



# **Slovak Government Measures for Automotive Exporters in Times of COVID-19 Crisis**

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## Abstract and Policy Implications

*The COVID-19 pandemic has led to an economic downturn in the Slovak Republic. To bridge corporate liquidity problems the Slovakian Government has introduced several support measures. The investigation discusses the effectiveness of the measures imposed. Based on theoretical foundations, the research question is empirically examined by using a qualitative expert survey. As the automotive industry plays a leading role in Slovakia, the research conducted is oriented towards the financing phases, a typical automotive exporter is undergoing. As a result of the research, bridging loans and government grants were identified as the most important measures. Additionally, tendencies towards political recommendations for action were identified. The research explored, that the Slovakian Government should focus on meeting the short-term liquidity needs, boosting exports and promoting innovation as well as considering a support package for the automotive industry.*

## 1. Introduction

The Slovak Republic is landlocked in Central Europe (European Union, 2020). In recent years, Slovakia has become an important trading nation within the EU. In particular, the strong automotive industry accounts for a large part of the country's exports (Jacobs, 2017). Furthermore, the automotive industry is responsible for 13% of the Slovakian GDP and for 50% of the total industrial production in 2019 (SARIO, 2020). Due to the importance of the automotive industry for the Slovak economy, this essay will focus on analysing the effects on this sector.

Slovakia's focus on exports has led to great successes but has also proved to be a weakness in times of COVID-19. The outbreak of the Coronavirus has led to considerable restrictions in everyday life and in international trade. According to studies by the OECD, these measures lead to a significant decrease in trade and global economic growth. According to current estimates, growth will diminish to at least 1.5% in 2020. In addition, the international exchange of goods is in decline (OECD, 2020a). Especially the Slovak automotive sector could be hit hard by these effects as shown in illustration 1.

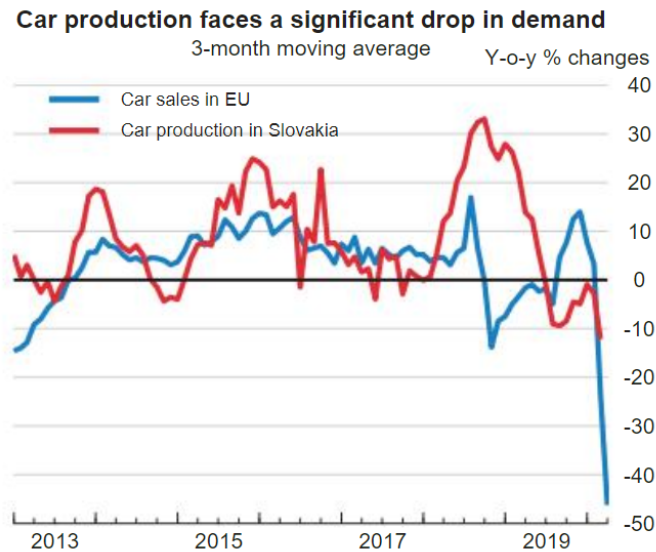


Illustration 1: The illustration shows the impact on the Slovak car production (OECD, 2020b: p.295).

These developments hit export nations like Slovakia particularly severe. Current forecasts by the European Commission expect the GDP to fall by 6.75% in 2020 (European Commission, 2020a). The OECD even estimates a decline by more than 9% this year (OECD, 2020b). The new elected government has reacted to the threatening situation and decided on first measures to support the country's economy. These include the introduction of short-time work benefits, new lending and the expansion of guarantees for bank loans.

This essay analyses the measures taken by the Slovakian Government and their potential effect on the economy and especially the important export industry. Therefore, the essay is structured as follows: Chapter 2 is dedicated to the question of how governmental support measures can be designed to alleviate an economic crisis and to promote growth again. It analyses how exports and an innovative capacity of a company can be promoted. The third chapter gives an overview of the primary and secondary sources of the essay and their analysis. Chapter 4 is devoted to the analysis of measures taken by the Slovak Government to support the economy. The analysis is divided into a typical financing cycle of a company. The fifth chapter draws the conclusion from the findings of the essay and provides recommendations for the future.

