the law will make us less secure, less independent, and poorer. It should be withdrawn.