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Export Credit Agencies in the Czech Republic and Their Market Power

Karel Janda[1]

Introduction

This paper introduces Czech export credit agencies as a representative example of the approach to state export credit guarantees adopted in the so-called Visegrad Group of EU member states, which includes the Czech Republic, Hungary, Poland and Slovakia. While Janda, Michalikova and Psenakova (2013) provides more detailed information about international trade and state export credit guarantees in the entire Visegrad, this short paper focuses solely on the Czech Republic.

Institutional arrangements of state export credit guarantees are usually based upon one of the following three models: (i) export insurance company only, (ii) Eximbank providing both export insurance and direct credit, and (iii) two separate institutions, one providing insurance and the other providing direct credit. All three institutional models are frequently used by many countries, as shown by Nakladal (2013). Among OECD countries, the first model with an insurance company only is used in Denmark, Italy, the Netherlands, New Zealand, Portugal, Greece, Britain, Spain and Switzerland. The Eximbank model is used in Australia, Belgium, Canada, Mexico, Romania, Slovakia, Taiwan, Turkey and the United States. Finally, the model with a separate bank and insurance company is used in three Visegrad countries (the Czech Republic, Hungary, and Poland) and in Bulgaria, France, Germany, Japan, Luxembourg, Norway, South Korea and Sweden. This country-listing shows that the post-socialist OECD countries generally prefer those models in which export credit insurance is complemented by the provision of direct export credit.

Export credit agencies (ECAs) worldwide differ not only in terms of the institutional model adopted, but also according to their type of ownership (public, private), their legal form and their relation to the government budget. In terms of the relation to the government budget, we can distinguish between (a) ECAs closely connected to the government budget with a low degree of independence in their decisions and risk management and (b) ECAs more loosely connected to the government budget, which are obviously more independent in their operations. Czech ECAs – Czech Export Bank (CEB) and export insurance companies (EGAP) – are highly independent ECAs.

The independence of Czech ECAs is highlighted by Czech legislation, which explicitly provides for the separation of the government insurance company EGAP from commercial export insurance; and offers all Czech commercial banks the opportunity to provide export credit insured by EGAP. In other words, Czech legislation clearly emphasises that the CEB does not have any monopoly power on using government supported export credit insurance provided by EGAP.

As shown in the previous discussion of the three most common institutional models of export credit support, all models always include an export insurance company. This shows that institutions like EGAP are clearly distinguished from commercial insurance companies. However, the fact that many countries do not provide direct export credit through Eximbank or through a separate export bank indicates not only that the CEB may not be an indispensable component of government export credit policy, but also that some of the export credit provided directly through the CEB could have been channelled through Czech commercial banks. After providing a brief description of the Czech export credit system, this paper therefore focuses on discussing possible reasons why the CEB retains its key position in the provision of EGAP insured credit; and why the commercial banks have not been able to secure a bigger part of this potentially important and profitable market.

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Czech export strategy

The export credit support in the Czech Republic is conducted according to the Export Strategy of the Czech Republic 2012–2020, adopted by the Czech government in March 2012. It describes the visions and activities of the state to promote and develop Czech exports. It follows on from the Czech Export Strategy 2006-2010 and its extended update for the year 2011. Its primary vision is to promote the Czech Republic as one of the 20 most competitive countries in the world by 2020.

The strategy identifies some of the major obstacles facing Czech exports. These barriers include high dependency on EU markets, a failure to adjust to world market trends, the weak utilisation of EU funding by Czech exporters, and a separation of a role of export agencies financed by the state (see also Janda, Michalikova and Skuhrovec 2013; Janda, Michalikova and Psenakova 2013).

The Czech Export Strategy is divided into three pillars: (1) export information (to build a so-called Export Intelligence providing easier access to information resources and databases, internalization), (2) export development (export education, consulting and financing), and (3) the development of business opportunities (building a network of exporters and their partners, marketing and lobbying activities, business policies). The major targets of the Czech Export Strategy to be achieved by 2020 include:

- Increasing the number of total Czech exporters by 15 percent, of SME exporters by 50 percent, and of overall exports by 25 percent per capita,
- Diversifying exports, especially into countries beyond the EU's borders,
- Shifting major Czech export items into a higher value-added sector, accompanied by more proactive innovation efforts.

