

SECTOR ASSESSMENT (SUMMARY): FINANCE¹

A. Sector Performance, Problems, and Opportunities

1. Since the deep recession that followed the twin crises in 2008 (the conflict with the Russian Federation and the global financial crisis), Georgia has witnessed a remarkable rebound. The impacts of the crisis on Georgia's finance sector were deleveraging and increased credit losses associated with a sharp contraction in lending to the private sector. Effective implementation of post-crisis measures contributed to the recovery, which began in early 2010. Measures included (i) improvement in information collected and distributed by the private credit bureau in Georgia; (ii) implementation of a central collateral registry with an online electronic database; (iii) amendment of its civil code to broaden the range of assets that can be used as collateral; (iv) improvement of the secured transactions system through an amendment to the civil code allowing a security interest to extend to the products, proceeds, and replacement of collateral; and (v) strengthening of the supervision and regulation of financial institutions by the National Bank of Georgia (NBG) through measures including the introduction of consolidated supervision and risk-based supervision. Banking regulation and supervision in Georgia is broadly in line with international standards, including those relating to governance and transparency. Georgia has a fully functional real-time gross settlements payment system, reserves management and accounting, and securities settlement software.

2. Georgia's finance sector is dominated by the banking sector. There are 21 commercial banks (with branch offices), 20 of which are foreign controlled. As of the end of 2013, the commercial banks accounted for more than 90% of financial system assets. The five largest banks accounted for more than 80% of total sector assets, while the top two banks—the Bank of Georgia and TBC Bank—accounted for more than 60% of banking sector assets. There is no deposit insurance. Other institutions operating in the financial market include 17 licensed credit unions (non-deposit-taking), 67 registered microfinance organizations, 41 registered money remittance units, 1,094 registered currency exchange bureaus, 14 insurance companies, 5 pension funds, the Georgia Stock Exchange, and the Georgia Central Securities Depository. There are seven brokerage companies. There are 3 listed companies and 130 non-listed companies admitted to Georgia Stock Exchange.

3. Georgia has limited access to long-term capital to finance growth. The securities market is at an early stage of development, and has narrow investor base and shallow market liquidity. Foreign direct investment (FDI) has declined since the crises, with the lack of confidence in the investment climate being a contributing factor. Savings mobilization is poor, because private pension funds are voluntary and underdeveloped. There is low insurance penetration. Noncontributory pensions constitute the largest social spending item in the state budget, accounting for 18% of public expenditure in 2013 and 4% of gross domestic product (GDP)—a cost that is likely to increase as the population ages. Micro, small, and medium-sized enterprises (MSMEs) are not reaching their economic potential because of weakness in the legal, regulatory, and institutional business environment, and inadequate levels of business management skills and financial literacy. Dollarization, at about two-thirds of loans and deposits, is a risk to the finance sector and poses induced risk to MSMEs and individual borrowers.

4. A resilient and stable finance sector and a supportive business environment for entrepreneurship development, job creation, and savings mobilization can have a positive impact

¹ This summary is based on ADB. 2013. *Technical Assistance for Financial Sector Development in Central and West Asia*. Manila.

on economic growth and poverty alleviation. Developing local currency finance can encourage the provision of long-term investment capital for the local economy. Restoring confidence in the financial system can contribute to household shifts from informal financial intermediaries to the formal financial system. Restoring business confidence and improving the business environment are critical for FDI recovery and enhanced, inclusive growth.

5. Developing the capital market can expand the contribution of the banking sector to economic growth and strengthen the nonbank finance sector to underpin domestic savings. Critical factors will be the development of the primary and secondary market for government securities, and corporate funding options for the (i) implementation of an effective and appropriate institutional structure to include securities market regulation, and legal, and accounting, and audit frameworks; (ii) cultivation of a benchmark debt issuance program; and (iii) expansion of the institutional investor base.

6. The deepening of the finance sector, especially the development of a vibrant domestic capital market, will also help fill the huge infrastructure gap in Georgia. Leveraging more private financing (e.g., through long-term financing and, in some cases, public–private partnerships [PPPs]) is important. Strengthening the government’s institutional arrangements and legal framework can facilitate private sector participation in infrastructure development through the use of PPP projects.

7. The growth of pensions and other savings can create an important additional source of investment, and strengthen the country’s social safety net. These long-term funds can be invested to stimulate the development of capital markets, especially interbank money markets and secondary debt markets, which is critical for domestic resource mobilization. Strong capital markets will be necessary to absorb pension inflows and generate reasonable returns. In the design of a new pension system it is also essential to take gender issues into account, as women are less likely to work in the formal sector, generally earn lower wages, and may perform other nonpaid labor such as caring for children and the elderly. The current pension eligibility age is 65 for men and 60 for women, and is paid to all citizens regardless of marital status.

