

Azərbaycan Mikromaliyyə Assosiasiyası



Azerbaijan Micro-finance Association



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AGRICULTURE CREDIT INSURANCE MECHANISM

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Brief on Project

Project title : Insurance Mechanism of Agriculture Loans

Ordering party: Azerbaijan Micro-finance Association /Oxfam

Implementing party: Center for Local Economic Development

Implementing period: 15 January 2010 – 15 August 2010

Project aim is to analyze current situation with agriculture and insurance in the country and to develop recommendations and policy for improving the insurance mechanism of agriculture loans in Azerbaijan Republic through learning best international practices on insurance of agriculture loans.

Main objectives

- Collecting related statistical and analytical data;
- Holding meetings with stakeholders/interested parties;
- Analyze of current situation (using PEST, SWOT and comparative analyses methods);
- ✓ Learning proper international practice;
- ✓ Analyze of state policy on agriculture and financial sector;
- ✓ Analyze of political, legal and institutional atmosphere on insuring agriculture loans;
- Defining policy selections / alternatives and mechanisms considering legal, institutional and economical issues.
- Developing recommendations on policy
- Preparing Final Report Package (including recommendations on mechanism and legal base)

MAIN HYPOTHESES

The research was conducted based on following hypotheses:

- Application of insurance mechanism of agriculture loans positively effects on the development of agriculture;
- Application of insurance mechanism of agriculture loans increases the effectiveness of agriculture sector;
- Application of insurance mechanism of agriculture loans widens and facilitates the opportunities for access to loan market;
- Application of insurance mechanism of agriculture loans encourages more the banks and MFIs to give loans for agriculture
- Application of insurance mechanism of agriculture loans increases competitiveness in agriculture sector and creates and opportunity for access to WTO and to be ready for financial crisis.

MAIN QUESTIONS

- Which legal, institutional and economical mechanisms exist relating the insurance of agriculture loans?
- What are the main peculiarities of related international practices on insurance of agriculture loans?
- Which policy selection can be more appropriate for us to apply insurance mechanism of agriculture loans?
- Which issues should be covered with the recommendations on the policy selected for successful application of this kind of insurance mechanism?

STRUCTURE OF THE REPORT

Acronyms and abbreviations

Content

Short summary

1. Introduction

2. Insurance Mechanism of agriculture loans: Current situation in Azerbaijan and analyses of international practice

- *Comparative analyses of international practice*
- *Analyses of policy, legal and institutional atmosphere on insurance of agriculture loans in Azerbaijan*
- *State policy on agriculture and financial sector*

3. Defining appropriate policy for application of insurance mechanism of agriculture loans

4. Recommendations on output and policy

Additions

Used resources

WORLD EXPERIENCE

- **Potential risks on agriculture**
- **Applied Insurance tools**
- **New tools and technological innovations**
- **Insurance and warranty mechanisms**
- **Common peculiarities of Loan Warranty Foundations**
- **Joint warranty mechanism**
- **Warranty scheme of Agriculture loans**
- **Mechanism of Loan disbursement with warranty**
- **Examples**

POTENTIAL RISKS ON AGRICULTURE

Risk Groups	Risk factors	
Natural - climate	Hail, aridity, flood, frostbite, storm, fire, earthquakes, volcanoes and etc.	
Sanitary	Diseases and epidemics	Controlled Impossible to control
Market	Differences in local and international prices, changes in quality standards.	
Political, legal, social, economic	Wars, financial crisis, weakness of institutional mechanisms and etc.	Controlled Impossible to control

APPLIED INSURANCE TOOLS

Unique risky insurance - *this type of insurance usually covers one (or sometimes two) type risk case (mainly the risk of fire or hail*

Insurance of Product - *insures the main risks influencing productivity capacity (for example, aridity).*

Insurance of price – *insures the risk of price decrease.*

Insurance of income from product sell - *insures the risk of income loss in case of price or production level decrease.*

Insurance of farmer economies in total - *covers the total insurance of agriculture goods produced in farmer economies.*

Income insurance – *covers products and price risks, as well as production expenses.*

