



Palestine Economic Policy Research Institute (MAS)

Microfinance in Palestine: The Legal Framework and the Enforcement of Contracts

Mahmoud Dodeen

2013



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Resilient nations.*

**This study was made possible through
the generous support of the UNDP/PAPP**



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The Palestine Economic Policy Research Institute (MAS)

Founded in Jerusalem in 1994 as an independent, non-profit institution to contribute to the policy-making process by conducting economic and social policy research. MAS is governed by a Board of Trustees consisting of prominent academics, businessmen and distinguished personalities from Palestine and the Arab Countries.

Mission

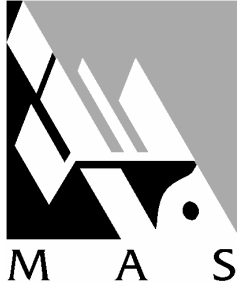
MAS is dedicated to producing sound and innovative policy research, relevant to economic and social development in Palestine, with the aim of assisting policy-makers and fostering public participation in the formulation of economic and social policies.

Strategic Objectives

- ♦ Promoting knowledge-based policy formulation by conducting economic and social policy research in accordance with the expressed priorities and needs of decision-makers.
- ♦ Evaluating economic and social policies and their impact at different levels for correction and review of existing policies.
- ♦ Providing a forum for free, open and democratic public debate among all stakeholders on the socio-economic policy-making process.
- ♦ Disseminating up-to-date socio-economic information and research results.
- ♦ Providing technical support and expert advice to PNA bodies, the private sector, and NGOs to enhance their engagement and participation in policy formulation.
- ♦ Strengthening economic and social policy research capabilities and resources in Palestine.

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Project: **Strengthening the Rule of Law and Fostering Economic Development
Through Improving Contract Enforcement**

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Microfinance in Palestine: The Legal Framework and the Enforcement of Contracts

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Foreword

Microcredit was introduced in the occupied Palestinian territory in the 1980s in response to the growing demand for financing from small and microenterprises, which were the backbone of production and employment in the Palestinian economy. Micro-credit associations were almost the only source of funding prior to the establishment of the Palestinian National Authority, which, through the Palestine Monetary Authority, has assumed the role of licensing and overseeing banks since 1995. The beneficiary base of micro finance organizations has expanded and the use of microfinance has diffused to all Palestinian governorates. This, in turn, has attracted the attention of donors given the role of micro financing as one of the key elements for development and the fight against poverty. This is especially so in light of the rising unemployment in the 1990s following Israel's limitation on the entry of Palestinian workers. The number of lending institutions, registered as NGO's or international organizations, has increased remarkably. Concurrently, more financial services have been introduced and the type and size of loans available has expanded. The successful development of the financial sector, of course, requires regulations to help these organizations grow, while simultaneously protecting the rights and obligations of the contracting parties. This task was entrusted to the Palestine Monetary Authority in 2008, which soon issued regulations in this regard.

This study seeks to examine the strengths and weaknesses of these instructions; the extent to which they are compatible with best practices; and whether they can achieve the objective of promoting the micro financing sector as an essential component of the financing tools needed to scale up development. The study also examines the quality of contracts concluded in this sector; the problems the parties face; and the causes of disputes and dispute settlement mechanisms.

With the release of this study, I would like to thank the key researcher Dr. Mahmoud Doudin and his assistants for their thorough, in-depth analysis, which will help develop the legal and regulatory environment of the sector. I also extend my sincere thanks to Dr. Anis Fawzi Qasim who supervised the study and reviewed the legal analysis. Finally, I would also like to extend MAS gratitude and thanks to the UNDP/PAPP - Rule of Law and Access to Justice Program in the oPt, for sponsoring this study.

Dr. Samir Abdullah
Director General

Executive Summary

This purpose of this study is threefold: first to provide a background of the microfinance industry in Palestine; second to examine the legal framework of the microfinance sector in relation to the industry's lending institutions, particularly considering the Palestinian legislative and regulatory framework with relation to the international best practices; and third to explore the way loan contracts are finalized, so as to come up with constructive developmental policies pertaining to the microfinance sector. To that end, the study reviewed the regulations of the microfinance sector in Jordan, Egypt, Morocco, Syria, India and the European Union. Further, a field research was conducted to extrapolate the status of micro-lending institutions; the context in which they work; as well as the scope of enforcing contracts with customers. Finally, the study seeks to measure the extent to which the new legislative regulation is compatible with the work of these institutions, and with the microfinance sector in general.

The study found that, from an internationally-recognized perspective, there are no Palestinian laws regulating the microfinance sector, whether in theory or in practice. There are no regulations that define the terms 'small credit' and 'micro credit.' Based on the idea of social inclusion in the framework of the overall financial system, the economically active poor and low-income individuals have not been defined as target groups. The focus of the legislative framework was on regulating the work of the lending institutions as non-banking financial activity rather than on promoting the interests of these groups.

The field research revealed confusion and uncertainty among a sample of lending institutions that couldn't meet the requirements of the new regulatory environment. The research also found that the majority of lending institutions registered as non-profit societies tend to turn into profitable companies because the regulations in force do not give such institutions advantages over companies, which might ultimately lead to restricting micro-finance services to profitable businesses.

The field research also found that the promissory notes, checks and personal sureties are the most frequent collaterals lending institutions use. At the same time, individuals represent the majority of beneficiaries, who, when asked about the services provided to them, said such institutions need to upgrade their financial services to further encompass accepting deposits, savings, remittances, and micro-insurance in line with these

individuals' financial situation which falls short of meeting the requirements of the banks. The study showed that the loan disputes between 1999 and 2011 represented 3.08% of the total loans granted in the West Bank, compared to only 1% in the Gaza Strip. Defaulting was found the main reason behind such disputes. Often, these disputes are settled by the court, particularly the divisions of enforcement in the competent courts, whereby the credit institutions file debt securities for enforcement based on 2005 law. Later, disputes are settled through direct negotiations between the creditor and the debtor. Sometimes, some people who are socially influential and who are well-acquainted with the debtors pressure them to comply with the terms of the loan contract.

The study concluded with a number of recommendations that would develop the microfinance sector in terms of improvement of legislation and the performance of lending institutions.