Opinions of the National Audit Office

Export financing

Exports play an important role in the Finnish national economy and thus also in central government finances. Exports have accounted for about 40 per cent of the Finnish gross domestic product. The export-related guarantee liabilities of the state are also substantial; currently they stand at more than 11 billion euros. However, in the on-budget entities guarantees, interest equalisation and credits play a fairly minor role as the activities are organised as off-budget entities. The most important state actors in export financing are the Ministry of Employment and the Economy, Finnvera plc and the Finnish Export Credit Ltd, a subsidiary of Finnvera. The audit covered the role of the state in export financing, steering of the operations and organisation of the supervision. Most of the decisions concerning export financing are classified as business secrets.

Role of the state in export financing

State guarantees cover about five per cent of Finland's total exports and ten per cent of the exports to countries with political risks. Nevertheless, the direct monetary inputs of the central government in export financing are fairly small. The state mostly provides guarantees for arranging financing. The state also has instruments using which long term loans granted for purchasing capital goods can be converted into fixed interest rate loans.

During the financial crisis that started in 2008, the state also introduced temporary arrangements under which it began to provide direct credits for export financing. The activities were put on a permanent basis in 2012 and the same year the provision of credits was made the responsibility of Finnvera plc. Thus, the financing is no longer part of the state budget.

In the long run, Finnvera must be able to recoup all the investments that it makes in export financing. Since 1999, export financing has generated a surplus in every year of Finnvera's operations and in the last few years, the surplus has amounted to between 40 and 50 million euros. The fees received by Finnvera for providing the guarantees have covered all the compensations paid and all administrative expenses arising from the guarantees. All direct loans must also have guarantees, which means that the requirement for self-supporting financing also applies to them. When realised, the risks can be substantial: During the recession of 1991 the guarantees that had to be paid as a result of the bankruptcy of Wärtsilä Marine and for other reasons were in such a scale that it took 20 years for the cumulative results of the operations to become positive again.

In interest rate swaps, the state may have to cover losses depending on changes in interest rates. The losses usually amount to a few million euros each year. The state may also benefit from changes in interest rates.

State liabilities have grown rapidly in the last few years

As a result of the global financial crisis that began in 2008 and the economic downturn that followed, the state has rapidly assumed a stronger role in export financing. Between 2007 and 2009, the state's export guarantee liabilities grew from five billion to nearly ten billion euros. At the time, the state also started providing direct export credits. At first, they were on a temporary basis but in 2012, direct lending was made into permanent arrangement.

As the financial and economic crisis has dragged on, state-provided guarantees and credits have become increasingly important as instruments of export financing. Until June 2014, the statutory upper limit for the liabilities stood at 12.5 billion euros. The guarantees are approaching this limit and from 1 July 2014, the upper limit for export guarantee authorisations was raised to 17 billion euros. There was a particularly steep increase in the upper limit for direct credits: it was raised from three to seven billion euros. However, it should be noted that direct credits, too, require state guarantees and thus the risks associated with this type of financing are already contained in the guarantee liabilities.

As the upper limits for state-provided export guarantees have been raised, there has not been any corresponding growth in exports: At first, they declined and since then the rate of growth has been slow. This means that the state has assumed an increasingly important role in export financing. However, in Finnvera's view, the risks of the state have not increased in the same proportion as the liabilities. Profitable operations have helped to augment the funds that serve as the prime source for covering any losses arising from the operations. According to Finnvera, the assets in the funds currently exceed the estimated total risk. However, legislative changes have been made so that higher-risk exports can also be supported and since the start of the financial crisis, it has been made easier for the state to assume specific risks. In July 2014, the authorisation was increased from 2.5 billion to 3 billion euros.

The growth in the state's role in export financing has been very demand-oriented. Because of the problems faced by Finnish exporters, the Government and Parliament have given a high priority to the matter and efforts have been made to ensure the competitiveness of the export sector. Market failure has been given as the main reason for higher demand for financing. Facing tighter solvency requirements, banks are less willing to provide financing. For this reason and prompted by the practices introduced in a number of competitor countries, the state now also provides direct export financing and the offerings are no longer limited to guarantees and interest rate swaps. In connection with the audit, the Ministry of Employment and the Economy expressed the view that if export financing is to keep pace with the demand, the financing may even double. In a difficult economic situation, increasing liabilities and financing has been considered a better alternative than a continuous decline in exports. At the same time, self-supporting schemes have not required monetary inputs from the state.

There is a risk that the operations become less transparent and that there is no longer any clear idea of the total state liabilities

As a result of the financial crisis, the state began providing direct export credits. Initially, this was through the state budget and as the scheme was put on a permanent basis, an arrangement was established under which Finnvera is responsible for the financing, while the state provides guarantees for the funds raised by Finnvera. This helps to keep the end total of the state budget lower. The liabilities are no longer directly entered in the state budget and the fact that there has been a rapid increase in guarantees and liabilities is not shown in the budget either. When acquired by Finnvera, the financing is also slightly more expensive than when directly provided by the state.

There are provisions in the state budget under which the losses arising from export and special guarantees can be quickly paid from state funds and the payments do not need prior parliamentary approval as part of the budget or supplementary budget process. The main title of the administrative branch of the Ministry of Employment and the Economy in the state budget contains a variable annual appropriation of 20,000 euros (item 32.01.60 Transfers to funds in the administrative branch), which under the rationale may be used for paying compensation arising from the guarantees provided under the Act on the State Guarantee Fund (444/1998), the Act on the State's Export Credit Guarantees (422/2001) and a number of other acts. The variable annual appropriation allows quick payment of the guarantee liabilities on the basis of the authorisation to exceed the appropriation without the slower supplementary budget process. Because of large risk concentrations, the variable annual appropriation may lead to substantial spending.

