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CIS Countries with Special Reference to Problems  
Encountered by Small and Medium-Sized Enterprises

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### GOVERNMENT SUPPORT TO TRADE FINANCE: DIRECT FINANCING AND EXPORT PROMOTION SCHEMES

1. Alexandru Vrabie, Director, Bucharest Branch, Eximbank (Romania)

On behalf of the Romanian Eximbank, I would like to thank the organizers of the seminar for giving the countries present an opportunity to express their opinions on current problems in trade finance.

Let me briefly inform you of the objectives and major types of support provided to Romanian exporters by the Eximbank.

The organization and functions of the Eximbank, as well as the mechanisms of foreign trade promotion through banking and insurance instruments are stipulated by the recently adopted "Eximbank Law".

The objective of our bank consists in providing efficient support to exports of Romanian products by issuing loans and insuring credits. This support is also lent to enterprises effecting deliveries abroad in countries belonging to zones of high political and commercial risk.

The basic mechanism of financial support for the Romanian foreign trade was laid in 1992. In institutional terms, this mechanism includes the following elements:

- 1) The Inter-ministerial Committee for Guarantees and Credits to Foreign Trade, which conducts analyses, offers advice and acts as a decision-making body, and
- 2) Eximbank of Romania, which is a banking and insurance agency designated by the State to implement supporting operations in the area of foreign trade.

As much as 75 per cent of the Bank's shares are held by the State Property Fund, with the rest being split between five Financial Investment Companies, which correspond to the country's main geographical regions. Eximbank operates both in its own name and in the name of the State. The Bank enjoys modern management techniques aimed at promoting Romanian export production.

Eximbank provides to customers the following services:

- guarantees to Romanian exporters;
- reimbursement of advances as well as guarantees to exporters participating in international biddings;
- importer guarantees to industries providing parts used in manufacturing sophisticated products and products with long production cycles which are for export;
- exemption from import duties, value-added tax and customs duties on imports complementing the production of complex exports and products with long production cycles;
- sovereign guarantees of the Romanian State, which are issued to foreign exporters of machinery and equipment aimed at the technological re-equipment or creation of new Romanian enterprises.

Proposals regarding such guarantees are prepared by special directorates of Eximbank dealing with country risks, products, industries, etc. The final decision on these guarantees is taken by the Inter-ministerial Committee for Guarantees and Credits to Foreign Trade.

In order to ensure a competitive environment for exporters similar to that in western Europe, a special "Interest Rate Stabilization Fund" has been established. The objective of this Fund is to balance high interest rates prevalent among Romanian commercial banks, which inhibit the competitiveness of Romanian exports. The Fund reimburses up to 50 per cent of interest paid by Romanian exporters, under the condition that their exports are cost-efficient and the interest paid by the exporter exceeds 20 per cent per annum.

Regardless of the nature of their capital (State, private, or mixed, of foreign or Romanian origin), exporters benefit from risk coverage against non-payment in cases where the modalities of payment do not include insurance. This service is also extended to exporters conducting sales to geographical areas with high political risk. The export risk insurance of the Eximbank plays an important role in supporting the system of commercial banks and insurance companies, and contributes to the international expansion of the latter.

Along the same lines, Eximbank is providing financial support for the acquisitions of equipment required to expand export production capacity. To this end, the Ministry of Finance has concluded a credit agreement to finance a "Project of Industrial Development". According to this agreement, Eximbank is authorized to implement a credit line opened by the National Bank. This credit line, in its turn, is intended for on-lending funds extended by the World Bank. Here, Eximbank provides refinancing for commercial banks participating in the project.

The Eximbank's programme for small and medium-sized enterprises aims at providing direct financing to SMEs for investment projects as well as at refinancing through participating commercial banks. Financing is provided to individual companies which prove to be eligible according to certain criteria. In more general

terms, the objective of this programme is to enhance the competitiveness of individual industrial sectors, create new jobs and strengthen the domestic market.

Among other relevant operations, Eximbank also discounts commercial paper and provides guarantees on its own behalf when foreign banks extend financing to domestic economic agents.

2. Martin Drabek, Senior Director, Banking Section, Eximbank (Slovakia)

I would like to outline a number of problems that the Slovak economy is facing. These problems have an important influence on the accessibility of trade finance. Then, I will highlight the activities of the Slovak Eximbank and describe the major services it provides to foreign traders.

