

THE MINISTRY OF EDUCATION OF THE REPUBLIC OF AZERBAIJAN

AZERBAIJAN STATE UNIVERSITY OF ECONOMICS

INTERNATIONAL GRADUATE AND DOCTORATE CENTER

MASTER DISSERTATION

ON THE TOPIC

**“THE ROLE OF CAPITAL MARKETS IN ECONOMIC
DEVELOPMENT OF AZERBAIJAN”**

FUAD SAFARLI GURBAN

BAKU – 2019

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DEVELOPMENT OF AZERBAIJAN”**

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Elm andı

Mən, Səfərli Fuad Qurban oğlu and içirəm ki, “The role of Capital Markets in economic development of Azerbaijan” mövzusunda magistr dissertasiyasını elmi əxlaq normalarına və istinad qaydalarına tam riayət etməklə və istifadə etdiyim bütün mənbələri ədəbiyyat siyahısında əks etdirməklə yazmışam.

Kapital bazarlarının Azərbycanın İqtisadi İnkişafında Rolu

Xülasə

Tədqiqatın aktuallığı: Qloballaşan və dinamik inkişaf edən dünyada xarici investisiyaların ölkələrin iqtisadi inkişafında rolu danılmazdır. Azərbaycanın yeni inkişaf modelləri axtarışı ölkənin xarici investisiyalara açıq olmasını zəruri edən amillərdən birinə çevrilir. Bunu nəzərə alaraq, ölkəmizdə iqtisadi artım yaratmağa meyilli kapital bazarının mövcudluğu resursdan aslı iqtisadiyyatımızın şaxələndirilə bilməsi üçün həyati əhəmiyyət daşıyır.

Tədqiqatın məqsəd və vəzifələri: Dissertasiya işinin əsas məqsədi Azərbaycanda mövcud olan kapital bazarının hazırki modelini, inkişaf meyillərini, problemləri araşdırmaq və kapital bazarının inkişafı istiqamətində tədqiqatın nəticəsinə uyğun müxtəlif istiqamətlərdə müvafiq təkliflərin verilməsindən ibarətdir. Tədqiqatın vəzifələri isə mövcud statistik məlumatlar əsasında Azərbaycanda hal-hazırda mövcud olan kapital bazarının hazırki vəziyyəti, inkişaf meyillərinin istiqamətlərinin aşkarlanması, qanunvericilik bazasının, xarici kapital bazarlarıyla inteqrasiya istiqamətlərinin, ümumi fəaliyyətin optimallaşdırılması istiqamətində analizlərin aparılması və qarşıya qoyulan məqsədə çatmaq üçün təhlillərin aparılmasından ibarətdir.

İstifadə olunmuş tədqiqat metodları: Dissertasiya işinin hazırlanması zamanı tədqiqat metodu kimi analiz metodundan istifadə olunmuşdur. Azərbaycanın kapital bazarlarında olan mövcud vəziyyətin qiymətləndirilməsindən, trendlərin və problemlərin analizindən sonra isə kapital bazarının inkişaf yarada bilmə istiqaməti nəzərə alınaraq təkliflər verilmişdir.

Tədqiqatın informasiya bazası: Tədqiqatın hazırlanmasında informasiya bazası kimi ilkin mənbələrdən, elmi-tədqiqat əsərlərindən, Azərbaycanda mövcud statistik məlumatlar bazasından, habelə müxtəlif internet resurslarından istifadə olunmuşdur.

Tədqiqatın məhdudiyyətləri: Tədqiqatın aparılmasında əsas məhdudiyyət Azərbaycanda mövcud olan statistik məlumatların məhdudluğu, habelə müxtəlif təyinatlı analizlər aparmaq üçün informasiyanın məhdud və ya heç olmamasıdır.

Tədqiqatın nəticələri: Tədqiqatın nəticələrinə əsasən Azərbaycanda kapital bazarının inkişafı üçün və ən əsasında bu inkişafın ümumi iqtisadi inkişafda öz əksini tapa bilməsi üçün potensial mövcuddur. Lakin bu potensialın reallaşdırılması üçün iqtisadiyyatda ciddi islahatların aparılması zəruridir.

Nəticələrin elmi-praktiki əhəmiyyəti: Öldə edilmiş nəticələr, gələcəkdə sahənin inkişafı üzrə aparıla biləcək mövcud islahatlarda istifadə edilə bilər. Həmçinin, kapital bazarının inkişafı əsasında yaranacaq təcrübənin iqtisadiyyatın digər sahələrində tətbiqinə nail olmaq olar. Günümüzə kapital bazarlarının dövryyəsinin artaraq birbaşa investisiyaları nə qədər üstələdiyini nəzərə alsaq, tədqiqatın praktiki əhəmiyyəti böyükdür.

Açar sözlər: Azərbaycan, kapital bazarları , iqtisadi inkişaf.

ABBREVIATIONS

AE	Advanced Economies
BOP	Balance of Payments
BSE	Baku Stock Exchange
CBAR	Central Bank of Republic of Azerbaijan
CGFS	Committee on Global Financial System
CIS	Commonwealth of Independent States
EME	Emerging Market Economies
EU	European Union
FDI	Foreign Direct Investment
FİMSA	Financial Markets Supervisory Authority
GDP	Gross Domestic Product
IMF	International Monetary Fund
IPA	Investment Promotion Agency
İSE	İstanbul Stock Exchange
MFAR	Ministry of Finance Republic of Azerbaijan
MIFID	Markets in Financial Instruments Directive
SCS	State Committee for Securities
SOCAR	State Oil Company of Azerbaijan Republic

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Introduction

The actuality of work. During the last years, Azerbaijan suffered from decreasing of oil prices and from external shocks. These issues made actual diversification of economy and reviewing existing economic policy. Capital markets seem to be key for the attraction additional investments and financing of government budget deficit. However, some important problems in capital market of Azerbaijan exist that stand as a barrier for its ability to operate as a growth driver. Relatively low volumes of trade could be explain with the population distrust and ignorance, closeness for foreign capital markets and with the overall problems of countries economy.

Statement of problem and level of learning. Financial system of Azerbaijan is heavily stand on the banking system. Yet, in world practice, it is more widespread to invest or attract financial resources from capital markets. Foreign portfolio investments enter to countries economy through the capital markets also. Yet, there are several problems regarding the integration of national capital markets with other capital markets. Low level of population confidence on capital markets became barrier for the energizing investment process in country economy also. There are several works regarding the problems of capital market yet they are not cover the problem of capital markets as a provider of economic development.

The purpose and missions of research. The main purpose of research is providing policy recommendations for the development of capital markets and activation its ability to provide economic development. Research gave comprehensive analysis about development history and current situation in national capital market try to define positive and negative aspects in structure of trade. The mission of research is to analyze and define the problems that exist in capital markets that stands as a barrier for economic development and prosperity. Capital markets in developed countries provide opportunity for the investment and financing process.

So, it is very crucial to define the key points that will allow to our countries also take the opportunities of such trade.

Subject and Object of Study. The object of research is the national capital market under current economic conditions. The subject of research is the potential benefit that could provide developed and proper working capital markets.

Research methods. Research aims at finding key correlations between the economic growth and the capital markets by discussing cause-and-effect instance on top qualitative research methods. At the end, in order to derive suggestions for better understanding of these two notions and how they are interrelated, we will look at the discourse analysis. Though the research mainly focuses on the explanatory and analytical discussion, the utilization of the quantitative data will be handful to support the evidential conclusions of the research results. First up, the data gathering will kick-off with primary academic resources from the following sources: statistics, report, conference etc. Secondary resources offer much wider insights to the analytical approach to the case with hand-picked ideas from various articles, review and many more. Below are major sources, which will utilized to research on the topic: academic investigations, books etc. All-in-all, the research will avoid biased opinions and facts to ensure the quality results at the end of the research project.

Research database. The key concepts of economic theories about capital, its place and role on economy etc. In addition, comprehensive theoretical background about working principles of capital markets from the works of prominent economists. The statistical data from the official website of Ministry of Finance, Central Bank, Financial Markets Supervisory Authority, World Bank and The Organization of Economic Co-operation and Development. Also closed research made by famous institutions, organizations etc.

Limitations of research. There are several problems exist in access to comprehensive statistics that needed. In addition, due to the primitivism of national capital market let make analysis only based on several most important indicators and that's all.

The practical importance. As our national capital markets are on development stage these types of researches could provide evidence for future reforms. Research provide with the policy recommendations applying which could result the positive progress for capital markets and economic development

The structure and length of dissertation. Master dissertation consists of Introduction, 3 Chapter, Results and Recommendations, References and Appendix. To improve the accuracy of the research 7 tables and 2 graphs were used in the dissertation. The total length of dissertation covers 65 pages.

CHAPTER I.

THEORETICAL BASIS FOR ANALYSIS OF CAPITAL MARKETS

1.1. Place and role of capital in the economic system

According Thomas Piketty does not matter nation, company or global economy the income considers the sum of capital and labor income. The dissertation topic is heavily relied on capital market, so it is crucial firstly answer the question what is capital? (T. Piketty,2013)

Generally, capital regarded as money. However, it is wrong to confuse money with capital, as capital is wider concept than money. First and most important aspect is that capital act as a factor of production like labor and land. Money can buy resources that will participate in production process but on itself could not regarded directly as a factor of production. Yet, capital also produced on itself. For example, machinery that participate in production process beforehand itself produced by labor and capital like other products. However, capital should take into consideration with the labor as a creator of wealth. (M. Gaffney, 1994)

Behind all of it, several characteristics of capital should considered.

Firstly, as mentioned before capital is produced factor of production. In a result, supply of capital easily could increase. In addition, capital involves element of time that is why it used to calculate the value of capital by the percent per annum. It can said that capital is able to improve the usage of other factors of production as well.

Capital can categorized in two forms.

- Working capital
- Fixed Capital

Fixed capital is more associated with the non-current assets. Usually fixed capital is going to serve business for more than one accounting period. Investment that made to fixed capital is required for long-term benefits and more strategy oriented. Fixed capital mainly used for promotion, expansion, modernization and so on. As fixed capital purchased and considered for use of certain period its price reduced over time. Working capital is required for short-term goals. Working

capital meet the daily requirements. Best examples of working capitals are raw materials that used during the production process.

