ASSESSING THE ROLE OF CREDIT GUARANTEE SCHEMES IN THE SOUTHERN MEDITERRANEAN - PRE AND DURING COVID-19

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ABOUT THIS SURVEY

EMEA-EMNES SURVEY – MAY 2021

Amidst the global health crisis, this new study updates the study of Ayadi and Gadi (2013) and extends the knowledge on credit guarantee schemes (CGS) in the South Mediterranean, whilst providing a preliminary assessment on the role of CGS – during and post COVID-19, based on a survey and various stakeholder engagement sessions conducted in 2020.

The study is led and co-authored by Prof. Rym Ayadi, President of EMEA and Director of EMNES and Mais Shaban, Research Fellow at EMEA and Fellow of EMNES.

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The study is accessible on: www.emgn.eu , www.emnes.org , www.euromed-economists.org

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EXECUTIVE SUMMARY

Small and Medium Enterprises (SMEs) play a key role in job creation and economic development, particularly in developing countries. However, access to formal finance represents a major constraint to their growth, as the majority of SMEs in emerging economies are unbanked or underbanked and exhibit a significant credit gap, this is particularly true for countries in the Southern Mediterranean.

Credit guarantee schemes (CGS) are a common form of intervention to facilitate SMEs' access to finance and to overcome deficiencies in the enabling environments and market failures, providing credit risk mitigation to lenders through ensuring a portion of their losses on the loans made to SMEs in case of default. These schemes play an important role in facilitating firms' growth and can be considered as an important tool for financial inclusion. Since their inception, CGS in the Southern Mediterranean have evolved to support SMEs' access to finance. Nevertheless, the COVID-19 pandemic has further emphasised the role of CGS, becoming one of the most important policy responses to support firms' financing needs during economic downturns and highlighting their countercyclical role.

This study reviews and assesses the guarantee schemes in a number of Southern Mediterranean countries in terms of type, objectives, outreach, design, and outcomes. The analyses are based on a survey conducted for the Euro-Mediterranean Guarantee Network (EMGN) involving 6 countries in early 2020. The majority of CGS in the region are public but with private shareholders; i.e., mixed ownership, and they share the objective of extending credit to credit rationed groups, of which SMEs are part. In terms of risk management, Southern Mediterranean CGS conduct only ex ante risk management (e.g., credit scoring models).

CGS portfolios grew significantly in the past 10 years and have the scope to grow further. Avenues for improvement exist specifically in terms of capacity building, counter guarantees, measuring additionality, evaluating sustainability, and digitalisation.

The use of CGS was accelerated during the COVID-19 pandemic to mitigate the dire economic consequences facing SMEs. Further research and policy intervention should shed further light on the performance of GCS during the pandemic and their capacity to alleviate access to finance constraints during external shocks.

1. INTRODUCTION

Small and medium sized enterprises (SMEs) in the Southern Mediterranean suffer from credit constraints more than their counterparts in middle and high- income economies. Given their contribution to employment and growth, similar to other regions, policymakers have developed credit guarantee schemes (CGS), sometimes with the help of EU official development assistance in order to facilitate small companies' access to debt capital. The COVID-19 pandemic has had negative impacts on SMEs worldwide, particularly in sectors that suffered from lockdown and social distancing measures. Loan and public guarantees have been used extensively in developed countries and less extensively in lower and middle- income countries to mitigate the economic consequences of the pandemic.

CGS are risk sharing mechanisms under which a guarantor ensures the lender against a share of the possible losses incurred when extending a loan. Despite the maturity of some schemes, credit to small companies in most countries in the region continues to lag behind.

In addition to the important role CGS play in facilitating SMEs access to credit, it can also improve the availability of information on these borrowers and reduce the problem of information asymmetries, especially in economies with weak institutional environments. Moreover, CGS can perform capacity building on the supply and demand side of credit by participating in training and technical assistance. Additionally, as proven by the current COVID-19 crisis, CGS can provide support to SMEs during economic downturns, playing a countercyclical role (Calice, 2016; Chatzouz et al., 2017; Cusmano, 2018). Brault and Signore (2019) provide a pan-European assessment of EU credit guarantees to SMEs and find that guaranteed loans positively affect the growth of firms' assets, the share of intangible assets, sales, employment, and lower their probability to default.

