ECONOMIC TRANSFORMATION IN THE CAUCASUS – GEORGIA'S ROLE IN FINANCIAL SYSTEM

Giorgi TURAZASHVILI
University of Georgia, Tbilisi, Georgia
Giorgiturazashvili@gmail.com

Nino DAVITAIA
University of Georgia, Tbilisi, Georgia
Nino_Davitaya@yahoo.com

Abstract
Historically, the Caucasus region has constituted a critical nexus of trade routes and strategic interests nevertheless, for centuries, persistent political instability and economic isolation have impeded the full realization of its economic potential. The legacy of the Soviet system, coupled with the political disintegration that followed in the post-1990s era, has profoundly shaped the region's economic structures. In the case of Georgia, the transition from a centrally planned economy to a market-based system introduced substantial challenges, necessitating deep structural adjustments and comprehensive reforms, a process that continues to be of critical relevance and urgency today. At the present stage, despite numerous challenges and obstacles, Georgia is perceived as an economically liberal and investment-attractive country, striving to establish itself as a financial hub within the Black Sea region. The country's macroeconomic indicators, fiscal policies, and a stable banking sector contribute to its growing and increasingly significant role in both regional markets and the broader international financial system and networks. The present research conducts a comprehensive analysis of Georgia's role in the economic transformation of the Caucasus region from a historical perspective to the contemporary era. It does systematically explore the fundamental drivers that enabled Georgia to overcome economic crises and progressively integrate into regional and global financial markets. Special focus is placed on the structural reforms undertaken during the 2000s, notably the strengthening of the financial sector, the enhancement of the business climate, the modernization of the banking system, and the negotiation and signing of international trade agreements. The study makes particular emphasis on Georgia's participation in multilateral economic platforms and its efforts to deepen ties with the European Union, emerging and developed economies of Asia, and global investment markets. Regarding future prospects, the study highlights both the opportunities and challenges facing Georgia. It examines the critical areas necessary for the development of the country's financial markets, emphasizing the need for deeper economic diversification, the integration of technological innovations, and the enhancement and effective utilization of labor productivity. These measures are essential for Georgia to maintain its competitiveness and to secure a significant and leading position within the global economic system. The paper also underscores the importance of addressing geopolitical risks, as well as challenges related to energy security and state stability, all of which exert a considerable influence on the country's future economic development. In conclusion, Georgia's historical trajectory, contemporary accomplishments, and forward-looking strategic planning collectively pave the way for the country to position itself as a leading economic center in the Caucasus region and to expand its influence within both regional and global financial markets.

Keywords: Caucasus economic transformation, Georgian financial markets, Regional economic integration, Capital market development, Structural reforms.

Business Excellence and Management
Volume 15 Issue 4 / December 2025

DOI: https://doi.org/10.24818/beman/2025.15.4-07

1. INTRODUCTION

The South Caucasus, strategically located at the crossroads of Europe and Asia, has historically served as a vital bridge between diverse civilizations and markets. Despite this advantageous geographical position, the region has long struggled with political instability, fragmented governance, and economic underdevelopment, particularly in the aftermath of the Soviet Union's dissolution. Among the three South Caucasus states, Georgia has emerged over the last two decades as a leading reformer, striving to reposition itself as a dynamic participant in regional and global economic systems.

Georgia's transition from a centrally planned economy to a liberal, market-oriented system has been both turbulent and transformative. The country faced severe economic contraction in the 1990s, hyperinflation, institutional collapse, and social hardship. Nevertheless, in the early 2000s, Georgia initiated a wave of ambitious structural reforms aimed at liberalizing the economy, strengthening institutions, and attracting foreign investment. These reforms laid the foundation for Georgia's current economic identity as an open, business-friendly, and fiscally disciplined state.