Throughout the history, term capital changed its scope. For classical economy, capital first of all is the factor of production. In the 19th century Marxist theory added new concepts like fictitious capital that is not real capital but claim the profit of real capital. (K. Marx, 1894) Banking capital, profit from securities and rent considered as a fictitious capital, which exist behind with real capital.

In modern times the term capital used for several meanings like financial capital, human capital, social capital, intellectual capital etc.

Financial capital usually regarded as an investment capital. It could regarded as the main resource that let company to operate and expand. Financial capitals mainly represented by the debt and equities.

In order to attract financial capital financial markets are used. Financial markets are places where securities traded. Securities are other types of capital. However, unlike from money and goods, securities can suggested as a good in market also could provide benefit on itself. Securities provide the all confirmed rights to holder. (M. Sadiqov, 2007) These rights expressed by the securities. For these reason, securities become ideal tools for the development and expansion of economy.

We can describe several characteristics of securities:

- Securities issued with a series
- Securities act as a property so they can act as a object of property relations
- The same types of securities have the same content in order that securities are standardized
- Cycling of securities
- Securities act as subject of trade relations in market (M. Sadiqov, 2007)

Securities have several very important functions:

- Securities deal with the distribution of capital between different sectors of economy including state, population and business.

- Securities could provide holder not only with the capital rights but also with the authority

- Securities provide the revenue from capital as well as provide return of capital

Securities can be divided into several groups by maturity dates, risk level, issuance type, ownership type, profitability etc. (M. Sadiqov, 2007)

There are several types of securities:

Stocks: Stocks are securities that confirm the ownership of holder, his right to participate in supervising activity, right to get dividend as well as right to get share after the closing of company or organization. Issuer of stocks could be only stock company.

Stocks divided into common stocks and preferred stocks. Common stocks are stocks that provide the ownership. In addition, common stock gave to its owner dividend from the company's profit in order that return from investment increase as company prosper. Common stockholder gets dividends that company decide to distribute. However, at the same time investor takes all that risks which could stretches non-professional management. In case of bankruptcy stockholder could claim assets that left after all liabilities of company will be done. Preferred stocks also provide ownership. Yet there are several differences between common stock and preferred stock. Firstly, unlike from common stock preferred stock gives to owner fixed dividend annually. Secondly, preferred stockholder gets its dividend before common stockholder get it. Finally, preferred stockholder does not have vote right unlike common stockholders that have say in company and vote during election of board of directors.

For companies, that established on corporate basis issuing stocks and operations with them became the main source of financing, investment activities and most importantly for profit. Profit that accumulated from stocks called dividend. Dividend is the net profit of company that has divided between stockholders based on its amount. It means those investors that owned more stocks on company's portfolio, will get also more dividend payment. Dividends could be

pay in different ways including with cash, with the products that company produces, in addition with the additional stocks. All these payment methods described beforehand of purchasing operations held by the company. Time for payment of dividend could be once a year, in decade, once in month etc. depending on companies policy that also described before the purchasing

Stocks have face value and market value. Face value is the value that showed in certificate of stock. This value is nominal value and described by the issuance of the stock. In company, all stock's face value could be the same and could not be any discrimination for stockholders. However, market value is the value that could change in daily basis and price defined by demand and supply in market. For that reason, stocks become the instrument of speculation. Performance of the company effect on the price of stocks that's why value can change over the time.

Stocks are divided into several groups:

For issuer: corporate and non-stock company's stocks

For profit distribution: ordinary stock - profit distributed equally based on stocks amount, preferred stock – dividend does not depend on profit of company and provide fixed profit for stock.

For liquidity rate: liquid – easily converted into cash that is the most liquid asset on itself and non-liquid – turned into cash hardly.

It is a common practice in developed countries to issue stocks that do not give any right to ownership to its holder. These stocks issued for getting financing yet actual owners of company do not desire to provide ownership. These stocks, do not provide stockholder with the vote right and supervision authority. From this side, they are similar with preferred stock. Still, buyer expect high profit from these types of stocks. In addition, prices of these stocks also relatively low. In practice, there are also stocks that gave voting right but this right ten time weaker than ordinary stock's. This is the limitation for the supervision yet gave certain type of authority right to owner.

There are also negative sides of owning stocks. If company going bankrupt the property that left after company distributed unequally. First creditors get their

share from this portion. Then preferred stockholders get their share and in the end ordinary stockholders.

Bonds: Bonds are the securities that let the buyer to get nominal rate of bond in distributed time. In addition, bonds let to get interest rate from nominal price of bond. The lifetime of the bonds is called maturity date. At the end of maturity date bonds withdraw from the turnover. In modern world, stocks are most essential instrument for attracting financing for companies, and for other institutions, yet bond's role as a most popular debt instrument is tremendous. As bonds also could be issued by the government different commercial and non-commercial organizations etc. Bonds is the security that define the debt relations between issuer and buyer. Issuer become obliged to make periodic payments to the owner of bond.

Bonds are also effective instrument for government borrowing as local government, municipalities, central banks used bonds for government spending including infrastructure projects, financing deficit etc.

There are several fundamental qualities of bonds as below:

- Define the relationship between buyer and issuer. Buyer of the bond automatically became the borrower of company
- Bonds have maturity date. At the end of maturity date, issuer pay the nominal value of bond
- For the revenue distribution, bond holders have advantage behind the stockholders. As interest rate for bonds paid before the dividend from stocks.
- In case of bankruptcy, bond holders has advantage behind the stockholders as it first get share from left property.

In addition, we must mentioned that bonds payments on interest rate is not depend on profitability of company and always fixed. This feature make bonds more conservative tool for the investment and less risky. However, yet there is existed difference between bonds for their risk level. For example, US government treasury bills can described as a low risky debt instruments.

Like stocks, bonds also have face value and market value. Face value of bonds issued on the bond and define the borrowed money. Face value act as a core value

for calculating interest rate. Face value in bonds is very important as it shows the bond's profitability. Market value is the value that changes over time depending on the demand and supply that is provided by the market configuration. Until the maturity date, bonds traded in capital markets by their market value. Several issues usually have an effect on the market rate of bonds:

- Maturity date – as the maturity date becomes closer its ability to provide interest rate decreases. As a result, most valued bonds are usually newly issued bonds.

- Rate of interest payment – that must be said that interest payment from the riskier bonds are usually higher than less risky. The reason for that is the desire to attract investors for the purchasing of the companies' bonds that have financial problems or urgently needed additional financing.

- Market value also depends on risk level, financial situation of issuer's company, guarantee level of bonds etc.

Buyers in developed countries prefer buying bonds rather than stocks as it has several advantages. Companies also are more interested in attracting debt capital by bonds than direct banking financing because bonds issued for a long time. In developed countries, average maturity date for bonds is 10-15 years.

As an issuer of bonds can act companies, governments, local governments, municipalities etc.

Bonds have several types as below:

- Call back bonds – give an opportunity to buy bonds before the end of maturity date with a higher price than face value.

- Cumulative bonds – interest payment made at the same time with maturity date

- Special bonds which maturity date can be extended. These issuer friendly bonds are usually have a long maturity date but could be extended depending on issuer's desire.

- Bonds that could be ended before maturity date.

- Convertible bonds – let the holder to adjust the bonds to preferred stocks or other bonds

There are two types of financial markets: money market and capital market.

Money market is the market where short-term securities are traded. Trades in money markets are in large sizes so small and medium enterprises usually do not participate in money market trade. However, they can participate through the joining in mutual funds. The most common debt instruments traded in money markets are treasury bills, bank certificates of deposits, commercial papers etc.(F.J. Fabozzi, 2006)

1.2. The essence and structure of capital market, its theoretical models

Any activity of company doesn't matter if it is a financing or operating activity is to increasing wealth of its owner. In order that, manager's decision of issuing bond or stock for getting financing directly influence on company's prosperity. That's why, it is very important for managers and decision makers to understand the structure and essence of capital market. As an functions and importance of capital markets we can mention as below:

- Capital markets attract savings into economic activity
- Regulate the flow of capital from one sector to another
- Act as a tool by government for the covering of budget deficit
- Define the real value of assets
- Enhance population participation on economic activities
- Affect on inflation rate
- Decrease the rate for capital turnover (M.Sadiqov, 2007)

Also we can describe several market functions of capital markets:

- Commercial functions
- Regulatory functions
- Value functions
- Informative functions

Firstly, for the time of realization securities divided into money markets and capital markets securities. Money markets are markets in which short term

securities are traded. Money market include short term debt obligations with the maturity date less than one year.

Capital market is the market where long-term securities traded. Long term securities regarded as securities with the maturity date more than one year. Capital market securities are divided into equities and debt securities.

Equities also referred as a stock give the holder ownership of company. Stocks can be common stock also preferred stock. Common stocks are stocks that provide the ownership. In addition, common stock gave to its owner dividend from the companies profit in a result, return from investment increase as company prosper. Common stockholder gets dividends that company decide to distribute. However, at the same time investor takes all that risks which could stretches non-professional management. In case of bankruptcy stockholder could claim assets that left after all liabilities of company will be done. Preferred stocks also provide ownership. Yet there are several differences between common stock and preferred stock. Firstly, unlike from common stock preferred stock gives to owner fixed dividend annually. Secondly, preferred stockholder gets its dividend before common stockholder get it. And finally, preferred stockholder doesn't have vote right unlike common stockholders that have say in company and vote during election of board of directors.

The second type of capital market securities are indebtedness. This type of debt obligations is made liable to pay face amount by maturity date and usually to pay interest rate for it. Debt obligations can be categorized as bank loans and debt securities. Before bank loans doesn't considered as a capital market instrument however in recent years syndicated bank loan was established. It is a special instrument that consider loan provided by several banks in order to distribute risk and stretch requested amount. Debt securities include bonds, notes, medium-term notes, and asset backed securities. Debt securities in most cases provide investor with a periodic payment. Interest rate that debt securities provide can be fixed or floating. Fixed interest rate as it seen from its name gave investor fixed payment.

However, floating interest rate can be pegged into market interest rate or the return on another investment.

For sales characteristics capital markets can be divided into primary market and secondary market. Primary market is the market where new issued securities are traded. Trade in primary markets are made by specific companies through buying securities directly from issuing company. In market, there are several new companies that try to attract investment for financing activities. It called IPO (initial public offering). Secondary market is the place where before issued securities are traded. Existence of secondary market increased the liquidity of capital markets as it is guaranteed that securities can be re-traded. Issuing party are mainly doesn't participate in secondary market trade.