This study builds on a previous study of CGS in the Southern Mediterranean region by Ayadi and Gadi (2013. It updates and extends the knowledge on CGS in the region, whilst providing a preliminary assessment on the role of CGS - during and post COVID-19. First, this study briefly reviews the macroeconomic and institutional conditions of Southern Mediterranean countries and highlights the pros and cons of such measures. Second, it provides a preliminary assessment of the schemes' design and performance, based on the survey conducted with CGS in the region under EMGN. Third, recommendations to strengthen the region's credit guarantee mechanisms are provided, taking into account the possible role EU development assistance could have. Finally, the paper reviews the role of CGS during the COVID-19 crisis, based on a short survey conducted in 2020 and various stakeholder engagement sessions.

2. CREDIT GUARANTEE SCHEMES (CGS) AS A MEANS TO FOSTER SMES' ACCESS TO FINANCE

A. SMES' ACCESS TO FINANCE IN THE SOUTHERN MEDITERRANEAN

In developing countries, most formal jobs are generated by SMEs, responsible for creating 7 out of every 10 jobs. However, access to finance is a key obstacle to SME growth (World Bank, 2020). Table 1 provides an overview of the state of MSMEs in selected countries in the region, based on the 2017 MSME finance gap database. There is a significant finance gap in the region, ranging from 39% in Lebanon to 94% in Egypt. On average, 33% of MSMEs are credit constrained with the highest percentage (41%) in Jordan and Tunisia, and women-owned MSMEs represent an average of 8% of total MSMEs.

Table 1. MSME Finance gap for the Southern Mediterranean (2017)

Country	Middle East & North Africa	Egypt	Jordan	Lebanon	Morocco	Tunisia	West Bank and Gaza
Supply of Finance (MLN USD)	34,734.85	2,819.75	2,308.45	8,835.80	12,500.00	6,005.00	NA
Potential Demand for Finance (MLN USD)	221,034.11	49,542.11	8,890.57	14,512.16	43,979.42	12,878.53	NA
MSME Finance Gap (MLN USD)	186,299.26	46,722.36	6,582.12	5,676.36	31,479.42	6,873.53	NA
Formal MSME Finance Gap as % of GDP	24%	14%	18%	12%	31%	16%	NA
Finance Gap % of Potential Demand		94%	74%	39%	72%	53%	NA
Number of Formal MSMEs (THOUSANDS)	5,528.63	2,453.57	156.06	170.50	1,410.00	601.42	109.43
Women-owned MSMEs, % of total	8%	8%	5%	16%	11%	10%	5%
Number of Credit Constrained MSMEs (THOUSANDS)	1,847.45	818.32	63.71	61.38	245.67	246.52	29.58
Credit constrained MSMEs, % of total	33%	33%	41%	36%	17%	41%	27%
Women-owned MSMEs with credit constraints, % of total women-owned MSMEs	29%	27%	49%	22%	28%	36%	7%

Source: MSME Finance Gap Database 2017 & Authors' calculation

B. CGS AND FINANCIAL INCLUSION

Financial inclusion for MSMEs is critical for their growth, productivity, job creation and economic development at the country level. However, as shown in the previous section, MSMEs in the region have a large financing gap and access to finance is cited as one of the most important constraints to their growth (Blancher et al., 2019). A number of policies have been suggested and implemented to enhance MSMEs' financial inclusion, including; improving regulatory aspects that enable increased access to finance for responsible SMEs, improving credit infrastructure such as developing credit registries, introducing innovation in SME finance such as promoting digital financial services, investing in enhanced financial literacy for the low skilled, and setting up and improving guarantee schemes for MSMEs (Ayadi et al., 2019; Ayadi & Shaban, 2020).

