

## INSURING AND FINANCING OF EXPORT CREDITS IN THE REPUBLIC OF MACEDONIA

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### **Abstract**

*The existence of corresponding credit risk insurance present in export credit is a placed condition in realizing export financing. Taken into consideration that international trade transactions are processed in many complicated conditions than those present on the domestic market, success in trade transactions means security and the protection from credit risks can only be achieved through the insurance institute. Main winnings from the export credit insurance are the secure demand payment, increase in export competition, new market involvement and, the possibility of the policy to be used as collateral in commercial banks. Essentially, the main point in export credit and insurance is to meet the importer's demand, without jeopardizing or exposing in danger the exporter's financial goals.*

**Keywords:** *export credit, credit risks, commercial risks, noncommercial risks, insurance of export credit.*

Financial institutions responsible for the financing and insurance of export credits are Export Credit Agencies. They can be state owned, private or with a mixed capital, whereby the state agencies can be organized as government agencies, departments of Central Bank, specialized banks, export-import banks etc [1]. Different countries in the world have different specialty and organization of Export Credit Agencies that conduct their activities of financing and insurance of export credits. Therefore, in the developed countries there are usually two institutions for the support of export, one of which is responsible for financing and the other for insurance of export credit and issuing export warranties, which even though at the beginning they were founded as state, today most of them are private property. In the developed countries the private capital, that in the beginning of the 90's in the 20<sup>th</sup> century starting penetrating the short-term insuring of export credits from commercial and noncommercial risks more and more, is a competitor to the export credit agencies.

In the developing countries, there is usually one financial institution - Export Credit Agency, which conducts both the financing and insurance of export credits. Also, it should be mentioned that in the developing countries there is almost no private market for insurance of export credits. Whereby in the developing countries, the Export Credit Agencies are organized as one institution that both finances and insures the export credits, it plans and manages, in a rational manner, the funds and state assets intended for promoting national export [2]. Because the Export Credit Agencies in the developing countries do not have big financial capacity and potential for accepting all credit risks, very often they make the reinsurance with famous and renowned Export Credit Agencies in the world. Such is the case of Macedonian Bank for Development Promotion - MBDP which has contract for reinsurance and within its frames it insures the export credits against credit risks.

In the Republic of Macedonia the financing and insurance of export credits is conducted by one institution, the Macedonian Bank for Development Promotion-MBDP. However, even despite all advantages that the insurance of export credits gives, according to the data of MBDP

the insured Macedonian export does not exceed 1% from the total Macedonian export. Contrary to the Macedonian exporters, their business partners in the countries from the region and Europe insure their export significantly more. For example, the Slovenian Export and Development Bank (SID Bank) annually insures around 20% from the Slovenian export, the Croatian Bank for Reconstruction and Development insures around 7% from the Croatian export, and the Serbian SMECA insures around 15% of the Serbian export, and additional 13,3% are supported by the second Serbian institution for insurance and financing of the export-AOFI.

The Macedonian Bank for Development Promotion is organized according to the model of the development bank which is promoted by the German Development Bank (KfW)<sup>1</sup> and which represents a dominant model in Europe, proven as a successful in almost all countries in central and eastern Europe.

The mission of the Macedonian Bank for Development Promotion is to support the development of the Macedonian companies through insuring means from financial sources and promotion of the Macedonian export. The basic task of the Bank is to promote the development through financing investments of small and middle enterprises, support of the source and providing credits and donations from abroad and in 2001 MBDP introduced the trade credit insurance and with it took over the role of the national Export Credit Agency. According to the Law on Establishing of MBDP<sup>2</sup>, the Status, the Credit Policy, the Policy for Promotion of export and other business acts, MBDP fulfils the following activities:

- Financing of the production aimed at export with credits approved for identified inflows of export,
- Financing for starting of work and development of small and middle trade companies, through middle-term and long-term credits,
- Insuring and reinsuring of identified inflows of export against commercial risks, on short term,
- Managing and administration of foreign credit and donation programs.

The Macedonian Bank for Development Promotion, since the beginning of the 2001 started insuring the export demands against commercial and political risks. A fund has been set aside by the state which is managed by the bank, and which is intended for insuring against political risks. MBPR insures the short-term export credits against commercial risks on a commercial base, by reinsuring the private sector. With the insurance policy of short-term export credits against commercial risks, the insurer, for a specific insurance premium, accepts the responsibility to compensate the damage originated from the insured persons' inability (the seller- exporter) to claim his demands from the foreign buyer. The subject of insurance is export credits with a collection period for the demands of 180 to 360 days, against the following commercial risks [3]:

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<sup>1</sup> The first promotion bank in the world is the German development bank (Kreditanstalt Fur Wiederaufbau- KfW) formed in 1948 with a seat in Frankfurt. The promotion banks from the develop countries are the Japan Development Bank and the Korean Development Bank, and from the countries in CEE: the Hungarian investment and development bank, the Bank for the development of Lithuania, OPTIVA- Bank for development of Estonia and the Croatian bank for Reconstruction and Development.

