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Export Credit Insurance in Albania – Policy Objectives and Options Reviewed

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Albanian government decision-makers should decide on choosing which policy objective to follow. This would, to a great extent, determine the selection of the policy option to implement. In turn, this would by and large delineate the actions to be taken, with a significant number of technical details of the system to be worked out later.

EXPORT CREDIT INSURANCE: POLICY OBJECTIVES/OPTIONS REVIEWED IN THE ALBANIAN CONTEXT

OPTION 1

Policy Objective	***Policy Option***	***Desirable Action***	***Required Budget Allocation***
No specific objective for export finance related competitiveness	"Hands-off " market-based, let the market ("the private sector") work it out	Legislative if any, creating a favourable legal environment, removing possible legal hurdles	None

This option describes fairly well the present situation in Albania, following the abandonment of the Albanian Guarantee Agency (AGA) experience. No state-supported export finance entity of any sort or size is operating at present and no relevant piece of legislation could be found. It must be mentioned that there is a Government Decision of April 2002 approving the proposed amended agreement with WB on the transformation of AGA into a fully blown Export Credit Agency. However, the proposed agreement needed to be signed by the WB too and subsequently ratified by the Parliament. Moreover, the other basic regulations, such as Law 8365, 2 July 1998 (the "Banking Law") are also "trade finance neutral", that is to say no specific reference is made to international business transactions and their specificities.

Private sector response, however, is anything but strong. Interviews in a number of exporting companies, private banks and insurance companies could not trace the presence of anything which would qualify as specific "export finance" instrument:

- Commercial banks finance exporters under the very same conditions they offer to clients interested in domestic-market transactions. These same conditions are *high collateral requirements and high interest rates.* (This is natural – no commercial bank has or should have a mandate to facilitate exports on the basis of its own initiative.)
- Export credit insurance in particular or credit insurance in general is not a product that is offered by insurance companies. At best in one insurance company it is possible to find an understanding of international payment guarantees but again this was not connected to actual products.
- As of March 2005, no credit information or receivable management company entered the market.
- The only field where a private sector initiative is present is the factoring of export invoices. A Greek company was said to consider launching this activity. This, however, is an instrument, which is used only under particular circumstances and is generally not considered competitive when compared to other, more sophisticated export finance products.

It seems therefore safe to conclude that after more than a decade into transition the *“market is not working it out”.* This is due primarily to the small size of the market as it is today and in years to come. It seems that in the current market, potential investors are discouraged by the likely low sales figures of export finance instruments and, consequently, low premium figures. Besides, other reasons – such as the lack of major international insurers in the country for whom “transplanting” products is possible with minor market entry expenses – may also contribute.

OPTION 2

Policy Objective	***Policy Option***	***Desirable Action***	***Required Budget Allocation***
Availability of marketable export finance instruments in the domestic market	Pro-active market based, assisting private sector actors to introduce new instruments	Legislative-administrative. Policy measures to facilitate market entry for private sector service providers	Relatively small for research, training, international lobbying, minor incentives

This option receives little attention internationally as its implementation by any country will be low profile. No institution enjoying international visibility will emerge and observers outside the country will hardly notice the difference unless they take a closer look. However, for countries not willing or capable to commit significant means to their export finance system and with a limited range of export products this option deserves attention. It does because it offers a solution going beyond the total neglect of the problem or complaints about funds, which are not available, or if they are so they are committed to other purposes.

The option has one serious limitation, though. Its mobilization effect can reach only marketable export finance instruments. This, in the case of Albania, consists of only one instrument and this is *short-term (maximum 180 days) export credit insurance for on-cover countries* (97% of total exports.) Here government intervention would try to tackle a specific market failure, namely the non-availability of insurance services due to high market entry expenses relative to premium potential. This market failure could be described in the following terms. Development of databases which are a fundamental tool of controlling risks is very expensive and with reason considered to be one of the main impediments to market entry for new actors in the credit insurance business. In the case of offering coverage on buyers outside Albania to Albanian exporters, the data is already there in the database of any of the major international insurers. For them offering this coverage to Albanian exporters indirectly would only need minor investments, mostly consisting of training of local staff, the establishment of IT systems enabling fast and reliable data exchange, marketing and eventual licensing and other legal expenses.

Indirect service providing would naturally require a local partner as a primary insurer and some of these expenses could also be shared with him. This is a cheap solution under a „fronting agreement” which could still very well fill this gap in the market. While it is not possible to say with precision why no local or outside insurer engaged himself in it yet, the most decisive factors are probably connected to the very small size of the market. For the local primary insurer, this translates into plain lack of knowledge on the existence of one more potential line of business to be added to existing ones. For any potential foreign reinsurer, this prevents this business line even from reaching the entry-point of relevant decision-making procedures. As a result, market actors neglect the opportunity.