The emergence of guarantee schemes helps overcome financing constraints faced by SMEs and plays an important role in enhancing financial inclusion. CGS can help banks overcome information asymmetry problems (linked to the inability of borrowers to provide information on their creditworthiness and the high costs of obtaining information on smaller firms) by improving transparency and creating additional information, as well as providing training to SMEs to present their financial information in a standardised manner. Additionally, it can act as a mechanism of risk transfer and diversification and reduce collateral requirements. Evidence suggests that credit guarantee schemes contribute to financial inclusion in developing economies and their role is even clearer during challenging times (as a counter-cyclical policy tool). For example, Wardhono et al. (2019) report that, in Indonesia, MSMEs that do not have a credit guarantee may not have much opportunity to access credit provided by formal microfinance institutions.

C. CGS ENABLING ENVIRONMENT

In the MENA region1, 25.3% of firms, irrespective of their size, rank access to finance as a major constraint compared with 15.9% in Europe and Central Asia and 14.1% in East Asia and the Pacific. A significant number of firms are excluded from bank lending in the region: only 26.5% of them have a credit line with financial institutions compared to between 33-47% in other developing regions. As of 2018, lending to SMEs as a percentage of total commercial bank lending represented 9% in Jordan, 17.6% in Lebanon, 18% in Morocco, and 17.4% in Palestine.

SMEs' lack of transparency, suitable collateral and financial track record exacerbate information asymmetries and moral hazard, which translates into acute credit rationing (Stiglitz and Weiss, 1981). In a bid to address this situation, policy makers have developed credit guarantee schemes (CGS) to induce banks to extend lending to credit constrained companies. CGS are risk-sharing mechanisms, under which the guarantor ensures the repayment of a loan to the lender in the event of a default by the borrower. Alternatively, some countries have developed similar mechanisms for equity finance (see Box 1). Southern Mediterranean countries have also established CGS, with some of them operating for more than 30 years. Yet, as figures show, little has been achieved in extending loan finance to SMEs. The reasons are to be found in

[1] MENA is the acronym used by the World Bank and other international organisations grouping the following countries: Algeria, Djibouti, Egypt, Gulf Cooperation Council members (GCC, Saudi Arabia, Bahrain, Oman, Qatar, Kuwait, and United Arab Emirates), Israel, Iran, Iraq, Jordan, Lebanon, Libya, Morocco, Syria, Tunisia, Palestine and Yemen. In this paper, the Southern Mediterranean classification refers to: Algeria, Egypt, Jordan, Lebanon, Libya, Morocco, Palestine, Syria, and Tunisia.

two sets of deterrent factors, preventing financial intermediaries from extending credit to the private sector in general and to small companies in particular.

Box 1. Equity Guarantee Schemes

Policymakers have sought to create equity guarantee schemes as a means of overcoming small firms' equity gap. Under these mechanisms, a public authority guarantees to an investor a part of the potential loss incurred, by holding equity from a small company in exchange of a fee. Designed as an incentive for venture capital and angel investors to overcome their reluctance associated with early stage investment, equity guarantee schemes' efficiency, that is, the number of companies which would not have had obtained finance without the existence of a guarantee, can be undermined by moral hazard. Investors could use guarantees to cover the most uncertain and risky companies so as to recover part of their money, whilst focussing their efforts on safer companies (Wright et al., 2006). Austria, Belgium, Finland and the Netherlands have developed equity guarantee schemes, subject to different features in terms of targeted companies, percentage of equity and maximum investment guaranteed (Aernoudt et al., 2007). At the EU level, under the 2007-2013 Competitiveness and Innovation Framework Programme (CIP), the European Investment Fund (EIF) is tasked with managing the SME guarantee facility (SMEG) which provides direct guarantees to investors, as well as counter guarantees to entities proposing loan and equity guarantees. Both are subject to varying fees and guarantee rates as well as a guarantee cap of 0.5 Eur. million. Besides the SMEG under the CIP, the EIF also provides direct guarantees to SMEs as well as counter guarantees to guarantee institutions. As regards the effectiveness of Equity guarantee schemes, their relatively recent emergence has not allowed rigorous evaluations to be undertaken, with the exception of a Dutch programme, which was found to be ineffective, since the assessment concluded that investments would have been made without the existence of a guarantee (Aernoudt et al., 2007). For developing countries, equity guarantee mechanisms can alleviate the consequences of capital markets' underdevelopment and provide companies in need with the equity they need. However, since equity capital is appropriate for innovative companies operating in high growth potential markets (OECD, 2011), the effectiveness of such mechanisms in countries where enforcement of intellectual property rights is poor might be undermined. More recently, the EIB Group (the EIB and the EIF) established the Pan-European Guarantee Fund (EGF) in response to the COVID-19 pandemic, to support EU-based companies affected by the crisis. Through the EGF, the EIF will deploy equity, debt funds and guarantee products in cooperation with selected financial institutions, to ensure that SMEs and Mid-Caps in the Participating Member States have sufficient short-term liquidity available to withstand the crisis and are able to continue their growth in the medium to long-term.