This paper aims to provide a comprehensive overview of Georgia's role in the economic transformation of the Caucasus region. By analyzing key historical developments, core structural reforms, and the country's engagement with global financial markets, this paper seeks to assess the extent to which Georgia has contributed to regional economic integration and positioned itself as a potential financial hub in the Black Sea basin. The analytical framework of this study is grounded in institutional economics and regional development theory, which explain how institutional reform and market integration contribute to economic transformation in transition economies. The paper adopts a qualitative-descriptive approach, supported by empirical indicators drawn from institutional and macroeconomic sources, including the World Bank, IMF, and the National Bank of Georgia. This framework allows for assessing the evolution of Georgia's financial sector not only as a national reform case but also as part of a broader regional transformation process. Furthermore, by applying comparative insights from Armenia and Azerbaijan, the study seeks to highlight Georgia's relative progress in financial liberalization and institutional capacity-building.

2. LITERATURE REVIEW

The literature on financial development in transition and emerging economies provides a rich analytical foundation for understanding Georgia's evolving financial landscape. Institutional theorists such as North (1990) emphasize that durable economic transformation requires not only market liberalization but the consolidation of credible institutions capable of enforcing property rights and ensuring regulatory predictability. Building upon this premise, Beck and Laeven (2006) demonstrate that the depth and efficiency of financial systems in post-socialist countries depend critically on institutional maturity and the consistency of policy reforms.

More recent studies have refined this discussion by examining the internal composition of financial structures. Xu (2021) highlights that economies with bank-dominated systems often experience constrained capital allocation and limited innovation in non-bank intermediation. This pattern resonates with Georgia's case, where despite strong banking stability, the capital market remains shallow, and institutional investors are only beginning to emerge.

Empirical reports from international organizations reinforce these scholarly perspectives. The World Bank (2022; 2023) and IMF (2024; 2025) underscore that the next stage of Georgia's economic advancement requires strengthening domestic bond markets, improving market supervision, and fostering financial inclusion. According to the National Bank of Georgia (2025), the policy focus has shifted toward building macro-financial resilience and maintaining price stability while advancing digitalization and sustainable finance initiatives.

Private-sector analyses deepen this narrative. TBC Capital (2024) and Long (2024) reveal that Georgia's capital market, though still nascent, demonstrates rising investor interest driven by pension reforms, ESG-linked bonds, and expanding regulatory transparency. These insights align with global trends identified in the broader literature, which associates market depth with institutional confidence and transparent disclosure practices.

A growing stream of research links financial innovation to sustainable growth. Zhang and Li (2024) find that digital finance significantly enhances inclusiveness and economic sustainability across developing economies. In Georgia, the integration of fintech solutions, digital trading systems, and modernized settlement platforms mirrors this global shift, suggesting that technology can serve as both a driver and equalizer of financial modernization.

Synthesizing these contributions, the specialized literature converges on three interdependent pillars of sustainable financial development: institutional credibility, market diversification, and technological integration. Yet, the comparative evidence for small transition economies—such as Georgia, Moldova, and Armenia—remains limited. This study therefore positions Georgia's financial evolution within this specialized scholarly context, aiming to bridge the empirical gap between institutional transformation and digital-era financial innovation.

3. HISTORICAL BACKGROUND AND ECONOMIC TRANSITION

Following the collapse of the Soviet Union in 1991, Georgia inherited an economic system that was heavily centralized, structurally inefficient, and closely tied to the former Soviet republics through interdependent trade and production chains. The abrupt disintegration of these economic linkages triggered a deep economic crisis characterized by GDP contraction, hyperinflation, high unemployment, and a collapse of industrial output.

The 1990s were marked by severe economic instability and institutional fragility. The country faced significant obstacles in building the foundational frameworks required for a market economy, including property rights enforcement, regulatory mechanisms, and financial infrastructure. The absence of functional institutions, coupled with political and social unrest, led to the rapid expansion of informal economic activity, a decline in state revenues, and deterioration in the delivery of public services.

Initial attempts at liberalization were fragmented and largely ineffective in reversing the downturn. Progress in stabilizing the macroeconomic environment remained slow, and the transition from a command economy to a market-based system continued to face structural bottlenecks. However, the early 2000s marked the beginning of a new phase, characterized by accelerated efforts to modernize the economic framework, strengthen institutions, and reduce administrative barriers to business activity.