As a structure capital markets can be divided into 3 main components: buyers, sellers and intermediaries. Usually, as a buyer acting each subject that needed long-term financing especially - entrepreneurs, corporates, banks, governments etc. As a seller acting those who made saving and their participation is based on desire to increase capital. Trading between buyers and sellers performed by the intermediaries. As an intermediary in capital markets usually act commercial banks, investment and trade banks, brokers etc.

In order to arrange professional operation of capital markets it is very crucial to build infrastructure, and organization work of professional participants of capital market. Infrastructure play an important role in organization of trade between professional participants. Infrastructure of capital market include professional participants, investors, electronic systems that allow and arrange work of market participants, payment systems etc.

Professional participants are core of market infrastructure. They organize the access of investors into capital market, deal with the operations, payment and registration of transferring ownership of securities from one side to another. The main professional participants of capital markets are as below:

Broker activity: Brokers are professional participants of capital market. Brokers act as an intermediary agent between buyers and sellers. Brokers act in a

contract basis on market from client's interests. Broker takes order from client about buying and selling of security and enter the order into trade system. Brokers does not operate with their own interests. Also, they do not trade with their own resources and only get brokerage in return for their activity.

Dealer activity: Dealers are another professional participants of capital markets. They do not serve for others interests but only by their own. Dealers buy securities by their own resources and hope to sell it with higher price. They do not get commission but take price difference as a markup.

Supervision of investment funds: Investment funds are special funds that deal with the investment of financial resources of their clients into certain securities in capital markets. Investment funds decide investment decision by their own and owners of money trust decision of investment funds. Investment funds could possess money, securities also property that is necessary for the operation of investment fund. Managers of funds conduct the work of funds. Supervisors of funds are threat separately from their funds and can deal with the several funds at the same time. Investment funds should create the depository and there can be only one depository to hold the all securities of fund. Also, investment fund could found registry for the all investors. In Azerbaijan, there are two types of investment funds: open-end funds and closed-end funds. Open-end funds are create in format of stock companies and own a lot of shares. However, closed-end funds are create in format of investment club and usually has limited shares in public. Open-end funds are obliged to repurchase shares that will sold. Hence, closed-end funds does not have such oblige.

Organization and activity of stock exchange: Stock exchange is the organization that deal with the proper organization of securities trade, defining of its fair price based on market demand and supply, broadcasting information about securities and creation of environment for the market participant's demonstration of their abilities from best side.(E. Sadiqov,2010) Stock exchanges are close-end organization that organize trade between its members and enhance the fulfillment of the results of this trade.

Stock Exchange could organize its work only after getting permission from corresponding authority. This authority is usually define by the government and can deal with several interrelated activities. Participants of stock exchange are brokers and dealers that agreed to act with stock exchange rules. They are those who got permission and their activities could related with the investment of others assets or with their own assets. In addition, stock exchange can deal with the depository activity and with clearing. Yet, stock exchange can not deal with professional participants activities like investment management, broker or dealers activities. As it could create moral hazard and asymmetric information problem. Stock Exchanges are responsible for the trade that organized in its market based on the authorities and its own legislation.

Stock Exchange responsible for the creation of system that will provide prices and let the operate with securities. Workers of stock exchanges could not act in the trade process and participate as a professional. Days organized by stock exchange for auctions are known as a trade days. There could be several sessions in one trade day. Participants of trade are those physical and juridical faces that get special permission for the trade in burden of defined laws. All professional participants of capital markets also could be participant of Stock exchange. Yet, Stock exchange keep the authority for defining participants and in several cases could refuse the participation in market.

Clearing activity: Clearing organize the trade procedure for the buyers and sellers in capital markets. Clearing ensure the receiving security for buyers and receiving payment for seller. This process cover the collection of information about deal, its controlling, and preparation of accounting documents on it. For the clearing activity you must get license from certain authority. Clearing organizer get fixed payment from each deal that does not related with the trade on itself.

Depository activity: Depository is the institution that deal with the security of traded securities and their certificates. Depository service simplify the activities with the securities. As huge amount of trade resulted with the rapid changes of security holder, it let become more operate than direct work with the register holder.

User of the depository service named as deponent. Depository also can act as a register holder yet it could not be broker, investment fund, dealer or stock exchange.

Register holders activity: Register holders deal with the registration of securities owners. There can be only one register holder for each organization and company. Still, one register holder can service for different companies in market. Only judiciary persons can act as a register holder. The functions of register holders can be described as below:

- Initial registration of issued securities ownership information for the other participants of market.
- Registration of adjustments in market about buying or selling.
- Controlling of mechanisms of dividend and profit legislation
- Informing security holders about information of annual or unusual meetings
- Reporting for the regulators

In world experience, there are two main models of capital markets: American model and European model.

American model of capital markets have several characteristics. First, source of investments in American model heavily rely on foreign investments. Main participants of market are investments funds, investment banks, private pension funds and other institutional investors. Market regulation is based on self-regulation. Main securities are state issued securities. In addition main trading securities are stocks.

European model characterized by the investments of internal investors. Main participants in this model are commercial banks are credit institutions. Regulation made by the government and main security types are bonds.

Main difference between of these two models is in professional market participants and their activities. In European model, the core participants of market are credit organizations and organizations that deal with the limited banking activity. However, in American as professional participants big financial and industrial groups, pension funds, investment companies and special funds operate in market.

There is also additional Japanese model that characterized as a mix of both of these models.

If we should define the model for Azerbaijan capital market, we can see specificity of our market is more closed to European model. This tendency already showed itself in the foundation of national capital markets and especially in foundation of BSE. As it is enough to look through the list of founders of BSE. It is easily has noticed that, with the formation of BSE mainly banking and credit companies has deal with.

Table 1: Founders of BSE

Yapı Kredi İnvest	Brokdil-Az
İstanbul Stock Exchange	Republic İnvest
AzeriGaz Bank	Technic Capital Management
Uni capital	Kapital Bank
İnternational Bank of Azerbaijan	Yunayted Kredit Bank
Kapital Partners	ADB Broker
Global Securities	Azerbaijan İndustrial Bank
Azer-Turk Bank	Standard Capital
Mars İnvestment	BOB Broker

Source: BSE website, <https://bfb.az/eng/tarixce>, 2019

1.3. Regulation of capital markets: international experience

Regulation of capital markets play an import role in its essence. There are two main types of capital markets regulation:

- 1) Government regulation
- 2) Regulation by market participants

Government regulation is based on norms that issued by governments. Self-regulation of market consider regulation by the specific organizations, market participants etc.

Government regulation describe several characteristics:

- Applying government program on Capital markets development
- Achieving security for professional participants and for clients
- Enhancing for the providing of information by market participants

For the regulation of capital markets several methods are applied:

- Registration of issuing securities
- Applying license
- Attestation of market participants
- Insurance of investors
- Ranking and audit control to issuance
- Registration of clearing activities
- Controlling of fund operations
- Controlling and publishing of information

In most cases financial markets regulated by specific government organization or authority by depending on its type. Before the creation of FIMSA in 2016, regulation of capital markets made by State Committee on Securities under President of Azerbaijan that deal with the below issues:

- Creation of the main directions of capital markets development
- Creation of legislation base for capital markets
- Regulation of capital markets, licensing of market subjects and their supervising
- Controlling the implementation of legislation by capital markets participants

However in some cases stock exchanges act in basis of self-regulation. There are several aims for self-regulation as below:

- Improving efficiency level of market
- Protecting the interests of investors and participants
- Introducing ethical norms between participants of market
- Informing government regularities with the scope of needed information

In order to ensure the durability of capital markets and to develop the regulation mechanisms since 2016, FIMSA was created. FIMSA deal with the regulation, licensing and supervision of capital and securities markets, investment funds, debt and insurance activities, payment systems also non-banking financial institutions. As a basis FIMSA takes international standards and norms. Since the creation of FIMSA, SCS has been abolished.

In Azerbaijan, regulation function made by not only by government but also non-government structures and organizations, associations and unions of professional participants etc. However, their roles in market regulation are not as like in developed countries. Unions and associations like this are work on self-regulated basis yet under the existing legislation.

The main strategic directions that will let to adopt the international standards in Azerbaijan capital markets and through this let to develop capital markets are to improving investor confidence, decreasing existed financial risks, implementation of pricing system etc. In order to achieve these goals several important steps should be taken in the level of overall economy.

- Achieving long-term development that will arise through the implementation of innovation
- Introducing proper working legislation that will serve both investors and savers
- Achieving population confidence on banking, insurance and overall financial system
- Creation of system that will stimulate of attraction population savings
- Creation of mechanisms enable of development financial markets
- Implementation of system that will create and serve fair competition on market
- Gradual integration of national capital markets into the world system

The capital markets by means of organization and functioning have a significant role in process of economic development. The size and scope of these markets and their turnover have become the standard of the prosperity of the economy for many countries. Such markets stimulate the economy through long-term measures. Firstly, it is an efficient instrument for allocating funds for development projects and infrastructural facilities. It resembles a pool for the government to sell their bond and finance its projects, which are expected to return multiplier effect for the economy overall. The government usually deal with the

sale of only bonds, yet private entities also arrange selling both bonds and stocks. In case a company plan to invest long-term on a strategical issue, it may decide to issue bonds or stocks. Such situations are often followed by capital markets taking an intermediary role. The thesis also explores how the funds are created by domestic savings as well as by mobilizing foreign capitals. In the perspective, increased investment by companies will lead to employment expansion, income generation, and with a larger percentage of the population's earning income, savings and consumption will increase resulting in a cycle of increased investment, increased production, enhanced economic growth and wealth creation. In addition, they will be able to expand to foreign markets and by these ways it will be possible to make a greater contribution to domestic economy.