This strategy explicitly distinguishes between two groups of countries according to their ability to grow and absorb foreign export, as well as their compatibility with Czech exporters. The most important group of so-called priority countries consists of Brazil, China, India, Iraq, Kazakhstan, Mexico, Russia, Serbia, Turkey, Ukraine, the United States and Vietnam. The second group (in order of importance) features the so-called countries of interest including Angola, Argentina, Australia, Azerbaijan, Belarus, Egypt, Ethiopia, Chile, Ghana, Croatia, Israel, Japan, South Africa, Canada, Colombia, Morocco, Moldova, Nigeria, Norway, Peru, Senegal, Singapore, United Arab Emirates, Switzerland and Thailand. The activities of the Czech export-promoting institutions described in the next section primarily focus on the priority countries, with a slightly lower level of exposure for the countries of interest.

Czech export promoting institutions

The Czech Export Strategy is supported by the three specialised export-promoting institutions: the Czech Export Bank (CEB), which specialises in export financing, especially to less developed and risky countries; the Export Guarantee and Insurance Corporation (EGAP), which provides insurance against political and non-marketable commercial risk; and CzechTrade, which provides export information and consulting services.

Czech Export Bank

The CEB was established in July 1995 as an important part of a government export-promoting programme. The Czech government directly owns 80 percent of shares in the CEB. The votes corresponding to these 80-percent of shares are divided among 4 relevant ministries, whereby the Ministry of Finance has the main decisive power with 52 votes out of 100. The Ministry of Industry and Trade has 30 votes, followed by the Ministry of Foreign Affairs with 12 votes and the Ministry of Agriculture with 6 votes. The remaining 20 percent of CEB shares are indirectly owned by the Czech government through EGAP. Since the CEB is fully owned by the Czech government, it does not belong to any bank group. This distinguishes it from all major Czech banks, which are owned by an international banking group. On its incorporation, the CEB had a registered capital value of 1.5 billion Czech korunas (59 million euros), which was subsequently increased to 4 billion Czech korunas (158 million euros).

The CEB was created to offer complementary products to Czech commercial banking products. Thus the CEB was to specialise in exporters unable to obtain the financing that they required from Czech commercial banks. That means export financing with a state guarantee for countries in which Czech commercial banks prefer not to invest because of their higher

riskiness. The CEB's goal is to increase the competitiveness of Czech exporters abroad (OECD 2011; CEB 2013).

CEB clients mostly use export buyer credit and export supplier credit. They deal especially with long-term credits with a maturity period of over five years. In both 2011 and 2012 just over 95 percent of the loan principal portfolio of the CEB had a repayment term of over five years. Exports from the Czech Republic are oriented towards countries with close geographical or political relations with the Czech Republic, primarily the EU countries. Those countries are evaluated as less risky according to a quarterly classification published by the OECD. However, most of the new CEB contracts are located in higher risk countries with a classification of 3 or more, where OECD country risk classification ranges from 0 (no risk) to 7 (very risky). The risk structure of the CEB's new commitments in 2012 according to this OECD country risk classification is as follows: 14 percent in class 0; nothing in classes 1 and 2, 36 percent in class 3 and 50 percent in classes 4 and higher.

Export Guarantee and Insurance Corporation

The Export Guarantee and Insurance Corporation (EGAP) primarily insures bank loans due in over 2 years that are intended to finance the export of energy, machinery and technological systems, investment projects, transport constructions and investments, usually to countries where the political, economic and legal environment increases the risk of default. The EGAP's services complement the range of commercial credit insurance products and fill a gap in the market. The EGAP therefore acts as a standard export credit insurance company in the role of a government instrument to promote exports. The EGAP is, according to its rules, obliged to provide insurance services to all exporters of Czech goods, services and investments, irrespective of their size, legal form and volume of insured exports.