Insurance based on Index – *payments are done not based on the farmer products volume, but based on the calculated indexes of government agencies or other institutions.*

NEW TOOLS AND TECHNOLOGICAL INNOVATIONS

New tools

- *“accident bonds”*
- *“insurance agreements based on improper climate circumstances”*
- *“insurance agreements based on area – product index”*

Technological Innovations

- *Weather forecasting by satellite system*
- *Taking cosmic photos*
- *“early – warning system”*

Stimulating private companies

(USA, Spain, France and Italy)

- *Providing allowances on insurance fees and payments to the farmers*
- *Providing subsidies to the private insurance companies to cover some part of administrative expenses*
- *Subsidized re-insurance*

WARRANTY AND INSURANCE MECHANISMS

Current forms of Warranty and Insurance mechanisms of agriculture loans

- State investment: Nigeria, Slovenia, Belgium
- State – private sector cooperation: Turkey, France, Czech Republic
- State – international foundations cooperation: Lithuania, Estonia.
- State – private sector – international foundations cooperations: Romania, Spain.

COMMON PECULIARITIES OF LOAN WARRANTY FOUNDATIONS

- **SME approaches to the bank directly for loan. For additional warranty, either the bank or the entrepreneur himself can approach to the Warranty Foundation**
- **Main risk assessment is conducted by loan disbursing party**
- **Warranty Foundation organizes a risk observation department under the foundation**
- **Participation of private sector, especially of banks and insurance companies is supported (decreasing risks and decision-making)**
- **Usually there is no need to open regional branches of Warranty Foundations. If required, there can be opened specialized Warranty Foundations covering one or two regions.**

JOINT WARRANTY MECHANISM

“European Mutual Warranty Association” (EMWA)

List of countries of which the warranty institutions are members of EMWA

Austria; Latvia; Belgium; Lithuania; Czech Republic; Portugal; Estonia; Romania; France; Slovakia; Germany; Slovenia; Greece; Spain; Hungary; Sweden; Italy; Turkey (18 country, 34 warranty organization)

