EVOLUTIONARY ASPECTS OF THE GEORGIAN BANKING SYSTEM

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Abstract
Georgian monetary relations have a centuries-old history. Credit associations were first founded in 11-13th centuries. Network of credit institutions became larger in the 19th century – independent commercial banks were established in the second half of the 19th century. Central State Bank of Georgia was established in the Democratic Republic of Georgia in the beginning of the 20th century. At the same time, there were efforts to create independent two-level banking system, although those efforts failed due to forceful sovietization of Georgia. But still, independent banking system was founded in Georgia after the collapse of the former Soviet Union. This work examines afore-mentioned evolutionary processes and some of peculiarities of modern banking system. The research shows that modern Georgian banking system is growing fast but it contains signs of oligopoly which contradicts the interests of vast masses of population and entrepreneurial development, while stimulating retaining of high interest rates and devaluation of national currency.

Keywords: *Democratic Republic of Georgia, Post-Soviet Economy, Banking System, Bank.*

JEL Classification: *E 42, E 50, E58, E59*

I. INTRODUCTION

After the collapse of the Soviet Union, in the beginning of the 1990s, Georgia regained its independence. Destruction of former Soviet economic system and development of new market relations took place simultaneously in Georgia. In the transitory period, a lot of problems were linked to Georgian banking sector – unjustified monetary policy. It was especially problematic to timely create proper legal base for banking sphere. Financial-banking legislative and statutory acts adopted in the first phase of development of the post-Soviet Georgian financial system proved to be inefficient: a number of mistakes made during building of banking system in the Democratic Republic of Georgia (1918-1921) were still not taken into account. Legal base of financial-banking relations adopted in the 1990s served as a foundation for Georgian two-level banking system. Numerous scientists dedicated their works to the research of this problem (1-42).

II. BASICS

Trade and credit organizations started to develop in Georgia in the 11th century. In the 12-13th century, a large-scale credit-trade association (Ortaghi) was functioning in Georgia which for the purpose of gaining profit gave real estate loans. Later, in medieval Tbilisi, Ortaghis were involved in large-scale trade operations on a national and foreign level. Namely, they sponsored distant trade operations, arrangement of feudal estates, dealt with real estate trade, etc. In this light, 19th century was especially distinguished because social care credit organization was established (Transcaucasia's Prikaz from 1849) while in the 1880s there were up to one hundred credit institutions functioning. (Atanelishvili 2006, 2013; Silagadze, 2005, 2010; Silagadze, Atanelishvili, 2010; Silagadze, N., 2010, 2011; Gogokhia, 2008; Kandelaki, 1935,1960; Mikhanashvili, 2006; Tsaava, 2005; Силагадзе, 2010; Силагадзе and Атанелишвили, 2010).

The Nobility Bank (1875) established by an outstanding Georgian writer and public figure Ilia Tchavtchavadze (1834-1907) played a vital role in the development of independent banking system. Significant part of the Bank's profit was used for charity purposes - to finance social causes. Ilia Tchavtchavadze chaired the Bank Board for about thirty years. (Atanelishvili, 2006, 2013; Silagadze, 2010, 2011; Silagadze and Atanelishvili, 2010; Silagadze, N., 2010, 2011).

28 May 1918, two days after the restoration of independence of Georgia on 26 May 1918, the government decided to found a central bank. At that time, the following banks were functioning in Georgia: Commercial Bank of Caucasus, Shareholders Bank of Transcaucasia, Tbilisi and Kutaisi Nobility Banks, different credit organizations, branches of some Russian banks. (Atanelishvili, 2006, 2013; Silagadze, 2010; Silagadze, Atanelishvili, 2010; Silagadze, N., 2010, 2011); Tsaava, 2005; Kokiauri, 2004).

Legislative organ of the Democratic Republic of Georgia could not adopt a draft law about state central bank in time submitted by the government. Principles of a new bank were long discussed. As it turns out, the charter of the Central Bank of Russia served as a foundation for the draft charter of the State Bank of Georgia but it had some differences: Russia's State Bank was subordinated to the government while Georgian State Bank to a legislative body. The Russian State Bank was managed by a head appointed by the Tsar, while the Georgian State Bank was managed by an administrative body and a supervisory board. (Atanelishvili, 2006; Silagadze, N., 2010, 2011).

The law on State Bank of Georgia adopted on 31 December 1919 determined purpose, structure, authorized capital, functions and management organs – administration and board of a body implementing national monetary policy and regulating country's banking system. (Atanelishvili, 2006; Silagadze, N., 2010, 2011).