A series of broad-based reforms were introduced to liberalize the economy, including simplification of the tax system, reduction of regulatory burdens, restructuring of state-owned enterprises, and modernization of the banking and financial sectors. These measures laid the groundwork for improving the investment climate and restoring macroeconomic confidence. Over time, Georgia began to attract greater levels of foreign direct investment and expanded its participation in international trade and financial networks.

While the transition process has been challenging and nonlinear, it has nonetheless enabled Georgia to shift from post-Soviet economic stagnation toward a more liberalized and globally integrated economic model. This transformation forms the basis for understanding Georgia's contemporary economic positioning within the South Caucasus and beyond. To provide a clearer empirical perspective, the following table summarizes key macroeconomic indicators that illustrate Georgia's economic transformation since the early 2000s. The data are drawn from the World Bank and IMF databases.

TABLE 1. MACROECONOMIC INDICATORS

Indicator	2000	2010	2020	2024	Source
GDP growth (annual, %)	1.8	6.2	5.9	7.5	World Bank (2025)
FDI inflows (% of GDP)	6.3	8.4	6.1	7.2	IMF (2025)
Inflation (annual, %)	19.2	5	3.8	2.7	NBG (2025)
Poverty headcount ratio (% of population)	53	37	21	15	World Bank (2025)

Source: Authors' research.

Compared to its regional peers, Georgia demonstrated a faster pace of macroeconomic stabilization and institutional strengthening. While Armenia achieved similar inflation control, Georgia's investment inflows and growth rates have been notably higher, largely reflecting its liberalized policy environment and stronger institutional frameworks.

4. STRUCTURAL REFORMS AND FINANCIAL MARKET INTEGRATION IN GEORGIA

In the early 2000s, Georgia embarked on a wide-ranging program of structural reforms aimed at transforming its economy from a post-Soviet, state-dominated system into a liberal, market-oriented model. The reform agenda focused on institutional modernization, simplification of the regulatory environment, and the development of a more attractive climate for investment and entrepreneurship. One of the core achievements was the overhaul of the tax system. The number of taxes was significantly reduced, rates were lowered, and procedures simplified. These reforms contributed to a notable increase in tax compliance and revenue collection, strengthened public finances, and helped formalize parts of the shadow economy.

Deregulation was another priority. The state reduced its intervention in business activities by streamlining licensing and inspection procedures, establishing one-stop shops, and minimizing administrative barriers. This enabled a significant improvement in Georgia's international rankings for ease of doing business and promoted both domestic and foreign investment. Also, the privatization of state-owned enterprises and also played a key role. By transferring ownership to the private sector, the government reduced fiscal burdens, increased operational efficiency, and stimulated market competition. This process particularly supported growth in sectors such as real estate, construction, tourism, and services.

In parallel with these structural reforms, Georgia initiated a comprehensive modernization of its financial sector. Banking supervision was strengthened, the legal framework was aligned with international best practices, and a more stable and transparent environment was created. Today, the banking system is well-capitalized, competitive, and plays a central role in financial intermediation.

Beyond the banking sector, Georgia has also made strides in developing its capital markets. The Georgian Stock Exchange (GSE), although still relatively small in scale and liquidity, serves as the main platform for trading equities and bonds. Corporate bond issuance has increased in recent years, and efforts are underway to improve market infrastructure through digital platforms and stronger regulatory oversight

The Georgian Stock Exchange (GSE), established in the late 1990s, remains relatively small in scale and liquidity. However, it has served as an essential platform for laying the foundation of the domestic securities market. The exchange offers trading in equities, corporate bonds, and government securities, although the market is still characterized by low activity, limited listings, and modest investor participation.

In recent years, government efforts have intensified to revitalize the capital market. The introduction of pension reform and the accumulation of long-term institutional savings are expected to generate growing demand for capital market instruments. At the same time, initiatives to improve market infrastructure, such as the implementation of an electronic trading system and the development of a central depository, aim to enhance efficiency, transparency, and investor confidence.