The EGAP was established back in June 1992. Like the CEB, it is also entirely owned by the Czech government and its capital is worth 1.3 billion Czech korunas (51 million euros). As with the CEB, the Czech Ministry of Finance holds the majority of votes (520 votes), with the remainder distributed among the Ministry of Industry and Trade (468 votes) and the Ministries of Foreign Affairs and Agriculture (156 votes respectively). The EGAP owns 20 percent of CEB shares and a 34 percent stake in KUPEG.[2]

The EGAP is a typical ECA and, according to its rules, provides state support only for products and territories where no commercial market insurance is applicable. This implies that the EGAP insures mid-term and long-term credits in more risky territories. The most common EGAP insured credit is the export buyer credit with a maturity period of 2 years or longer, according to the OECD Arrangement. The EGAP cooperates with almost all Czech commercial banks, however, with the CEB as its main partner. Both institutions also work with foreign banks to finance Czech exports (EGAP 2013).

One of the fundamental principles stipulated in the OECD Consensus, which the EGAP and other insurance companies providing insurance for export credit risks must adhere to, is the principle of self-financing their activities, which is intended to apply to the long term and is measured on this basis. This indicates that the Czech Republic should not subsidise the operations of the EGAP insurance company on a long-term basis, since this would make it an illegal support. From the very beginning of its existence, i.e. since 1992, the EGAP has fully covered all of its operating expenses, including payments of claims to clients, from revenues generated by its own activities. The EGAP functions as a self-sufficient, yet targeted and *de-facto* non-profit tool of state support for exports in the long term. Obviously, like other ECAs all over the world, the Czech government continues to provide backing just in case large scale defaults etc. should occur, as the EGAP would not be able to satisfy the insurance claims out of its own budget and reserves.

CzechTrade

The Czech Trade Promotion Agency, or CzechTrade, was founded by the Czech Ministry of Industry and Trade in May 1997. Its objective is to promote Czech exports by improving its competitiveness in foreign markets. CzechTrade has a network of eight managers operating in different regions in rural areas outside of Prague. They closely cooperate with the Czech Chamber of Commerce, the EGAP and the CEB. There are 33 permanent CzechTrade offices abroad on four dif-

[2] KUPEG is the biggest domestic risk insurance company and was created outside the EGAP by separating commercial insurance from government-supported core insurance business. KUPEG insures various kinds of commercial risks, usually for a short-term period.

ferent continents. CzechTrade promotes exports, especially in markets outside the EU (CzechTrade 2013).

CzechTrade provides various services for potential exporters, including consulting, information, export assistance and export education. It organises lectures and seminars, publishes export manuals and other publications, provides contact information for potential clients, market research, marketing in foreign markets, etc.

Market power of the Czech Export Bank

As already mentioned above, the Czech system of the government support of export credit is based on the model of two separate independent ECAs (the CEB and the EGAP). The CEB was set up in 1995, three years after the establishment of the EGAP. Given the transition situation in the Czech trade and banking sector in the mid-1990s, the establishment of the CEB was a logical and fully justified decision on the part of the Czech government. At that time the majority of the Czech commercial banks were not focused on developing departments dedicated to export financing. Moreover, the on-going transformation of essentially all major Czech exporters meant that their credit and performance risk was quite high, and they were not sufficiently attractive for many Czech commercial banks.

Together with the privatisation of Czech banks in the late 1990s and their gradual acquisition by well-established international banks, the quality of these Czech banks improved. Their internal processes, their rating and the portfolio of the services that they offered to their consumers also improved and broadened. The majority of Czech banks, however, did not establish export financing departments until the advanced stages of economic transformation. A number of Czech commercial banks nevertheless currently already boast a significant amount of experience with export financing. Moreover, the rating of these banks is comparable with the rating of the Czech Republic, which means that the share of the export financing market held by Czech commercial banks can be expected to rise. This hypothesis is supported by a comparison of the CEB's high 54 percent share of EGAP's outstanding commitments as of 31 December 2012, with a lower (31 percent) share of newly EGAP insured export credit provided during the year 2012 (EGAP 2013).

The dominance of the Czech Export Bank in the export financing insured by the EGAP falls into line with state policy goals to support the competitive environment in Czech export financing and to provide EGAP export insurance to all Czech banks, and not only to the CEB. A number of possible explanations for the Czech Export Bank's dominant position in the Czech export finance market are discussed below.