Government action could change exactly this. A government, keen to promote exports and aware of this problem could conduct consultations with both sides. These in the first place would familiarize both local and the foreign insurers with this opportunity. More detailed analysis would reveal the exact structure and size of initial expenses mentioned above. It is quite likely that international donors would cover some or most of these as a very manifest gesture to assist the

introduction of a market-based export promotion tool to Albania. The government, offering donor-provided or other financial assistance and throwing his weight behind the initiative has a good chance of breaking the deadlock existing up to the present day.

OPTION 3

Policy Objective	***Policy Option***	***Desirable Action***	***Required Budget Allocation***
Tangible improvement of competitive position of national exporters	"Hands-on" soft non-market based, positive impact through indirect government involvement	Introduction of interest rate subsidy schemes and/or government reinsurance facilities for contracts made by private sector service providers	Could be substantial, depending on quality of risks accepted and size of interest rate differences compensated. A management fee payable to private sector actor is also necessary.

This option is followed in an ever-increasing number of countries, mostly in Western Europe. True, it describes matters more as they are and not as they were: this state of affaires is mostly the end-result of the privatization of state-owned ECAs. In most countries government reinsurance is provided only for medium and long-term export credit risks and possibly for short-term risks in non-OECD countries. Interest rate subsidization is offered through commercial banks to exporters selling on medium-long term credits. Exceptionally, in countries such the Czech Republic, Australia, Canada, the United States the government also reinsures the performance risks of exporters in relation to their working-capital loans obtained from commercial banks.

From an Albanian perspective, this latter instrument could be of particular interest. The reason being that exports on medium-long term credit terms are not made from the country while the need for better access to working capital of exporters is evident. Moreover, it is probably the single biggest obstacle, in the field of export finance, to stronger export performance. It is essential to stress, however, that government reinsurance is not an actual budget transfer at the time of the commitment made. This is only a payment guarantee if and when non-payment occurs and is subsequently reported. Even then the final balance of the budget transaction is influenced by the eventual success of recovery of claims on the foreign buyer/guarantor or, in the case of a guarantee on a working capital loan, on the local debtor to the commercial bank. This implies that the budgeting process differs as at the time of submitting the central government budget to parliamentary approval only a ceiling is determined for that year and actual call-offs from the ceiling are referred to next year's budget. This procedure is repeated in every budget year as a rollover.

An Export Working Capital Guarantee is a very powerful tool to assist businesses to obtain otherwise partly or even fully unsecured pre-shipment finance to enable them to accept export orders. In the absence of this these businesses would not have sufficient security to obtain bank finance needed. Consequently, their cash flow deficit would prevent them from taking and processing export orders that otherwise they would be qualified in terms of price, quality, and delivery terms to fulfil. The insurer backed up by government reinsurance provides a guarantee to the exporter's relationship bank, which then provides the necessary working capital funds to correct the cash-flow deficit. All this is done on the basis of careful scrutiny of the relevant export documents and taking into consideration the exporters previous track record with smaller sized orders in the past. The relevant regulation of the Bank of Albania would be supportive to lending by commercial banks under a facilitation scheme of this kind. Albanian government guarantee is accepted 100% as fully sufficient collateral as opposed to a 70% sufficiency ratio for market-based collaterals.

OPTION 4

Policy Objective	*Policy Option*	*Desirable Action*	*Required Budget Allocation*
De-facto elimination of competitive disadvantage of national exporters	"Hands-on" hard non-market based, positive impact through direct government involvement	Establishment of government owned institution / institutions providing export finance services	As in 3. + start-up capital allocations and possibly operating expenses of institutions

In most transition countries governments chose this option back in the first half of the 90's. The initial capital allocation (counting also subsequent increases) for institutions of this type was in the range of EUR 3-15 million, meant to cope with the financing needs of economies with exports ranging from EUR 4.0 to15.0 billion in mid-90s. However, even under the most optimistic scenario – both in terms of business covered and in terms of agreements with state reinsurers on premium sharing (that is 100% of premium left with the agency while all indemnification paid from government budget funds) – the agency would not still be self-sustainable. Keeping estimates in the realistic 10-20% market penetration and in the 5-95%-15-85% the premium retention-cession ratio ranges, a yearly operating loss of between EUR 182,275 (10% combined with 5-95%) and EUR 151,669 (20% combined with 15-85%) can be expected from the short-term export credit business.