

# Estonian Government Measures for Exporters in Times of Crisis

Erki Aamer, André-Julian Becher and Marco Mütsch

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## Abstract and Policy Implications

This essay is about Estonia's measures to help its exporters responding to COVID-19. The purpose is to analyse the companies' need for help measures and the governmental objectives behind the measures and finally to analyse the possible effects. We used the two latest surveys dealing with the entrepreneurship situation and conducted two interviews with governmental representatives exposing their objectives. The outcomes show that more than half of Estonian companies are asking for governmental help mainly as a consequence of a drop of demand. Limiting the increase of unemployment and bankruptcies as well as strengthening the economic recovery were identified as the main governmental objectives while restraining fiscal costs is a subordinated objective but becomes more important the more money will be spent. The help measures offered by KredEx are in line with these objectives. After the crisis the implications of the established measures should be analysed so that others can learn from the Estonian Government's approach.

## 1. Introduction

The Coronacrisis suppresses the global trade in 2020, including Estonia. Regarding the ongoing uncertainty about a second wave, the OECD estimates the Estonian exports to decline between 11 per cent (Single Hit scenario) and 13.5 per cent (Double Hit scenario). Its open economy is highly depending on exports and hence particularly vulnerable (OECD, 2020c). Foreign demand sustains more than half of the employment in the business sector (OECD, 2020b). Facing this situation, the Berne Union claims to support exporters to maintain the trade ecosystem (Berne Union, 2020, p. 2).

The purpose of this essay is to analyze and assess these governmental measures supporting exporters responding to COVID-19. While it is hard to predict the outcomes of the measures yet the authors want to contribute to that research problem by analyzing the possible effects based on an investigation of exporters' demand, the governmental objectives and the concrete design of the help measures. The analysis will help both, the official and institutional as well as the private sector to understand each other. Furthermore, the outcomes will contribute to the assessment of the governmental performance that will follow the crisis. Interviews with representatives of the Estonian Government and KredEx offer insights for all interested parties.

This essay is structured in the following way. The analytical framework in chapter two explains the empirical working approach of the authors and justifies the chosen methods. Chapter three offers a brief overview of the Estonian Economy. Chapter four describes the demand of the exporters on the one hand and the governmental objectives and established

measures on the other hand. Based on this their fit is assessed. In the end the outcomes will be concluded and summarized.

## 2. Analytical Framework

This paper is structured according to a model designed by the authors to provide an analytical framework and work process structure. Figure 1 shows the model.