The CEB's most obvious advantage is its ability to provide long-term credits at fixed interest rates. The CEB is essentially the only Czech bank that uses the fixed Commercial Interest Reference Rate (CIRR). Czech commercial banks provide almost all of their long-term loans under the variable rates derived from LIBOR or EURIBOR. This is because the costs of fixing the long-term interest rates of loans provided in a foreign currency are relatively high for the bank and, therefore, the resulting interest rate would be too high to be competitive. Should Czech commercial banks wish to use the interest rate support provided by the Czech government, they have to ask the administrator of this interest rate support (namely the CEB) for refinancing credit. Arranging this refinancing credit takes some time and a significant administrative effort on the part of the commercial bank.

Since the CEB is owned by the government, there tends to be a lack of strong incentives for and/or pressures to achieve high profitability. As a result, this lower pressure on profit may lead to lower profit margins on CEB credit contracts than is the case for private contracts. In other words, the CEB may be offering lower interest rates and/or better conditions for debtors than commercial banks.

Whereas the CEB tends to be less profit-oriented, its management is likely to be interested in maximising its size as measured by the volume of credit provided. In connection with the CEB's lower risk aversion, this may lead the CEB's management to reject many possible syndicated credit contracts in favour of credit types provided entirely by the CEB. This may, in turn, result in a much higher share of CEB credit in export credit markets compared to the scenario whereby the CEB invites commercial banks to participate in syndicated credit or other joint credit arrangements.

However, there are also a number of other factors supporting the dominant position of the CEB. One of them is insufficient legislation. The OECD Consensus provides only general statements about the comple-

mentary role of ECAs in the export finance market, which is similar to its treatment of export credit insurance. Yet, unlike export credit insurance, the export credit provision is not covered by EU legislation in sufficient detail. The absence of specific rules and laws promoting export finance competition gives the CEB a significant advantage over commercial banks.

An additional factor supporting the CEB's strong position in Czech export financing is lobbing by big exporters. The profit maximising commercial bank may easily justify the rejection of export credit if the risk is too high relative to the expected return. It is far harder for the CEB to reject such high risk loans: since its mission is to promote Czech exports, it is more vulnerable to lobbing by big exporters. These big exporters lobby the CEB's major shareholders (e.g. Ministry of Finance and Ministry of Industry and Trade) to support riskier credit. Should an exporter be afraid that a commercial bank could reject its project as excessively risky, it prefers to go directly to the CEB. This notion of risk applies not only to risky territories, but also to project financing (financing through special purpose vehicle) connected with commercial risks. The CEB has a lower aversion to risk than commercial banks. Its shareholders do not require any long-run profitability and short-run losses are considered natural. The CEB is therefore more willing to provide risky loans than commercial banks.

Another reason for the CEB's heavy involvement in some risky countries is its ability to finance large projects worth hundreds of millions of euros without needing to cooperate with other banks. The majority of the commercial banks in the Czech market would not be willing to extend such large loans and would search for partners to share these loans with them.

Unlike commercial banks, the CEB is also not subject to the internal limit of territorial credit exposure. As of 30 June 2013, the total value of the CEB's product portfolio (2.9 billion euros) was distributed in the following way: Russian Federation 42 percent, Turkey 17 percent, Slovakia 15 percent, Azerbaijan 8 percent, Georgia 7 percent, Ukraine 3 percent and Bulgaria 3 percent. The total share of all other 18 countries covered in the CEB's portfolio is 5 percent; and none of these countries has an individual share of 3 or more percent of CEB's total product portfolio (Bakajsa 2013). Almost half of the CEB's portfolio is in the Russian Federation and the CEB does not apply conservative portfolio risk management. This difference between the CEB's portfolio management and that of commercial banks is clearly understandable and appropriate given the CEB's goals and mission. In addition to territorial limits, commercial banks may be restricted by exposure limits related to industry and to the Czech government. For example, as long as their internal limit of exposure to the Czech government is binding, the increase in the volume of credit insured by the Czech government agency EGAP has to be compensated for by the sale of Czech government bonds.

