

# EBRD strategy for Georgia 1996-97: a summary

## Overview

The main priorities in Georgia for the European Bank for Reconstruction and Development (EBRD) are:

- **financial sector restructuring and development:** To serve the credit and equity needs of emerging small and medium-sized enterprises (SMEs), the EBRD will provide investment and technical cooperation to private commercial banks and funds.
- **restoration of secure and environmentally safe electricity supplies:** The main objectives of the ongoing US\$ 24.1 million power rehabilitation project are to: (i) alleviate power shortages and improve system reliability; (ii) reduce the country's energy intensity; and (iii) establish Georgia's electric power utility, Sakenergo, as a commercially viable enterprise.
- **removal of critical transport bottlenecks:** This includes a joint-venture project to upgrade Poti port and the refurbishment of Tbilisi Airport.
- **support for privatisation and SMEs:** In line with the Bank's strategy for privatisation and restructuring, efforts will focus on post-privatisation support of SMEs. In cooperation with multilateral and bilateral agencies, EBRD technical cooperation funds have been used to prepare an investment project to establish a fresh produce wholesale marketing and distribution system.
- **private sector investment:** The Bank will continue to pursue opportunities for investment in private, foreign-exchange earning, joint-venture enterprises. The most promising areas appear to be oil and gas extraction, wine and tea production and processing, mineral water bottling and mining and processing of ores, notably manganese.

## EBRD priorities

The main work of the EBRD in Georgia will be to continue to focus on implementation of the existing portfolio and the start of two additional infrastructure projects. Work will also continue on the preparation of a second power rehabilitation project and on possibilities for supporting a railway modernisation

project. Projects will be selected on the basis of effective management, foreign exchange earnings/savings potential, direct cost recovery prospects and establishment of commercial repayment structures. The overall strategy will be to continue to focus the Bank's programme on greater private sector investment.

Strengthening of, and investment in, private banks will be the main focus, since the principal short- and medium-term need will be for the financing of both new and privatised SMEs. In parallel, work will also continue on preparation of investment operations with private export-oriented joint ventures. Every effort will be made to support creditworthy operations, but opportunities will be few in view of the fundamental structural problems confronting Georgia. The Bank will seek to provide legal assistance in connection with Bank operations.

The EBRD will maintain a highly selective approach in Georgia. Despite the improvement in business and investor confidence, bankable opportunities for private sector lending will continue to be limited by the constraint placed on sovereign lending by the external situation, creditworthiness considerations and structural problems.

In keeping with the EBRD's environmental policy and mandate, the Bank's programme in the fields of power, energy and infrastructure development concentrates on the efficient use of resources and the protection of the environment. Private sector activities will be implemented in strict accordance with the Bank's Environmental Procedures.

Underlying the EBRD's evolving strategy is the assumption that the security situation will continue to improve, the political and economic situation will remain stable and business confidence will continue to strengthen. Bank activities will continue to be coordinated closely with the transition assistance activities of other international financial institutions and multilateral and bilateral agencies.

## *Power and energy*

Georgia has the gas and oil reserves and the hydro-power potential to be a substantial net regional exporter of energy in the medium- to long-term. The continuing emphasis of the Bank's programme on restructuring and developing the

power and energy sector aims to address critical short-term needs and to support the realisation of these medium- to long-term prospects.

In line with the EBRD's continuing sector strategy, the Bank's power rehabilitation project loan will: (i) improve energy efficiency, in both supply and end-use; (ii) reduce the country's dependence on imported energy through the development of indigenous energy resources; and (iii) promote sector reform by commercialising utilities, strengthening their financial performance and designing socially sustainable tariff structures.

Discussions are ongoing with the World Bank and KfW on co-financing a second power rehabilitation project. This would mainly include completion of improvements to the Tblisi thermal power plant and critical repairs to Enguri hydropower plant, the country's most important source of primary energy. Development of the project will depend on continuing progress with restructuring the sector, tariff adjustment and improvement of collection rates.

Other investments also under consideration by the Bank include: (i) introduction of gas meters for residential customers; (ii) energy savings initiatives in key sectors; (iii) development of existing infrastructure in a privately sponsored project to allow increased transit of Russian electricity to Turkey and/or Armenia; and (iv) development of geothermal resources to provide hot water and space heating.

### **Transport**

Development of transshipment and transport infrastructure will play a crucial role in the country's development. The Bank will thus continue to give emphasis to investment aimed at removing critical bottlenecks in transshipment infrastructure and developing trade. Wherever possible, commercial ownership and management will be introduced. Where there is no alternative to public ownership, a sovereign guarantee will be required, but particular attention will be paid to self-sustainability, direct foreign exchange earning/savings potential and establishment of commercial repayment structures.