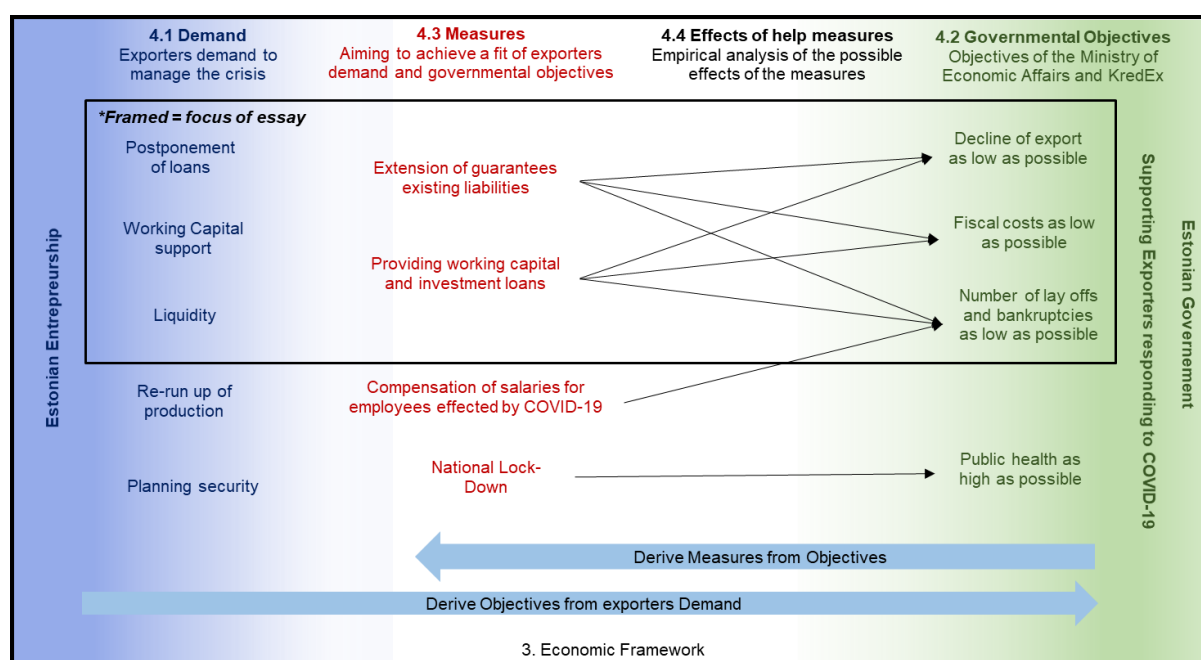


Figure 1: Model of the Analytical Framework

Source: Own representation, the frame shows the focus of the essay.

The economic framework in which Estonia and its economy operate is described in chapter three and was investigated by secondary data research.

Exporters suffering from the crisis have a demand for help measures, identified by a quantitative approach in form of two surveys that were ordered by the Ministry of Economic Affairs (MKM). On the other side, the Estonian Government has different objectives, some of which run against the companies' demand. In this field of tension, the Government and its institutions like KredEx designed trade finance instruments to support the economy. The intensions behind the design of these instruments are determined by structured anonymous interviews with MKM and KredEx. This bounded ethnography approach is in line with the limits of the research project. Finally, the authors analyze the possible effects of the measures resulting in another model.

It is not possible at this stage to make a final assessment of the outcomes of the measures. Furthermore, since the Coronacrisis is not comparable to any situation in the past it is not possible to compare the established measures with previous ones either.

### 3. Economic Framework

#### 3.1 Estonia and the Estonian Economy

The Republic of Estonia (in the following: Estonia) is a small country located in the Baltic region. The Baltic States include Estonia, Latvia and Lithuania. Its population is about 1.3 million people (Statistics Estonia, 2020d).

In 2019 its GDP at current prices was 31.04 billion USD (IMF, 2020). Estonia is member of the European Union, the Euro area, the OECD and several other international organizations (Republic of Estonia, 2020). Its economy and society are influenced by its Scandinavian neighbours. The Estonian financial sector is dominated by subsidiaries of multi-national banks (Branten et al., 2019, p. 7). Estonia is famous abroad for its digital society, some call it the 'world's most digitally advanced society' (Reynolds, 2016).

Comparing to other European countries Estonia is a quite young state; it became a sovereign state in 1991 as it was previously part of the Soviet Union. 'The Baltic countries ... have undergone a rapid transformation since the early 1990s. While the first decade of transition was marked by a significant loss of productive capacity, since joining the EU, these countries have experienced high economic growth levels' (Woolfson et al., 2008, p. 317). The consequences can still be seen today in the structure of the Estonian economy. 'Private companies and small and medium-sized companies have entered the economic arena as the dominant type of enterprise in the Baltic States while the large-scale enterprises more typical of the Soviet period are now exceptions' (Woolfson et al., 2008, p. 317).

The European Commission investigated in its policy initiative 'Small Business Act for Europe' (SBA) the role of SME in Europe. The relevant numbers for Estonia are shown in the following figure.

| Class size   | Number of enterprises |               | Number of persons employed |               | Value added   |               | Export of goods |
|--------------|-----------------------|---------------|----------------------------|---------------|---------------|---------------|-----------------|
|              | Estonia               | EU-28         | Estonia                    | EU-28         | Estonia       | EU-28         | Estonia         |
| Micro        | 91,3%                 | 93,0%         | 32,8%                      | 29,7%         | 29,3%         | 20,8%         | 14,7%           |
| Small        | 7,1%                  | 5,9%          | 24,3%                      | 20,1%         | 23,1%         | 17,6%         | 15,6%           |
| Medium sized | 1,3%                  | 0,9%          | 22,0%                      | 16,8%         | 24,3%         | 18,0%         | 38,5%           |
| <b>SMEs</b>  | <b>99,8%</b>          | <b>99,8%</b>  | <b>79,2%</b>               | <b>66,6%</b>  | <b>76,7%</b>  | <b>56,4%</b>  | <b>68,9%</b>    |
| Large        | 0,2%                  | 0,2%          | 20,8%                      | 33,4%         | 23,3%         | 43,6%         | 17,7%           |
| unclassified |                       |               |                            |               |               |               | 13,4%           |
| <b>Total</b> | <b>100,0%</b>         | <b>100,0%</b> | <b>100,0%</b>              | <b>100,0%</b> | <b>100,0%</b> | <b>100,0%</b> | <b>100,0%</b>   |