## **2. Finance in Times of Crisis**

To determine which governmental measures are useful to support trade and economic growth, it is necessary to look on the current state of science. Therefore, this chapter will analyse the relevant literature on the research topic. To enable a structured presentation the underlying scientific paper subordinates the financing cycle of an automotive exporter. The financing cycle was designed based on Volkart & Wagner (2018). However, it has been slightly modified to classify the aid programs more easily. In the first phase, financing is necessary to enable R&D. The second phase includes the financing of operating costs as for staff or material. The third phase covers export financing and the fourth contains financing of investments such as construction of a new production hall.

### **2.1 Financing Innovation**

As innovation plays an essential role in the economic development of a country, the government should promote this factor in times of crisis (Ferrucci, Guida & Meliciani, 2020). The state has different possibilities to promote innovation, which are shown in the following.

External relations, for example with universities, strongly influence the innovative strength of companies. Small and medium-sized enterprises (SME) in particular benefit from the exchange of knowledge (Lasagni, 2012). The settlement of innovative companies, universities or research institutions is made possible by governmental financing of a suitable infrastructure (Klasen, 2020).

In order to strengthen the financial power of an innovative company, according to Klasen (2020) governmental grants or tax concessions are useful tools. Innovation subsidies can be granted as allowance that are not or conditionally repayable or within the framework of an innovation fund. Furthermore, tax incentives can be successfully applied, if i.e. wage costs can be credited in the context of research and development (R&D) (Klasen, 2020). Equity or venture capital programs are especially in the founding phase, as it is more difficult to obtain bank loans, a useful instrument to cover the high financing needs of start-ups (Pongratz & Vogelgesang, 2019).

Development loan programs, which are mostly provided with favourable interest and repayment terms, are the main instruments to enable sustainable support according to Pongratz and Vogelgesang (2019). According to Deloof and Vanacker (2018) access to debt capital plays a critical role for start-up survival in times of crisis. Equity-like financing and subordinated loans with postponement of priority are also conceivable here (Pongratz & Vogelgesang, 2019). In addition, promotional loans can be secured by state guarantees. This form of financing has become increasingly important, especially during and after the latest financial crisis (Klasen, 2020).

### **2.2 Direct State Measures to Support Companies**

Another way of supporting companies in times of crisis is the implementation of direct governmental measures against the background of countercyclical fiscal policy. This policy theory states that the government should cut spending and increase taxes in times of economic recovery. In times of crisis, it is the state's task to support declining private demand with its own measures. For example, through higher expenses or tax breaks (Spremann, 2019; Horton

& El-Ganainy, 2020). In the last economic crisis in 2008-2009, measures such as short-time work benefits or the famous German “Abwrackprämie” proved to be useful. The slump in private demand and larger unemployment rates were mitigated (Hinze, 2009; Barabas, Dhörn & Gebhardt, 2011).

Despite the effect of direct state measures, there is also criticism of the principle of fiscal policy. In particular, the tendency of the state not to detach itself from the crisis measures in the expansive phases of the economic cycle. In this way, government debts that have been expanded for the aid programs are usually not repaid, but are dragged into the next crisis (Pauly, 2019). In addition, countercyclical measures such as tax increases are not taken up by responsible politicians in order not to jeopardize their own popularity among companies and citizens. This development could lead to a potential government-debt crisis. Regarding potential aid measures for the automotive industry these conclusions should be considered (Romer, 2012; Pauly, 2019).

## **2.3 Financing Trade**

The financial crisis in 2008-2009 has shown that the withdrawal of private providers from the financing markets has made financing costs more expensive. As a result, international trade declined. In order to support trade and the associated economic growth, it is therefore necessary to maintain cost-effective financing options (Ahn, Amiti & Weinstein, 2011; Chor & Manova, 2012). During the last crisis, the state accomplished this task with the help of Export Credit Agencies (ECA). These Institutions were specifically founded to strengthen the export economy (Salcic, 2014). In the financial crisis 2008-2009, as private providers withdrew from markets, ECAs have expanded their credit capacities and guarantees. The ECAs have thus contributed to strengthening exports and prevented the financing market from collapsing (Klasen, 2012).