<sup>2</sup> Macedonian Bank for Development Promotion AD Skopje is the only development bank in the Republic of Macedonia founded with a special Law on Establishing the Macedonian Bank for Development Promotion on May 21st, 1998 (Official Gazette of RM No. 24/98, 6/2000, 109/2005 and 130/2008). In 2009, a new Law on MBDP was adopted (Official Gazette of R.M. No. 105/2009) aimed at improvement of the Bank position and the specific role MBDP has as a development bank in the banking industry and in the economy of the Republic of Macedonia.

- insolvency of the foreign buyer- bankruptcy, special type of executive procedure according to which from the property of the company (the foreign buyer) all creditors are settled, i.e. the debtors' liabilities are paid.
- suggested nonfulfillment of the liabilities- when the debtor (the foreign buyer) does not fulfill its obligations for a longer period, i.e. does not settle the debt (the demands) in the extended deadline as of the day of the submission of the demand.

The policy for export insurance against commercial risks on short-term, covers a portfolio of buyers or single transactions and MBDP pays a compensation of 90% of the amount of unsettled demands within the frames of the approved credit limit for the insurance. The insured persons request a credit limit for each buyer in the amount that is approximately equal to the maximal amount of the open unclaimed demands of the buyer. For the purpose of reducing the risk in its working and in interest of solvency, the Macedonian Bank of Development Promotion executes the activities of commercial insurance on the grounds of the concluded contract for reinsurance with a specific national export credit agency- member of the Berne Union, before it starts concluding insurance contracts with the potential insured persons. With the purpose of broadening the scope of insurance in respect of risks, MBDP includes in the insurance also the non-commercial risks through contracts of optional insurance and reinsurance in investments with high creditworthiness and rating in the field of insurance and credit risks.

The Macedonian Bank of Development Promotion issues policies for insurance of export transactions whose values is not lower than 5.000 Euros, and the maximal amount of the insurance of single foreign buyer is not over 3.000.000 Euros. These limitations of the insurance value are aimed at rightful allocation of the support of the export; however the bank can retreat from the prescribed values in specific individual cases, i.e. when the source of specific products is strategically significant for the country. Therefore, the bank can make an agreement for insurance of the export credit with an amount lower than the prescribed minimum or not higher than the established maximum amount. In respect of the coverage percentage of the export credit, the bank shall cover, i.e. will compensate 85% to 100% of the damage, which is the result of commercial and non-commercial risks. The amount of the damage will depend on the reinsurance contracts, and the disbursement of damage will proceed according to the established procedure of the reinsurer [4]. The premiums that MBDP is claiming from the insured persons, the exporters are defined according to the tariff which is applied for insuring against commercial and non-commercial risks, established and accepted by the reinsurers. If the processing of the individual requests for insurance demands additional activities, such as establishing of the credit rating, analysis of the financial reports from independent financial institutions etc., the provision will increase proportionally to the increase of the expanses for the processing of the insurance request. The methodology for determining the premium rates is appropriate to the methodologies used by the Export Credit Agencies, members of the Berne Union [5]. The criteria that the domestic economic entities have to fulfil, in order to use the insurance offered by the MBDP are:

- to be registered in the trade registry of the Republic of Macedonia,
- the goods that are subject of the export should have a domestic origin, according to the dominant criteria for defining origin or accepted by the reinsurer,
- the entity shall not engage in activities that the MBDP ha excluded in compliance with the credit policy,
- the entity has a concluded sales agreement for goods or services with foreign buyers.

The Macedonian Bank for Development Promotion during the fulfilment of the activities in respect of the insurance of short-term export credits against commercial and non-commercial risks applies<sup>3</sup> and follows the General requirements for insurance in compliance with the reinsurance contracts. The insurance policy against commercial and non-commercial risks of the Macedonian Bank for Development Promotion is based on:

- the basic concept of the macroeconomic policy and interests of the Macedonian exporters for the presence on the permanent markets and conquering new markets,
- insuring long-term investments and investment activities of the Macedonian businessmen, as well as insuring investments and direct foreign investment in the Republic of Macedonia in cooperation with the World Bank and MIGA.
- cooperation with the competent ministries, diplomatic representatives in the Republic of Macedonia with other countries, cooperation with the National Bank of the Republic of Macedonia and the Economic Chamber of Macedonia, for establishing and monitoring of the existing markets and gradual introduction to new markets that interesting for the Macedonian exporters.