8. MSMEs are an important source of employment in urban areas, and they can play a similar role in rural areas where about two-thirds of the workforce is employed.² MSMEs can be further developed through greater rural penetration of financial services and improved business development skills. Strengthening the legal, regulatory, and institutional framework for consumer protection and supporting innovative technology for mobile financial services can increase financial services outreach. Enhancing the legal, regulatory, and institutional framework for competition, MSMEs, PPPs, and priority sectors can contribute to an enabling environment for businesses to establish, grow, and expand. The business sector holds considerable potential to create more income-generating opportunities, in particular in the agricultural sector. Improving the investment climate to further strengthen investor confidence and foster sustained private-sector-led growth is also critical for the recovery of FDI.

B. Government’s Sector Strategy

9. The Socio-economic Development Strategy of Georgia (Georgia 2020), approved by the government in June 2014, establishes policy directions for sustainable and inclusive economic

² About two-thirds of the workforce is self-employed, predominantly in the agricultural sector, where most people are engaged in subsistence farming. The unemployed and self-employed account for about 70% of the country’s active workforce.

growth, macroeconomic stability and effective public administration, human capital development, access to finance, and private sector competitiveness.³ Labor code revisions passed by Parliament in June 2013 are expected to enhance workers' rights, including job security.

10. The government has increased social spending in 2014 (offset by reduced capital spending), however it plans to resume higher capital spending levels in 2015. Public investment, averaging 8% of GDP during 2009–2013, is among the highest in the region. In contrast, total social expenditure on pensions, health, and education is among the lowest averaging 11% of GDP during the same period. The government is spending an additional GEL800 million (3% of GDP) on an annualized basis to address high private health care costs, low quality of education, and household poverty and inequality. Reforms have included introducing a universal health care system, raising pensions, doubling targeted social assistance allowances, and expanding schools. Despite this increase in social expenditures, the authorities remain committed to fiscal consolidation and to meeting the 30% limit on spending introduced by the Economic Liberty Act from 2014 onward. While capital spending was reduced to meet these objectives, it remains broadly in line with comparator countries at above 6% of GDP. Given the limited fiscal space, the government is developing PPPs in infrastructure, and is looking into resolving issues on allocation of risk and managing government liabilities.

C. ADB Sector Experience and Assistance Program

11. The Asian Development Bank (ADB) has been active in providing loans and technical assistance (TA) for finance sector development in Georgia since it became a member in 2007. An emergency loan of \$70 million was provided following the 2008 war with the Russian Federation, and \$80 million was provided in quick-disbursing financial support to mitigate the adverse impact of the global financial crisis in 2009.⁴ In 2010, ADB provided a loan of \$100 million to support social services delivery. The assistance ensured continuity in maintaining critical public expenditures for social services delivery and social protection. Three nonsovereign loans have been provided to commercial banks (the Bank of Georgia and TBC Bank) totaling \$125 million to support lending to small and medium-sized enterprises.⁵ The loan to TBC Bank is dedicated to MSMEs operating in the regions outside the capital, Tbilisi. ADB has provided TA to (i) help restructure the NBG's supervision department, (ii) introduce a risk-based approach to regulation and supervision, (iii) strengthen its risk assessment capabilities, (iv) support the introduction of Basel II and III standards alongside capacity building of internal capital adequacy assessment programs at private banks and the NBG's capacity to supervise this process, (v) streamline TBC Bank's lending processes toward its MSME clients, and (vi) improve the business and financial literacy of MSMEs through TBC Bank's in-house training academy. ADB has also engaged in knowledge work in the pension sector.⁶ In June 2013, the NBG hosted a one-week regional training program on financial reporting and disclosure, under the Technical Assistance for Financial Sector Development in Central and West Asia Project.

³ Government of Georgia. 2014. *Socio-economic Development Strategy of Georgia (Georgia 2020)*. Tbilisi.

⁴ ADB. 2008. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to Georgia for the Emergency Assistance for Post-Conflict Recovery*. Manila; ADB. 2009. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to Georgia for the Growth Recovery Support Program*. Manila.