Figure 2: SMEs in Estonia in comparison to EU-28 in 2019

Source: Own representation based on European Commission (2019) and Statistics Estonia (2020b), with the following definitions: Micro: 0-9 persons employed, Small: 10-49, Medium-sized: 50-249, Large: +250. EU-28 includes EU-27 and United Kingdom (as it was part of EU in 2019)

As Figure 2 shows the share of SME in the total number of enterprises is not different from EU-28 average. But the share of persons employed is with 79.2 per cent significantly higher in Estonia than in EU-28 (66.6 per cent). The significance of SMEs becomes even more evi-

dent in the comparison of the value added. While the value added in EU is 56.4 per cent in Estonia it is even 76.7 per cent of total economic value added. In return, large companies play a minor role.

Export plays a significant role for Estonia. In 2019 Estonia exported goods and services with a total value of 16.12 billion USD (WTO, 2020). The main export countries are Finland, Sweden, Latvia, also Germany and Russia are very important trade partners. Summarized European countries are the main export directions (82.4 per cent of exports), a minor share is exported to North America (7.8 per cent) and Asia (6.8 per cent) (Statistics Estonia, 2020c). Estonia mainly exports machinery and mechanical appliances, electrical equipment, mineral products and wood (incl. products made out of wood) (Statistics Estonia, 2020a).

To be able to classify these figures, it is advisable to take a look at the export quota. This number indicates how high exports are as a percentage of the GDP. In 2018 Estonian exports amounted to 74.3 per cent of the GDP. For comparison, world's largest exporters China and the USA have a quota that is less than 20 per cent. Estonia is among the top 10 per cent of the countries with the highest export quotas (World Bank, 2019). It can therefore be stated that Estonia is very much dependent on exports.

The authors want to highlight the remarkable connection between SME and export in Estonia. Caused by the small domestic market nearly two-thirds of the SME are involved in export business, which is the third highest value in the EU and over 50 per cent higher than the EU average (Kwaak et al., 2019, p. 144). Furthermore, Figure 2 shows that SME are responsible for 68.9 per cent of the Estonian export, which proves their importance.

### 3.2 Relevant Players offering export support

The Estonian Export Credit Agency (ECA) KredEx provides the majority of support measures for exporters. Its connection to other relevant players in the field of export support is shown in Figure 3.

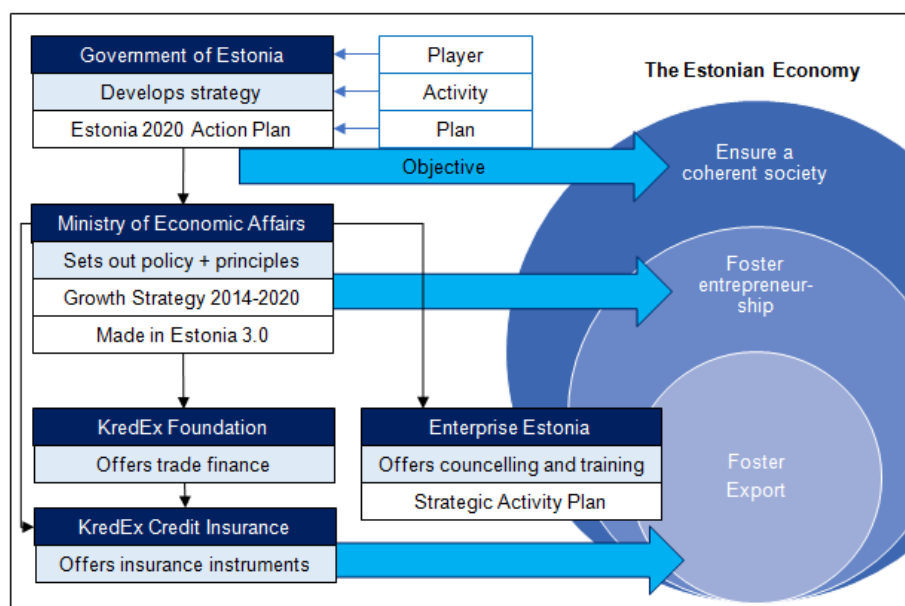


Figure 3: The interaction of relevant players offering export support

*Source: Own representation based on the Government of Estonia, the Estonian Ministry of Economic Affairs and Communication, KredEx and Enterprise Estonia in line with Meyer and Klasen (2013, p. 6).*