Secondly, it is open ways for the establishment of institutional investors and tools like private pension funds, banks, mutual funds, hedge funds, retail investors etc. As investments of pension funds usually take a long-term basis, they are active beneficiaries of capital markets. It should be noted that in almost all OECD countries public and private pension schemes exist alongside one another. Public pension plans are often designed in such a way that redistribution, savings and insurance objectives are combined. It is fair to say that the existence of funded pension plans should have a positive impact on the size of the capital market. First, while funded pension plans may exist in many countries, we would expect them to have a significant impact on the size of the capital market only where a substantial part of retirement income is in fact covered by these plans. Second, it should be noted that retirement income can come from multiple sources. Employees may decide during their working life to use other saving alternatives, like life insurance contracts, real estate or mutual fund investments, other private savings, etc. Therefore, it could well be that even though funded pension schemes in a given country is small, a substantial portion of retirement savings is allocated via the capital market because of these alternatives. Third, the saving propensity in an economy is likely to be influenced by the overall tax treatment of retirement savings. Of course, to the extent that pension plans are mandatory, as is the case for

most public plans, but also to some extent for private plans, tax treatment is less relevant. However, voluntary retirement savings will be strongly influenced by the tax framework. It is worth noting in this regard that because of the pressure exerted by increasing longevity on public pension schemes, several countries have introduced favorable tax treatment of retirement savings. One example in this regard is deferred income taxation. This might apply to occupational pension plans only, or to personal retirement savings as well.

Moreover, the development of capital markets creates a legal basis, norms, and corporate governing practices for the whole economy. Through full disclosure requirements, companies are encouraged to observe better accounting and management practices, hence leading to greater transparency in the business sector and lower incidences of corruption. This will lead to good corporate governance.

Capital markets are very important in several aspects

- Capital market attract free money into economy and act as an intermediary between saver and investor

- Regulate the development of different sectors of economy by ensuring movement of capital

- Act as an source of financing for government in order to cover government deficit

- Ensure population's participation in production and economic activities overall

- Define market prices for the assets

- Let to define the economic situation through the situation of financial markets

- Affect the inflation rate

- Cut the capital movement cost for investors and savers

In international experience, especially in European countries, capital markets established as private institutions. However, in time as capital markets became more

complicated institutions government regulation become the crucial in order to defend participants rights.

CHAPTER II.

PECULIARITIES OF CAPITAL MARKET IN AZERBAIJAN

2.1. Evolution of capital market in Azerbaijan

Performance of financial markets in Azerbaijan directly interrelated with the formation of financial institutions and corresponding infrastructure. Accordingly, formation and development of financial markets are strongly depend on government actions, orders. Hence, it is one of the main barrier in formation and development of proper working financial markets.

In world practice, capital markets are most regulated financial markets as it is raise from the necessity to maintain the security of participants, high financial risks and the volume of trade. In most cases, these regulations made by governments or self-regulated participants of capital markets. The main regulator of capital markets is government.

The formation of first capital markets in Azerbaijan happened in the late of 19th century. Under the Russian Empire began the turning process of Azerbaijan from agrarian feudal country into commercial industrial with the capitalist elements. Oil boom of that period stimulate the development of other sectors that related with oil sector like construction, transportation, refinery, banking sector etc. and formulation of first joint-stock companies at the same time development of first capital markets. Baku Commodity Exchange was the first such financial institution that served oil trade. Increasing oil demand and interest resulted that shares and bonds of national companies like Baku Merchant Bank's, New Baku Oil refinery companies traded on foreign markets like Moscow Stock Exchange, St. Petersburg Stock Exchange etc. On that period by the banks like Baku Merchant Bank issued bonds that actively stimulate the development of debt relations. As an example of existed companies that deal with the stock exchanges we can show below companies:

- “Oil Products” Stock company
- “Bul-Bule” Oil and trade company
- “Balaxani-Zabrat” oil company
- “Petro-Baki” oil refinery company

- Electric power company
- “Absheron” oil refinery company
- “Kaspi-Black sea” company

However, this process has stopped after the establishment of Soviet Union that takes as a basis anti-capitalist Marxian model of economic development and government regulated planned economy. This model did not consider development of capital markets and the only securities that traded are state issued lottery bonds.

The new page of capital markets development has opened after the collapse of Soviet Union and getting independency. Modern Azerbaijan Republic was able to define its own foreign and internal policy. The late 20th century market reforms that were implemented by government consider the development of a capitalist economy with the private sector and market elements.

Conditionally, we can divide development of capital markets in modern Azerbaijan into three stages:

- 1) First stage – Foundation, 1990-1995 years
- 2) Second stage – Formation, 1995-2000 years
- 3) Third stage – Development, from 2000 - until nowadays

During the first years of independency for the reason of political instability and economic declined it was impossible to introduce reforms that was needed. Hence, several steps have taken in legislation for formation of capital markets.

The first step in the establishment of capital markets was the Law of Republic of Azerbaijan about Securities. Still it was not enough and more serious reforms should be introduced. In 1991, first BAKU Securities Exchange was established and it would be foundation for the Baku Stock Exchange. In 1994, Law about Joint Stock companies has accepted.

As a result, of these reforms first privatization has begun in 1995. As it known, in post-soviet countries privatization process act as an accelerator for the development of securities markets. In the first wave of the privatization there was established infrastructure that will served to this process which however far from the classical concept of capital markets. Deeping of market relations in economy needed

proper regulation on it. As a result, on December of 1998 decree “About establishment of State Committee under the President of Republic of Azerbaijan” signed.

Another important step for the development of capital markets is the establishment of The State Committee for securities of Azerbaijan Republic. Before that, new established capital markets regulated by the Central Bank. This committee deal with the regulation of securities market, rights and relations of investors, also controlling issuance and turnover of securities in Republic of Azerbaijan. Committee also participate in formation of legislation. By the initiative and help of Committee first stock exchange has established in country. Systematically, State Committee for Securities deal with the below issues:

- Turnover and issuing of securities
- Standards and rules
- Enhancing standards and rules in capital market
- Providing capital markets participants with license
- All issues about lottery
- Reporting about deals
- Information system
- Billing process between buyers and sellers in capital market
- Protecting rights of buyers and sellers
- Transparency in information exchange
- Creation of norms about advertisements

State Committee for securities established new program on development of national capital markets. This program cover the current situation on capital market, state policy on creation and development of market, establishment of institutional investors, preparation of specialist on capital markets, development of international relations etc. According to this program several goals have been defined for the government in existing situation:

- Establishment of proper working capital markets

- Creation the conditions for the investment of internal savings
- Formation of the business friendly environment that would attract foreign investments

- Integration into world's capital markets
- Creating stable and secure environment on capital markets

In order to achieve these goals several steps should be taken as below:

- Creation of useful legislation
- Ensuring the implementation of legislation by government
- Openness and avoiding asymmetric information issue
- Creation of mechanisms that will maintain the rights of issuers, investors and professional participants of market

- Minimizing risks that could arise during trade
- Development of relations with the institutions of other countries
- Prevention of illegal actions on capital markets
- Creation of competitive conditions for all market participants

However, one of the most important event for the development of capital markets was the establishment of Baku Stock Exchange in 2000. Baku Stock exchange has been established totally by the private capital including banks, investment funds, brokers, professional participants of financial markets etc. and it is only licensed stock exchange in Azerbaijan. Existence of stable and mature stock exchange play an important role in increasing investor's confidence on Azerbaijan economy. The main aim of BSE is to provide investment and financing chance to the market participants. The core purposes of BSE include below:

- Organization trade for state, corporate, municipal etc. securities
- Organization of scheme for trade in stock exchange
- Providing trade and price information
- Dealing with the clearing and counting
- Providing reports for authorities

The member of BSE could be those who professionally deal with the capital markets and also those who get license from State Committee on Securities.

On Stock markets securities are divided into three types for their listing categories:

- Primary market segment
- Standard market segment
- Alternative market segment

Listing categories are established on based of different requirements and securities could change their positions on listing categories on time.

Also there are several market sectors on BSE:

- ✓ Equity market
- ✓ REPO
- ✓ Debt securities market
- ✓ Derivative market

Clearing and counting in BSE are handle by the National Depository Centre of the Republic of Azerbaijan.

NDC is the central depository organization of Azerbaijan. As a mission NDC provide reliable, efficient and transparent services to all stock market participants. The main services of NDC are holding all types of securities, registration of operations, stockholders and securities, clearing and calculation of the amount of dividend etc. Also BSE keep strong relation with NDC as BSE use electronic system that directly related with the NDC.

As other capital markets there are several other participants of Azerbaijan's capital markets excepting supervisory institutions.

- Firstly, national capital market consist of investors. As an investor can operate individuals and also institutional investors like insurance companies, banks, funds etc.

- Intermediaries. Include investment companies, brokers, dealers etc. They act as an intermediary between issuers and investors and get certain amount of commission.

- Issuers. Those who want to attract additional financing for their business activity mainly for expansion and for development activities. As an issuers act mainly local and foreign companies, funds, governments etc.

In BSE, biggest proportion of trade activities are made by investment companies. Investment companies serve to individual investors by buying and selling market instruments. As investment companies are more involved in market depending on situation investment companies could give advice about current configuration in market and help for investment decision. Before the trade individual should open an account in investment company. After the trade made on individual could see the size of securities, amount of the deal, and also confirmation letter for the trade.

Table 2: Azerbaijan Invesmtment Companies Ranking

Investment companies	Turnover in M. AZN.
“Pasha Capital Investment Company” CJSC	3938,5
“AzFinance Investment Company” CJSC	1351,2
“Invest-Az Investment Company” CJSC	946,7
“Xalq Capital Investment Company” CJSC	919,9
“Uni Capital Investment Company” OJSC	818,9
“PSG Capital Investment Company” CJSC	157,4
“BTB Capital Investment Company” OJSC	43,6

Source: Assosiacion of Azerbaijan Stock Exchange Participants,
<https://www.afbia.az/renkinq,2019>

According to the Law about Securities Market of Azerbaijan, investment companies can deal with the below main and secondary operations.

Main activities:

- Receiving and realizing customers orders about capital market
- Managing private investors’ portfolio
- Consulting on investment decision
- Placement and underwriting of securities without any liability
- Placement and underwriting of securities with liability
- Acting as an independent participant of stock exchange and central depository based on its own resources

- Margin trading

Secondary activities:

- Supervision of client's securities account
- Providing investors with funding for the trading activities
- Research and financial analysis of capital markets for investment decision
- Foreign currency exchanging for the dealing with the main investment activities

Since the year 2000, new stage of development of capital markets had begun. Capital market growth in both quantity and quality measures. Trade in capital markets has increased tremendously, new international relations developed and new directions for development improved. Strategic reforms and privatization push the development of capital markets. Also, political and economic stability become the factor.

