German Advisory Group Ukraine

NEWSLETTER

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An Export Credit Agency: Good idea, but more work needed

A well organised and managed Export Credit Agency (ECA) can be a strong instrument to foster the export performance of the national industry. Covering commercial and political risks of export transactions as well as political risks of foreign direct investments, an ECA enables domestic companies to develop commercial activities abroad and become successful in the global market.

Ukraine is one of the very few industrialised countries which have not yet established an official ECA. Ukraine's Parliament passed a "Law on the establishment of an ECA" in December 2016, but it did not provide any funding for it in the state budget 2017, and necessary secondary legislation was not adopted. Consequently, the ECA was not established as a legal entity.

In order to serve Ukraine best, the ECA should be established soon. However, the necessary time should be taken to secure a sound and proper launching process. The Law shows some fundamental weaknesses and needs to be amended before an ECA can be set-up and start operations. With an unrestricted access to its products for all interested Ukrainian export companies, the ECA can play an important role to improve Ukraine's success in the global trading system.

Basic features of export credit insurance

Export credit insurance provides insurance cover against the non-payment of export claims due to commercial and/or political risks. The core activity of the credit insurer is to check the creditworthiness of the foreign buyer and to analyse the political risk of the buyer country. Global experience with such insurance proves that there are a number of associated benefits, like an improved access for national exporters to foreign markets, the diversification of exports and increasing the share of SMEs in the export business.

Export Credit Agencies (ECAs) are usually official or officially supported institutions that offer protection against risks which are characterised as "non-marketable". The purpose of official ECAs thus is to fill a market gap. Under WTO-Regulations, export subsidies are in principle prohibited. Export Credit Insurance is allowed according to the WTO Agreement on Subsidies and Countervailing Measures (ASCM) only if the premium rates are adequate to cover the long-term operating costs and losses of the programmes. The rationale behind this regulation is that state-supported export credit insurance shall not become an export subsidy. Furthermore, there is a common understanding amongst OECD members and beyond, that competition between exporters should be based on quality and price of goods exported, rather than on the most favourable officially supported financial terms and conditions. The state-linked ECAs shall therefore cover only risks which are normally not covered by the private sector.

Setting up an Export Credit Agency in Ukraine

Ukraine is a very open economy, which is closely integrated into the world trading system. It is therefore no surprise that there have been plans to set up a national ECA in the past. However, only in late 2016 a law on the establishment of a Ukrainian Export Credit Agency was adopted by Parliament, and subsequently entered into force. At the same time, since the budget for 2017 did not foresee any funding for the agency and the necessary secondary legislation was not adopted, the ECA was not established. In addition, in the cooperation memorandum with the IMF, the authorities pledged to make the ECA operational only after all costs and capital needs are identified for the next three years and included in the state budget.

A closer analysis of the law reveals indeed a number of issues, which immediately raise certain questions. In the following section, we will briefly highlight the main points:

1. <u>Capitalisation and state support</u>: The Law states that the charter capital of the ECA shall be at least UAH 200 m (currently about USD 7.7 m). This is a relatively low capitalisation for an ECA. Coupled with the limited state support (e.g. in terms of public guarantees), this is a fundamental structural weakness. An ECA needs either a strong capitalisation, or strong and reliable state support to achieve its objectives in case of possible future financial difficulties. The draft budget 2018 foresees only the mentioned UAH 200 m, from which in addition initial establishment costs and operating expenditures need to be covered.
2. <u>Interest rate compensation</u>: The Law foresees a programme of partial interest subsidisation, even though further details are lacking. We are highly skeptical of this instrument, as it is extremely expensive and a possible invitation for fraud. We also severely doubt that this instrument is in conformity with WTO rules.

3. Areas for support: Somewhat surprisingly, not all goods, works and services produced or originating in Ukraine are eligible for ECA support according to the Law. In fact, according to information compiled by the Ministry of Economic Development and Trade, the sectors eligible for ECA support represented only 16.5% of Ukraine's total goods exports in 2016. The immediate question arises why other products or industry branches, representing 83.5% of Ukraine's goods exports, are not eligible.
4. Corporate Governance: The distribution of responsibilities between Cabinet of Ministers, General Shareholders Meeting, Supervisory Board and Management Board is not fully convincing and should be discussed again. Also, there should be Independent Directors in the Supervisory Board.
5. Types and conditions for ECA operations: We strongly recommend that investment insurance, which is included in the Law, should only cover non-commercial (e.g. political) risks, but never commercial risks.
6. Special status of ECA: The regulatory rules must be worked out very carefully and must guarantee a comparable level of solvency, good governance, financial regulation and control like the one foreseen in the Law on Insurance.

Implementation aspects

According to the Law, the ECA shall be established within six months after the effective date of the Law. This deadline has expired without results in the meantime.

The establishment of an ECA needs sufficient time and must be made in a careful, reliable and proper manner. A six months period is by no means sufficient. Even for the legal establishment of the ECA the deadline of six months is extremely short. Developing the products, setting up the core team of the ECA, buying and adapting proper IT systems, training of employees and starting of marketing and sales activities needs a considerably longer time.

Furthermore, all these steps should not be done without consultations with and advice by international consultants. The professional exchange with other ECAs being members of the Berne Union or its Prague Club Committee (a committee of young and small ECAs mainly from emerging markets), should be established as early as possible.

Conclusions

The establishment of an Export Credit Agency in Ukraine is a good idea. The legal framework, however, needs further development, both in terms of amending the existing Law and the creation of the required by-laws. This should be the near-term focus of the authorities.

Assuming this process succeeds and the – yet to be adopted – budget for 2018 provides the funding for the establishment of the agency, the Ukrainian ECA must then be given the necessary time for establishing its operations in a professional manner, and for building up good relations to international fora for Export Credit Agencies like the OECD Working Party for Export Credits and Credit Guarantees or the Berne Union Prague Club Committee.

Following this route opens Ukraine the possibility to start with a state of the art ECA which is able to support the national export industry and improves competitiveness of Ukrainian export products on the global market.

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A more comprehensive analysis is provided by the Policy Paper PP/03/2017 "An Export Credit Insurance Agency for Ukraine: Analysis of the current legislation and the Statute".

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