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BANK SYSTEM EVOLUTION IN GEORGIA

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The development of loan and banking relationship in Georgia has a multi-century history ("Ortaks" – in the 13th century), but the development of independent commercial banks structure takes roots in the 19th century by establishing the estate bank in Tbilisi.

For establishing the central bank in independent Democratic Republic of Georgia (1918-1921) were under consideration the German, French, Russian and other models which ended in 1919 by creating "The Georgian State Bank", though it was not liberated from the government pressure, was not formed two-tier bank system; the bank was not able to gain the right to pursue a monetary policy exclusively and so on. However, these principles were reflected in the independent bank system of post-Soviet Georgia which was formed in the middle period of the 90-es in the 20th century. That time there was adopted the law on the activities of commercial banks and the State National Bank that laid the foundation for completing the formation of two-tier independent bank system in Georgia.

The modern bank system of post-Soviet Georgia developed significantly; the commercial banks practically function by participation of foreign capital, though 3-4 banks dominate in credit market that sustains cartel deals – maintenance of high interest rates and development of other negative phenomena over the years.

Overall, the growth rates of the Georgian bank system in the post-Soviet period greatly exceed the growth rates of the country's economy, but for the development of economy's real sector it didn't turn out to be the stimulating effects due to extremely high interest rates. The share of agriculture and industry in the structure of commercial credits is insignificant, and the share of trade in it is high. Moreover, non-bank microfinance institutions didn't fulfill the effective role in the reduction of bank credits interest rates.

Keywords: Georgia, Bank system, Monetary policy.

Introduction

After the collapse of the Soviet Union, at the beginning of the 1990-ies, Georgia regained its independence. In Georgia, the destruction of the former Soviet economic system and the formation of new market relations were taking place in parallel with each other. A lot of confusion and chaos existed in the transitional period were directly related to the banking sector. Especially problematic turned out the timely creation of the comprehensive legal framework in the financial-banking sector.

In post-Soviet Georgia, the financial and banking legislative acts which were passed at the initial stage of the creation of financial system proved to be incomplete; a number of mistakes made by the Georgian Democratic Republic (1918-1921) in building banking system were not taken into account. However, in the mid-1990-ies there was created the legal basis of financial and banking relations which laid the foundation for the creation of two-tiered banking system in Georgia. Various scientific works are devoted to the research of the noted problems [1-39].

Introductory Remarks

In Georgia the best conditions for establishing trade and credit organizations were created yet in the 11th century. In the 12-13th centuries, the large credit and trade union – "ortak" (Association) was in operation in Georgia which with the goal of receiving benefit used to make loans on the basis of putting up real estate as collateral. The medieval Tbilisi's "ortaks" carried out large commercial operations, both inside and outside the country. They funded remote trade expeditions, establishment of feudal estates; also they were engaged in buying and selling of real estate.

At the beginning of the 19th century, in Georgia there was established the credit organization (since 1849 it had been under the name "Prikaz"), and in the 1980-ies there had been functioning about a hundred credit organizations. [1-3; 20-26; 30; 35-37].

The Land Bank which was established in Tbilisi in 1875 under the leadership of Ilia Chavchavadze (1834-1907), the outstanding Georgian writer and public figure, was a landmark on the way to building an independent bank. A significant part of the bank's profit was spent on public affairs in the form of charity. Ilia Chavchavadze led the bank's board for about three decades. [1-2; 30; 35].

On May 26, 1918, in Georgia, upon the restoration of independence, the government decided to establish a central bank.

During this period, there were functioning the Caucasus commercial bank, Transcaucasia's joint-stock bank, Tbilisi and Kutaisi land banks, several credit organizations and several Russian banks' branches. [2; 31].

Unfortunately, the legislative body of the Democratic Republic of Georgia failed to pass the law in time on the central bank presented by the government. Long discussions were on what principles should be based the new bank.

As it turned out, the draft of regulations of the Georgian state bank was based on the Russian bank regulations, but with a number of differences: the Russian State Bank was under the control of government, and the Georgian state bank – under the control of the legislative body; the Russian state bank was led by the official who was appointed the tsar, and the Georgian state bank was governed by the board of the bank and the supervisors council. [2; 31].

On December 31, 1919, was adopted the Law "on establishing the state bank." This law defined the goal, structure, fixed capital and functions, ruling bodies – boards and council of the organ regulating the country's banking system and carrying out a national monetary policy. [2; 31].

Overall, the basic principles of banking legislation adopted in that period responded to the challenges of that time (independence from government, a two-level system of governance, the right to exclusive conduction of money emission and monetary policy…). However, due to delays in the adoption of banking laws and other unsolved organizational issues in a timely manner, the "Georgian State Bank" came into operation later – from the second half of 1920.