In the past markets have especially failed to cover the funding for small and large transaction volumes. Also, business transactions with long maturities suffer from lack of funding by private institutions because of the higher risk that comes with the long time periods (Krummaker, 2020). Research has also shown that increasing credit volumes and guarantees have a positive effect on exports. That is why it is necessary to take appropriate measures to support economic growth, especially in times of crisis (Felbermayr & Yalcin, 2013; Auboin & Engemann, 2014). In addition, ECAs can also provide advice to their customers who do not have sufficient knowledge of the risks in the export markets. This is especially the case with many SMEs (Klasen & Krummaker, 2017; Krummaker, 2020).

### 3. Analytical Framework

The interest of the scientific research arises in collaboration with the Institute for Trade and Innovation (IfTI) and due to the current demand for pursuing studies about governmental measures in pandemic times. The focus of the scientific paper is derived from the importance of the automotive sector for the Slovak economy. Thus, the following research question can be derived:

*“Which measures has the Slovakian Government introduced for automotive exporters in response to the COVID-19 Crisis and how effective are they?”*

The present research includes a qualitative induction, because this approach allows a query based on subjective and explorative data. This is indispensable for the research question, as it has not yet been thoroughly explored due to the novelty of the current situation. In addition, a qualitative research creates a high validity and enables a high information content (Bell & Bryman, 2015).

A qualitative interview is suitable for the research question, because it enables an open discussion with experts. Experts are defined on their specific knowledge of the current measures of Slovak institutions and the automotive industry. A semi-structured interview fits for the research question as it offers the possibility to document key questions in advance (Lewis, Saunders & Thornhill, 2016). Moreover, the key questions could vary or enlarge depending on the interviewee. Thus, the questions are adapted according to whether the respondent is employed in a measure generating institution or a measure assessing organization.

According to Bortz and Döring (2016) a qualitative sampling is achieved by the targeted selection of specific cases. In this research, the sample therefore includes organizations implementing the measures and their beneficiaries. The ethical standards of the European Science Foundation are observed within the research (ALLEA, 2017). Due to the international nature of this study, the interviews are conducted over video telephony. As the interview will not be recorded for data protection reasons, a complete transcription is not possible. Field notes are therefore made during the interview to reflect the survey and to prepare a postscript, which can be found in Appendices 2 to 6.

In this scientific work the expert interviews are evaluated with the help of qualitative content analysis. This makes it possible to work out systematically manifesting contents from the transcripts of the qualitative interviews by forming categories (Bortz & Döring, 2016). The categories follow the structure of a typical financing circle of an automotive exporter.

In the following, the results of the qualitative study are presented using secondary data to explain the measures imposed and to accentuate the findings.

#### **4. Analyses of Governmental Measures using the example of an automotive exporter**

In the following, the measures to support Slovakia's economy are explained.

##### **4.1 Stage of Innovation Finance**

As of June 15th 2020, the Slovak Government has not implemented any innovation-promoting measures to provide incentives for R&D in times of Corona-Crisis. The qualitative expert survey revealed that measures to promote innovation are required. Given the focus of the scientific work, the following analysis focuses on the promotion of innovation in the automotive sector.

In consideration of the increasing trend towards e-mobility, it seems reasonable to promote progress in R&D and to provide incentives to increase the sales of electric vehicles. However, the experts were critical of e-mobility. A professor who is researching the development of the automotive industry does not see any possibility of achieving a significant change towards e-mobility in the next 10 years. He therefore specifically advises against promoting e-mobility within the framework of a current aid package, an opinion shared by a supplier of the industry. As part of the measures to mitigate the economic damage of the pandemic, an EU wide solution has been proposed. A so called "EU-Green-Deal" could promote R&D into lower-emission combustion engines and could help boosting demand from automotive companies.