Development of oil industry and dramatic growth of export revenues become the stimulating factor for the other sectors of economy including capital markets. Through the economic policy that oriented to growth and development of Azerbaijan get high ratings from international ratings that would become the positive signal for international investors.

So, for see by future for Azerbaijan capital markets development perspectives will be as below:

- Concentration of capital
- Globalization and integration of capital markets into world system
- Development of market infrastructure
- Increasing demand stimulation of supply
- Introducing corporate standards that will satisfy world standards
- Increasing potential and institutional development of market intermediaries
- Introducing training and development programs
- Associations with other capital markets

2.2. The dynamics and current structure of capital market in Azerbaijan

Since the establishment of capital markets in Azerbaijan, trade volume has increased strongly. Hence, this growth did not distribute equally through the years. Capital markets dynamics in Azerbaijan is quite vulnerable for external shocks. During the 2000-2008 years, growth in world economy effected positively on Azerbaijan's economy also. High oil prices had become the main source of financing for internal projects and gave multiplier effect. In a result, trade volume in capital markets between 2004-2008 years increased more than 100 times. The biggest portion of this trade's structure was the state securities. In 2008, 97 percent of trade was made by government securities and only 3 percent of trade was corporate securities.

Hence, the volume of trade decreased as, a result of world financial crisis. Yet, from 2009 growth restored. Growth rate in corporate securities market for 2009 was 10.3 percent.

During the financial crisis years, CBAR applied soft monetary policy. As a result, volume of central bank's issued securities decreased by 68 percent. Yet, securities issued by MFAR increased in volume by 55 percent. The reason for such increase was the new market instruments introduced by MFAR including bonds with two or three years maturity dates.

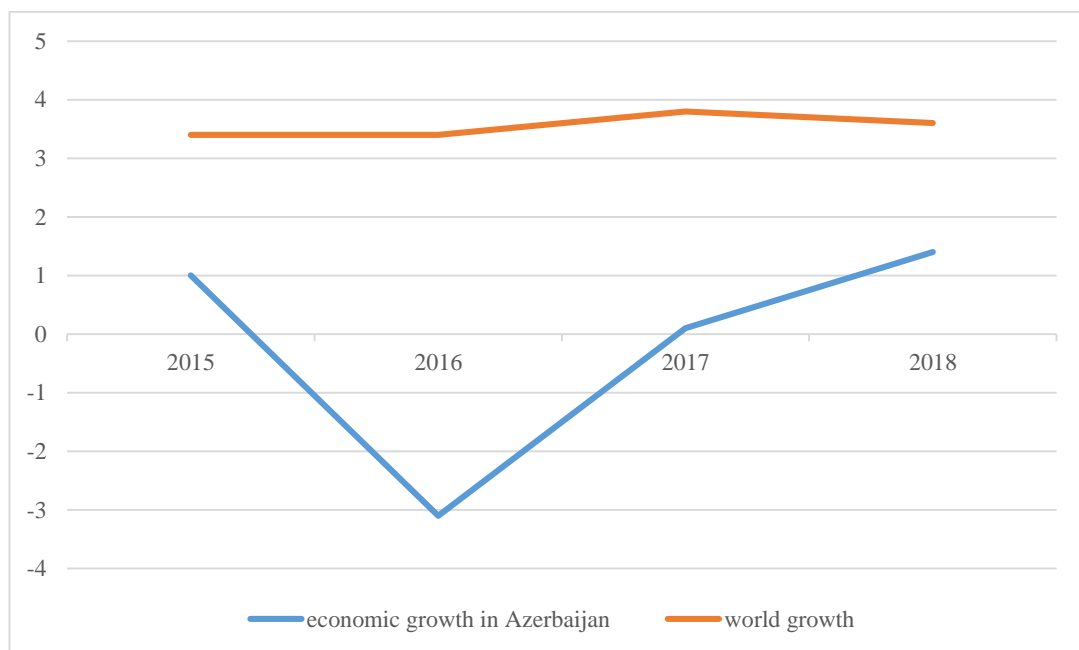
Since then we can observe stable increase in trade volume of national capital market. However, last years become new, specific stage for Azerbaijan's capital market with several character issues.

In 2014, world oil prices that was remain high since the end of world financial crisis declined. This decline effect on most oil exporting countries including Azerbaijan. Decreasing oil revenue resulted with the stagnation in construction sector that on itself has serious portion on economic growth.

Still this decline did not long-run stagnation. After the stabilization of world oil prices economy showed slow recovery tendencies. However, this issue show in what amount national economy depended on oil export. As a result, government decided to take several very important actions. First of all, government introduced several

very important reforms. Strategic road maps define the future development of several sectors of economy that will aimed to decrease the dependence of country from export of oil. The main directions of improvement are related with the development of human capital, privatization, development and creation of suitable business environment etc. However, these factors are take into account for the future perspectives. For the short-term country faced with the serious problems that generally affected on current economic situation.

Graph 1: Real GDP growth in percent between 2015-2018



Source: International Monetary Fund, <https://www.imf.org/external>, (2019)

Yet, despite the years of stagnation and decline in economic growth capital markets remind increasing trend. The main reason of this trend associate with the government policy to control the situation. Between 2015 and 2018 we could observe a tremendous growth in state securities from 20,8 M. AZN to 13340,5 AZN that become the main driver for growth in overall securities market. However, situation in corporate securities market and derivatives market was fluctuating. In different years, market size was also differ both expanding and declining. Corporate securities market increased from 4186,1 M. to 8746,9 M. AZN between 2015 and 2016. And then declined from 8746,9 M AZN. in 2016 to 2196,0 AZN in 2018. Derivatives market also quite vulnerable in this period of time. From 6194,4 M.

AZN. in 2015 it has decreased to 4440,7 M. AZN. in 2016. But then still increased from 4440,7 M. AZN. in 2016 to 8406,5 M. AZN. in 2018.(fimsa.az, 2018) Growth in government securities market is highly related with the stagnation and decline. From this reason, external shocks became the factor that will lead to development of capital markets despite the decreasing of economic growth. In addition, from these period, FIMSA become publicly share the volume of trade both in corporate and state securities market which let to define the situation in capital market.

Table 3: The overall trade overview of capital markets

	2015	2016	2017	2018
Overall trade amount, in M. AZN	10525,1	14025,8	15718,1	24554,8
Corporate securities, in M. AZN	4186,1	8746,9	3659,9	2196,0
State securities, in M. AZN	20,8	836,2	6066,6	13340,5
Derivatives, in M. AZN	6194,4	4440,7	5940,1	8406,5

Source: Financial Markets Supervisory Authority,
<https://www.fimsa.az/assets/upload/files/> (2016, 2017,2018)

Growth in state securities market for the 2015-2018 period was tremendous. The main reason for that is the policy that has implemented in order to keep inflation law along with the desire to stabilize national currencies rate.

As we mentioned before, these period characterized with the declining of oil prices and economic problems in the main economic partners and neighbor countries. Due to these issues began problems with the foreign currencies for below reasons:

- Firstly, Azerbaijan as a resource economy get the serious - almost 90 percent of its export revenues from exporting of oil. For the period of 2014-2015 year's fluctuations of oil prices approached almost 4 times difference.

- Secondly, every year, Azerbaijan economy gets inflow of serious amount by remittances from abroad. Crisis in source countries of this inflow especially in Russia, automatically resulted of cutting in this amount. In 2014, this amount reached 1708,9 USD. However, Azerbaijan's economy does not highly depend on

this sources as it is only 2,45 percent of 2014's GDP.(maliyye.gov.az) Yet, it is additional charge for already worsening situation.

- Thirdly, keeping national currencies rate stable stimulate import and become burden for export. As, neighbor countries economy-especially Russia suffer from economic problems they devalued currencies in order to cut capital outflow via import. In a result, hard currencies become so valuable in these countries and it stimulate outflow from Azerbaijan.

Such issues became the factor that force CBAR devalued national currency. In such conditions, capital markets played an important role for stabilizing the situation.

In order to keep inflation rate low CBAR ensure the collection of excess money from turnover. In a result, bond issuing became the tool that served for that. For the 2015-2018 years period CBAR securities market increased from 20,793 mln. AZN. to 12242,9 M. AZN.(cbar.az) For the same period, MFAR introduce the policy of internal borrowing. These policy characterized by the issuing of state bond. This segment of market showed stable increase for several years annually. As state securities market known as the less risky it is normal that trade with them increasing despite the hard situation in countries economy. State bond market increased from 567,4 M. AZN. in 2016 to 1097,6 M. AZN.(cbar.az, 2016) In 2015, there was no trade with state bonds.

Table 4: State securities market

	2015	2016	2017	2018
Overall state securities market, M. AZN.	20,793	836,2	6066,6	13340,5
CBAR securities, M. AZN.	20,793	268,8	5227,1	12242,9
State bonds, M. AZN.	0	567,4	839,4	1097,6

Source: Financial Markets Supervisory Authority,
<https://www.fimsa.az/assets/upload/files/> (2016, 2017, 2018)

For the 2015-2018 years, corporate securities market display fluctuating tendency for the different years. Between 2015-2016 years, there was tremendous increase in corporate securities market. This growth mainly accumulated by the bond market as government preferred financed strategic projects by the national capital markets. However, this growth was not long-term and for 2017 and 2018 market volume decreased again.

Stock market also quite vulnerable for this period. From 2015 to 2017 trade increased from 657 M. AZN. to 2031,6 M. AZN. The reason for this growth was the companies and public sectors desire to attract financing from capital markets. Especially banking sector trade in stock market in order to fulfill capital requirement. Yet this growth also did not long-term growth and from 2018 market level again decreased.

Table 5: Corporate securities market

	2015	2016	2017	2018
Overall corporate securities market, M. AZN.	4186,1	8746,9	3659,9	2196,0
Stock market, M. AZN.	657,0	913,0	2031,6	925,1
Bond market, M. AZN.	3529,2	7833,9	1628,4	1270,9

Source: Financial Markets Supervisory Authority,
<https://www.fimsa.az/assets/upload/files/> (2016, 2017, 2018)

Between the 2015-2018 period derivative markets also quite vulnerable. The biggest proportion of trade was made with the currency based derivatives against the commodity based derivatives. It can be explained by that operations by commodity exchanges is not widespread in Azerbaijan.