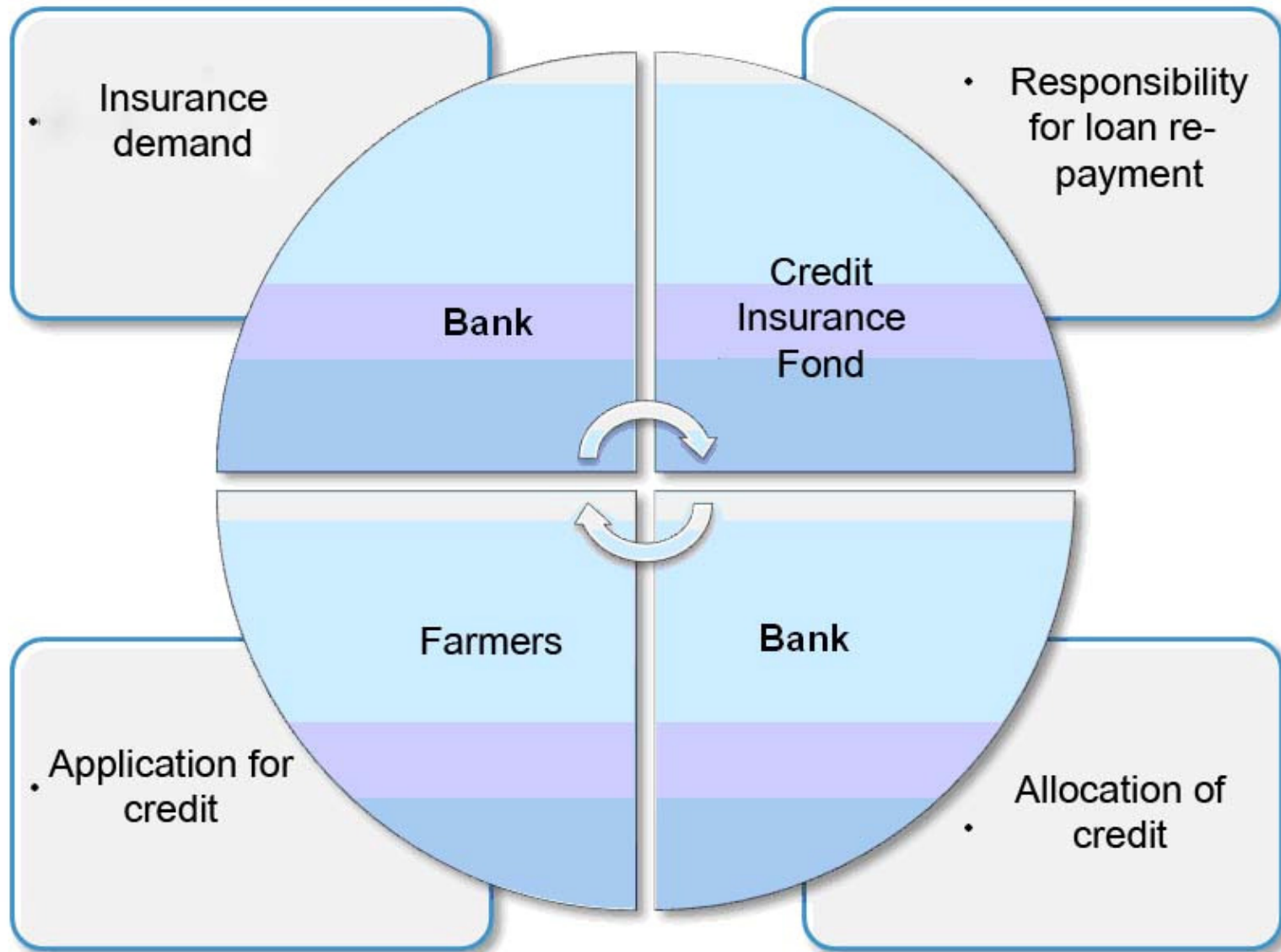
Charter objectives

- *Strengthen the role of warranties*
- *Maintain transparency*
- *Develop “joint warranties” as unique investment tool*
- *Strengthen information exchange among member institutions and etc.*