The main principles of the banking legislation adopted during the independence of Georgia was relevant to the challenges of that time (independence from government, two-level management system, right to exclusively implement money emission and monetary policy…), but they were in force for a short period of time.

As the banking legislation was adopted later and other organizational issues were not solved in time, the State Bank of Georgia started functioning only in the second half of 1920. The Bank managed to do lots of helpful things for the country: it implemented money reform, created considerable reserves of foreign currencies, withdrew from circulation bonds of Trans-Caucasian commissariat, started preparatory works for creating Georgian national currency unit (banknote design was developed by an artist Iosif Charlemagne (1880-1957)). Marchili – term denoting a monetary unit spread in Georgia from the 16th century was chosen as a name of the national currency. (It is known that Chronicles of Spirits of Jerusalem Jvari Monastery contain information on Marchili amounts given for charity by Georgian nobility). (Atanelishvili, 2006; Silagadze, N., 2010, 2011; Javakhishvili, 1996; Jgerenaia, 2000).

After forceful sovietization of Georgia (25 February 1921), the State Bank of Georgia was closed. Afterwards, banking business was conducted within the scales of the uniform Soviet Union. For almost 70 years, the functions of central bank were performed by the People's Bank of Soviet Socialistic Republic of Georgia which was one of the branches of the State Bank founded in Russia in October, 1921. (Atanelishvili, 2006). In this period, imperative-administrative system did not provide for independence of the banking system. This lasted until the beginning of the 1990s, when Georgia regained its independence after the collapse of the Soviet Union.

III. TWO-LEVEL BANKING SYSTEM

After the collapse of the former Soviet Union, National Bank was founded in the independent post-Soviet Georgia (1991). Banking legislation of that time was incomplete and did not respond to the requirements of those times. Namely, independence of national (central) bank was not established that would rule out undesired interference of executive and legislative powers in its activities, important issues of monetary regulation were solved by the head of executive authority. (Silagadze and Gelashvili, 2009; Silagadze and Tokmazishvili, 2008, 2009; Силагадзе, 2011, 2012; Силагадзе and Атанелишвили, 2014).

Former state-commercial banks were privatized in the middle of the 1990s. Before that, the country faced severe crisis caused by irresponsible monetary policy. (Papava, 2013; Silagadze, 2011, 2013).

The above-mentioned problems as well as some other problems were regulated by the laws on the National Bank of Georgia (1995) and the Commercial Banks (1996). The first one explicitly defined rights and obligations of the bank, its business activities and guarantee for independence. Therefore, the central bank was granted full independence in implementing monetary and currency policy. The two laws served as a foundation for two-level banking system in Georgia. (Atanelishvili, 2006, 2013; Basilia and Silagadze, Chikvaidze, 2001; Silagadze, N., 2010, 2011).

IV. CURRENT ASPECTS

According to the applicable laws of Georgia, the National Bank controls target inflation rate, and influences the currency exchange rate via monetary mechanisms. Unfortunately, Georgian national currency - lari has sharply devaluated against US dollar from 1.7675 (21.11.2014) to 2.4892 (08.02.2016) (Geostat. ge 10.02.2016) during last two years. The country has been facing monetary crisis and the situation is still graving. We think that the National Bank did not use available mechanisms to avoid the devaluation of national currency, including part of international reserves which composed 2.5 billion US dollars in total (27 billion US dollars at the end of 2014) (42). Failure to use international reserves to stop devaluation resulted in Lari's devaluation in Georgia and accelerated currency crisis.

Besides the National Bank of Georgia, 19 commercial banks were functioning in Georgia at the end of 2015. 18 out of 19 banks had foreign capital, while 1 bank is a branch of a non-resident bank. Total volume of assets of commercial banks increased by 18% in 2012-2015 and exceeded 25 billion US Dollars (Pictogram 1).