MBDP should offer the Macedonian market more specialized policies, guided by the practical needs of the exporters and the financial institutions in our country. The current position of MBDP according to which, and on the grounds of the former reinsurance contract with a renowned export credit agency, it accepts the credit risks in the insurance, can be improved significantly. By studying the national export credit insurance systems of other countries, MBDP can use the experience and follow the example of specific Export Credit Agencies in respect of the policies that they are offering to their exporters.

Good example is also the Czech Export Credit Agency EGAP [6], which offers several types of policies, especially useful are:

“Policy E”- Insurance of bank attested documented letter of credit. This policy covers the commercial and political risks that can lead to partial and total nonpayment according to the requirements of the documented letter of credit, with which the bank – confirmer of the letters of credit can bear loses. In the insurance with policy E, the role of insured party can be taken by the bank that confirms the documented letters of credit, and the insurance premium is usually paid in advance in the full amount.

“Policy D”- Insurance of buyer’s export credits against risks of nonpayment of debt. This insurance covers the credits approved by the bank of the exporter of the foreign buyer or the bank of the buyer, for a period longer than a year. This type of insurance protects the banks or the other financial institutions against risk of nonpayment of debt by the foreign buyer or his bank. The insurance Policy D is always prepared on an individual base by respecting the specific characteristics that related to the export activity.

“Policy V”- Insurance against risks of breaching the export contract, because of the importer’s fault. By insuring the production risk, the exporter is protected against loses (production costs) that can come as a result of the termination of the export contract because importer’s fault, before the goods are delivered or because of the political, financial and macroeconomic situation in the country of the importer. The Policy V is always formulated on individual grounds, taking in consideration the specific characteristics of the export contract. The insurance premium is paid in advance, in one installment. The insured party is the manufacturer i.e. the exporter of the goods, but in case when with the insurance policy, the right

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<sup>3</sup> In its operation, the MBDP applies the rules and agreements of the Berne Union (for example, defining of export goods and services, start of the insurance, period of insurance etc.), as well as rules of OECD (duration of export credits, minimal premium rates, insurance deadlines etc.), of the European Union and MIGA.

of compensation is transferred in favor of a third person (usually the bank that finances the manufacturer), the damage compensation is paid to the specified person.

“Policy BF”- Insurance of short-term export credits of the seller, financed by the bank. Insured risks are the risk of nonpayment of the claim because of political and commercial risks, and the insured party is the bank. The insurance contract issued by the Export Credit Agency should be signed by the insurer, the insured party and the exporter. The exporter with his signature obligates himself to compensate every damage that the insured party is to suffer because of the payment of reimbursement to the bank, in case the obligations are not fulfilled because of his fault. The insurance premium is usually paid in advance, in one amount.

Additionally to the listed policies of the Czech Export Credit Agency EGAP, also good examples are the specific policies of the Hungarian Export Credit Agency MEHIB [6]:

“Policy CF”- Insurance of unsettled claims of the factor. Through this policy, the bought debts are insured by the factoring companies and the financial institutions with a maximum credit period of 360 days. The insurance is against commercial risks, such as insolvency and delayed payment, also additional insurance against political risks can be offered. With the Policy CF the whole amount of claims bought off by the factor is covered.

“Policy G”- Insurance of the production risks. This policy covers the risks in the period before the delivery of goods, i.e. during their production. The policy is issued for short-term and long-term export transactions and serves as a warranty for the banks, in cases where they finance the production intended for export. The insurer, on the grounds of the Policy G, is obliged to compensate the damage in case the agreed export sales are not fulfilled.

The Polish export credit agency KUKA offers a policy which insures the costs connected to the market research and it is available to the domestic entrepreneurs, which plan to start or develop the export of domestic goods or services. The insurance insures against failure in the process of concluding export contracts with the trade partners of foreign markets, whereby KUKA covers 65% of the achieved costs. A similar insurance program has the OeKB from Austria, which offers insurance for conquering new markets, and with the policy the export promotional activities of small and medium enterprises on the markets outside of EU can be covered. The insurance is limited to 346.000 Euros pro activity, and the coverage percentage is limited to 65%. The insured party shall be reimbursed if the expected growth of the export on the whole market is achieved.

Having in mind that the exporter in Macedonia have a poor knowledge of this protection instrument for their foreign exchange claims (the export credits), it is necessary for a specific policy to be offered, through which specific interested parties will very easily recognize their interest in appropriate protection against credit risks. In the future MBDP should offer support through the issuing of policies, not just for the exporters, but also for other financial institutions that participate in the implementation of one export transaction.