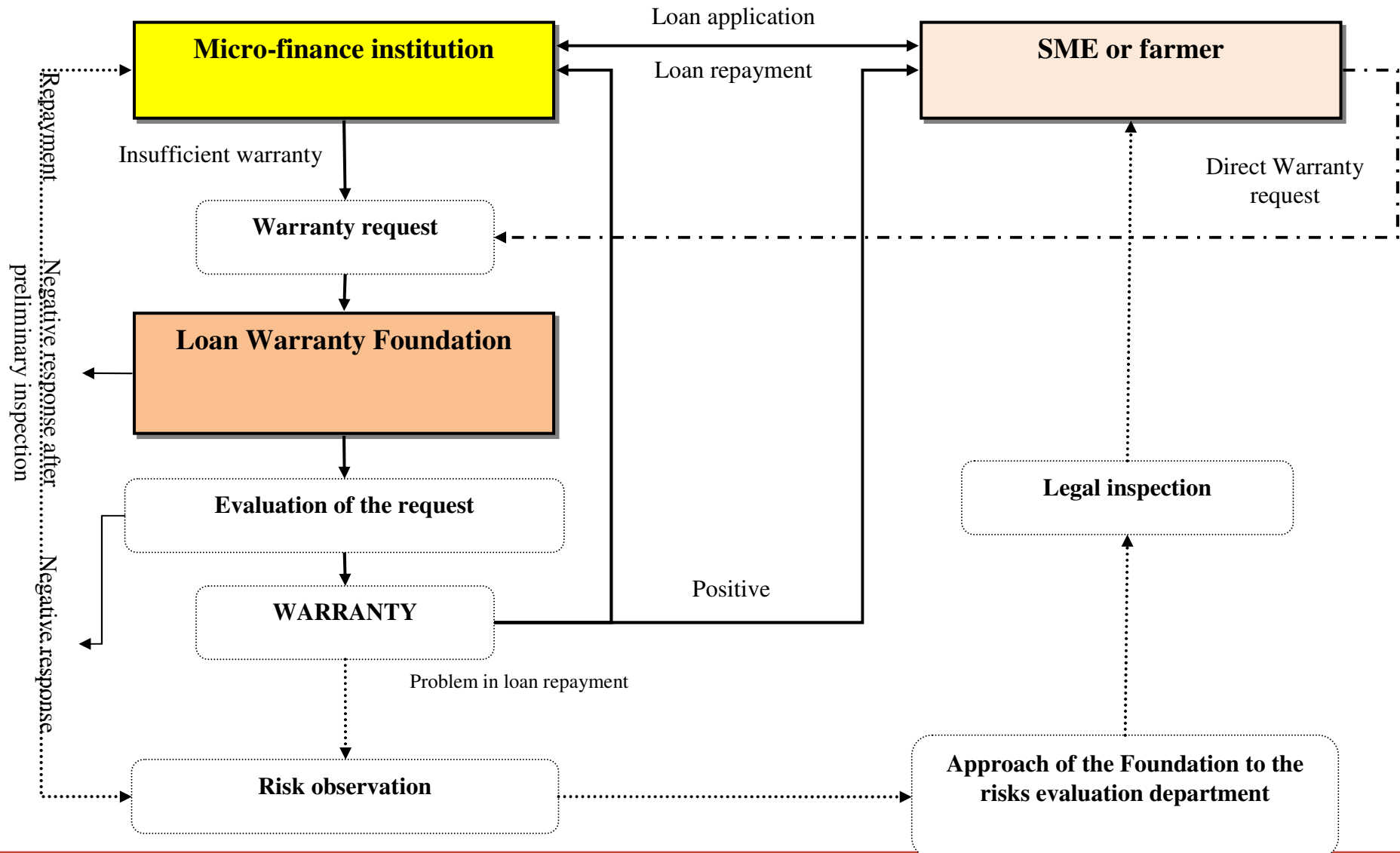
Warranty institutions – 34 institution

Represent 40 billion euro's power with 4 billion euro investment.

WARRANTY SCHEME OF AGRICULTURE LOANS



MECHASIM OF DISBURSING LOANS WITH WARRANTY



EXAMPLES

Japan – *Agriculture Loan Warranty System (“Village Associations” and “Loan Foundations”).*

Nigeria – *Warranty Scheme Foundation of Agriculture Loans*

Romania – *Loan Warranty Foundation of Rural Areas*

Turkey - *Loan Warranty Foundation*

USA – *Agriculture Loan Insurance Foundation*

Liyhuania - *Loan Warranty Foundation of Rural Areas*

Current situation in Azerbaijan Republic

- **Legal – normative base**
- **Institutional mechanisms**
- **Economical mechanisms**
- **Main challenges**
- **Recommendations**

LEGAL – NORMATIVE BASE

Legal-normative base for the development of Agrarian Reforms and Agriculture

- The Law of Azerbaijan Republic on “Basics of Agrarian Reforms” - 18.02.1995
- The Law of Azerbaijan Republic on “Reforms of State and Collective farms” - 18.02.1995,
- The Law of Azerbaijan Republic on “Land Reforms” - 16.07.1996
- Related decrees of the President of Azerbaijan Republic
- Related orders of the Cabinet of Ministers of Azerbaijan Republic and etc.

In general, there have been accepted more than 100 legislation and legal-normative acts.

Legal-normative base on development of Entrepreneurship

- The Law of Azerbaijan Republic on “Entrepreneurship activities” – 15.12.1992
- The Law of Azerbaijan Republic on “State support to Small Entrepreneurship”– 04.06.1999

LEGAL - NORMATIVE BASE

Legal-normative base on insurance activity and development of insurance market

The Law of Azerbaijan Republic on “Insurance activity” – 25.12. 2007

Legal-normative base on Microfinance Institutions and development of Microfinance market

Legal-normative base on insurance of agriculture loans.