Notwithstanding the foregoing, the noted bank did a lot of useful work for the country: carried out currency reform, created considerable foreign currency reserves, withdrew the bonds of the Transcaucasian commissariat from circulation, started preparatory works for the creation of the Georgian national currency; its sketch was made by the artist Josif Charlemagne (1880-1957). The national currency was called "Marchili" which was the common monetary unit in Georgia in the 16th century. (It is known that the donation of "Marchili" coins by the Georgian aristocracy to the Monastery of Cross in Jerusalem is mentioned in the Monastery's "Chronicle of Spirits"). [2, 31].

As a result of the violent establishment of the Soviet system in Georgia (February 25, 1921), the Georgian State Bank ceased to exist. Subsequently, the banking activities continued within the border of the Soviet Union: the central bank functions were performed by "the Peoples" Bank of the Georgian Soviet Socialist Republic which represented one of the branches of the state bank founded in Russia in

October 1921. [2, 31]. Its sphere of activity was significantly reduced as the widespread commanding administrative system no longer considered banks' independent sphere.

It lasted until the beginning of the 90-ies of the last century, when Georgia regained its independence.

Independent Two-level Banking System in Post-Soviet Georgia

The national bank in independent post-Soviet Georgia was established at the beginning of the 90-ies, after the dissolution of the Soviet Union (1991). In the mid-90-ies, former state commercial banks were privatized. In this period the banking legislation did not meet the time requirements. In particular, the national (central) bank's independence was not definite which would exclude an undesirable interference by executive and legislative authorities in its activities; at the same time, in the conditions of the absence of legislative authority, important issues of monetary regulations were solved by the head of the executive authorities ... [2; 31].

The above and others problems were regulated and solved by the laws "On the National Bank" (1995) and "commercial banks" (1996). The first determined the rights and obligations of the National Bank, rules of operation and guarantee of independence. In addition, it granted the central bank independence in carrying out monetary policy. As a result, there was formed a two-level banking system. [2; 7-24; 31].

Modern Banking Sector

Currently, in the Georgian financial sector operates: 19 commercial banks, among them 18 banks operate with foreign capital participation, 1 - non-resident bank branch; 69 microfinance organizations and others. (Table 1).

Table 1. Commercial banks: financial sector institutions (end of period)

	2011	**2015**	**2013**	**2014**	**2015**
Commercial Banks, total	19	19	21	21	19
Among them:					
With Participation of foreign capital	18	17	20	19	18
Per 100 000 people	0.43	0.42	0.47	0.47	0.51
Branches	144	142	164	168	125
Service centers	564	691	739	796	827
Commercial banks					
Declared fixed fund, thousand Lari	915583	909,167	1,053,978	1,157,712	1,070,222
Joint-stock capital	2104361	2,390,064	2,916,232	3,586,798	3,512,735
Currency exchange offices (licensed)	1500	1,029	1,089	1,116	1,161
Per 100 000 people	33.56	22.88	24.29	24.85	31.13
Non-bank depository institutions, unit	18	18	17	17	15
Microfinance institutions (licensed)	62	62	67	70	69
Stock exchanges, unit	1	1	1	1	1
Insurance companies (current), unit	15	15	14	16	14
Pension schemes, unit	7	6	5	5	5

https://www.nbg.gov.ge/uploads/publications/bulletinstatistics/statbiul/2013/bullettin2015_geo_opt.pdf

The volume of the total assets of commercial banks in the period of 2012-2015 increased 1.8 times. (Figure 1).