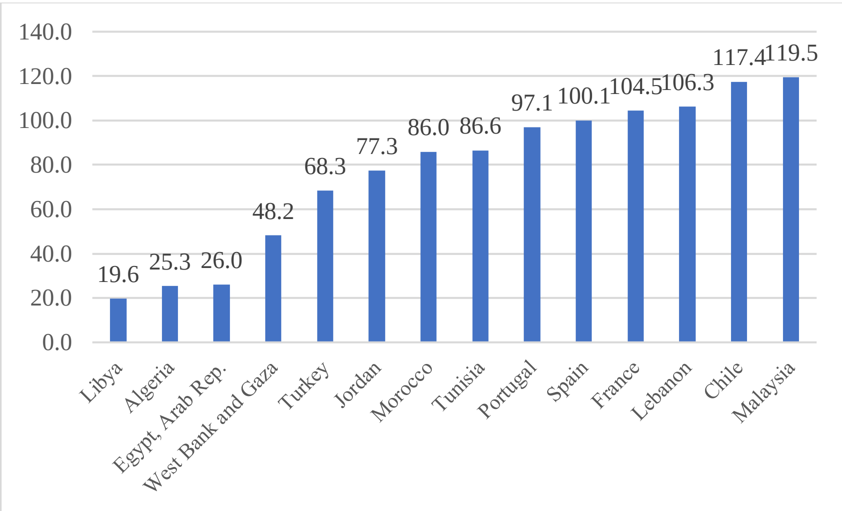
First, macroeconomic and regulatory conditions are poor when compared to other countries (Table 2). High interests on government paper and state involvement in the banking sector translate into lower levels of credit directed to the private sector (Figure 1) (Bouis, 2019; Djankov et al., 2008). In most countries, the existence of implicit government guarantees within the frameworks of deposit insurances do not give banks incentives to extend lending to profitable borrowers, translating into high levels of non-performing loans (Diamond and Dybvig, 1986; Ayadi et al., 2011).

Table 2. Macroeconomic and financial soundness indicators for the Southern Mediterranean and other economies (2017-2019 averages)

	Algeria	Egypt	Jordan	Lebanon	Morocco	Palestine	Tunisia	Chile	Malaysia	Portugal	Spain	Turkey	Italy	France	Malta
Average deposit rate	1.75	11.78	4.25	7.89	3.07	1.40	7.10	2.73	3.02	0.15	0.05	21.40	0.74	0.80	0.65
Average lending rate	8.00	17.53	8.57	9.30	5.16	5.79	NA	4.37	4.80	2.80	1.36	NA	2.76	1.77	3.74
NPL Ratio	12.83	4.47	5.33	7.96	7.52	2.68	14.05	1.89	1.52	11.35	3.77	3.26	11.38	2.91	3.71
Inflation	3.94	21.95	2.85	4.47	0.95	0.53	6.45	2.39	1.81	0.90	1.44	14.22	0.99	1.33	1.39
5 year Treasury Bonds	N.A	14.94	4.22	7.21	1.93	N.A	5.34	0.84	2.120	-0.180	-0.22	12.47	0.51	-0.57	0.10

Sources: World Development Indicators, trading economics, the global economy, world government bonds.

