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Building a Sustainable Financial Future: Exploring Georgia's Path to Green Finance

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ABSTRACT

Sustainable finance is becoming a central issue and a critical driver of decision-making for the majority of global investors and policymakers. By taking environmental, social and governance (ESG) considerations into account, and integrating them into the corporate business strategy, financial institutions are ensuring long-term investments in sustainable economics and contributing to meaningful global change.

However, sustainable goals may conflict with other short-term economic objectives of the institution. Many green projects, such as renewable energy infrastructure and eco-friendly buildings, require large upfront investments, while cost of capital in developing countries is often much higher than in advanced economies.

Other challenges, such as regulatory gaps, lack of direct incentives, need for additional competencies and low awareness, also affect the sustainable finance market.

This paper analyses the evolution of sustainable finance over the past decades, and examines the key challenges and prospects associated with sustainable finance in developing countries, particularly in Georgia.

The paper also highlights some recommendations that may help address the current challenges and improve the sustainable financial ecosystem in Georgia.

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Introduction

This study aims to explore the challenges and opportunities associated with sustainable finance in Georgia, focusing on the structural changes needed in financial systems and regulatory frameworks to support sustainable investments.

Our planet is experiencing the escalating adverse impacts of climate change. The effects of global warming are reflected in the increasing frequency and severity of extreme weather events, among them heat waves, floods, droughts, storms, wildfires and hurricanes.

According to the World Meteorological Organization (WMO), 2023 broke every single climate indicator and went down as the warmest year on record. Global temperatures have risen to 1.45°C, for the first time dangerously close to the 1.5°C lower limit of the Paris Agreement on climate change.

The greenhouse gas concentrations reached record high observed levels in 2022, 50% higher than pre-industrial levels. The long lifetime of CO2 means temperatures will continue to rise for many years to come (WMO, 2023).

Despite these alarming developments, the global financial resources allocated for climate mitigation and adaptation remain insufficient in comparison to the scale of the challenge.

Since over half of global GDP has a high or moderately high dependency on nature, investing in nature-based solutions will not only limit global warming, but also result in about US$4 trillion in revenue for businesses and over 100 million new jobs each year by 2030 (UNEP, 2021).

The investments needed to address current sustainability challenges are twofold: they must both “finance the green” (i.e. invest in environmentally friendly solutions) and “green the finance” through reorienting the financial system.

This transition is crucial for the financial industry, as climate change poses risks to both the financial system and the broader economy. A shift towards a low-carbon economy is necessary and inevitable, though it has only just begun (IFC, 2023).

It is clear that without sustainable finance, there will be no sustainable development. Reorienting private capital towards more sustainable investments would require structural changes being made to both the existing financial systems and to the regulatory framework.

Methodology

This study utilizes a quantitative approach, relying on data from secondary sources, such as annual reports, research articles, conference proceedings and industry analyses.

The main sources of data used in the study are official statistical data of the National Bank of Georgia, and data from the annual reports of commercial banks in Georgia.

The Evolution of Sustainable Finance

Sustainability has been defined in a variety of ways over the past decades. The most

frequently cited definition was created by the UN Brundtland Commission in 1987, defining sustainability as "meeting the needs of the present without compromising the ability of future generations to meet their own needs".

The global movement towards sustainable finance took a significant step forward in 1972 with the UN Conference on the Human Environment in Stockholm, which highlighted the interconnectedness of environmental, economic, and social issues and led to the creation of the UN Environment Programme.

Later, in 1997, the United Nations Environment Programme (UNEP) launched a Finance Initiative to promote sustainable investments in the financial industry and to help the sector reduce its negative impact on the environment.

UNEP FI supports financial institutions to develop practical approaches to setting and achieving green targets in areas such as greenhouse gas emissions, green finance, sustainable production and consumption, and financial inclusion to address inequality. It was the first global organization to engage the financial sector in sustainability issues and develop the principles of responsible investment.

Today, more than 500 global banks, investors and insurance companies, with assets of over US$ 170 trillion, are implementing UNEP FI's Principles for Responsible Banking, and Principles for Sustainable Insurance, to deliver more sustainable economies worldwide (UNEP Finance Initiative, 2024).