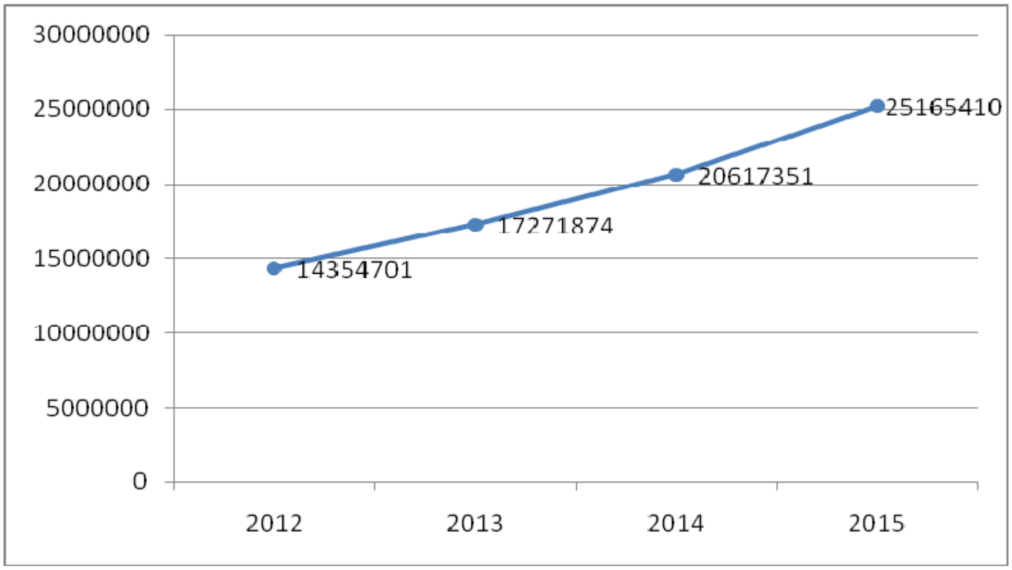


Figure 1. Dynamics of the total assets and liabilities of the commercial banks (by the end of the year, thousand lari) https://www.nbg.gov.ge/index.php?m=304

The banking sector's total loan portfolio reached 16 billion lari by the end of last year, which is 1.8 times more than the same indicators of 2012. [Figure 2]. Unfortunately, in the total loans the share of the real sector, especially – the percentage share of the loans made to agriculture is minimal. Microfinance organizations are still weak: their total assets amounted to just 1.8 billion lari (2nd quarter, 2015.). In recent period, the two largest banks: JSC “Bank of Georgia” and JSC “TBC Bank” placed their shares at the London Stock Exchange (LSE) that will promote the international integration of the banking system.

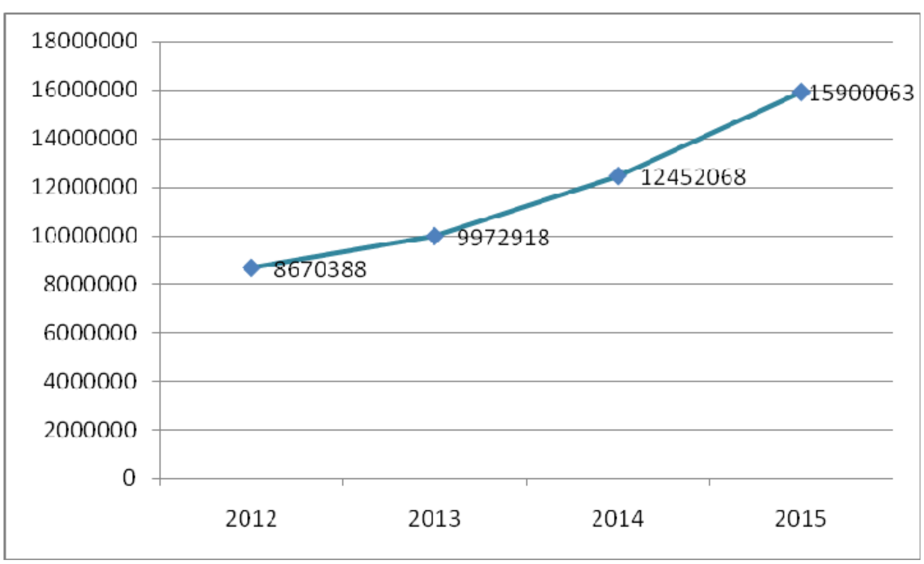
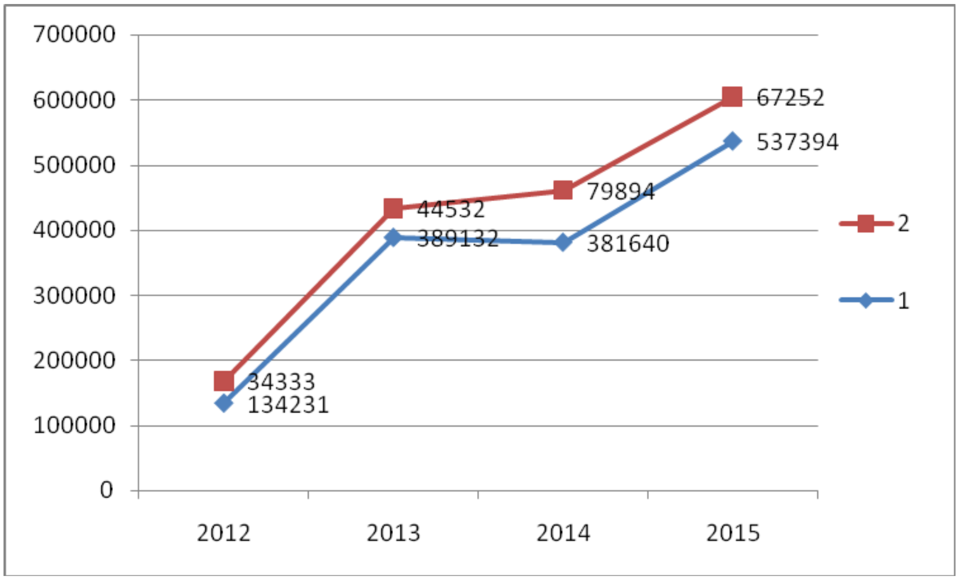