From 2015 until the 2017 derivatives market decrease from the 6194,4 M. AZN. to 5940,1 M. AZN. However market increased again from 5940,1 M. AZN. to the 8406,5 M. AZN. between 2017 and 2018 years.(fimsa.az) Currency based derivatives market is not stable. Yet, commodity based derivatives market showed

stable increasing trend. It is normal as commodity trade is less developed than the trade of capital markets.

Derivatives market development is highly related with the development of overall capital markets development. This development is the factor that related with the confidence of foreign investors. Derivative markets let to insure from the loss from price fluctuations in commodity, capital or money market. As trend shows, derivatives market is not enough developed in Azerbaijan. Recovery from the stagnation resulted with the decreasing of derivatives market volume again because of the decreasing market risks. Yet, in developed countries capital markets, derivatives market increase with the same of overall market. As fluctuations in capital markets is widespread tendency. Yet derivatives market used as a tool for speculation in market depending on it is futures, swaps or options.

Table 6: Derivatives market

	2015	2016	2017	2018
Overall derivative markets, M. AZN.	6194,4	4440,7	5940,1	8406,5
Commodity based derivatives, M. AZN.	98,9	272,1	402,1	1030,1
Currency based derivatives, M. AZN.	6095,5	4168,6	5538,0	7376,4

Source: Financial Markets Supervisory Authority,
<https://www.fimsa.az/assets/upload/files/> (2016, 2017, 2018)

For the 2015-2018 period in BSE also made repurchase and reverse repurchase agreements. Repo and reverse Repo operations let to attract short-term financing as it consider the repurchasing of securities after certain period. There is no stable tendency for the growth or decline in market as operations volume in market was quite vulnerable for considered period. In addition, there is no existed base for the development of such types of markets. It is correctly seen from the statistics that provided by FIMSA. Yet, for 2018 it is growing tendency in Repo and reverse Repo operations market.

Table 7: Repo and reverse Repo operations in market

	2015	2016	2017	2018
Repo and reverse Repo, M. AZN.	119,8	2,0	51,6	611,8
Repo with government securities, M. AZN.	87,5	2,0	30,8	404,1
Repo with corporate securities, M. AZN.	32,2	0	20,8	27,6

Source: Financial Markets Supervisory Authority, [https://www.fimsa.az/assets/upload/files/\(2016, 2017, 2018\)](https://www.fimsa.az/assets/upload/files/(2016, 2017, 2018))

One of the main points in the capital markets was the issuing securities by SOCAR. First SOCAR securities was issued in 2016, in amount of 100 M. USD. with the maturity date for five years. SOCAR is the biggest national company that aimed not only make profit but also deal with the serious projects in social life of country. SOCAR securities issued with the 1000 USD. each and gave 5 percent of profit from face value with each three month. High demand for these securities increasing the market price and made them most traded securities in secondary market. Even from the reason of high demand, market price for one security reached 1046 USD. Overall profit for the April 2019, is the 12.5 M. USD. Purchasing of SOCAR securities is possible from the ASAN service.

The aim of SOCAR securities is to giving alternative options for the investment to population. As factors that make attractive these securities, we can mention below issues:

- Reliability
- Liquidity
- Profitability
- Easy to buy and sell(socaristiqraz.az)

As we see, there are several positive trends of growth in capital markets trade volume. However, trade volume, still remains very low and quite vulnerable as a result national capital market far from realizing existed potential. The growth of

capital market provided by the CBAR and MFAR issued securities, which aimed to stabilize the quite complicated situation that existed in market.

2.3. The connection of capital market in Azerbaijan with international capital markets

In the period of globalization, barriers between countries reduced which push the capital, labor and ideas out of national borders. This process does not go through the capital markets.

Integration of capital markets is the process in which one capital market synchronize the work with another capital market. As there is no single international organization that deal with the relations between different capital markets so connection process is hugely depend on capital markets own choice and initiatives.

Integration between different capital markets become possible only for the development advanced technologies that let to get in touch without any distance, time and other barriers. Still, behind the integration stand other burdens.

Connection become possible only in case if two capital markets would be able to adjust the prices and risks. In result, integration in capital markets also highly depended on integration level of overall economic activities.

Yet, in the modern world integration of capital markets become necessity as scopes of foreign portfolio investments increasing replacing foreign direct investments.

In case of integration of Azerbaijan capital markets this issue still can not be solved. Azerbaijan has already different agreements with the capital markets of foreign countries. But it is far from to catch the level of direct integration.

BSE has two main directions and aim in case of international relations:

- First, is the establishment relations with the main and biggest capital markets of the world.
- Second, is the develop and maintain relations with the organizations that deal with the capital markets.

BSE already has good relations with the Istanbul Stock Exchange. It is enough to say that ISE was the one of shareholders that established BSE. ISE help BSE to organize and developed the work of stock exchange and regularly share with the experience about different field of exchange markets which cover IT, professional training etc. BSE also has relations with the Thessaloniki Stock Exchange, Warsaw Stock Exchange et. (bfb.az/news)

Yet, this relations cover the mutual cooperation and sharing experience. Integration process covered law. The reason for the slow movement in the way of integration is about the some objective reasons. Capital market integration consider several issues that related with this process:

- Firstly, integration mean the free movement of capital across the borders freely. This issue should agreed in more high level as countries legislation could differ from each other.

- Secondly, two capital markets that try to integrate their system must obtain law of one price that consider price across the borders will be the same.

So, behind the integration process several barriers could exist:

- Government can restrict the free inflow and outflow of capital across the country. As in developed countries economies are more sustainable for foreign activities yet in developed countries free flow of capital could result with the outflow of reserves and problems with the BOP.

- In different countries tax level could differ.

- Possible fluctuation in exchange rates.

- Fear to invest in foreign country

- Problems with the transferring in foreign country

Behind the problems of international integration there is a standing problem with the economic situation inside the country that affect the capital markets integration process. As there are two main circumstances behind the desire of integration of capital markets.

- 1) Desire to open the national economy to the foreign investments

2) Open foreign markets for the investment activities

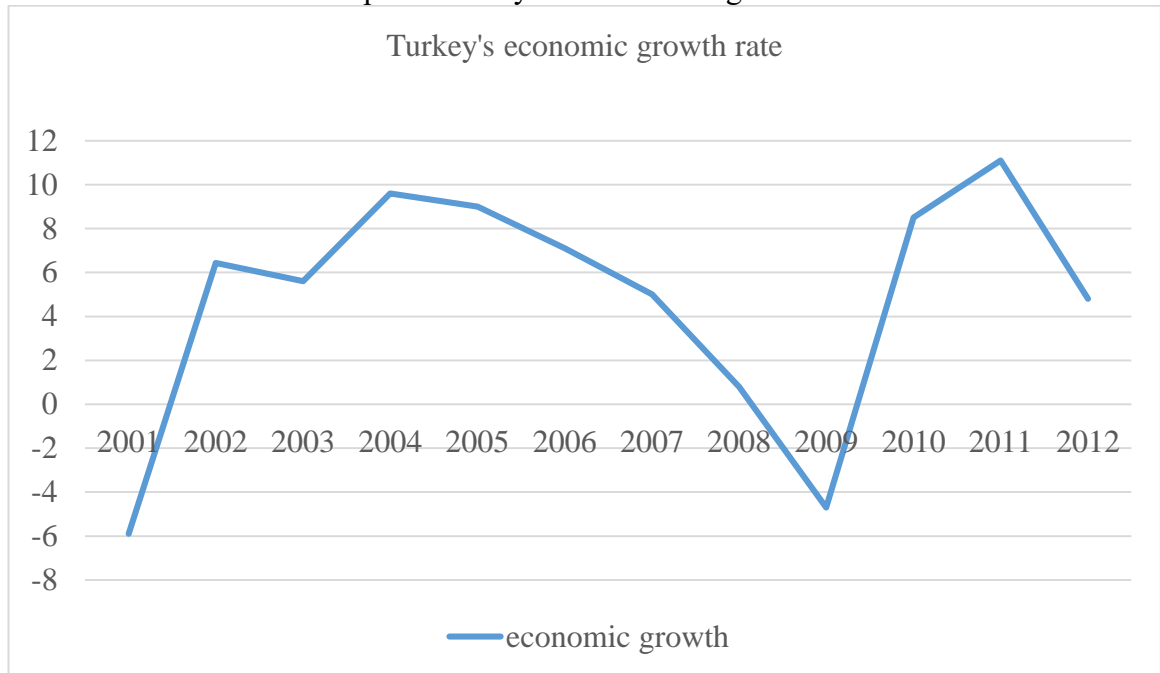
As a successful example for capital market integration we can show Turkey case. During the 2000's and after 2008-2009 years financial crisis Turkey get tremendous amount of foreign investments. Before, inflow of capital financed the BOP deficit as this inflow do not effect on economic growth for. However, after the 2000's capital that inflow become the investment that was financed economic growth. The reason for that turnover was the proper macroeconomic policy, stimulated fiscal policy and improvement of legislation. (OECD, Rauf Gonenc, 2010)

Turkey was the one of those economies that was able to reforming and take advantage of positive trends in international capital markets. As a result of integration with the foreign capital markets Turkey's interest rates become harmonization with the worlds interest rates. This process also stimulates the domestic market borrowing which push the consumption process as well as for investment.

As we now, there is a strong tendency in Turkish economy for the development of production. Leading world and especially European companies, directly invested into Turkish economy and transfer their productions to the Turkey. Dynamic population growth, urbanization and harmonization of labor code with the European Union became the overall stimulating factor for overall development of economy. In addition, Turkey's desire to enter the European Union, was become message to the investors. Tremendous direct and indirect investment to the Turkish economy push consumption also and overall life expectancy also has increased. Also there are other factors that become driver for the economic activities of Turkish economy. It includes:

- Development of Turkey as a transit corridor
- Development of tourism industry
- Development of construction industry

Graph 2: Turkey's annual GDP growth rate



Source: World Bank group data, <https://www.imf.org/external/datamapper>, 2001-2012

However, before these processes Turkey already liberalized its financial markets in 1989. Yet, due to the high inflation rate and flexible exchange rates became barrier behind the development of capital markets. Since 2000's due to several issues, it became possible to generate economic growth. These issues could be characterized as below:

- Effective fiscal policy that consider relevant taxation
- Increasing trade, especially export that was driven by export oriented industrialization
- Central Banks inflation prevented policy
- Political Stability

Another important reason that stand behind the capital market development of Turkey is the improving credit ratings of Turkey. Credit rating is very important factor for the investor's assurance about countries situation. Credit rating agencies evaluate situation based on several factors. For example, Standards& Poor's agency analyze based on ten criteria that include: political risk, income and economic structure, growth prospects, monetary stability, public external debt etc.