Government securities have become a reliable instrument for both investors and policymakers. Regular issuance of treasury bills and bonds has supported monetary policy implementation and fostered a domestic yield curve. Georgia has also successfully issued Eurobonds on international markets, enhancing access to foreign capital and strengthening its creditworthiness. Despite progress, Georgia's capital markets remain underdeveloped compared to regional peers. Key challenges include low public awareness, limited retail investor participation, a narrow issuer base, and insufficient secondary market activity. Structural reforms aimed at boosting market depth, encouraging private sector listings, and fostering financial literacy are necessary for sustainable capital market development. Looking forward, Georgia's growing economic ties with the European Union, international financial institutions, and regional platforms present opportunities for broader market access and deeper financial integration. Strengthening the role of capital markets will be essential for diversifying financial intermediation, supporting long-term investments, and enhancing the country's resilience to external shocks.

Also, recent developments, such as pension reform, are expected to play a catalytic role in expanding long-term savings and institutional investment in the securities market. However, capital market depth remains limited due to low investor awareness, a narrow issuer base, and weak secondary market activity. Addressing these constraints is vital for ensuring diversified financial intermediation and fostering economic resilience.

Georgia's growing integration into regional and global financial markets, through trade agreements, international financial institutions, and open capital flows, is a testament to its liberal economic framework. Continued structural reforms and targeted support for capital market development will be essential to ensure the sustainability and competitiveness of Georgia's financial system in the long term. In summary, Georgia's reform trajectory reflects both policy-driven modernization and gradual financial integration within the region. From a theoretical perspective, Georgia's case illustrates the principles of financial deepening and institutional economics, emphasizing how structural reforms expand access to finance and enhance stability (Levine, 1997; North, 1990). The modernization of the banking sector and liberalization of capital flows have strengthened financial intermediation and investor confidence. Over the past two decades, private sector credit and banking assets have increased sharply as a share of GDP, while the capital market remains modest and requires further diversification. These trends show that small transition economies like Georgia can leverage institutional reforms and open-market policies to integrate more deeply into regional and global financial systems.

5. OPPORTUNITIES AND FUTURE CHALLENGES FOR GEORGIA'S FINANCIAL MARKET DEVELOPMENT

Georgia's ambition is to become a regional financial hub, through the continued development of its financial markets. While significant progress has been made in stabilizing the banking sector and initiating capital market reforms, deeper transformation is necessary to build a dynamic, diversified, and resilient financial ecosystem capable of supporting long-term economic growth and global integration.

5.1 Capital market expansion and diversification

Georgia's capital market remains underdeveloped and highly concentrated. The equity market is characterized by a limited number of listed companies and low liquidity, while bond market activity is largely dominated by government securities. To attract both institutional and retail investors, it is essential to expand the range of financial instruments, including corporate bonds, asset-backed securities, green bonds, and exchange-traded funds (ETFs).

Incentivizing private sector participation through tax benefits, improved listing procedures, and targeted support for small and medium-sized enterprises (SMEs) to access capital markets will be key to creating depth and diversity in financial offerings. This process demonstrates how expanding financial instruments and deepening market participation can accelerate financial development in small transition economies. In Georgia's case, a broader range of financial products would not only improve liquidity but also strengthen the overall resilience of the financial system.

5.2 Institutional investor development

The recent pension reform, which introduced a funded, mandatory savings system, represents a transformative opportunity for Georgia's capital markets. The accumulation of long-term domestic savings by pension funds creates demand for investable assets and can serve as a foundation for institutional investor growth.

However, to fully leverage this potential, it is essential to establish robust asset management practices, promote transparent governance structures, and support the development of a professional investment ecosystem. This includes attracting private investment funds, insurance companies, and sovereign wealth institutions willing to operate under international best practices. The emergence of institutional investors,

Business Excellence and Management
Volume 15 Issue 4 / December 2025

such as pension and insurance funds, reflects the financial deepening process described in institutional and market-based development theories. Their growth is crucial for mobilizing long-term domestic savings and fostering sustainable capital market expansion.