Figure 1. Domestic credit to the private sector in the Southern Mediterranean and other economies as a share of GDP (2017-2019 averages)

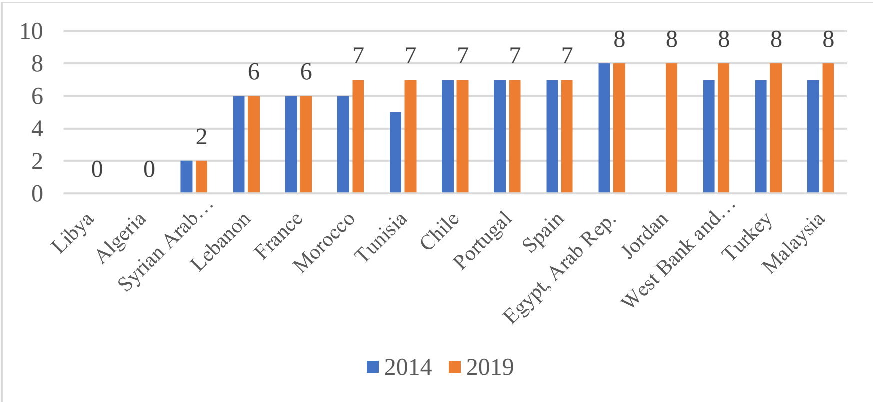


Source: World Development Indicators (WDI).

Second, financial infrastructure in the region is poor. Ayadi et al., (2018) provide an assessment of the factors determining financial development in terms of the financial sector structure, contribution to the economy and financial inclusion in four countries, namely: Egypt, Jordan, Morocco and Tunisia and find that the financial systems in these countries are underdeveloped, but the level of development varies across countries, over time and depends on several factors, including: institutional development, property rights, and regulatory frameworks.

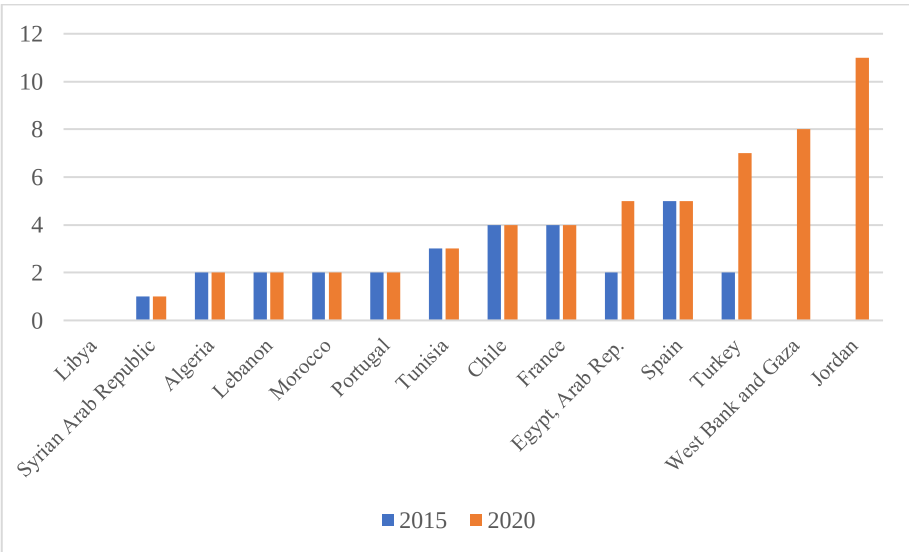
Despite the significant improvement during the past 5 years, the lack of effective credit information sharing mechanisms between financial institutions (Figure 2), the weak enforcement of creditor rights (Figure 3), and inappropriate collateral regimes in the region, further exacerbate difficulties in small companies' access to finance (Maddedu, 2010; Ayadi et el., 2011.; De La Campa, 2010). A good financial infrastructure is instrumental in supporting small companies' access to debt capital, since it allows lenders to evaluate borrowers based on their riskiness, whilst providing them with some degree of certainty on a loan's recovery prospects in case of a default by the borrower. Deficiencies in the region's financial infrastructure partly explain both banks' high collateral requirements – for example 158% of a loan's value in Egypt (Enterprise survey, 2016) - and their preference for immovable property to secure a loan; a set of conditions excluding SMEs from the credit market.