In 2015, the United Nations adopted the Sustainable Development Goals (SDGs) as a universal call to action to end poverty, protect the planet, and ensure peace and prosperity for all people.

The 17 SDGs have been adopted by all United Nations Member States. There are 169 sub-goals and targets to be achieved by 2030 or earlier. The goals and targets are universal, meaning that they apply to all countries. The 17 SDGs highlight the connections between the environmental, social and economic aspects of sustainable development. They are integrated and recognize that actions in one area affects outcomes in others, and that development must balance social, economic and environmental sustainability.

The SDG Progress Report published by the UN Economic and Social Council in 2024 demonstrates that the world is unfortunately far behind schedule in achieving its 2030 agenda. Of the 135 targets, only 17% are progressing as expected so as to be implemented by 2030; almost half of the targets (48%) show moderate or severe deviations from the desired trajectory; 18% of the targets have stalled; and 17% have even regressed below the 2015 baseline.

According to the World Economic Forum, the risks related to the environment continue to dominate the risk landscape for the short- and long-term periods. Based on the findings of the Global Risks Report 2024, five environmental-related risks (extreme weather events, critical change to Earth systems, biodiversity loss and ecosystem collapse, natural resource shortages, and pollution) were included in the top ten risks that are most likely to cause a significant global

crisis over the next 10 years (World Economic Forum, 2024).

In parallel, we see increasing pressure from multiple stakeholders (customers, employees, governments) on financial institutions to take environmental, social and governance (ESG) factors into account when implementing business strategies and making financial decisions.

The Global Sustainable Finance Landscape

Sustainable finance encompasses financial activities contributing to sustainable development, which includes environmental, social, governance and economic characteristics.

According to the European Commission, sustainable finance refers to the process of incorporating environmental, social and governance (ESG) considerations into investment decisions in the financial sector, resulting in long-term investments in sustainable economic activities and projects.

Environmental considerations may include climate change mitigation and adaptation, as well as wider environment issues, such as biodiversity conservation, pollution prevention, and the circular economy (European Commission, 2024).

In the context of the EU policy, sustainable finance is understood as finance to support economic growth, while reducing pressures on the environment, so as to reach the climate objectives of the European Green Deal, taking into account social and governance aspects.

According to the United Nations, green finance is “environment-oriented financial products or services, such as mortgages, loans, insurances or bonds, which recognize the value of the environment and its natural capital, and seek to improve human well-being and social equity while reducing environmental risks and improving ecological integrity”.

Climate finance, as support provided to developing countries, increased at a compound rate of 5% from 2015 to 2020, reaching US$ 41 billion. While there are a number of estimates and no agreed methodology to account for the US$ 100 billion per year target, this target has not yet been reached (UN Economic and Social Council, 2024).

In 2023, the overall global sustainable finance market reached US$ 5.4 trillion. It is expected to grow at around 22% per annum over the next decade, according to the Sustainable Finance Market Report by Global Market Insights.

Growing awareness of environmental and social issues has become a significant driver in the evolution of sustainable finance markets. Investors are placing greater emphasis on ESG criteria in their decision-making processes. This shift is driven by the understanding that companies with strong ESG practices tend to exhibit better long-term financial performance and greater resilience.

As a result, there has been a notable increase in the demand for ESG-focused investment funds which cater to investors seeking both finance returns and positive societal impact (Global Market Insights, 2024).

Figure 1 below shows the sustainable finance market dynamic from 2021 to 2023.

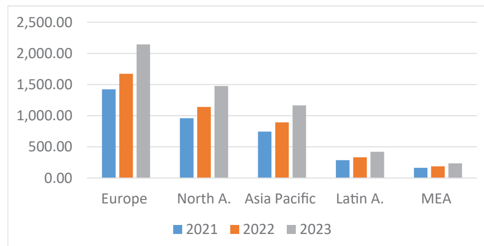

Fig. 1. Global sustainable finance market growth by region, 2021-2023 (USD/billion)
Source: Global Market Insights, 2024.