5.3 Financial infrastructure and digitalization

Modern and efficient financial infrastructure is critical for market trust and functionality. Georgia has made strides in this regard, including the digitalization of trading and clearing systems, improvements in settlement procedures, and the development of a central securities depository.

Nevertheless, further modernization is needed, particularly in areas such as real-time settlement systems, regulatory technology (RegTech), and cross-border financial transaction platforms. The integration of blockchain technologies and digital assets, under proper regulation, may also present an opportunity to leapfrog traditional barriers and attract a new generation of investors. The ongoing digitalization of financial services underscores the importance of technological innovation in enhancing transparency, reducing transaction costs, and broadening financial inclusion. Georgia's progress in this area aligns with global trends toward digital finance as a driver of competitiveness and investment attraction.

5.4 Investor protection and market confidence

Sustainable capital market development depends on strong investor protection mechanisms. While Georgia has made improvements in financial supervision and transparency, gaps remain in areas such as corporate governance, disclosure requirements, and enforcement of market conduct rules.

Enhancing the legal and regulatory framework, strengthening the independence and capacity of supervisory bodies, and fostering financial literacy among the general population are essential steps to build market credibility and investor trust, both domestic and foreign. Strengthening investor protection is not only a legal imperative but also a foundation for building trust and deepening capital markets. Theories of financial intermediation emphasize that credible enforcement and transparent disclosure mechanisms are central to long-term market stability.

5.5 Regional integration and cross-border access

Georgia's geographic and geopolitical positioning enables it to serve as a financial bridge between Europe and Asia. Active participation in regional financial platforms and alignment with international financial standards will facilitate cross-border capital flows and support integration into global financial value chains.

Opportunities exist to establish specialized financial zones, offer cross-listed securities, and promote regional financial instruments denominated in local currencies. These initiatives can increase Georgia's relevance in the regional financial architecture and support the internationalization of its financial sector. The persistence of structural challenges such as limited liquidity and narrow investor participation reinforces the need for institutional innovation and targeted policy reform. Georgia's ability to adapt its regulatory and market frameworks will determine whether it can transition from a bank-dominated system to a diversified financial ecosystem. In summary, Georgia's financial market development reflects a dynamic interplay between reform-driven modernization and regional integration. While the country has made substantial progress, sustaining long-term growth will depend on deepening institutional capacity, fostering innovation, and enhancing investor confidence—key pillars of financial transformation in emerging economies.

5.6 Key challenges and strategic priorities

Despite these opportunities, Georgia faces a number of persistent challenges:

- Low market liquidity and limited investor base, which reduce efficiency and discourage participation.
- Fragmented financial education and awareness, limiting retail investor engagement.
- High dependence on banking, with non-bank financial institutions playing a relatively minor role in credit provision and financial intermediation.

To overcome these obstacles, Georgia must pursue a multi-pronged strategy focused on:

- Deepening capital market reforms and regulatory modernization
- Supporting fin-tech and digital innovation in finance
- Enhancing regional financial cooperation
- Building domestic investor capacity and attracting international capital.

6. CONCLUSIONS

Georgia's path from a centrally planned, post-Soviet economy to an emerging player in regional and global financial markets has been marked by bold reforms, institutional transformation, and strategic openness. The country's ability to modernize its financial infrastructure, maintain macroeconomic stability, and create a liberalized business environment has laid the groundwork for its growing influence in the Caucasus and beyond.

While the banking sector has become a cornerstone of economic stability, the development of capital markets remains a critical next frontier. Georgia's emerging institutional investor base, modernizing legal frameworks, and integration into international financial systems offer a strong platform for future progress.

Business Excellence and Management
Volume 15 Issue 4 / December 2025

Yet, unlocking the full potential of its financial markets will require persistent efforts in deepening structural reforms, enhancing investor confidence, and fostering financial innovation.

