

Microfinancing in Azerbaijan: social and legal aspects in development
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Микрофинансирование в Азербайджане:
социальные и правовые аспекты развития
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Abstract: *the article discloses the authors' conception of microfinancing philosophy based on legal factors. Some recommendations are provided in terms of its development. Being a pressing matter for developing countries, microfinancing systems are reviewed as an economic leverage of region-wide microfinancing resources, with Azerbaijan's example provided. The study aims at developing and justification of methodic provisions for development of credit union-related regulatory and microfinancing with an account for regional peculiarities. The subject of this study are the legislative aspects of microfinancing entities management in developing countries.*

Аннотация: *в статье раскрывается понятие авторов о философии микрофинансирования с учетом правовых особенностей. Даны некоторые рекомендации по его совершенствованию. В качестве экономического рычага воздействия на совершенствование микрофинансовыми ресурсами на уровне региона рассмотрена система микрофинансирования, что крайне актуально для развивающихся стран, на примере Азербайджана. Целью исследования является разработка и обоснование методических положений по формированию законодательства о кредитных союзах, микрофинансирование с учетом особенностей регионов. Предметом исследования служат законодательные аспекты управления микрофинансовыми организациями в развивающихся странах.*

Keywords: *regulatory, microfinances, microfinancing, region, developing countries.*

Ключевые слова: *законодательство, микрофинансы, микрофинансирование, регион, развивающиеся страны.*

Introduction

The role of microfinancing (MF) in today's development of economy and regions in developing countries (Azerbaijan, for instance) is steadily growing. Therefore, required is a further study of MF's theoretical and practical aspects as not only an additional source of business development loans but also a strategic direction of the national social capital and management improvement lever. MF is a product of new thinking and practice in economy development. According to many scientists, MF is but a revolution in finances [7].

MF has made a breakthrough in the philosophy and practice of inclusive economic development for developing countries, Azerbaijan among them. There are over 20 MFOs running in Azerbaijan today. Greatly influencing the national business development, they have contributed to cash liquidity and stability of economics. Their main function today is to focus on boosting the social and cultural sphere and innovative business alike [2].

1. Microfinancing

It is well known that boosting microfinancing is one of the efficient and recognized regional development acceleration methods as the local economic power begins with the development of small and medium businesses. It calls for allocating available credits to financially unstable small and medium businesses, especially farmers. For a number of objective reasons this category of businesses is just unable to take out loans in banks, while banks are not interested in granting loans to small and medium businesses (because microcrediting does not cover the bank's operating expenses). And that is where microfinancing comes to play! Crediting micro-entities or granting short-term loans to small businesses is a proven and effective method of economic development, which encompasses a lot of private owners and micro-entities in developing countries of Asia, Africa and Latin America. In turn, microcrediting is used in highly developed North American countries to fill market niches and across small target regions. Microcrediting may have a huge potential influence on the economic development in Central and East European countries (CEU) and new independent states (NIS) of the former Soviet Union [2].

It is well known that no activity can reach fruition without a proper regulation. Short of a regulatory framework, economic relations remain "suspended"; economic entities have to "make up" their own regulations which would anyway result in a blooming black economy, lack of continuity, inconsistency, corruption and tax evasions. Stefan Staschen rightly said that "drafting regulatory documents is an important step in setting up the

respective legal framework for microfinances. This stage is neither the first nor the last, but still very important” [2].

2. Regulatory framework of microfinancing

The factors that necessitate the regulatory framing of microfinancing may be conventionally grouped on two levels. The first level factors are the result of an associative relation between microfinancing and banking activity as well as of the necessity to introduce a precise statutory delimitation between the banking loan function and microfinancing institutions. They are as follows [2]:

- 1) Application of banking legislation to microfinancing institutions, including:
 - Licensing microfinancing institution activity, in particular the right to systematic granting of loans as a main activity;
 - Microfinancing institution activity reporting and monitoring.
- 2) Approval of non-commercial status for microfinancing institutions with refundable and paid loan services, including: [1]
 - Taxation of microfinancing institutions;
 - Business legal structure of microfinancing institutions;
 - Attraction of foreign technical assistance by microfinancing institutions with discounts established by the regulatory.

The credit unions institution was established by the Law “Credit Unions” dated 2 May 2000. Under this law, a credit union is a non-bank credit entity established by physical persons and/or legal entities, which join forces voluntarily in view of their mutual interests with the purpose of mutual crediting by means of allocation of available funds. A credit union shall be set up in accordance with the procedure established by the legislation (as provided in the Civil Code of the Republic of Azerbaijan and the Law «State Registration and State Register») by no fewer than 11 physical persons and / or legal entities. The credit union is managed by the general assembly of its members; this general assembly is the supreme management body and employs a supervisory board to oversee the union activity, board of directors to perform the overall management, and credit commission to make conclusions whether a loan shall be granted or not [1].

In order to carry out its activity, the union sets up a back-to-back credit fund, which is the source of a granted loan. The back-to-back credit fund is formed using charter capital, credit union revenues as well as funds attracted from other sources [2].

It is noteworthy that the legislation and good international practice restricts granting credit unions’ loans to their own members. Though limiting the microfinancing activity of the credit union, this provision still meets the goals and principles of the credit union as a microfinancing entity [1].

Yet another restriction of credit union activity is the banking legislation provisions that permit no deposit taking by credit organizations save the banks (Law “Banks”, Article 3.2), despite the good international practice permitting credit unions to take deposits from their members. Hopefully, legislative branches of the Republic of Azerbaijan would not leave this issue unattended [2].

Apart from the Law «Credit Unions», the credit unions activity is governed by two Regulations endorsed by the National Bank of the Republic of Azerbaijan on 27 January 2001 [2]:

- 1) Issuing special authorization (license) to credit unions for banking operations;
- 2) Provisions (prudential regulations) concerning economic regulations of credit unions.

The special role in regulating credit union activities play namely the Provisions (prudential regulations) of economic regulations of credit unions, for it is them that define the following mandatory provisions for credit unions to adhere [1], [2]:

- Minimum charter capital (currently 20 million AZN);
- Minimum standard capital and its adequacy ratio;
- Standard identity of funds attracted as of the date of repayment;
- Standard maximum loan granted to a single member;
- Standard maximum amount of straight loans;
- Standard capital reserve and rules of its establishment for credit unions;
- Classification of loans, standards and rules of surplus fund establishment.

Conclusion

A new stage of microfinancing has commenced in Azerbaijan today. The law to govern this sphere is being drafted. In lawmaking process, the legislative body should decide which regulatory requirements are to be foreseen and at what “level”. Several levels of legal management are distinguished, which differ in terms of democratic accountability, binding power, and flexibility to changes. So one should clearly define which requirements would be reflected in the law, which in Decrees of the President of the Republic of Azerbaijan, resolutions of the Cabinet of Ministers, or in the regulations of the National Bank of Azerbaijan. For instance, it would be reasonable to specify the maximum amount of charter capital and other quantitative limitations in the National Bank regulations rather than in the law as these categories are sensitive to inflation and changes in

international microfinancing standards. Drawing revisions and amendments to a law would be a time- and effort-consuming process and it would be impossible to react in a timely manner [2].

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