Although all regions are demonstrating growth dynamics from year to year, the global sustainable finance market is dominated by Europe, with a share of 39%, followed by North America (27%) and Asia Pacific (21%).

As expected, the majority of developing and least developed regions (Latin America, Middle East & Africa) accounted for a critically small market share (13%), illustrating the significant gap between the demand for sustainable finance and the available supply.

According to the study conducted by McKinsey, to get emissions to net zero, US$ 275 trillion would need to be spent on physical assets by 2050. That is about US$ 9.2 trillion per year, or about 30% more than the US$ 5.7 trillion allocated today. These huge funding requirements present financial institutions with a significant investment opportunity in sustainable finance (McKinsey & Company, 2023).

McKinsey estimates that of the trillions of dollars needed to finance the green transition, about one-third (US$ 2.8 trillion) would go towards legacy obligations to support critical high-emission assets that cannot be completely phased out. The remaining two-thirds (US$ 6.4 trillion) would go to new green technologies, low-emission green assets, or assets transitioning to be less carbon-intensive.

Based on McKinsey's findings, significant investments in the near term will be needed in clean energy to power electric vehicles and decarbonize buildings. Approximately US$ 170 trillion is projected to be invested in low-emission assets across three sectors: 1) electric vehicles and infrastructure (US$ 67 trillion); 2) the power sector (US$ 57 trillion); 3) the building sector (US$ 46 trillion).

Characteristics of Sustainable Finance in Georgia

According to the ND-GAIN Country Index, which measures a country's vulnerability to climate change and other global challenges, Georgia ranks 109th in terms of vulnerability, with an overall score of 58.7. However, it is ranked 34th for its readiness to engage in climate finance. While adaptation challenges remain, Georgia is well positioned to adapt (University of Notre Dame, 2022).

The National Bank of Georgia (NBG) has been working on developing the sustainable finance framework since 2017, when it joined the Sustainable Banking Network (SBN). In 2019, NBG launched the Sustainable Finance Roadmap, the ultimate goal of which is to create a reliable, predictable and stable regulatory framework, and to

prepare the market for the transition to sustainable finance.

In 2022, the NBG adopted the Regulation on Loan Classification and Reporting according to the Sustainable Finance Taxonomy. The new regulation officially defines green, social, and sustainable loans, and sets the reporting requirements for taxonomy-aligned loans for commercial banks. The Taxonomy Regulation came into force on 1 January 2023.

The taxonomy is composed of green and social taxonomies. Green taxonomy provides a list of activities that aim to achieve environmental objectives and contribute to green economy development. Social taxonomy provides a list of categories aimed at achieving social goals for the target population, including: people with disabilities, eco migrants, displaced persons, socially vulnerable individuals, people living below the poverty line, etc. (National Bank of Georgia, 2024).

The total green loan portfolio of Georgian commercial banks by the end of 2023 stood at GEL 1.7 billion, a 21% increase compared to 2022. The share of green loans in the total portfolio of banks was 3.2% in 2023 and 2022, compared to 2.9% in 2021 and 2.2% in 2020. The total volume of green loans issued by banks during the year was around GEL 0.5 billion. As some banks still do not classify green loans according to the green taxonomy, these figures may be underestimated.

Two commercial banks led the green finance market in Georgia as of 2023: TBC, with 47% of total green market share, and Bank of Georgia, with 43% of green market share. BasisBank claims 8% of the market share, followed by Procredit with 1.5%.

Figure 2 below shows the dynamics of green financing in Georgia from 2020 to 2023.

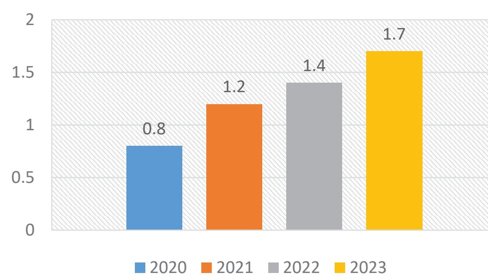

Fig. 2. Green loan portfolio of Georgian commercial banks, 2020-2023 (GEL/billion)
Source: Annual ESG reports of banks, National Bank of Georgia.