Additionally to insuring export credits, MBDP has the task of providing favorable and long-term financing sources from domestic and international sources (such as the World Bank and the European Bank for Reconstruction and Development), and the secured assets are later placed through commercial banks that execute the whole credit process, they take the credit risks and realize the credit. It is important to emphasize that the financial products of MBDP are offered according to the market conditions, and are realized through commercial banks in the Republic of Macedonia. The banks involved in the realization of the projects of MBDP receive a status of “banks- participants in the MBDP programs” and through a framework agreement they define the mutual rights and obligations. By following the basic principles of the development banks, MBDP only supplements the offers and services of the commercial banks in the Republic of Macedonia in those areas that they are not interested in being involved. In order to have an approach on the international markets of capital and credits under favorable

conditions, MBDP should respect the international rules for working of the promotional and development banks in the world. Also the Law on Establishing of MBD determines that the approval of projects will be conducted according to international principles of free trade and competition, as well as the rules of the World Trade Organisation.

The programs of MBRD for financing the export are represented through the following financial products [7]:

- export credit financing - working capital for pre-shipment export finance and working capital for bridging the period between export and collection of payment from the foreign buyer;
- credit support to SMEs - permanent working capital and investment financing from various fund sources: ICL-Revolving, MBDP, EIB-Revolving, EIB-50 million euros, EIB-100 million euros;
- credit support to agriculture and agroindustry - primary production, processing and export - through commercial banks or directly through MBDP;
- micro financing - micro and small scale enterprises, individual entrepreneurs, handicraft shops, private merchants, market counters, and other micro and small scale entities;
- financing energy projects - energy efficiency and renewable energy sources;
- loans for reducing unemployment - creation and preservation of jobs and self-employment financing;
- loans for accommodation facilities - micro, small and medium-sized enterprises, with registered office in the Republic of Macedonia, for purchasing, building and adaptation of small accommodation facilities not exceeding 70 beds and having up to 3 stars standard.

These credits are mainly approved in order to strengthen the competitive position of the exporters, especially the net exporters. The potential users of assets from the credit programs of MBDP from domestic asset sources are:

- For the export credits - the trade companies that are oriented toward export, which show solid results in the working, which have concluded contracts for export and which are privately owned with over 51% and have a net foreign exchange effect in the export;
- For investment credits - the small and medium enterprises, which have a short business history or are newly founded, show solid results in working and are privately owned with over 51%.

The potential users of the credit program assets of MBDP provided by foreign sources are mainly the small and medium trade companies. In principle, the financial support is primarily intended for trade companies which provide higher degree of finalization, technological innovations and development, new work places that are competitive with the domestic and foreign market, export oriented trade companies or trade companies that reduce the import dependency.

The efficiency of MBDP in specific programs can be improved and therefore it is necessary to introduce new programs or modifications of the existing, according to the claims of the business community, by using the positive experiences of the countries that are the closest to our country's level of development. Additionally, in the next period the government must work on recapitalization of Macedonian Bank for Development Promotion, which will increase its authority, whereby they are considering the possibility for the bank to have authorization for project investments, insurance of middle and long-term claims, as well for direct financing without using the business banks as mediators. The possibility for the bank to

directly allocate the assets to the final users - exporters, would mean assets with lower interest rates, as well as simplification of the procedure for approval of assets.

## CONCLUSION

The insurance of export credits is very important, i.e. it is an essential component of the system for export crediting, because without an appropriate insurance against commercial and non-commercial risks, the creditors are not prepared and do not accept to finance the sales of credit goods. Coming from the need to support the exporter of our country, MBDP should offer the Macedonian market more specialized policies, guided by the practical needs of the exporters and the financial institutions in our country. The current position of MBDP according to which, and on the grounds of the former reinsurance contract with a renowned Export Credit Agency, it accepts the credit risks in the insurance, can be improved significantly. By studying the national export credit insurance systems of other countries, MBDP can use the experience and follow the example of specific export credit agencies in respect of the policies that they are offering to their exporters.

Also, the exporters from the Republic of Macedonia think that the export of the country is not appropriately handled and followed by the state and private finance institutions. They demand that adequate forms of financial support to be found, especially for the big business deals, for which the offer of the business sector is very small. According to them the state should redefine the role of the MBDP and make it a serious partner to the export business entities. The exporters of MBDP expect to receive a support through middle-term and long-term financing of export credits, because the commercial banks usually approve the short-term assets and with relatively high interest rates.

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