Based on the findings in Chapter 2, the proposed measure is particularly appropriate for State grants or development loan programmes granted with governmental guarantees. It could be considered to introduce the measures described in cooperation with the Innovation Fund of the Ministry of Economy of the Slovak Republic, which aims to advance innovation development in Slovakia (European Commission, 2020b).

##### **4.2 Stage of Financing Operating Costs**

The Slovak economy is currently facing a major challenge. According to a study by the German-Slovak Chamber of Foreign Trade (AHK Slovakia), 32.5% of the 123 companies surveyed expect a drop in turnover of 10% to 25%. 27.6% of the interviewees even expect a decline between 25% and 50% for 2020 (AHK Slovakia, 2020). The results of the survey are shown in the following table.

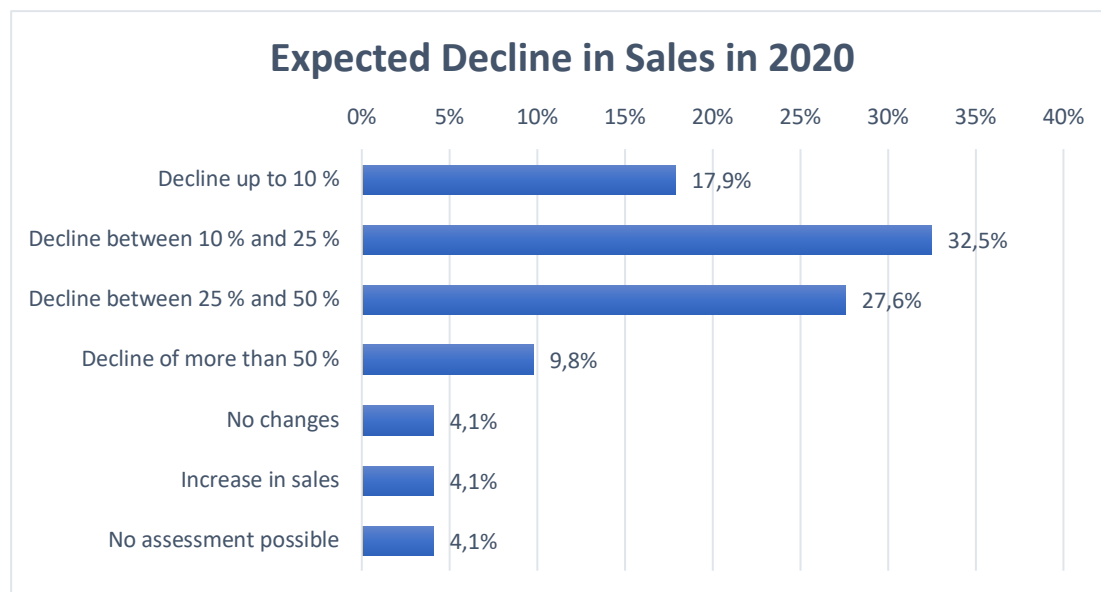


Illustration 2: Results of the survey on the expected change in sales as a result of the coronavirus pandemic in 2020 (Own preparation based on AHK Slovakia, 2020: p.3).

The Slovak Government recognized this problem at an early stage and introduced the first aid measures mid-March 2020. Regarding the focus of this scientific paper only measures that are suitable for the automotive industry are presented. The main others are summarised in Appendix 1. For an automotive exporter, the relevant measures are those relating to entrepreneurs who are in need as a result of the Corona-Crisis.

There are two ways of obtaining the subsidy, either the receipt of a subsidy amounting to a maximum of 80% of the paid wage replacement of the employee affected by an impediment to work<sup>1</sup>, or receipt of a lump sum payment in proportion to decrease in sales. If the aim is to secure employment, the employer is obliged not to terminate the employment relationship with the employee for whom the subsidy requested for 2 months after the application (Noerr LLP, 2020). In an interview with the AHK Slovakia it became clear that this measure, in both forms, is the most frequently requested from SMEs. But an expert criticizes that the measure is not flexible enough. According to the experts' opinion, an instrument would be useful which would make it possible to receive the subsidy if a certain percentage of the workforce returns to work. Furthermore, the expert is critical of the high bureaucratic hurdles in the application procedure.