According to the NBG's 2023 Sustainable Finance Report, the sectorial breakdown of green financing in Georgia is as follows: the largest portion of green loans, 63%, is directed toward the renewable energy sector (57% specifically targeted towards hydropower projects), while 17% is directed towards sustainable transport, followed by sustainable production and trade (8%) and Waste Management (5%). Sustainable agriculture and green buildings accounted for 3% of total green loans.

Official statistics clearly show that the sustainable finance market in Georgia has experienced steady growth over the past few years, largely driven by increased investment in the renewable energy and sustainable transport sectors. Additionally, this growth in green financing has been supported by government initiatives, subsidized programs from international institutions, and co-funding from donors.

Key Challenges of Sustainable Finance in Georgia

Although the official statistics of recent years point to a positive trajectory of sustainable financing in Georgia, we can observe a number of challenges and obstacles that hinder more dynamic growth of the market. Among such challenges, the following can be highlighted:

- **Limited awareness**. Although there is a positive trend towards increasing general awareness of climate and sustainability issues, it is still at a low level and is characterized by many contradictory perceptions.
- **Regulatory gaps.** There is often a mismatch between the global green standards and local regulations.
- **Mismatches in timeline**. Expectations of short-term profit maximization conflict with the long-term nature of green investments.
- **Large upfront investments.** The cost of capital in developing countries is much higher than it is in advanced economies.
- **Uncertainties**. Large upfront investments, long payback periods and high business risks must be considered alongside the reality that the return on investment is not clear.
- **Conflicted objectives**. Sustainable objectives may conflict with other business goals of banks, such as short-term economic benefits or cost-optimization measures.
- **High cost of "going green"**. Since sustainable finance is a relatively new concept, many banks do not have enough flexibility or the right infrastructure to adapt smoothly and cost-effectively.
- **Risks of "green-washing"**. As more green-washing practices are disclosed, banks are becoming fearful of innovation and of investing in sustainable products, wanting to avoid accusations of green-washing.
- **Limitations of green taxonomy**. Due to the requirements of green taxonomy, some climate-positive and eco-friendly projects cannot be classified as "green" by banks.
- **Lack of direct incentives**. Exceptions are those cases where donors partially subsidize interest rates, or provide targeted Technical Assistance support.
- **Excess bureaucracy**. Additional documents, data, information and competencies are needed to meet the formal requirements of green funders.

Climate change creates both risks and opportunities that can affect the performance of financial institutions, as well as the companies they invest in. Among the potential drivers of sustainable financing, the following can be distinguished in particular:

- **Growing awareness** of environmental and social issues.
- **Increasing pressure** from government and the public towards sustainability.
- **Growing regulations** globally and locally.
- **Rising focus** of businesses towards enhancing their goodwill.
- **Export-oriented sectors** will gradually need to increase green components into their business strategies.
- **Economic effects** in the form of reduced costs due to savings in energy, and increased revenue due to the bet-

ter performance of the new energy efficient equipment.

- **Compliance** with environmental norms and standards; commitment to reducing GHG emissions and promoting green initiatives as an EU candidate country.
- **The new generation** increasingly prioritizes sustainability issues.

Conclusion

The sustainable finance market has demonstrated steady growth over the past few years in Georgia. This was facilitated, in particular, by increased investment in the renewable energy and sustainable transport sectors.

There is increasing pressure from multiple stakeholders (customers, employees, investors, governments) on local banks to take ESG factors into account while implementing their business strategies and making financial decisions.

Climate change presents both risks and opportunities that can enhance the financial performance of banks and the sectors they invest in. Banks have the potential to expand their sustainable portfolios while playing a crucial role in decarbonizing the economy and driving positive change.

Growing awareness about climate issues is pushing banks to expand their green portfolios. By integrating ESG considerations into the business strategy, and by prioritizing sustainability factors, banks can ensure long-term and profitable investments in sustainable economics and promote positive changes within society.

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