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## THE SIGNIFICANCE AND PERSPECTIVES OF THE EXPORT CREDIT INSURANCE

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### *Summary*

*The high growth rate of the world trade is unavoidably connected with the problem of financing the great bulk of business transactions. Many of them are influenced by a wide range of risky factors, that may finally influence the success of the business.*

*In consequence of higher riskiness of the foreign trade transactions, there is a greater necessity to provide their financing against relevant risks. The export credit insurance is one possibility of ensuring the return on credit sources. The level of utilisation of this sort of insurance depends on insolvency growth in the economy, because it underwrites an exporter against the insolvency risk.*

*The paper analyses the problems and evaluates the situation of the export credit insurance in the Slovak Republic.*

*It defines the development of the export credit insurance provided by various institutions and Eximbanka's activities. The paper also compares the insurance systems of the developed market economies and that of the Slovak economy.*

**Key words:** *export credit insurance, political risks, commercial risks, insurance contracts, premium, guarantees*

### INTRODUCTION

In the 90ies the world economy is characterised by a high growth rate of the world trade, which outstrips the growth rate of the world production almost doubly. While the growth rate of the world production in 1995 reached 2.4 %, in the same period

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\* Author's translation and proff-reading into English.

the world export was increased about 8 %. In 1996 the world trade growth significantly slowed down and reached the absolute value of 5,100 bn USD.

In this article, I would like to respond these urgent problems and evaluate the situation of the export credit insurance in the Slovak Republic.

## **SLOVAK EXPORT**

The Slovak economy is characterised as relatively opened towards the world economic system. The export of goods and services represents more than a half of gross national product. This fact emphasises necessity of supporting the exporters through financing and insuring their export transactions.

Even small economy can overcome the lack of resources through export. On the other hand, the regulation of the export structure in the top branches can bring the high odds for the small countries to succeed at the foreign markets.

The chemical products, semi-finished products and simple final products represent the biggest part in the commodity structure of the Slovak export. All these products have the law added value. As concerning the size of the export markets, Slovak industry has at its disposal only the small markets. The production, and also the Slovak export is too wide in a product range. And that is why, the economies of scale do not occur.

To improve this situation, it is necessary to apply long-term pro-export policy, and therefore it is inevitable to use an export credits and subsequently to assure the export credit insurance.

The credit insurance, so as credit export insurance, can be defined as a legal relation between insurance company and insured, where the insurance company obliges to indemnify the insured in the case of loss, caused by the insolvency of a debtor, to whom the goods and other property had been supplied.

The export credit insurance includes the insurance covering economic and political risks in the foreign trade insured either in the private company or within the state guarantee. The private insurance of the export credits is the insurance of exporter's debt toward the foreign purchaser in the private enterprise. The private insurance covers only negotiable risks. This is the reason why it is impossible to insure the outstanding debts in trade with the foreign governments and public institutions, neither the risks in the international system of payments (convertibility risk, moratoria), exchange rate risk, military risk.

The public export credit insurance is a comprehensive term for the public export guarantees. Its task is to ensure all foreign risks and to support the export of goods in benefit to domestic exporters a banking institutions.

There is an important role of the public administration in supporting the export financing and insuring. But in practice the public bodies may interfere in this system to a

certain extent in every country, which has its own export credit system. This fact derives from the high riskiness of the markets and increasing insurance rates for risky countries.

In the developed countries, there exist several ways of institutional organisation of the public export support. The countries lay stress on the connection between financial and insurance activities, on the decision-making process and on the transparency of the public export support. In these states, impact of the historical and economic development, created different financial and insurance systems. There are different institutions, and within them: eximbanks, credit insurance companies, financial institutions and special institutions.

## **THE EXPORT CREDIT INSURANCE IN THE SLOVAK REPUBLIC**

Until 1989, when the political conditions changed, the trend of the export credit insurance in the countries of RVHP did not exist. The most of the goods and services exports of RVHP was on the basis of multilateral contracts, or there were other political intentions, mainly in the developing countries.

After the political and economic system had changed, after establishing the democratical arrangements trying to revitalise the economic system, the urgency of implementing the export support occurred.

That was the reason, the Exportní a garanění pojišťovací společnost was founded in Czech and Slovak Federative Republic. Its main object was to insure export risks. After the division of the CSFR, the Slovak branch of the company was transformed into Spoločnosť pre poistenie exportných uverov, a.s. In July 1997 this company was transformed to Eximbanka, which should become modern institution offering the insurance and credit services to exporters and importers.