To support their customers Eximbanka SR, as well as the Slovak Guarantee and Development Bank (SZRB) and commercial banks, postpone maturity of instalments especially for SMEs. (Squire Patton Boggs International Association, 2020).

In order to enable global trade in times of crisis, the Eximbanka SR has launched the "COVID-Loan", which can be used to finance SME exporters' working capital needs to maintain business activity and employment. The loan is guaranteed by the Ministry of Finance, up to 80% of the principal residual, and the amount is based on the annual turnover of the company with a maximum of EUR 500,000 (Eximbanka SR, 2020a). Eximbanka SR reported that exporters recorded a high interest in "COVID-Loan". The time-consuming application process was simplified with the help of an explanatory video. However, a Slovakian automotive supplier

<sup>1</sup> § 142 Labour Code Act No 311/2001 Coll. of the Slovak Republic



pointed out that the "COVID-Loan" requires a volume of at least EUR 1 million in order to have a sustainable impact on medium-sized companies.

Moreover, Eximbanka SR is currently working on a guarantee scheme for commercial banks in order to mobilize bridging loans to Slovak entrepreneurs. The loan can be issued almost independently of the companies' size<sup>2</sup> and is intended to finance working capital and investments with maturity of two to six years (with one-year grace period on principal and interest) from amount EUR 2 million up to the EUR 20 million per loan. Eximbanka SR will assume a risk up to 80% of the principal (Eximbanka SR, 2020b). By July 7th 2020 four commercial banks participate. The feedback so far is that many banks are interested in the guarantee scheme, but a higher level of risk assumption would be needed so that the bank is able to issue the loan and bear the residual risk. However, it is expected that more banks will join, otherwise the risk of losing existing customers to banks using the instrument is too high.

The Slovak Investment Holding (SIH) has also introduced guarantee schemes. The "SIH Anti-Corona Guarantee 1" was one of the first instruments which makes use of the European Structural and Investment Funds (ESIF) and is designed for SMEs to overcome the financial difficulties. The "SIH Anti-Corona Guarantee 2" removes the requirement of being SME. The aim of the instruments is to ease lending from commercial banks up to EUR 1.2 million or 2 million under favorable conditions due to a risk assumption from SIH. The purpose of the loan is to finance operating costs and investments (SIH, 2020a; SIH, 2020b).

#### **4.3 Export Finance**

Due to the global economic slump caused by the Corona-Crisis, commercial insurances are gradually reducing their limits. Eximbanka SR has recognized the need for further risk assumption for exporters and has implemented an "insurance of short-term export supplier credits against commercial and political risks" intended for SMEs enabled by the temporary exemption of the EU Commission (Eximbanka SR, 2020c). The exemption allows Eximbanka SR to insure trade receivables for countries with typically marketable risks, such as the EU countries or the USA, until 31.12.2020 (European Commission, 2020c).

In an interview it became clear that the demand for the insurance is restrained due to higher pricing. The exporters must now get used to the conditions of Eximbanka SR which are less favorable than those of private insurers. However, since Eximbanka SR must bear higher risks due to the current situation, a higher price is essential. This could create the problem that companies, especially SMEs, avoid export insurance. It is possible that Slovak exporters will reduce their export volume and thus lose competitiveness globally. However, in an interview with Eximbanka SR it became clear that this insurance is mainly requested by exporters who trade with countries severely affected by COVID-19, such as Italy or Spain.

Based on the focus of the underlying scientific work, the experts were asked whether they would consider specific measures for the automotive industry necessary. The Slovakian Government has not introduced any aid packages addressed especially for automotive exporters. The opinions of experts are diverging on this issue. Voices close to the industry criticize that the measures imposed do not sufficiently promote the export business. This increases the companies' inventories, which in turn leads to a higher capital commitment. One

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<sup>2</sup> The guarantee scheme excludes micro companies (Eximbanka SR, 2020c).

possible aid instrument would be interest-free interim financing of inventories to release the tied capital. Besides a supplier of the industry requested for a stimulus package as the “Abwrackprämie”<sup>3</sup>, implemented during the latest global financial crisis. A local or an EU-wide solution could be envisaged to boost demand for vehicles after the Corona-Crisis.