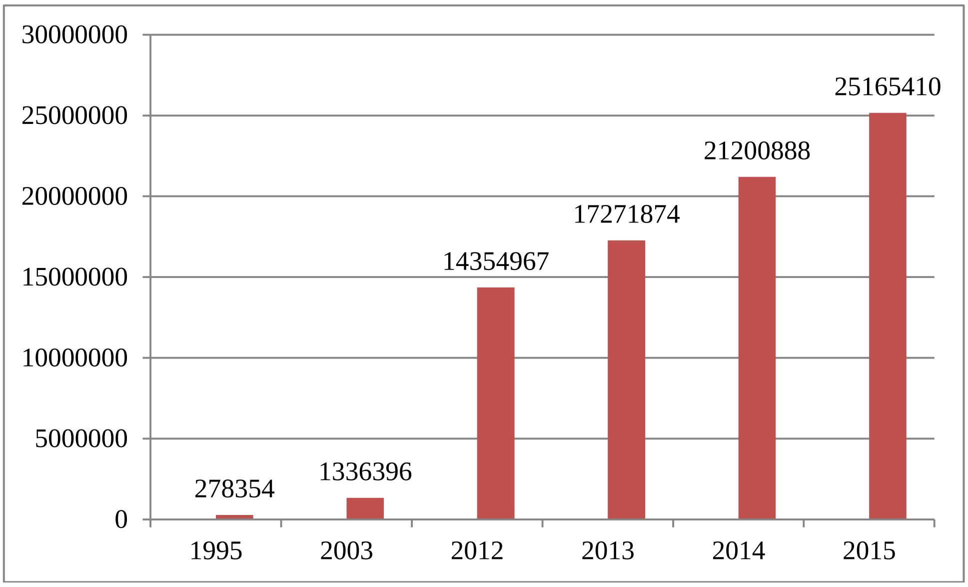

Figure 1: Dynamics of total assets of commercial banks (at the end of year, tens of Laris)
https://www.nbg.gov.ge/index.php?m=304 10.02.2016.

The following commercial banks are leading the banking sector with their total assets: Bank of Georgia, TBC bank, Liberty Bank, Bank Republic and VTB Bank. They hold dominating positions on the credit market which makes a dangerous chance of cartel with regard to establishment of interest rate levels. It is not accidental that Georgian banking system has been separated for some extent from real economic sector due to high interest rates on loans. The situation has improved to some extent recently, but the problem still remains: market interest rate on loans has averagely decreased from 18.6 % in 2012 (December) to just 15.4 % in October, 2015. Interest rate on deposits decreased too from 8.5% to 5.1% (41; 42).

Thus, interest rate on deposits and loans is quite high which makes banks' profit larger and hinders economic development of the country.

Introduction of Georgian banking system to international banking sector will promote sales of shares of commercial banks on international stock markets. For example, shares of two largest Georgian banks - Bank of Georgia JSC and TBC Bank JSC has been traded at London Stock Exchange. Tax relief packages has been developed for such banks.

Total credit portfolio of Georgian banking sector reached 16 billion Laris at the end of 2015, which exceeds by 1.84 the same index of 2012 (Figure 1).

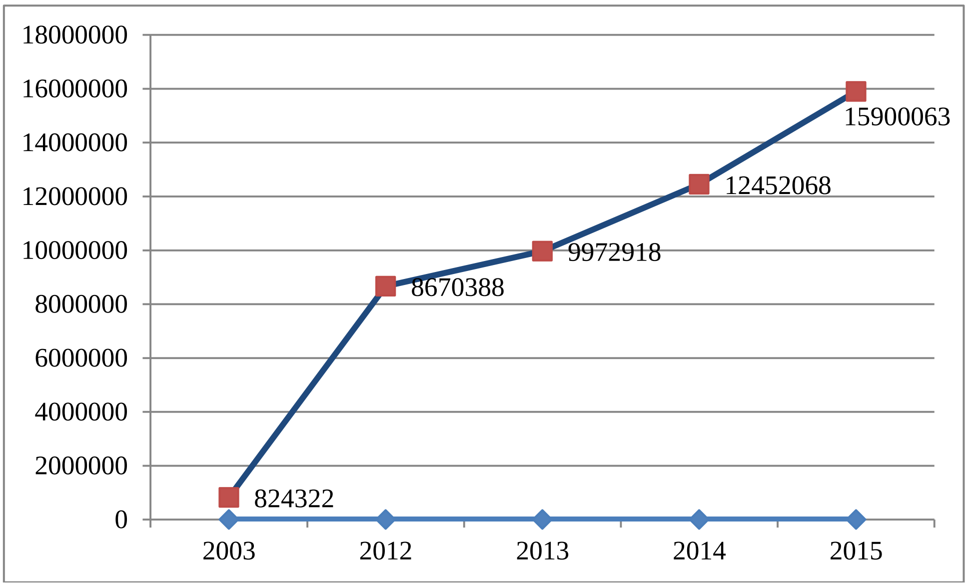

Figure 2: Volume of loans given by commercial banks (at the end of year, tens of Laris)
https://www.nbg.gov.ge/index.php?m=304 10.02.2016.