Eximbanka is a body corporate residing in Bratislava. It is an institution, which in accordance with the foreign public policy, supports export and import activities, insures export credits and finances them.

It came into being by the Act n. 80/1997 on Eximbanka, the founder is the Slovak Government. Eximbanka is a member of the Slovak insurance association, associated member of the Bank association and Bern union, which joins the world insurance agencies.

The activities of Eximbanka are (such in the developed countries) aimed at supporting the domestic exporters and reduction of the foreign trade risks, by providing an export credit insurance. An insurance has a character of a supplier credit insurance.

Eximbanka provides also the insurance of the export purchaser credit. The domestic bank grants this kind of loan, and when the conditions agreed between bank and exporter are fulfilled the conditions for export credit insurance are created. The implementation of export purchasing credit increased the capacity of banks to grant such a loan.

Except insurance activities, Eximbanka provides financing and refinancing of long term, middle-term and short-term loans, too, for supporting the foreign investment.

The Eximbanka's services are offered for remittance, the premium depends on the riskiness of:

- agreed terms of payment,
- export territory ,
- concrete customer.

An inevitable requirement for concluding the insurance contract is:

- existence of a valid treaty between the Slovak Republic and the purchaser's country,
- existence of a contract between the exporter and customer,
- payment realised by common instruments of payment, - participation of the exporter on the insurance,
- the insured and purchaser must settle the general sale conditions, - insurance will be realised after period of time determined,
- at least 60 % of exported goods must be produced in a domestic country.

The insurance rates, such as the extent of participation are calculated in the resultant chart, which is an internal document of Eximbanka. The insurance contracts are concluded individually. There are several discounts depending on the site of a customer, the trade traditions, long-term smooth course of insurance, etc. The insurance bonuses are updated when necessary, but at least once a three months.

In the area of the political risks, the insurance rate reflects the public concern in this service offered to our exporters, so the premium is minimal. The possible profit is not taken into account, only the coverage of service expenses.

The relation between Eximbanka and client is based on the general insurance conditions, that differ depending on the risk they cover and duration of export credit as follows:

1. short-term export contract insurance (to 1 year) against commercial risks,
2. short-term export contract insurance against political risks in customer's country. Political risk presents an impossibility of remittance from customer's country because of administrative decision or the public body's decision. This sort of insurance is very risky,
3. middle-term and long-term export contract insurance against commercial and political risks, which relates to credits with expiration date above 1 year,
4. long-term and middle-term export credit insurance against political and commercial risks, which includes the purchaser credit risk .

Eximbanka SR underwrites also following types of the bank guarantees:



- guarantee on offer ("bid bond") - this sort of a guarantee is common for tenders on equipment supplies or carrying out various works. The bidders demand the supplier to deposit the vadium in about 2 % - 5 % from the price listed in the offer. This guarantee should compensate the damage, the bidder could suffer in case, if the supplier did not keep the terms of contract or if he had not endorse the treaty (even, if his offer had been successful).

- (advanced payment bond) - in this sort of guarantee the bank underwrites, to return the advanced payment provided or the part of it in case, if the seller did not supply the goods or he supplied only a part of that. This guarantee assures the quantity - the amount of supplies. The advanced payment bond is to be effectuated generally on the first appeal without objections, and it may include an establishment about guarantee decreasing depending on the supplies. The advanced payment fluctuates usually between 10 % and 20 % of the contract value, and it is feasible to make the guarantees effective after the seller had accepted the advanced payment.

- (performance bond) - serves to insure the delivery. The guarantee is between 5 % and 10 % of the contract value. As in previous case, the guarantee should be effectuated on the first appeal without objections. It is usually long-term guarantee for whole period of validity of the technical guarantee, that may last in case of great complete industrial plant for 3-4 years. The performance bonds are the most frequent guarantees and they usually become valid when the validity of bid bond is expired. The wording of the bid bond often says, that the claim is valid until the performance bond is issued.

- (retention money bond) - is used in contract, which blockades some percent of every payment, until the project is finished and delivered to customer. The retention money bond enables the seller to obtain entire payment, and the customer to get back the funds, in a case of default.

The insurance contract is concluded with an exporter. An insured value is the whole value of the bank guarantee. The insurance rate depends (as in the case of export credit insurance) on customer's country and duration. The insured must pay even a charge for risk analysis. The premium is due single-shot. There is an increasing concern of businessmen in such an insurance. The execution of this insurance depends on the real state capacity to act as a reinsurer of the political and economic risks.