This is contradicted by the fact that Eximbanka SR has not registered substantially increased demand from automotive industry so far. A representative of the AHK Slovakia reported as well that there are no special adjustments needed as the measures imposed are equally suitable for the automotive industry.

#### **4.4 Investment Finance**

So far, no significant measures have been implemented to support financing in the investment phase of a company. Eximbanka SR has introduced a guarantee scheme which enables lending for financing operating costs and investments (see Chapter 4.2). The “SIH Anti-Corona Guarantee 2” must also be mentioned in this context, as the use allows the financing of investments up to EUR 2 million. The guaranteed investment requirement applies primarily to i.e. replacement investments of tangible assets or financing digitalization and not to major projects such as investments in a new site. As this financing phase focuses on large projects (Volkart & Wagner, 2018), the instruments are only partially included in this phase.

From the expert interviews it could be concluded that this is not an omission of the Slovakian Government, but the promotion of long-term investment financing is not an appropriate support measure in times of crisis. The reason for this is, that companies require mainly short-term bridging measures to cover liquidity shortage rather than embarking on long-term investment projects.

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<sup>3</sup> The „Abwrackprämie“ granted private individuals a subsidy in the course of exchanging an old vehicle for a new one to increase the demand and to support the automotive sector and its suppliers.

## **5. Summary and Conclusion**

In the following the main points are summarised, evaluated and the authors evince implication of the research for practice and policy.

### **5.1 Summary of the Key Findings**

Following the financial cycle of an automotive exporter, the underlying scientific paper has presented the measures imposed by the Slovakian Government and its institutions due to the economic crisis caused by the COVID-19 pandemic. It has been discovered, that experts of the industry require R&D promoting measures in the framework of lending, governmental grants or equity capital programs. To bridge the shortage of liquidity and to finance the operating costs the subsidy depending on the drop in sales and short-time work are the most demanded. The Eximbanka's "COVID-Loan" is highly requested as well. But experts criticize that the bureaucratic hurdles are too high and the measures only partially meet the needs of the applicants. To enable export in times of crisis Eximbanka SR has launched an insurance which covers receivables for countries with typically marketable risks. Due to higher pricing it could be feared that Slovak exporters will lose global competitiveness. However, the drawdowns to date show that, the insurance is particularly demanded by exporters who trade with countries severely affected by COVID-19, so it can be concluded that the insurance covers the needs of the exporters. The surveys have shown that there is currently no significant demand for products for financing long-term investments.

The experts disagree on government measures for the automotive industry. Eximbanka SR, as well as the AHK Slovakia, have not record a significant increase demand from the automotive industry. Experts of the industry criticize that the measures imposed do not sufficiently promote the export of automotive companies and their suppliers. In addition, an interviewee fears that Slovakia's global competitiveness will decline because less money is made available compared to other countries.

### **5.2 Evaluation of the Key Findings**

The research has revealed, that the Slovakian Government should concentrate to serve the short-term liquidity needs, boost export and promoting innovation, to enable a sustainable growth. To ensure a lasting recovery of the economy a flexible solution is required, which adapts to the changing needs of the companies. Therefore, the experts pointed out, that a high level of communication between the exporters concerned and their stakeholders is indispensable. Furthermore, from the current state of research can be concluded that a measure for the automotive industry, i.e. in the framework of R&D promoting grants or a stimulus package, should be considered.

Given the novelty and volatility of the situation further research should be conducted. It should be investigated how the needs of automotive exporters will change in the course of 2020. It would also be of great interest to consider at the different needs per company size. A representative quantitative research could help here, which was not possible in the context of this research due to lack of market access resulting from the severity of the current situation. The present investigation has identified trends which should be confirmed in more in-depth investigations in order to continuously optimise the Slovak Republic's measures.



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