In 2015, compared to 2012, total credit portfolio of commercial banks for national economy increased by 1.8, including (01.12.2015):

- consumer loans – 16.9%

- real estate loans 0 58.27%
- agricultural loans – 2.54%. (2012 = 0.67)

It is evident that scarce crediting and high interest rates caused problems for population with low income, and real sector. Namely:

1. Average interest rates on consumer loans are too high (17-21 % in national currency and 10-14 % in foreign currency);
2. Commercial banks accept real state under mortgage for about 1/3 of the market price of the real estate. Most of them are residential flats and tens of thousands of people were left, or they face the danger of being left without homes due to failure to pay loans;
3. Agricultural sector of Georgia, which has big potential of success, has been financed minimally leading to its critically small portion in GDP.

Commercial banks face new challenges, too. They often get low-interest foreign loans. Consequently, foreign debt of the banking sector composes 28 billion US dollars, 835 million US dollars of which are to be paid immediately. (41). In this light, the following financial indices of banks with foreign debts have increased: assets – by 1.8, earnings – by 1.1, net profit – by 4.0, expenses- by 1.5 (Table 1); percentage ratio of expenditures in earnings (Figure 2).

Table 1. Financial indices of commercial banks activities (thousands of Laris)

	Revenue	Interest earnings	Expenditures	Net profit/loss(-)
Jan.-Dec. 12	2 143 095	1 502 461	1 964 504	134 231
Jan.-Dec. 13	2 424 246	1 634 429	1 987 281	389 132
Jan.-Dec. 14	2 685 930	1 763 121	2 124 599	474 808
Jan.-Dec. 15	3 454 460	2 196 920	2 834 300	537 394

https://www.nbg.gov.ge/index.php?m=304 08.02/2016

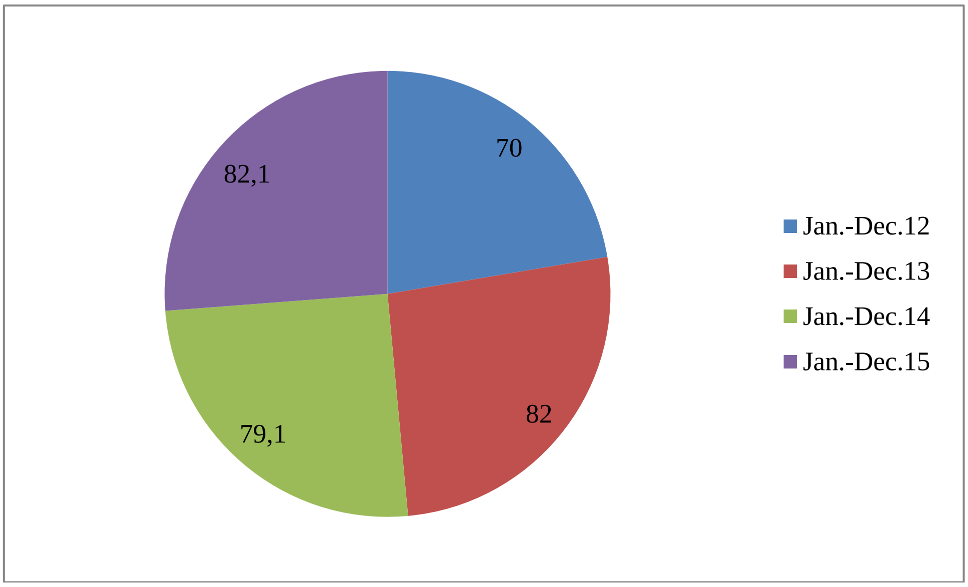

Figure 3: Portion of expenses in earnings of commercial banks (%)
Calculated based on: https://www.nbg.gov.ge/index.php?m=304 10.02.2016.

In general, modern banking sector of Georgia is dominated by overdue loans, foreign debts, high interest rates stimulated by high percentage of expenditures in banking revenue, which on its turn is often caused by ungounded growth of salaries and bonuses of high-level bank managers'; defects of the bankng system have adequately been reflected in the development of national economy and business. (Aziri and Nedelea, 2013; *TVALCHRELIDZE AND SILAGADZE, 2011, 2016; SILAGADZE AND ZUBIASHVILI, 2015, 2016).*

V. CONCLUSION

The centuries-long history of Georgian monetary relations has shown the following facts:
a) Institutions were founded in the 19th century;
b) Firm foundation was laid to the creation of an independent banking system in 1918-1921;
c) Independent banking system ceased functioning from the day of Georgia's sovietization (1921);
d) Two-level banking system was firmly established in the middle of the 1990s;
e) Banking system of post-Soviet Georgia has been developing fast but it contains some signs of oligopoly which is dangerous and hiders well-being of population, business development, and serves as an incentive for retaining

high interest rates and devaluation of national currency.

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