Key areas such as capital market expansion, institutional investment development, and cross-border financial integration must be prioritized to ensure diversified financial intermediation and long-term economic resilience. Addressing challenges related to liquidity, regulatory enforcement, and financial literacy will be essential for building a transparent, inclusive, and efficient financial ecosystem. In the face of global uncertainty and regional complexity, Georgia's strategic vision and continued reform commitment position it to emerge as a financial and economic leader in the Caucasus region. By leveraging its geographic advantages, policy agility, and reform-oriented trajectory, the country holds the potential not only to integrate more deeply into global financial markets, but also to serve as a model for successful economic transformation among small and developing economies. The Georgian experience offers valuable insights for other small transition economies undergoing similar reforms, such as Armenia, Moldova, and the Western Balkans. It demonstrates how institutional transformation, supported by liberal market policies and financial openness, can drive sustainable economic modernization even under conditions of limited resources and geopolitical uncertainty. From a theoretical perspective, the case of Georgia reinforces the assumptions of institutional and regional development theories, which highlight the pivotal role of governance quality, policy coherence, and market liberalization in shaping long-term economic outcomes. Therefore, Georgia's trajectory not only represents a national success story but also provides a replicable framework for emerging economies seeking to integrate into regional and global financial systems.

REFERENCES

Beck, T., & Laeven, L. (2006). Institution building and growth in transition economies. Journal of Economic Growth, 11(2), 157–186.

IMF (2024). Georgia: Staff Concluding Statement of the 2024 Article IV. Retrieved from: https://www.imf.org/en/News/Articles/2024/03/18/mission-concluding-statement-georgia-2024-article-iv-mission.

IMF (2025). Georgia: Staff Concluding Statement of the 2025 Article IV. Retrieved from: https://www.imf.org/en/News/Articles/2025/06/04/06042025-mcs-georgia-staff-concluding-statement-of-the-2025-article-iv-mission.

Long, K. (2024). Georgian capital market growth shows strong ESG focus. The Banker, October 5, 2024. Retrieved from: https://www.thebanker.com/content/09250d96-8d27-56b5-b760-cae3b26a5c1d.

National Bank of Georgia (2025). NBG governor on IMF conclusions and price stability. June 4, 2025. Retrieved from: https://www.nbg.gov.ge/en/media/news/natia-turnava-the-primary-function-of-the-national-bank-of-georgia-is-to-maintain-price-s.

North, D. C. (1990). Institutions, institutional change and economic performance. Cambridge University Press.

TBC Capital (2024). Georgian Capital Market Overview. Retrieved from: https://tbccapital.ge/static/file/202404233129-georgian-capital-market-overview_eng.pdf.

World Bank (2022). Charting Georgia's Future: Country Economic Memorandum. World Bank. Retrieved from: https://documents1.worldbank.org/curated/en/099435012022237049/pdf/P17548605921fd062093cb077bd2d45cd13.pdf?fbclid=IwAR0LNCa6FIdoglGKL6BfM9Luj5J62auoUxXdrsGs-n4KuSIeHeS_-zMEaWc.

World Bank (2023, August 17). Georgia Country Economic Memorandum: Delivering Another Decade of Success. Retrieved from: https://www.worldbank.org/en/results/2023/08/17/georgia-country-economic-memorandum-delivering-another-decade-of-success.

World Bank (2023, September 26). Georgia advances on financial inclusion and enterprise financial transparency with the support of the European Union and the World Bank [Press release]. Retrieved from: https://www.worldbank.org/en/news/press-release/2023/09/26/georgia-advances-on-financial-inclusion-and-enterprise-financial-transparency-with-the-support-of-the-european-union-and.

Xu, G. (2021). Reassessing the literature on the relationship between financial structure and economic growth. Review of Economics, 72(2), 149–182. https://doi.org/10.1515/roe-2021-0016.

Zhang, Y., & Li, H. (2024). Digital finance and sustainable development: Evidence from 52 developing economies. The Economic Review, 75(1), 33–5.