Figure 2. Depth of credit information in Southern Mediterranean and other economies (2014 & 2019)



Source: World Development Indicators (WDI).

Figure 3. Index of creditor rights (2015 & 2020)



Source: Doing Business Indicators 2020.

3. PROS AND CONS OF GUARANTEE SCHEMES

Whilst CGS have been advocated as a means of overcoming borrowers' lack of collateral and institutional shortcomings by putting a ceiling on the lenders' possible losses, there is a lively debate - in developed and developing countries alike - on the need for public policy to put in place such mechanisms.

Opponents of CGS argue that microfinance institutions are better positioned to expand credit to small companies because they have better lending technology. Another argument relates to the fact that government interventionism in credit markets should be avoided since it results in an exacerbation of moral hazard, whilst bearing a potentially high fiscal cost that would overweight the benefits of extending credit to rationed groups. On the other hand, CGS proponents argue that CGS create "additionality"; that is to say they give access to credit to groups that would not otherwise have had access to it without their existence. In addition, the provision of finance to credit rationed groups through CGS can result in increased activity that would generate spill-overs in which social benefits outweigh CGS potential costs (Honohan, 2010).

Evidence on CGS additionality is scarce, since its evaluation requires a counterfactual; a pool of firms that applied for unguaranteed loans similar to a sample of companies that applied for a guarantee. The formal evaluation of CGS additionality is also challenged by the possibility for lenders to engage in "intra-portfolio substitution"; lenders may change the purposes of loans so that borrowers to whom they extend credit fit in the guarantee programme. In addition, a formal evaluation should also take into account the possibility for lenders to move distressed loans to the guaranteed portfolio in order to cover their losses (Vogel and Adams, 1997). As a result of these caveats, few studies have tackled CGS additionality and no univocal evidence has been established. An evaluation of the Canada Small Business Financing Programme found that 74.8% of companies that had benefitted from a guaranteed loan would not have had access to debt finance without the provision of guarantees (Riding et al., 2007). Similar evidence of financial additionality has been reported for Chile's FOGAPE (Cowan et al., 2015), for the Special Credit Guarantee Programme in Japan (Wilcox and Yasuda, 2008) and for the MA MSME Development Project in Morocco. On the other hand, a study of the Malaysian CGS failed to find evidence of additionality (Boocock and Sharif, 2005). Looking into whether the Korean guarantee programme had succeeded in improving companies' growth and productivity, research found that Korean businesses have failed to increase productivity through increased R&D spending and investments. On the other hand, firms that benefitted from a guaranteed loan had a better survival rate than others and had been able to maintain their size (Oh et al., 2009). Hennecke et al. (2019), using cost-benefit analyses, show that the economic benefits of the guarantee banks in Germany are substantial due to increased production and employment, whilst the economic costs are negligible. Similarly, a study on the French guarantee programme found that companies that had recourse to a guaranteed loan tended to have higher employment and capital growth, yet they also experienced a significantly higher default rate, compared to companies that did not have recourse to guaranteed finance, a fact that points light at the existence of risk shifting from banks to guarantors (Lelarge et al., 2010). In line with these findings, an assessment of the UK's guarantee programme for SMEs found evidence on additionality, since 75% of guaranteed companies would not have had access to finance by other means. However, the funds' losses, that later translated into a fiscal cost higher than the tax benefits arising from guaranteeing SMEs' access to finance, question both the creditworthiness of borrowers and the relevance of CGS compared to market-based mechanisms (Cowling, 2010). The strength of market-based mechanisms, combined with the provision of guarantees to alleviate constraints in access to finance, is further outlined by a study of the US' guarantee scheme which found that the provision of guarantees mainly benefitted riskier borrowers, such as minority owned companies and start-ups, yet the latter also had to pay higher interest rates than non-guaranteed borrowers (United States Government Accountability Office, 2007).