Regarding the first group of issues, the following problems are of relevance to trade finance:

- the lack of creditworthy projects/borrowers in the area of exports;
- high interest rates in previous years; recently they have drastically fallen leading to a loss of demand for the services of Eximbank on behalf of banks and borrowers;
- problems related to pre-shipment financing; these problems relate to the high loan default risk when the exporter is unable to comply with the contractual conditions;
- the lack of long-term funds and the reluctance to accept longer-term risks;
- the high loan concentration and insufficient capital adequacy of many banks;
- the high proportion of classified loans in banks' portfolios;
- the depressed capital market;
- the insolvency or lack of liquidity of a large number of companies.

In general terms one can distinguish three groups of products within which Slovak exports are deemed to be competitive. These are: (1) intermediate or semi-finished products; the competitive advantage here is based on processed raw materials available domestically (wood processing, glass industry, production of cement, etc.); (2) high value added products (machinery, transportation/vehicles, electrical engineering and electronics, chemicals, etc.); (3) end-user/consumer products with a comparative advantage of low labour costs (textile and clothing products).

Unfortunately, Slovak exports are primarily composed of goods with low value added such as intermediate materials, energy, labour- and capital-intensive commodities. According to the statistics available, the share of sophisticated, technologically-advanced products and capital goods in overall exports has been increasing recently. At the same time, it remains insufficient.

With regard to imports, the Slovak Republic depends heavily on purchases abroad of raw materials (particularly from Russia) and imports of machinery and electronics from the European Union and other OECD countries.

In terms of its geographical destination, more than 90 per cent of exports go to OECD countries, with as many as 61 per cent going to EU States. Another important export area are the countries belonging to the

Central European Free Trade Agreement (CEFTA). One can finally note the gradual reduction of trade volumes with the Czech Republic: its share in exports fell from one third in 1994 to 18 per cent in 2000.

Over the last two years, the trade balance of Slovakia has improved with regard to almost every country or group of countries with the exception of Russia. In 1999, the overall deficit of foreign trade fell from SKK 80 million to SKK 45 million, which should be interpreted as a very positive development. The driving forces behind the recent improvements in the balance of trade are: an import surcharge, the depreciation of the Slovak crown against the USD, and the recent growth of import demand in other European economies, notably Germany.

Despite an accelerated growth in Slovak exports over recent years, one can point to their still low per capita volume: Slovakia's USD 2,200 worth of exports per capita is significantly lower than Austria's USD 11,000 or Luxembourg's USD 30,000 per capita.

Now, let me introduce the activities of the Slovak Eximbank.

The Slovak Eximbank was founded in 1997 under a special law as a sui generis institution, acting as a "one-stop shop" for exporters, providing both funds and insurance cover. The mission of Eximbank can be defined as the "promotion of Slovak exports to overseas markets by providing export credit cover and funding to Slovak enterprises on terms commensurate with those offered by ECAs in OECD countries".

Total assets of the Slovak Eximbank represent about USD 125 million and its equity stands at USD 70 million. The difference between the two figures mentioned above represents the State funds that have been entrusted to Eximbank – a subordinated debt, with no specific maturity attached to it.

In 1999, the Bank's net income after tax amounted to USD 3 million. Two major principles guide the operations of the Eximbank. The first one is finding financing solutions to support creditworthy transactions while observing the rule of prudent management. The second principle calls for transparency and consistent rules in the lending process in order to prevent favouritism, protect the bank's assets and make sure the taxpayer's money is used in an effective manner.

Historically, the Eximbank was intended to become a major banking institution, with a projected headcount rising to 300. The management of the Bank chose direct financing as the principal activity but exercised limited due diligence and was unable to achieve appropriate risk mitigation. At the end of 1998, a new management was appointed, which implemented a programme of restructuring and streamlining of the organization. The Bank was considerably downsized, with the number of staff not exceeding 110 at the beginning of 2000.

At the same time, the focus has been changed from direct lending to refinancing, the latter implying channelling funds through commercial banks via credit lines to exporters. There has also been a modification of refinancing schemes enabling more efficient financial control, the introduction of new products and, finally, the promotion of high value-added exports.