The figure is in line with the concept of a 'strategic econsystem' introduced by Meyer and Klasen (2013, p. 6). This concept calls the government to define the fundamental objectives and approach (Klasen, 2020a, p. 211). In his speech for forming a new government Prime Minister Juri Ratas stated the main objectives, focusing on a coherent society (Ratas, 2020). The 'Estonia 2020 Action Plan' breaks this down to the support of export and determines the MKM as the responsible authority (Government of the Republic of Estonia, 2017, p. 14). The ministry sets out the principles to foster Estonian entrepreneurship in form of two strategic plans, namely 'Made in Estonia 3.0' and 'Estonian Entrepreneurship Growth Strategy' including concrete goals (cf. MKM (2014, p. 6) and (2013, p. 21f.)). Furthermore, the plans clarify the interaction between and the activities of the three main institutions executing the measures (MKM, 2013, p. 28).

First of all, Enterprise Estonia (est. 2000) supports exporters through counselling and trainings, stated in a strategic activity plan (Enterprise Estonia, 2018, p. 10ff.).

KredEx was founded by the Estonian Government in 2001 and operates independently 'in the form of a fund' but on behalf of the Ministry (KredEx, 2018, p. 8). The institution offers a range of finance instruments such as loans and guarantees to support Estonian companies if the private market is unable or unwilling to offer them (KredEx, 2018, p. 6). Because KredEx acts risk-conservative and is provided with sufficient capital it is able to be self-sustainable even in markets that are avoided by the private sector because the margin does not justify the risk (Krummaker, 2020, p. 539). Nevertheless, the issued guarantees are provided by the state and if KredEx is unable to fulfil its obligations the state will step in (KredEx, 2018, p. 8). The fund is equipped with extra capital to offer the support measures described in section 0 facing the extraordinary risks arising from COVID-19 and leading to a broader market gap (Berne Union, 2020, p. 3f.).

Because the Estonian insurance market was not attractive enough for large international credit insurers, MKM and KredEx founded another institution in 2009, AS KredEx Krediidi-kindlustus, which acts as KredEx subsidiary and offers different credit insurance products (cf. MKM (2014, p. 22) and KredEx (2018, p. 28f)).

In this way the three institutions described execute the concrete measures to contribute to the fundamental objective of strengthening the Estonian Economy, as shown in Figure 3. As depicted in the chapter before, SME play an extraordinary role in the Estonian Economy and so they do in regard of this strategic econsystem. SME are both a key driver for employment and dependent on official support instruments (Meyer and Klasen, 2013, p. 6). In 2018, SME received 90 per cent of the total volume of guarantees offered by KredEx (KredEx, 2018, p. 24).

## **4. Government Support Measures for Estonian Companies**

### **4.1 Exporters' Demand**

Many companies 'face direct damage as a result of the coronavirus outbreaks' (Klasen, 2020b). Global interruptions of supply chains and national lock-downs affect Estonia as they affect other countries (Berne Union, 2020, p. 2). In a survey ordered by MKM (Preegel, 2020) in May 2020 69 per cent of the participating companies said that they see big or very big financial problems while the spread across the various sectors is very large (from 44 per cent in the financial sector up to 94 per cent in accommodation). The main effect in general is a loss of demand (71 per cent). The essay focuses on cash-flow problems in form of difficulties in paying incoming invoices (29 per cent), receiving money from customers (28 per cent) and repaying loans taken out (14 per cent). Based on lessons learned from the 2009 crisis Chauffour and Farole (2009, p. 10f.) established the thesis that particularly SME that work with open account methods financed by retained profits have a higher need for working capital and pre-export financing in case that the profits are lost, what seems to be true in Estonia. Berne Union highlights pressure on cash-flow as a major challenge for many companies (Berne Union, 2020, p. 6). Within the next six months the numbers in Estonia will increase as today more than half of the companies expect the cash-flow problems to become even worse. Furthermore, there are a significant proportion of companies that do not know the impact of COVID-19 to evaluate the company's activities in the near future.