Another rating agency Moody's also gave positive background for Turkish economy. Moody's evaluate Turkey's rating based on three criteria.

- First criteria include several aspects like GDP per capita, countries sustainability on foreign shocks, government reaction and policy about foreign shocks etc.
- Second criteria is about debt level, taxation, government spendings, fiscal and monetary policy.

According to these criteria's Moody's gave Turkey speculative grade for 2010. (Moody's, 2010)

Achievement of high ratings by Turkey become the important factor for the economic growth and development. For example, After the world financial crisis 2008-2009 years Fitch increased the rating of Turkey to BB+. (fitchratings.com, 2009) According to the Fitch agency, Turkey's economy has showed more durability than estimated. Also agency provide strengths and weaknesses of Turkish economy:

Strengths:

- Proper working institutions, effective regulation system and business environment

- Developed banking sector and effective bank management

- Low inflation

- Strong GDP growth before the crisis period

- Strong demographic growth

Weaknesses:

- Increasing government debt

- Increasing unemployment

- Problems with fiscal policy (Fitch rating agency, 2009)

- Political risks

As we see, Turkish economy become one of those economies that benefited from the development of capital markets. Yet, the situation in Azerbaijan from this perspective remain slow. As we already see, in foreign experience capital markets

development and integration is highly interrelated with the dynamics and trends in overall economy.

CHAPTER III.

MAIN DIRECTIONS OF IMPROVEMENT OF CAPITAL MARKET IN AZERBAIJAN

3.1 Methods of improvement of the role of capital market in energizing investment processes in Azerbaijan

In the example of successful countries models in which, capital markets became the driver for foreign investments it is quite understandable that developing countries needed capital markets in order to achieve strong growth rate. Yet, creation of these capital markets is not straightforward as it can be seen.

Today developing countries with a growing economy needed additional investment for national infrastructure. Developed infrastructure is that factor which push economy to development and attract investors to country. Usually, big infrastructure projects need huge financing that provided from international investments in case of government could not be able to provide this financing. However, developing countries not in every case are interested in to provide access to such strategic projects in front of fair of political risks. It can be good pool for the development of capital markets as such investments could be too heavy and too risky for developing countries banking system. By issuing bonds or part of shares financing could be attracted. It also must mention that stimulation of capital markets development at the same time can be driver for economic growth.

Capital markets act in interest for the several participants in market. For companies that needed financing capital markets can act as an alternative for commercial banks. Capital markets can offer access to a wider investor base. They can also offer financing for riskier initiatives like startups that are not able to get financing from banks. So, by this way capital markets will support innovations in an economy.

Even if government can get access to foreign capital markets, the development of local capital markets let government increase access to local currency financing and help better regulate exchange rate risks and the level of inflation in national economy. As an example for this case, we can provide Azerbaijan economy between

2015-2018 years as government in order to regulate and stabilize the situation actively used capital markets. CBAR notes and MFAR bonds became tools that let to stabilize the situation until the oil prices stabilized in world market. For governments, it opens perspectives for financing fiscal deficits by local markets and keep valuable foreign currency reserves inside the country. So, the establishment of local capital markets is highly beneficial to governments in its desire to finance development internally.

For investors and savers, capital markets can offer more attractive investment opportunities with higher return on investment than bank deposits, depending on risk level, interest rate of security etc. From this perspective, in order to make capital markets more attractive for investment CBAR could decrease interest rate as it make capital markets more attractive. In addition, with a wider range of securities and market instruments, capital markets can help investors diversify their portfolios and manage risk.

This is especially important for certain investors like pension funds and insurance companies. Despite the fact that private pension funds are not developed in our country from the future perspective it will be quite interesting to national economy. As an example of effective operator of private pension funds and also capital markets development overall we can describe Chile. In the 70's of 20th century, Chile introduce several very important structural reforms that covered labor code, privatization, trade, interests rates and overall liberalization of economy. Chile also has quite liberal approach to pension funds that also quite effective. Actives of these funds strongly invested into capital markets. By this way, capital markets could better effect on a society. Yet, there is a still government control over the investments of pension funds as there are several requirements for the portfolio and directions of investments that must be less risky investments. Using derivatives, developed markets can provide risk management tools not only to market participants, but also to end users like companies, agriculture producers etc.

Despite the existence of effective working capital market Chile introduce new reforms that aimed to stimulate the development of capital markets. First series of

reforms cover the initial public offerings and protection the existed rights of minority investors. This reform include below issues:

- Improvement of the corporate governance that will protect the rights of minority investors
- Liberalization of the work of investment funds and giving them more authority
- Stimulate the participation of pension funds in initial public offerings
- Increasing the banking system regulation in order to avoid the systematic risks in overall financial risks
- Regulate the banking investments into initial public offerings

Second series of reforms include the overall improvement of the capital markets and increasing the level of capital markets integration with foreign countries.

- First, reforms cover the establishment of suitable environment for the access to the capital markets small and medium enterprises. In order to achieve this goal government introduce tax incentives for such companies also helping to these investors in getting access into short-term financing
- Second, reforms aimed to increase market liquidity. In addition, reforms developed environment for the companies with the high turnover and decreasing collection of taxes from their profit. Behind all of it, several barriers eliminated for the investments funds, investment companies and pension funds that are main institutional investors in Chile capital markets.
- Third, government decrease the level of protection for national commercial banks. This action aimed increase the level of competition. Government reduces the 4 percent requirement for the foreign banks interest rates.

Well-developed capital markets also provide benefits at the macroeconomic level by supporting monetary policy transmission, which is facilitated through liquid securities markets. Well develop capital markets protect national economy from foreign shocks and stabilize capital flow. According to several research developing

countries with better capital market infrastructure better handle with the 2008 global financial crisis by helping to companies and citizens maintain liquidity problem.

Also, in most countries, as a result of rapid economic growth, population growth, and urbanization, the financing needs of infrastructure, housing, and climate adaptation and mitigation are dramatically increased.

Development of capital markets can be significant factor for reducing shadow economy. As like in most developing countries in Azerbaijan also, shadow economy especially informal savings remain as problem. In most developing economies private informal investment took several forms like cash holding under mattresses especially in foreign currency, buying gold and other precious metals in jewelry. In addition, investment on foreign assets like house and property in other countries. In order to avoid informal saving problem, government should take several steps:

- 1) Provide better investment alternatives – development of proper functioning capital market is the key for that. Also, government could introduce specific markets like gold exchange market or silver exchange market etc.

- 2) Greater investor education – government could stimulate the trade in capital markets by increasing the common level of knowledge about through the trainings, education programs etc.

- 3) Investment insurance system – each investor want to be sure about the protection of its investment and return on it. By using this as a tool government can increase the level of confidence and attract more investments.

Generally, around the population it is more common to invest in property, gold and in best case to put the money into bank accounts. Yet, it will be more effective both for investors and from perspective of overall economy side to invest these savings into capital markets.

In common words, we can claim that development of capital market is essential for the economic prosperity. According to CGFS publication, in the capital market development we could mention two main directions. Firstly, capital market development is highly interrelated with the development of overall country and economic environment. These factors do not directly relate with the capital markets

yet affect positively. These factors include macroeconomic stability, market autonomy, efficient and proper working judiciary, efficient government regulations etc. Secondly, development of capital markets highly depend on the specific market regulations and policy implications. These factors include openness for foreign investments, efficient market infrastructure, hedging and funding of securities etc. (CGFS papers 62, 2019)

Macroeconomic stability: For the capital markets, macroeconomic factors including inflation rate, unemployment level, BOP issues etc. are very important. Economic growth that depend on macroeconomic factors provide investor credibility and market optimism. Also, several factors including BOP could directly effect on government securities prices. From these perspectives, it is very crucial to maintain macroeconomic stability. According several researches corporate market is highly correlated with the inflation level. (Burger and Warnock, 2006)

Market autonomy: Market liberalization is another factor that push the development of capital market. Elimination of restrictions, capital requirements and market liberalization positively affect on investors confidence and stimulate the operations in market.

Efficient judiciary and legislation system: According to Douglass North “how effectively legal contracts are enforced is the single most important determinant of economic performance” (North, 1991). Reliable legislation that will protect the investor’s rights create assurance on market and attract investors.

Disclosure: Timely disclosure is very important for the capital markets in which successful trade highly depend on information. Effective disclosure inform the investors with the trends and let them timely make predictions about current situation. Timely disclosure let to avoid asymmetric information and moral hazard cases also.

Diversified investor base: In capital markets, not everyone operate similarly. Some market participants invest long-run to less risky securities and others invest short-run risky ones. Yet, each of these investors participate in market formation process and their actions are more likely will reflect to situation.

Developing Complementary markets: In capital markets trade, it is very important to oversee at least insured from market risks. So in AE's capital markets hedging instruments are widespread. According to several researches, there is a direct positive relationship between the volume of derivatives market from one side and capita per income, international integration and financial markets development from other side (Upper and Valli, 2016).

Capital market infrastructure: Market infrastructure provide the operational services to market participants. Proper working infrastructure provide the assurance to market participants and increase the liquidity in market.

3.2. Mechanisms of integrating capital market of Azerbaijan into international capital market

Integration into other capital markets is very important in terms of attracting new investors to national capital market and in addition, in terms of providing new investment opportunities to national investors. From the domestic market's perspective capital markets integration let the increase securities issuance and volume of market.

Standard asset pricing models claim that integration of capital markets let the share risks between two markets participants and as a result decrease the price.

International investor entrance, can provide some specific novelties and also know-hows with them. For example, uncertainty that rise from the entrancing to new market, push the investors to invest on derivatives actively. In a result, this segment of market will developed which does not characterized for EME.

According to several researches, market liberalization process during 1980-1990's years reduces the cost of capital and increase risk sharing in market (Bekaert and Harvey, 2000). Also, openness increase efficiency by stimulating competition on market.

Opening national capital markets into foreign investments could be complementary action for other reforms and initiatives. However, integration

process without any regulation could result with a spillover in a capital market. In order to avoid it, jurisdiction and supervisory could consider all these factors.