Eximbanka is engaged also in other areas, not only in insurance and financial business. Eximbanka also provides subventions to cover the losses caused by the differences in domestic and foreign interest rates in investment exports. To ensure this activity, there are some funds from the state budget.

Last but not least Eximbanka should represent the place where the information about the tenders in the World bank, EBRD, and even other international finance institutionare distributed for the Slovak exporters. Eximbanka insure also the following activities:

- activities connected with insuring, financing and reinsuring of the export loans,

- transactions connected with keeping the outstanding debts and their requisition,
- consultations and advisory services, - broker's activities,
- administration of state budget funds determined on the export supporting.

In the first year of Eximbanka's existence, the concern of Slovak business enterprises was directed mainly on the commercial risks insurance in export to the countries of OECD and CEFTA. The exports to the transitive economies, e.g. Czech Republic, Poland, Hungary and others, were additionally insured even against the political risks. The increasing concern in short-term export credit insurance was shown by growing number of insurance applicants.

From the aspect of territory the highest share of export belongs to the countries of CEFTA (42.4 %), followed by OECD (35.1 %). Detailed survey specifies the Table 1.

Table 1

Territorial structure of the insured goods

Country	share on export (in %)
Czech Republic	29,7
USA	4,6
Persia	17,9
Switzerland	2,2
Germany	13,6
Greece	1,8
Italy	12,2
Great Britain	1,3
Poland	11,3
Others	2,4

*Source: Internal materials of Eximbanka*

From the aspect of commodity structure the most significant percent of insurance amount in pursued period is in conveyance, wood and wooden products, metals, paper, machinery and apparatuses, textile and glass production. Detailed data includes Table 2.

Table 2

## The commodity structure of the insured exportation

Commodity	Commodity share on export (in%)
Conveyance	21,1
Wood and lumber products	19,2
Metals and products of metal	18,6
Paper and products of paper	13,5
Machinery and apparatuses	12,7
Textil products	5,2
Glass and products of glass	4,8
Plastic	3,6
Furniture	1,2
Others	0,1

Source: Internal materials of Eximbanka

## CONCLUSION

Even if in comparison with the insurance systems in developed market economies there is common things then differences among them, the Slovak export insurance system is used by Slovak exporters below standard. The share of the insured export is deeply under the value of 1 % . For example in Belgium it is 3 % , in Austria 16 % and in Denmark 25 % . The cause of this low share may rest in the low capitalisation of Eximbanka. Next reason may be the limited offer of the risks coverage in middle and long-term loans.

Tradable and untradable risks are not separated in our system. In developed economies, the market risks are left to the private sector. Our private sector is very little developed. This phenomenon is indeed inherent sign of all transitive economies.

Exibanka SR so far does not offer the direct guarantees for banks financing the export credit. The bank can be insured only if it provides an insurance of the purchasing loans.

For the Slovak system the low differentiation of insurance contracts is also characteristic.

I suppose, that the export credit insurance will become a vital part of foreign trade support in the Slovak republic in future. Shall we catch this trend and how we will support the significance of the export in the Slovak republic, depends on us.

Generally I can say, that the modern insurance system of export credits was created and is still developing and it is completely compatible with the systems of the developed countries.

## LITERATURE

Act NR SR 80 /1997. on Export-import bank

Internal materials of Eximbanka

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### VAŽNOST I PERSPEKTIVE OSIGURANJA IZVOZNOG KREDITA

#### *Sažetak*

*Visoka stopa rasta svjetske trgovine je neizbježno povezana s financiranjem brojnih poslovnih transakcija. Na mnoge od njih djeluje veliki broj faktora rizika, koji mogu utjecati na uspjeh poslovanja i koji su u uskoj vezi sa sve većim rizikom transakcija u vanjskoj trgovini.*

*Zbog visokog rizika vanjskotrgovinskih transakcija potrebno je osigurati njihovo financiranje od rizika. Osiguranje izvoznog kredita je jedna od mogućnosti osiguranja povrata kredita. Korištenje ovakve vrste osiguranja ovisi o insolventnosti ekonomije jer se izvoznik mora osigurati od rizika insolventnosti.*

*U radu se analiziraju problemi i ocjenjuje način osiguranja izvoznog kredita u Republici Slovačkoj, definira se razvoj osiguranja izvoznog kredita dobivenog od različitih institucija i djelatnosti Eximbank-e, te se uspoređuju sustavi osiguranja razvijenih tržišnih ekonomija sa slovačkim sustavom.*

**Ključne riječi:** *osiguranje izvoznog kredita, politički rizici, trgovački rizici, ugovori o osiguranju, premije, garancije.*

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