'Finnish interest' is determined on a case-by-case basis

The purpose of the export financing schemes is to promote Finland's economic growth by providing internationally competitive export financing that helps to correct market failures. This purpose is laid down in section 1 of the Act on the State's Export Credit Guarantees and the act on export credits and interest equalisation. The aim of the financing is to promote Finland's economic growth. In other words, its purpose is to advance Finnish interests. The acts do not contain any detailed provisions on what is meant by 'Finnish interest' and how it is defined as further provisions on the matter are given by decree. The act on export credits and interest equalisation lays down stricter requirements for domestic content. The domestic content must be high and in a decree it is set at one third of the value of the export contract.

The decree on export guarantees and the decree on export credits and interest equalisation contain vaguely worded examples of when Finnish interest can be considered to exist. One possible criterion is the domestic content of a product or service, which under the decrees must be high. Under the decree on export credits and interest equalisation, the domestic content is high when it is at least one third of the value of the export contract. No similar definition is contained in the decree on export guarantees. Export credits and interest equalisation are the responsibility of the Finnish Export Credit Ltd, while export guarantees are provided by Finnvera.

The requirement for Finnish interest can also be met on the basis of other criteria if the criteria in question are considered important. The decrees do not contain any detailed definitions of what constitutes an important criterion. The provisions contained in the decrees are vague and leave room for interpretation and for this reason normative steering provides the parties granting the financing with a great deal of discretion on how they assess the benefits of the financing and its importance for economic growth in Finland. Both Finnvera and the Finnish Export Credit Ltd have internal guidelines defining the Finnish interest.

Under the rationale of the legislative proposals concerning the forms of export financing, the purpose of the financing is to increase the number of jobs and person-years in Finland and to avoid layoffs and dismissals. Under the proposals, financing also has positive effects on tax revenue. Only estimates of very general nature have been given of the impacts of the financing on employment and tax revenue. When the legislation on permanent interest equalisation and export credit arrangements was adopted, it was stated in the rationale of the proposals that it is very difficult to give detailed estimates of the impact of the legislation on employment and the value of production. In fact, it was only stated in the rationale that large export contracts may generate thousands of person-years, substantial increases in exports and more tax revenue. At the same time, it was warned that uncompetitive financing might have significant negative effects on economic growth, employment and central government finances.

The scope of the export guarantees was widened in September 2014 as Finnvera was also authorised to provide guarantees for domestic investments supporting exports. The aim is to ensure that when seeking financing Finnish companies would not in a disadvantageous position compared with foreign suppliers that can make use of the guarantee schemes available in their own countries.

According the audit, there are no special reasons for defining Finnish interest slightly differently in different financing schemes. Moreover, defining the interest has, in practice, been left to the providers of financing even though Finnish interest is the reason why the state is involved in the schemes. The Ministry of Employment and the Economy, which is responsible for steering the activities, should define the content of the Finnish interest. This would make it easier to assess to what extent it is reasonable for the state to assume export liabilities from the perspective of achieving higher employment rates and tax revenue.

Supervision of Finnvera has been inadequate

The operations of Finnvera have not been supervised in a manner that would allow the achievement of the objectives set out in the legislation. Under the act on the company, supervision must, as appropriate, be in accordance with the principles laid down in the other provisions on the supervision of credit institutions. Responsibility for the supervision of the financing provided by Finnvera lies with the Ministry of Employment and the Economy. However, the ministry has not allocated adequate quantitative and qualitative resources to the supervision in such a way that it would be in accordance with the principles of the supervision of credit institutions.

Transferring the supervision to the Financial Supervisory Authority has been examined on several occasions. However, the Financial Supervisory Authority has been against the move and the supervision has remained the responsibility of the Ministry of Employment and the Economy.

The internal audit of the Ministry of Employment and the Economy has audited the financial supervision of Finnvera. However, the audits have been at a fairly general level. Moreover, because of inadequate resources, the ministry's internal audit has not carried out all planned audits in recent years. The amount of supervision has been increased in recent years.

Recommendations of the National Audit Office:

1. The liabilities of the state are substantial and they continue to grow. The purpose of export financing has been to provide Finnish exporters with internationally competitive financing. Even though the providers of financing have been able to react to the changes in the operating environment resulting from the financial crisis they have lacked the strategic vision on how much they are prepared to expand the schemes and, in connection with this, the knowledge base on how the schemes impact the operations of the financial markets. Both the Ministry of Finance and the Ministry of Employment and the Economy should determine to what extent export financing liabilities can and should be expanded.

2. Making export credits a responsibility of Finnvera has made the acquisition of financing slightly more expensive than it would be if it was a direct state responsibility. The transfer has also made it more difficult to monitor state liabilities as budgetary appropriations have been replaced with guarantees. Together with the increases in other state liabilities, the export guarantees increase state risks. The Government and the Ministry of Finance must ensure that reporting on state liabilities as part of the financial reporting of the state gives a true and fair picture of the state's liabilities irrespective of whether the liabilities are on-budget entities or not.

3. As the guarantees and financing aimed at supporting exports have expanded the manner in which they relate to domestic production destined for export has changed. Even though production has been increasingly transferred outside Finland, Finnish interest is used as the justification for financing it. The schemes are also in the process of being expanded to domestic investments. The Ministry of Employment and the Economy should clarify what is meant by Finnish interest or specify when employment and tax revenue growth targets can be used as a justification for export financing.

4. Financial supervision of Finnvera has been inadequate. If the supervision of Finnvera is not transferred to the Financial Supervisory Authority, the Ministry of Employment and the Economy must ensure that the operations of Finnvera are supervised in such a way that the

supervision is in accordance with the legislative objective of super-vision in accordance with the principles governing the supervision of credit institutions.