Figure 2. The volume of loans made by commercial banks (by the end of the year, thousand lari) https://www.nbg.gov.ge/index.php?m=30 28.06.2016.

Over the years the "expensive loans" did not encourage economic development. High interest rates on bank loans were reduced in the last period but currently they still remain high and made up an average of 15%, in the national currency – 21%, and in foreign currency – 10%. In this light, the net profit of the commercial banks increased sharply and in 2015 it was four times more than the same indicator in 2012. (Figure 3).



1 – Net Profit
2 – Profit tax

Figure 3. Net profit of the commercial banks and budget taxes, 2012-2015. (thousand lari) https://www.nbg.gov.ge/index.php?m=304 28.06.2016.

The data from Figure 3 indicate also "low-preferential" terms of taxes for banks.

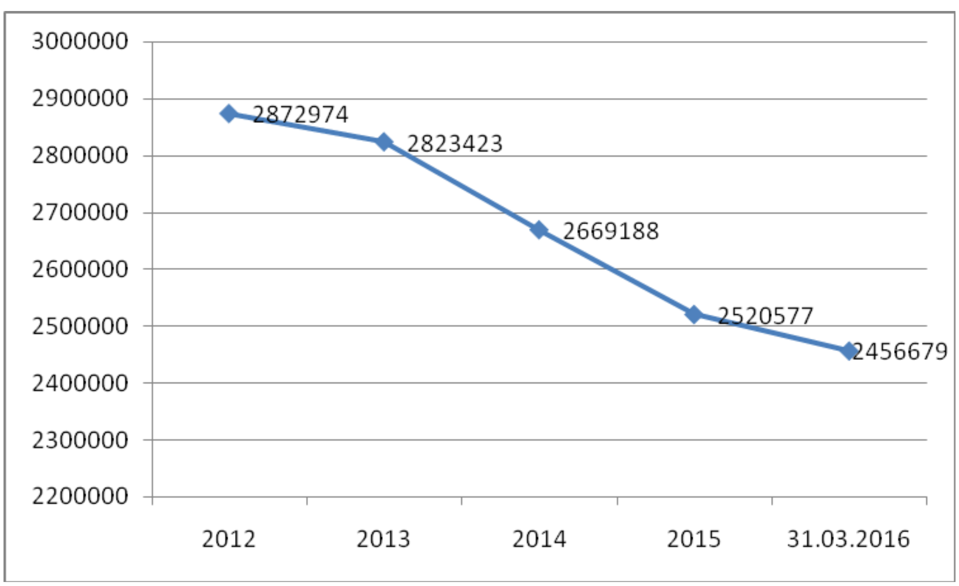


Figure 4. Gross international reserves, thousands of US dollars https://www.nbg.gov.ge/index.php?m=304 28.06.2016.

Since the end of 2014 the national currency – lari has depreciated quickly. In 2014, the net international reserves decreased slightly, out of which, 100 million US dollar was provided to exchange market through foreign exchange interventions. At the end of 2015 the gross international reserves exceeded 2.5 billion US dollars, in early 2016 (03.2016) they amounted to approximately 2.2 billion US dollars. It can be said that in the conditions of heavy depreciation the international reserves were held, but if they had been used in a timely manner, the national currency would not have been depreciated in the vicinity of 40%. (Figure 4).

Conclusion

Georgia's financial and credit relationships have a long history:

- A large loan and trade association was established yet in the 11th century;
- Banking structures were formed in the 19th century;
- A solid foundation was laid for the creation of the independent banking system in 1918-1921;
- The building of independent banking system stopped by the violent "Sovietization" (1921);
- The privatization of the former state commercial banks and the adoption of banking legislation which laid foundation for the creation of two-level independent banking system (National Bank; commercial banks) in Georgia, were carried out in the mid-90-ies of the 20th century;
- In Georgia the banking sector is one of the most successful and developing sectors, which is deeply integrated into the global space.

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