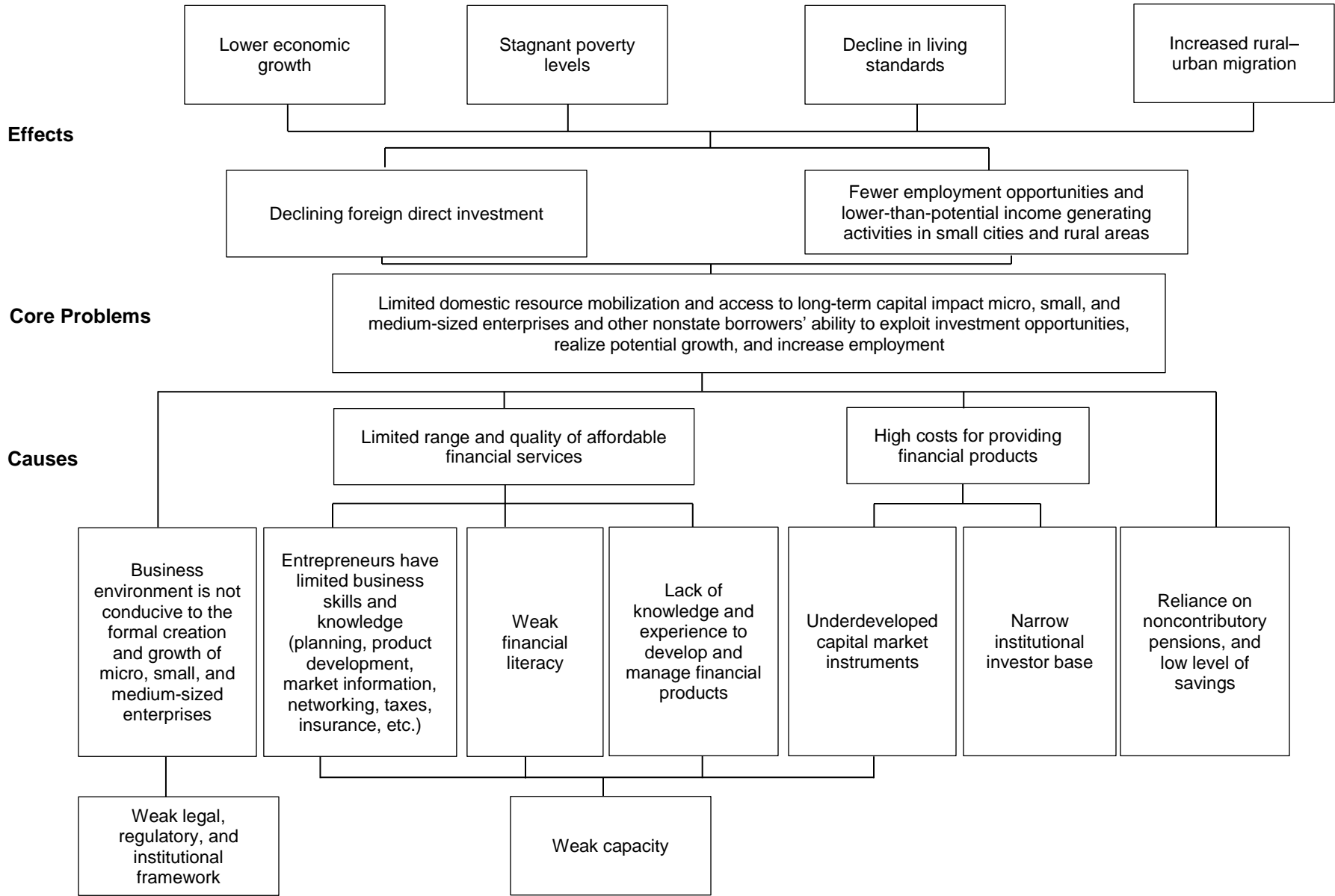
⁵ ADB. 2007. *Report and Recommendation of the President to the Board of Directors: Proposed Senior Loan to Joint Stock Commercial Bank of Georgia*. Manila; ADB. 2010. *Report and Recommendation of the President to the Board of Directors: Proposed Senior Loan to Joint-Stock Company Bank of Georgia*. Manila; ADB 2010, *Report and Recommendation of the President to the Board of Directors: Proposed Loan to Bank Republic Joint-Stock Company*. Manila; ADB. 2013. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to TBC Joint-Stock Company*. Manila.

⁶ ADB. 2011. *Pensions and Pension Reform in Georgia*. Manila.

12. ADB's planned support to Georgia's finance sector during the country partnership strategy, 2014–2018 continues ADB's ongoing assistance by focusing on enhancing the business environment, expanding economic opportunities through MSME development, and mobilizing savings. ADB nonsovereign assistance will particularly focus on providing finance to the underserved regions, and helping develop products to improve access to and use of finance for MSMEs. ADB efforts to enhance access to financial services will build on sector development and progress achieved to date in close coordination with development partners for a more viable, effective, and sustainable financial system. ADB will support private-sector-led inclusive economic growth through increased access to finance (and financial literacy) and business development opportunities for low-income groups, including women, particularly in small cities and rural areas. ADB TA projects will strengthen domestic resource mobilization focusing on capital markets, pension reforms, PPPs, and public debt management. ADB will support the government in setting up legal, regulatory, and institutional frameworks to facilitate the availability of long-term capital for productive business and infrastructure investments. The development of a pool of investible instruments to absorb pension contributions also necessitates the pairing of pension reform with capital market development.