At times the CEB may profit from strategic competitive considerations on the part of commercial banks. Many commercial banks use a number of internal restrictions in their operations that do not apply to the CEB. Some commercial banks do not provide credits for some industries (like nuclear energy or weapons, for example), while many commercial banks do not want to finance some risky debtor, even with credit insurance provided by the EGAP. In many cases commercial banks follow a certain blacklist of countries or individual borrowers in a stricter way than the Czech government and the CEB. Such internal restrictions mean that bank staff may be obliged to reject potential borrowers and advise them to ask the CEB for a loan, instead of advising them to go to another commercial bank. This is because the CEB only provides export financing, so any given commercial bank that is not able to provide export financing may lose only this specific export contract, while retaining the client for general banking purposes. Should the client be directed towards some other commercial bank, on the other hand, there is a danger that this client could switch some or all of its banking operations to that bank.

Similar strategic reasons may lead to an increase in the CEB's portfolio should banking group exposure limits be binding in a particular case. Since the Czech commercial banks generally belong to some larger international bank group, the provision of a large credit by a Czech bank may occasionally violate a group-wide exposure limit with respect to some country or subject. In such cases, commercial bank staff may again be likely to direct rejected debt applicants to the CEB, instead of to some other commercial bank.

The simplicity and speed of loan approval is another factor that gives the CEB an advantage. Essentially all Czech banks are foreign-owned and each large loan, usually exceeding the credit limit by some tens of mil-

lions of euros, has to be approved by the appropriate body of the bank in question located outside the country. Together with the previously mentioned pooling of credit risk among several lenders, this gives CEB loans clear advantages from the borrower's point of view. The speed and convenience of dealing with a single financing institution based in the Czech Republic is one of the CEB's key competitive advantages.

The role of the CEB as an experienced incumbent in the Czech export credit market constitutes another key advantage. In many cases, it takes over a year to finalise the arrangement of major credit transactions. Personal contacts and a track record of smooth cooperation among lenders and borrowers are very important. The experience of CEB staff members in relevant markets in many countries is also a key asset both for exporters and export insurers (EGAP).

The incumbent advantage of CEB is also relevant in the case of some financial covenants to existing credit contracts. These covenants do not allow the debtor to significantly increase its indebtedness without prior approval from the bank providing the previous credit to which these covenants were related. Therefore, as long as some party in the contemplated export credit contract is already related to the CEB through some of these covenants, it is quite likely that this new contract will be financed through the CEB, rather than through any other bank.

While debtors in many developed market economies do not really care whether they are dealing with a private or a government-sponsored bank, many clients from developing countries clearly prefer to deal with a government-owned bank. Should the debtor be some government agency, any part of government or any public institution, the CEB is often assessed as an official export bank of the Czech Republic. In some cases debtors explicitly require the involvement of a government institution, like the CEB, in the investment process.

A misperception of the CEB's role also provides it with a competitive advantage. Some small exporters may think that the CEB is much better suited to export credit financing than commercial banks. They expect the CEB to provide better and cheaper services than any commercial bank. In some cases customers do not distinguish between the services of the CEB, the EGAP and the subsidy programmes operated by other Czech public institutions.

Conclusions

This analysis primarily focuses on a brief institutional description of the Czech export credit support system and on several selected policy issues addressed in terms of the Czech Republic's institutional setup. However, the export credit policy lessons dealt with in this paper are much more general; and are also relevant to other post-socialist new EU member countries, as well as essential to any country in which the export credit support has an institutional setup similar to that of the Czech Republic. Since this paper focuses on Czech export credit support, we do not provide a general discussion of the economics of credit guarantees and trade finance. An up to date review of these topics is provided by Felbermayr and Yalcin (2013) and by Auboin and Engemann (2014).

This paper offers a detailed discussion of possible explanations for the CEB's strong position in the direct financing of Czech exports as compared to the much weaker position of Czech commercial banks. It also shows that the CEB's advantage is based not only on the low profit margin argument, but also on a number of more complex reasons. One of the CEB's major strategic advantages is its specialisation in export finance, which allows commercial banks not to view the CEB as a competitor in their general banking business. Another key advantage of the CEB is its clearly defined role as a Czech government-owned export bank aimed at promoting Czech exports, as opposed to other Czech banks, which are almost always part of some bigger international banking group and aim to maximise their profits.

As long as no European legislation is introduced to restrict the role of government export banks (similar to regulation of the role of government export insurance companies), the CEB and export banks in other EU countries are very likely to retain a significant share of direct export financing, despite the potential ability of commercial banks to play a more active role in this market segment.

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