Openness of capital market is not enough for the attraction of foreign investors. Market also need capacity to accept and satisfy these investors activities in local market. In case of investors estimations about market will not covered they can easily exit market. For that reasons, special reforms could introduced before opening for international investors.

So in order to maintain such issues it is very important to contact with the international investors and get their expectations and recommendations for policy formation. Yet, In most cases these recommendations will cover the issues about taxation, judiciary, regulations, infrastructure and general environment.

In most cases before the entrance to the market institutional investors make research about macro and micro environment of country. Recent researches confirm that countries with low level of inflation are more strong standing behind the foreign shocks and their markets accept this shocks more smoothly. (Koepke, 2015)

Most researches claim that direct integration process with foreign market could be in several stages. In other words in some cases market will not be ready to integrate and accept more advanced investor base. Otherwise, it can be shock for the economy to accept these investment or it will result with outflow of capital from country to another markets. In the beginning, it is more recommended to open the market for stock investments and corporate securities. This will stimulate business activities in market and will be additional source of financing. In last stage of opening the market could be short-term government bonds.

Especially in EME's in most cases are already opened up their capital markets for the trade with the stocks and shares. However, big EME like China and India complete the process of integration. Especially in case of Indian economy that closed for a long time for international investments (both direct and indirect investments) we can see the positive sides of investments to capital markets. After the oil prices crisis in 1991, which born from the war in Gulf countries that resulted increase with the oil prices, Indian economy that import the oil from other countries faced with the

serious process BOP account as import pressed to currency reserves. In order to maintain the problem and find solution for financing problem government opened up country for international investments including to the capital markets. In several years, foreign investments became the main driver for the economic growth.

In order to avoid problems that could bring capital market integration several steps could be taken:

- Preparation BOP to the short-term outflow of currency to other countries. In order to maintain this Central Bank should full its foreign country reserves and to be able to make intervention into market.

- Applying capital flow management tools in face of some short-term restrictions, taxation etc. for the restrictions of capital outflow

- Gradual integration for the certain period of time. It include partial opening of capital market and improvement integration for the future period.

Another tool for the capital markets integration is the applying MIFID. MIFID is the generally accepted laws that harmonized investments standards and financial markets operations for the countries of European Union and European Economic Area. These comprehensive rules standardized and maintain EU values to financial markets including capital markets. MIFID applied to markets that are:

- Fair
- Efficient
- Transparent
- Integrated

First, aim of MIFID is to create competitive market that will cover all member countries capital markets. In addition, these laws aimed to provide security of investments and especially participants protection. MIFID harmonized the rules for the establishment or opening branches in other member countries, in the basis of general rules of EU or at least rules of home country. MIFID rules applied several standards as below:

- MIFID consider the registration of companies in their origin countries. Despite this, companies are free to provide and sell its products in host country. In addition, all activities of this companies will regulated by their home country.

- MIFID rules divide customers into two category that includes professional and retail customers. This rules let to protect the rights for each group as certain gray of customers could be less informed.

- MIFID rules regulate the clients order handling as well. This include the requirement for acting in the best interests of customer.

Applying MIFID rules seem hard for the realization. Yet, eastern Europe countries increasing their integration and provide themselves with better chance to integrate into EU.

3.3 Legislative initiatives for improvement regulation of capital market in Azerbaijan

Generally, we can divide reform initiatives that should be implement in order to stimulate capital market development into three category.

- Attraction of new investors in face of foreigners and informal national economy

- Creation and implementation of new market instruments

- Protection of investors

Firstly, in order to bring foreign investors and making Azerbaijan's capital market more attractive for them several conditions should be create.

- Implementation of reasonable tax policy. These include transparency of collection of taxes as in case of some participants of market will not pay taxes it lead to that, other participants that pay taxes damaged from this situation. Tax holidays for the certain period could be a key for the stimulation of development of capital market. In addition, reasonable ta policy include soft tax burden especially for those who are new market participants.

- Any barriers that could stand behind the movement of capital inside and outside the country could threat the investors. Each investor want to assure that it

will be possible to get out the revenue without any technical barriers. In order that, the government should remove all formal barriers. It will lead to that in case of emergency, investors want to know that there will not be any problems for the kick off the capital.

▪ In ideal and efficient markets, chance for arbitrage is minimal as law of one price works properly. Significant differences from foreign countries in prices of securities could turn the national capital markets into a pool of speculations. Therefore, demand and supply laws could be the only regulators for the market. In addition, it is very crucial to harmonize exchange rates with foreign countries.

There is also a big potential for the investment of domestic formal and informal savings. This capital usually includes capital that does not get into account by the economy. The source of these earnings could be different. Yet, it is very important to give a chance for the legalization of these holdings. Giving the capital amnesty could be the great solution for that as people could use their property as a starting point for their future investment. Amnesty is the special procedure that considers the government's recognition to the cash, property, securities and etc. The property that will be implemented by the capital amnesty could be used as a guarantee for banks and other financial institutions.

Moreover, in the reforming process, government should concentrate in those key points that are responsible for the capital market success. In previous sections, we already found those points that are main drivers for capital markets development.

Firstly, it is very important to ensure capital market liberalization. It means restrictions and requirements that will harm the market-based pricing and funding allocation should be reduced by government.

Improvement of the judicial system is another very important step toward the market development. An effective judicial system promotes and provides investors assurance on investment. The basis for the work of an efficient judiciary is the reliable and proper working court system. In order to enhance the work of courts, it is a very good tool making litigations open to the public. Also, improvement of the supervisory role of higher courts. Establishment of a new court that will deal with the only business cases is the

another step for improvement judiciary. However, it will be more efficient to maintain solving issues before they will catch the court. In order to attain special groups that will deal with the problem solving could be created. Improvement of existed laws and judicial laws crucial also. Especially for capital markets investors establishing well understandable property rights are very important. Defining problematic cases beforehand can be useful as well. According several studies problems could identified beforehand and could be solved (Andrews, OECD, 2017).

As we mentioned before effective regulation characterized developed and good functioning capital markets. First of all, regulatory authorities could be independent and theirs interests in capital markets should be limited. That why in most capital markets there are restrictions for the market stuff for trade activities. Secondly, market stuff could be competent in controlling and regulation, must know all rules and laws, accounting standards that exist in market. Stimulating market participants role and initiatives for improvement market environment is desirable. Improvement standards is the obligatory issue for national capital market. These improvements should cover legislation, and could be based on recommendations of market participants as well as standing to best international experience. Private sector's participation in improvement process is very important as they could give practical recommendations and know how.

Attracting new investors from abroad and stimulating local savings participation in capital markets is crucial. Diversification of investor base is the key to capital market development (World Bank publication, 1994). New professional participants could increase the size of domestic capital market that will probably attract to market those savings that before went to gold, property etc. investments. Also institutional investors like investments funds and especially pension funds participation and existence in market especially gave good message to other investors and issuers. As institutional investors, heavily invest on long-term securities, it will improve long-term liquidity in market. For attraction of these investors, it is recommended to stimulate them by tax heavens in order to motivate them. In order to attract new investors to the market it is very crucial define potential

investors in local market and stimulate them to invest on capital markets. Special educational programs and trainings is good tool for improvement of financial literacy around population and targeted group.

Improvement of additional markets that will serve the hedging and increase the investor's awareness on market is crucial for EME. Development of these markets like derivatives market need same procedures like development of capital markets generally. It includes judiciary, legislation, regulation etc. issues. Yet, derivatives market improvement push the capital market development on itself.

CONCLUSION AND RECOMMENDATIONS

Globalization process push the countries to cooperate with each other in order to develop. This unstoppable process also effect on our country also. However, from capital markets perspective this integration and cooperation remain slow.

Last trends show that Foreign Direct investments become secondary tool behind the Foreign Portfolio investments. This trend can explained by the development of the international capital markets at the same increasing literacy and financial education's role, improvement of payment systems etc. This push developing countries to introduce reforms that liberalize capital markets, making them open for the international investments.

Despite the international trends on capital markets development in Azerbaijan this process remain slow. Although, national capital markets demonstrated tremendous growth since the gaining independence, this growth still not enough for the accumulating economic growth. Volume of trade in capital markets is low and structure of this trade so primitive.

State securities market cover the main activities of capital market's trade. For the financing and operating activities of business still banks are main sources. It must be said that financial system of Azerbaijan is heavily stand on the banking system rather than capital markets.

However, there are some positive trends in capital markets which arise from the government activities. Between the 2015-2018 years, government introduced internal borrowing. Also CBAR used capital markets as a tool for the regulation of inflation rate and decreasing pressure on national currency manat.

Still existed capital market does not strong enough to create economic growth. Research provide several examples in face of countries that achieved significant development and growth through the stimulation of capital market development. The main examples for these countries are Chile and Turkey. Time and the situation in which these countries capital markets development began was differ however the reason that stand behind of this development is the same.

In order, to maintain this situation several very important reforms should be introduced.

Reforms must focused not only on capital markets but also overall situation in economy. These reforms, must cover the legislation, regulation and improvement of already existed infrastructure.

Development of capital markets provide future perspectives for the creation of private pension funds. As payments that was accumulated in funds then invested into capital markets and usually into long-term investments.

In order to attract local savings that usually go to property, gold or just keep under mattresses into economy government should give amnesty to capital, increase the financial education level around the population, and introduce proper advertisement of alternative investments like capital markets.

And most important issue for the development of national capital markets is the integration with foreign capital markets. In order to attract foreign investors to national economy and invest to foreign countries economies integration is very crucial issue. However, before the integration government should take several actions as below:

- market liberalization
- improvement of regulation
- Stimulation of internal savings and attraction of new investors base
- providing new trade instruments
- improvement of existed judiciary system

Capital markets development rarely follows a linear path. Developing local capital markets and making greater use of them to fund private investment and strategic economic needs tends to happen in stages. Therefore, some sequencing of policies is essential. This is particularly true for debt markets, which require well function money markets to create government bond markets, and they in turn are essential for corporate bond markets.

Understanding the linkages between different segments of the market and their building blocks is critical to ensuring a proper sequencing of policy and regulatory

reforms. The experiences of countries across the globe shows that capital markets development is a gradual process requiring strong leadership from government authorities as well as a significant commitment of time and resources. If done correctly, the payoffs can be substantial and long-term. The strategic imperative, however, is to develop strategies that fit the particular country circumstances.

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