The Law of Azerbaijan Republic on “Stimulating Insurance in Agriculture” -18.06.2002

- The decree of the Cabinet of Ministers of Azerbaijan Republic on approval of the Regulation on “Allocating financial assistance to stimulate agriculture insurance and its repayment guides”– 04.03. 2004

INSTITUTIONAL MECHANISMS

Regulating and controlling bodies:

- Ministry of Finance
- Ministry of Economic Development
- Ministry of Agriculture
- Central Bank

Credit Institutions

- State Agency on Agriculture Loans
- National Foundation on Support to Entrepreneurs
- Banks
- Non-bank Credit Organizations
- Credit Unions

Insurance Companies

Economic Mechanisms

The decree # 32 of Cabinet of Ministers dated February 15, 2007 states that 50 % insurance fee for wheat, barley, maize, sunflower seeds, potato, vegetables, sugar beet, citrus plants, and orchards' fruits will be paid by state budget resources. In this case, the insurance accidents (cases to be provided) are considered fire, hail, flood and frostbite.

MAIN PROBLEMS

- In Azerbaijan, the legislation considers the agriculture insurance eligible situations only in case of natural disasters; and therefore, the insurance cases covered by financial assistance of government are indicated in related normative act which defines limited list of natural disasters (fire, hail, flood, frostbite and torrent);
- Related law states that all agriculture products and property are considered as insurance objects, however, agriculture products which are eligible to receive state financial assistance are only some plant growing products;

MAIN PROBLEMS

- Already limited financial resources allocated by government budget to stimulate the agriculture insurance in Azerbaijan, even are not being used at all. For example, according to Ministry of Finance, the actual level of usage of allocated limited financial resources is very low. Although, State Budget 2006 allocated 172 thousand manats, and State Budget 2007, 400 thousand manats, during that FY these resources had not been used. From the allocated 550 thousand manats of State Budget 2008, only 7800 manats were used. State Budget 2009 allocated 750 thousand manats, out of which, 50 thousand manats were used;

MAIN PROBLEMS

- Awareness of farmers on such state support to stimulate agriculture insurance and mechanisms of this kind of support are in very low level;
- In general, there is a need to improve state support mechanism considering best world practices, in order to stimulate agriculture insurance in the country.

RECOMMENDATIONS

Taking into consideration high risk level in agriculture sector as well in Azerbaijan Republic, it's recommended to establish Agriculture Loans Insurance and Warranty Foundation (hereinafter, "Foundation") with the initiative of government

It's recommended to refer to best international practices on this.

RECOMMENDATIONS

It's worth of mentioning that for this purpose, there is no need to develop new law. Relatively, it can be referred to the 2nd sub-article of the article 8 “State financial support to Small Entrepreneurship” of the Law of Azerbaijan Republic on “State Support to Small Entrepreneurship” dated June 4, 1999. This sub-article states that “state financial support to small entrepreneurship is impleted through providing loans, subsidies, compensations, grants, **warranty for loans**, leasing, stimulating actions to stimulate financial-credit institutions working with entrepreneurs”.

RECOMMENDATIONS

The decree of the President of Azerbaijan Republic dated August 4, 1999 on implementation of the Law of Azerbaijan Republic on “State Support to Small Entrepreneurship” dated June 4, 1999, assigns the Cabinet of Ministers “to draft the proposal concept on establishing **loan warranty foundation** with the purpose to enlarge the opportunities of small entrepreneurs for access to the financial resources and to submit this proposal to the President of Azerbaijan Republic”.

RECOMMENDATIONS

While establishing the Foundation the following issues are recommended to be considered:

- Organization of the Foundation Stakeholders based on cooperation.
- Sharing risks based on accurate mechanism
- Exemption from tax of the activities of Foundation
- Defining Target Groups
- Defining priorities of the loans to be insured or provided warranty
- Defining maximum limits for insurance and warranties
- Defining period limits for insurance and warranties;
- Defining insurance and warranty fees and commissions;
- Defining in which cases there will not be provided insurance and warranties;
- Defining assessment criteria for insurance and warranties.



Hər kəsə, hər yerdə inkişaf üçün bərabər imkanlar yaradılmasına nail olmaq!

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