With regard to the product range offered by Eximbank to Slovak exporters, one should mention that approximately USD 70 million are allocated to banking activities, which encompass the following products:

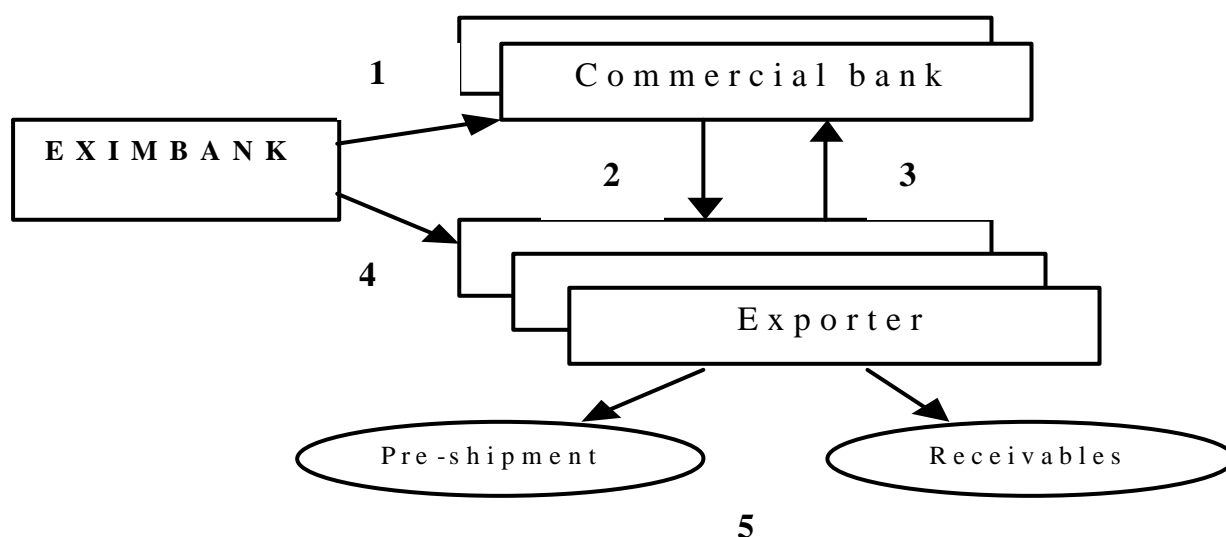
- refinancing facilities;
- small volume refinancing through the bill of exchange programme;
- bank guarantees and bonds;

At the same time, new products “in the pipeline” include:

- loans denominated in foreign currencies;
- forfeiting and factoring;
- project financing;
- import loans to support acquisition of state-of-the-art technology.

More specifically, refinancing facilities are designed for larger manufacturers or exporters, with the minimum amount of the loan rising to USD 250 thousand. Financing is undertaken by a commercial bank through an on-lending scheme. The purpose of the funds is to provide short-term working capital financing, which includes the financing of export receivables and pre-shipment financing. These refinancing facilities are intended to ensure the viability of projects so that they are subject to meticulous scrutiny and review by the commercial banks.

#### **Slovak Eximbank: Re-financing facility funding**



1. Refinancing loan facility extended to a commercial bank (1 year revolving)
2. Funds on-lent to exporters (working capital financing)
3. Loan collateral
4. Eximbank's recourse to end-user (exporter) in case of default by commercial bank
5. Use of funds

The refinancing facilities scheme (see Diagram 3) is applied in order to mitigate the risk of Eximbank. Therefore, only financially sound banks are eligible for cooperation. All applicant banks are subject to careful examination, while the client banks already cooperating with Eximbank are subject to on-going monitoring and credit review. Eximbank also mitigates the credit risk exposure through recourse to the end user in case of commercial bank default. The Bank exercises due diligence and risk management, which implies putting ceilings on the credit lines to banks based on financial ratios, size of the bank, performance record and non-public information. The shortcomings of this system are that the cooperation with the private sector becomes a tedious and rather inflexible process.

In terms of pricing of its products, the aim of Eximbank is to ensure that Slovak exporters can compete on level terms with exporters in other countries. Eximbank practises uniform pricing for banks, i.e. the interest rate charged to the commercial bank is pegged to the discount rate, currently 8.8 per cent, on which the commercial bank can add a margin of up to 3 per cent. To give incentives to exporters, Eximbank offers certain reductions or bonuses – for example a reduction of interest rate (over 60 per cent) for exporters of high value added products or manufacturers that produce predominantly for export. Another incentive applicable when getting insurance with Eximbank is the possibility for the exporter to partially offset the interest rate charge against the premium paid.