13. International financial institutions and bilateral development partners are active in the finance sector. The World Bank Group focuses on, among others, a regulatory framework for payment systems; pensions; and finance sector advisory, including a potential deposit insurance scheme. The International Finance Corporation has supported housing and real estate finance, private equity funds, and corporate governance. The European Bank for Reconstruction and Development has financed initiatives to develop the local capital market, reduce dollarization, provide credit lines for local partner banks, support real estate and energy efficiency finance, and establish the Georgian Agriculture Financing Facility. The United States Agency for International Development supports leasing and access to finance for the agricultural and non-agricultural sectors and MSMEs, and housing refinance. The European Bank for Reconstruction and Development, the European Investment Bank, FMO—the Entrepreneurial Development Bank, the International Finance Corporation, and KfW (through DEG) are significant shareholders in the banking and microfinance system. KfW also provides assistance for SME development, agricultural insurance, and housing finance. The IMF supports macroeconomic and financial stability through standby arrangements, advises on tax administration, and has assessed the implementation of anti-money-laundering policy. ADB's strategic interventions will be closely aligned and coordinated with the activities of these key partners.

Problem Tree for Finance Sector in Georgia



Sector Results Framework (Finance, 2014–2018)

Country Sector Outcomes		Country Sector Outputs		ADB Sector Operations	
Outcomes with ADB Contribution	Indicators with Targets and Baselines	Outputs with ADB Contribution	Indicators with Incremental Targets	Planned and Ongoing ADB Interventions	Main Outputs Expected from ADB Interventions
<p>Nonbank finance sector provides increased levels of financial intermediation</p> <p>Increased use of efficient and reliable financial services by MSMEs</p>	<p>Domestic savings as percent of GDP increases to at least 22% by 2018 (2013 baseline: 12.3%)^a</p> <p>Access to financing through local equity markets rank improves to at least 100 by 2018 (2013 baseline: 126)^b</p> <p>Bank credit to GDP increases to at least 38% in 2018 (2013 baseline: 35%)^c</p>	<p>Insurance and contractual savings improved</p> <p>Financial system access improved</p>	<p>Number of participants in private pension schemes increases to at least 25,000 by 2018 (baseline 2012: 18,397)</p> <p>Number of depositors in commercial banks increases to at least 950 per 1,000 adults in 2018 (2012 baseline: 845 per 1,000 adults)^d</p>	<p>Planned key activity areas Finance sector development, money and capital markets, insurance and contractual savings, and small and medium-sized enterprise finance (100% of funds)</p> <p>Pipeline projects with estimated amounts Improving Domestic Resource Mobilization for Inclusive Growth Program, Subprograms 1, 2, and 3 (\$200 million)</p> <p>Development for Public–Private Partnerships (PATA, \$500,000) Development for Public–Private Partnerships 2 (PATA, \$500,000) Support for Financial Sector Supervision and Corporate Governance (S-CDTA, \$200,000) Support for Financial Inclusion (PATA, \$1.5 million)</p> <p>Nonsovereign financial Institution investments to support financial inclusion and literacy of MSMEs with particular focus on regions</p> <p>Ongoing projects with approved amounts Senior Loan to Bank of Georgia (\$50 million) Senior Loan to TBC Bank (\$50 million) Promoting Financial Sector Resilience (S-CDTA, \$150,000) Strengthening Domestic Resource Mobilization (PATA, \$500,000)</p>	<p>Planned key activity areas Strategy for pension reform completed</p> <p>Pipeline projects Strategy for capital market development completed</p> <p>Institutional capacity developed to support public–private partnership</p> <p>Ongoing projects Regional loan portfolio increased to more than 40% of gross loan portfolio^e</p> <p>Internal Capital Adequacy Assessment Program is integrated into strategic plans of commercial banks</p>

ADB = Asian Development Bank; CDTA = capacity development technical assistance; GDP = gross domestic product; GEL = Georgian lari; MSMEs = micro, small, and medium-sized enterprises; PATA = policy and advisory technical assistance; S-CDTA = small-scale capacity development technical assistance

^a Target is based on targets in Government of Georgia. 2014. *Socio-economic Development Strategy of Georgia (Georgia 2020)*. Tbilisi. Baseline data is drawn from National Statistics Office of Georgia. <http://www.geostat.ge> (accessed 4 November 2014).

^b Global Competitiveness Report ranking and ADB staff estimates.

^c National Bank of Georgia and ADB staff estimates.

^d World Bank. Country Statistics. <http://data.worldbank.org/country/georgia> and Asian Development staff estimates.

^e This relates to TBC Bank assistance.

Sources: ADB, Government of Georgia, and World Bank.