In view of the importance of the Black Sea ports of Batumi and Poti both for Georgia and for other countries in the region, the EBRD's main priority has been provision of technical cooperation support to identify and design an investment project for the improvement of their efficiency, capacity and management. A newly formed joint-venture company is scheduled to start preparation of a project to upgrade Poti port, the centrepiece of

which will be a new terminal. Project costs are expected to be about US\$ 14.5 million.

The EBRD has begun preliminary discussions on the possibility of a Bank-supported project to improve performance of the railway linking Poti with Armenia, Azerbaijan and the Trans-Caspian central Asian countries. The Bank has also been approached about the possibility of investment in electricity and gas transit infrastructure development and projects to facilitate Russian and Turkmen energy exports to Turkey. Preliminary discussions have already taken place in Ankara on a two-phase gas transit project. Another transit project under consideration is the development of the regional pipeline network for export of Caspian oil. The Bank's activities are closely coordinated with World Bank and EU transport projects.

### **Banking and financial sector**

Georgia's economic development will for the foreseeable future critically depend on the availability of short- and medium-term SME credit. The emphasis of the Bank's programme aims to address these SME needs.

The Bank aims to provide financial support to those private banks or other financial institutions with a modern committed management and the potential to become creditworthy. The main priority will be improvement of management and credit skills of the most promising banks so that they can attract and support foreign investment. The overall goal will be to serve the term credit and equity needs of emerging SMEs.

Under a multi-project framework facility, preparations are nearing completion for the launch of a new bank with capital of US\$ 5 million, in which the EBRD will have an equity role and a major foreign bank will have a majority stake. Two credit line projects are also being prepared. The first is a credit line of up to US\$ 5 million to the largest emerging private Georgian bank (Absolute Bank – signed March 1997). The second is a US\$ 12 million credit line with a sovereign guarantee, under which banks will compete to meet specified eligibility criteria (signed January 1997). Consideration is also being given to Bank participation with the International Finance Corporation in a privately sponsored US\$ 12-16 million investment fund. This would focus on small and medium-sized joint-venture companies.

### **Agriculture**

Agriculture is leading Georgia's return to growth. The main need in the sector, addressed by the Bank's financial and banking sector initiatives, is seasonal and term credit for smallholders and for

small- and medium-sized input supply, trading and agri-processing enterprises.

The EBRD's strategy is to support investment that will improve agricultural input supply and productivity and improve the efficiency of produce distribution and marketing. Such investment will help to create markets for produce, introducing new technologies, and encouraging quality and productivity gains. The strategy hinges on making credit available to small and medium-sized farm enterprises. The Bank will also facilitate market reform by supporting the development of agricultural wholesale market infrastructure and credits.

A proposed US\$ 13.1 million project comprises a central wholesale market in Tbilisi and collection and assembly markets in three of the principal crop-producing regions in southern Georgia. A US\$ 10 million sovereign guaranteed investment role is envisaged for the Bank (signed June 1997). The Bank is also looking into possible direct investment with a strategic foreign investor in a US\$ 15 million private tea production and processing project. The Bank would co-finance the new equipment and working capital requirements for 22 processing factories.

#### **Telecommunications**

The EBRD's strategy is to assist the Ministry of Communications with harnessing the private sector to develop a modern telecommunications sector for Georgia's business community and thereby support Georgia's economic transition.

#### **Natural resources**

The Bank's strategy is to facilitate foreign direct investment in economically viable and environmentally sustainable extraction and

processing of natural resources. The EBRD will usually achieve this through investment participation in joint-venture start-ups established for this purpose.

The Bank is actively considering investment in a joint venture established to further develop an oil and gas field in eastern Georgia. Discussions are also ongoing with potential foreign investors and local partners on investment roles for the Bank in manganese and in perlite mining and processing, and also in the modernisation of Georgia's mineral water industry (Borjomi – signed June 1997). The Bank is also considering technical cooperation support for development of the special legislative and fiscal regime needs of the natural resources sector.

#### **Environment**

In line with the EBRD's environmental policy and mandate, the Bank's programme in the fields of power, energy and infrastructure development focuses on enhancing efficiency in the use of resources and protection of the environment. Private sector activities are under preparation and will be implemented in strict accordance with the Bank's Environmental Procedures. Georgian banks acting as financial intermediaries for the EBRD are required to adhere to the Bank's Environmental Procedures for Local Banks.

An *Investor's Guidebook on Environment, Health, and Safety in Georgia* is under preparation. The Guidebook has been funded by the EC Tacis programme, and will provide information and guidance to investors on environmental and health and safety requirements and liability issues in the Bank's region of operations. It will be available in English and Russian.

**This document is based on the EBRD's Strategy for Georgia, approved by the Board of Directors at its meeting on 16/17 July 1996.**