Derived from these effects the survey identified a demand for governmental support measures, 59 per cent of the companies stated that they need support. The figure is also affected by outliers that are less relevant for the essay due to lower export business. Hence, the sectors with a spread larger than 1.5 of the interquartile range (gastronomy, hotel industry, financial sector) were removed. The result is an adjusted demand of 54 per cent of the companies. Particularly for KredEx most relevant, companies ask for postponement of loans, liquidity and working capital support, identified by a second survey ordered by MKM (Josing et al., 2020, p. 39). Also a point of interest is the fact that 13% of the interviewed companies state that they do not know the KredEx measures.

With regard to the relevance of exporting SMEs underlined in chapter 3.1, it is an interesting fact that empirical studies show that a higher export quota as well as a minor size of companies lead to higher demand for cost-efficient trade finance instruments (cf. Krummacker (2020, p. 548f) and Meyer and Klasen (2013, p. 6)).

### **4.2 Governmental Objectives**

The analysis of the governmental objectives is based on interviews with representatives of MKM and KredEx which provide first-hand insights. Using literature, the findings are compared to lessons learned from past crises, today's recommendations and, probably most interesting, to Estonia's extraordinary performance in the financial crisis in 2009.

An effective approach requires careful assessment of the situation (Allen, 2003, p. 14). MKM monitors the demand for help by surveys. The OECD compliments Estonia's high level of digitalization enabling this up-to-date and effective monitoring (OECD, 2020c). Both, MKM and KredEx, underline their good relationship and active information exchange with the companies giving them evidence-based feedback.

Looking back to 2009, Estonia was in a totally different situation preparing the introduction of the Euro and was forced to focus on fiscal stability to fulfil the Maastricht criteria. Hence, the government could not use typical anti-crisis measures but rather they had to cut back expenditures and stabilize revenues. As a result, GDP dropped by around 20 per cent and unemployment rose to over 19.5 per cent in 2010, what was still accepted by the population. This approach secured the compliance with the criteria keeping the debt level below 10 per cent of GDP even in 2009 (Friedrich and Reiljan, 2015, p. 39f.).

Today Estonia still benefits from that, offering the government a wide scope of action to react to a macroeconomic crisis like the one the world faces now (Lehnfeld, 2018, p. 2). The conducted interview points out that MKM is willing to make use of this scope and rating the objective of keeping layoffs as minimal as possible as most important and far higher than limiting fiscal deficit. Agreeing on this objective the Ministry and its ECA reacted quickly by setting up cost-intensive untargeted 'first aid measures', as most countries did (OECD, 2020a, p. 4). While KredEx handles the self-financing problems of the companies, the unemployment department offers salary support. An analysis of the last crisis emphasizes the importance of coordinated actions (Chauffour and Farole, 2009, p. 18). Furthermore, Estonia's advances in digitalisation have facilitated the implementation of the measures. This approach shows the government's strong willingness to prevent such drastic effects to which the country was subjected to in 2009. In accordance with its two-sided mandate of secure jobs and support export (Klasen, 2011, p. 220), the second main objective for KredEx is to reinforce innovative and strategic growth aiming "to rank Estonia first place after the crisis", as said in the interview. To conclude, the main governmental objectives are to limit the socio-economic effects and a strong recovery of export while the fiscal costs are secondary, as shown in the established model (Figure 1).

### **4.3 Design of the Support Measures**

'As the use of ECAs might open the opportunity for hidden export subsidies and state aids, the provision of public export credit insurance and financing is highly restricted and regulated by international agreements, e.g. ... EU laws' (Krummaker, 2020, p. 539). This regulatory framework determines the limit which KredEx operates in. The European Commission relaxes some of the restrictions such as short-term credit insurance to enable national institutions like ECAs to avoid a market failure (cf. European Commission, 2020, p. 9f).

Lessons learned from the 2009 crisis show that the design of support measures should be 'properly ring-fenced and conditions are attached' (Chauffour and Farole, 2009, p. 18).