Eximbank's funding via the bill of exchange programme is targeted at small and medium-sized enterprises and is applicable for amounts not exceeding USD 250 thousand. The major purposes of this scheme are pre-shipment and export receivables' financing, and the method of disbursement involves a commercial bank drawing a bill of exchange to its own order, which is then accepted by the exporter. The main advantages of the bill of exchange discounting scheme are simpler administration, flexibility (tailoring conditions to export contract requirements) and the possibility of roll-overs.

In addition to loans, Eximbank also provides bond and payment guarantees. The bonds in question are not debt instruments. They rather represent bid bonds, performance bonds, advance payment/refund bonds, retention money bonds and maintenance/quality bonds. I should also emphasize that payment guarantees are used on a limited scale as they are sometimes perceived as too risky.

Re-financing through loans represents almost 90 per cent of the overall transaction volume of the Eximbank with the bill of exchange programme and guarantees representing 6 per cent and 5 per cent of the activities, respectively. The breakdown by territory of exports supported by Eximbank is consistent with the overall trade structure of Slovakia with the supported export sales destined predominantly for EU and CEFTA countries.

As was already mentioned, one of the products to be launched by Eximbank in the near future is project financing, which represents the financing of capital investments undertaken by an economic unit. This type of financing implies that the project generates sufficient cash to cover its operational expenditures and to service the debt used for its financing. In the context of project financing, the Eximbank's role will consist of:

- Assessment of the economic feasibility, viability and risks of projects financed by domestic and foreign banks applying for State guarantees;
- Participation in syndicated export loans;
- Provision of comprehensive project financing for Slovak exporters through buyer credit;

- Export credit political risk coverage and provision of guarantees.

Among the Bank's strategic objectives for the future is to increase the share of top 100 exporters serviced by Eximbank (from 25 per cent to 50 per cent), and that of attracting additional funds, in particular, through the use of foreign exchange resources, forfeiting activities and import refinancing loans.

### Strategic Objectives of the Slovak Eximbank: budgeting of banking activities

		Current	Budget	Projection		
		1999	2000	2001	2002	2003
% of total Slovak export supported		2.1	3.0	4.5	6.0	7.5
No of exporters	Top 100	25	30 – 35	35 - 40	45	45 – 50
	Other	30	50	100	150	250
Funding requirements (USD million equivalent)	In SKK	68	88	100	113	125
	In foreign currency	-	25	50	75	125
Allocation of resource to products (USD million equivalent)	Export refin.loans	57	88	105	123	150
	SME loans	4	9	13	15	20
	Guarantees	7	11	13	15	20
	Forfeiting	-	5	8	10	13
	Import refin. loans	-	-	13	25	50
<b>TOTAL: (USD million equivalent)</b>		<b>68</b>	<b>113</b>	<b>150</b>	<b>188</b>	<b>250</b>

The introduction of new products and conditions related to new products is hampered by the lack of flexibility of the current law, especially with regard to procedural matters. These constraints need to be eliminated by minor amendments slated for legislative approval.

In 2001, an entirely new legislation is expected to be introduced. This would establish the Eximbank as a corporation, ensure the compliance of Eximbank operations with EU requirements, enhance its ability to raise funds on international financial markets, provide a link to the State budget and, finally, enable it to issue guarantees in the name of the State.

Among the current issues relevant to the work of the Eximbank, I should mention the interest rate conditions. Since the interest rate is pegged to the discount rate, the recent fall of the latter rendered Eximbank loans less attractive for the exporters. Therefore, Eximbank will seek approval from the Government to change the mechanism for setting up interest rates. For example, the introduction of a base rate consistently below market rates is feasible. In relation to sources of finance, Eximbank is in the process of raising foreign currency denominated debt to the value of EUR 25 million.

In order to harmonize its procedures with EU standards, the Eximbank intends to spin off its commercial or marketable insurance activities and redefine procedures within the bank to ensure greater flexibility.

Finally, I would like to draw your attention to several factors which should contribute to the enhanced economic growth of Slovakia.

Emphasis should be made on imports of advanced sophisticated technology which would contribute to the restructuring of the Slovak economy and the sustainable development of foreign trade. Another important factor is foreign direct investment – there is evidence that higher FDI from multinational companies (such as Volkswagen or AssiDomän) contributes to the exchange of goods between countries. As far as import-intensive products are concerned, I do not think that Eximbank will in the future be less interested in supporting such production since there is generally 92-95 cents of import costs for every USD of export revenue.