Doing so, the Estonian Government has implemented a package of economic measures with an amount to at least EUR 2 billion (Deloitte, 2020). The measures have a wide range while this paper focuses on those of relevance for exporters. Berne Union emphasizes that a 'significant number of ECAs have boosted their programmes to support working capital, including direct lending and guarantees' (OECD, 2020a, p. 6). Besides the usual services offered by an ECA (chapter 0) KredEx has implemented some 'additional measures aimed at assisting Estonian companies' (KredEx, 2020). The majority of the measures are provided by the private banking sector while KredEx offers the guarantees for the loans provided. Deloitte (2020) classifies the measures as follows:

- Loan collateral with a volume of up to EUR 1 Billion for existing bank loans with the maximum guaranteed amount per company of EUR 5 Million.
- Business loans with a volume of up to EUR 500 Million with the maximum loan amount per company of EUR 5 Million and an interest rate of 4 per cent p.a.
- Investment loans with a volume of up to EUR 50 Million for new business opportunities with the maximum loan amount per company of EUR 5 Million and an interest rate of 4 per cent p.a.

KredEx itself outlines the sequence of measures as shown in Figure 4.

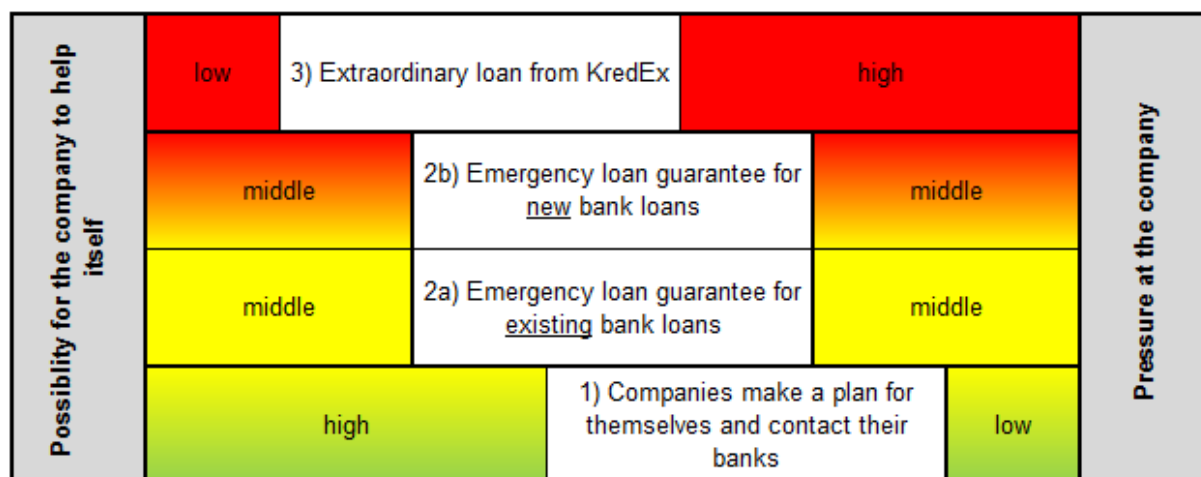


Figure 4: KredEx measures

Source: Own representation based on KredEx (2020)

#### 4.4 Prediction of Outcomes of the Governmental Measures

The analysis of the paper is shown in the following model:

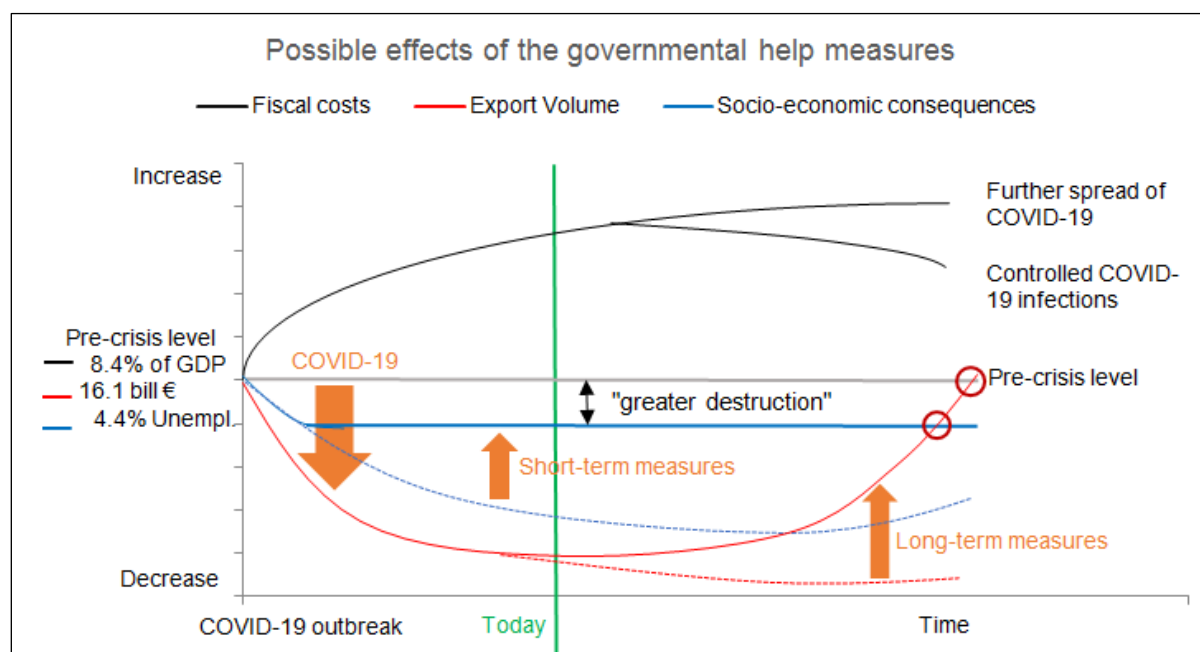


Figure 5: Possible Effects of the governmental help measures

Source: Own representation and anticipations based on the interviews with MKM and KredEx

As described above, the economy suffers from a significant drop of demand caused by COVID-19. Due to the high dependence on exports the Estonian economy is extraordinary vulnerable. This might lead to a faster fall of the export volume curve. The resulting lack of liquidity enhances the number of layoffs and bankruptcies. To limit the socio-economic consequences the Government implemented wide-spread short-term measures, which result in a rapid increase of the fiscal costs. On the one side the well-developed digitalization supports fast and fitting distribution of the measures. But on the other hand, the distribution is restrained by the structure of the Estonian financial sector mentioned in chapter 3.1. In times of crisis, the objective of the foreign banks is to preserve their financial covenants, which is not in line with the governments' objective of wide-spread financial help. Another restriction is the communication, as chapter 4.1 shows that 13% of the companies do not know the KredEx measures.

From today's perspective the further development of the costs is uncertain. It depends on how the government reacts with reassessed or new measures to the further spread of COVID-19 and the companies' feedback about the effectiveness of the established measures.

With the intention of "using the crisis" the more targeted long-term measures focus on fostering recovery and strategic growth by innovating the economy, as mentioned in the interview. Also, the discussion with KredEx points out the expectation that the small and flexible economy will lead to a fast 'V'-recovery while the worst case could lead to a slower 'long U'-scenario. The government describes its ideal as a "greater destruction" in which only competitive companies will be rescued while the bankruptcies of the non-competitive ones will release labour force. This will lead to further growth once the companies reach the point of demanding new employees. As described in chapter 3.1, the economy has already shown its ability for a change process leading to an increased level of growth after a destruction such as the fade-out of the Soviet large-scale enterprises in the 1990s.

## **5. Summary and Conclusion**

COVID-19 hits the Estonian economy and society. Based on the description of the economic situation this paper investigates the exporters' demand for help measures, the governmental objectives and the resulting measures. Finally, the possible effects of the measures are analyzed.

The paper allows the Estonian decision makers to compare their strategy with other European countries. Briefly summarizing this strategy, the authors compare the crisis with a 'dam breach'. To limit the short-term flood wave in form of a drop in employment the government established fast and wide-spread help measures. Long-term measures should re-build the dam stronger than before by innovating the economy supporting further growth and making the companies more resilient.

As a possible result the authors expect the following trade-off. While Estonia completed 2019 with an extraordinary low debt level the fiscal debts will increase during this year. On the other side the exporters' competitiveness was moderate but the strategic measures could contribute to a re-enforcement. Among others, the short-term measures' objective is to return to the pre-crisis socio-economic situation.

The empirical analysis contributes to the understanding of the objectives behind the strategy. Unlike the 2009 financial crisis, this time the government focuses primarily on the socio-economic consequences, benefiting from the comfortable financial situation. Within its mandatory KredEx is focussing on long term strategic growth. Among other factors the success depends on the budget provided. The KredEx-interview showed that the ECA faces restrictions in its budget.

The Ministry of Economic Affairs and KredEx seem to be optimistic about the future of the Estonian entrepreneurship. To conclude, the further development depends on many factors, one of which are the analyzed measures which can be one component of a positive outlook for Estonia.

### Author Information

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