Leaving aside the controversial efficiency of CGS, the design of such programmes must ensure that the services provided by the guarantee programme reach their objectives: CGS have to be appealing to lenders by guaranteeing a significant share of loans; to borrowers by avoiding charging an excessive fee; whilst at the same time ensuring that the provision of guarantees will not entail fiscal costs. Hence, the key to the success of a CGS is the incentive structure it provides to both borrowers and lenders to have recourse to guarantees whilst tackling moral hazard. In the next session, an assessment of Southern Mediterranean CGS is made by reviewing their design features: CGS types, objectives, outreach and design.

4. PRELIMINARY ASSESSMENT OF CREDIT GUARANTEE SCHEMES

The analysis in the following sub-sections relies on the proceeds of a survey administered to CGSs in Jordan, Algeria, Egypt, Morocco, Lebanon, and Tunisia. Details of the survey are presented in Annexe 1.

A. TYPES OF GUARANTEE SCHEMES

The provision of credit guarantees can be made via four types of schemes (OECD, 2008):

- Public guarantee schemes stem from a government's policy objective to extend access to finance to credit constrained groups. These schemes need subsidies to function – especially in their first years of operation - and can be administered by a government agency or by a private organisation.

- Corporate guarantee schemes are funded by the private sector and administered by business executives, which can potentially give them an informational advantage on the borrower over the lender.
- International guarantee schemes are operated and funded by bilateral and/or multilateral donors through official development assistance (ODA).
- Mutual guarantee schemes are private organisations independent from the government in terms of objectives and management but they often enjoy some form of government support.

Table 3 provides data for the ownership structure for the South Mediterranean CGS. Majority of CGS are public but with private shareholders: i.e., mixed ownership.

Table 3. The ownership structure for the South Mediterranean CGS

Institution	Type	Biggest Shareholder	Actual ownership of biggest shareholder	Other shareholders
Jordan Loan Guarantee Corporation - JLGC Jordan	Public (mixed)	Central Bank of Jordan	45%	Banks
Caisse de Garantie des Crédits d'Investissements PME - CGCI Algeria	Public	Public treasure	60%	Banks
Egypt Loan Guarantee Facility – Egypt	International	Global Communities	100%	
Caisse Centrale de Garantie - CCG Morocco	Public	Moroccan Government	100%	
Credit Guarantee Corporation - CGC Egypt	Private (mixed)	Central Bank	20%	Banks and insurance companies
Kafalat Sal –Lebanon	Private	NIGD (National Institute for the Guarantee of Deposits)	75%	Banks
SOTUGAR – Tunisia	Public	ETAT (the state)	33%	Banks

Source: Based on EMGN Survey (2019-2020)

B. CGS OBJECTIVES

The primary objective of CGS is the extension of credit to credit-rationed groups, of which SMEs are part. However, South Mediterranean countries' guarantee programmes have broader developmental objectives than exclusively addressing credit rationing. Whilst all schemes in the region have the objective of expanding credit to SMEs (Annexe 2.1), which contributes to job creation, growth and economic development, some of them have linked their programme's objectives to the expected outcomes of broader policies towards small companies. For example, Jordanian and Tunisian guarantee programmes seek to support the export capacities of national companies.

The adoption of multiple objectives translates into the fact that different types of guaranteed credits can be extended - ranging from investment credit to export credits. As a consequence of these broad objectives, South Mediterranean CGS have a potentially broader definition of additionality, further challenging a quantitative assessment on methodological grounds (Saadani et al., 2011).

C. CGS OUTREACH

The performance of CGS should ideally be assessed in two steps: first by estimating by how much target groups of the guarantee programmes are credit rationed, and second by calculating by how much the provision of guarantees has contributed to narrow this gap. However, methodological caveats prevent the use of this methodology. Whilst not being hard evidence, World Bank Enterprise Surveys give an indication of financial constraints (Bhattacharya and Wolde, 2010) and the use of indicators, such as the ratio of outstanding guarantees on a country's GDP per capita, the share of guarantees to credit constrained groups in the CGS portfolio, allows one to gauge their performance (Saadani et al., 2011).

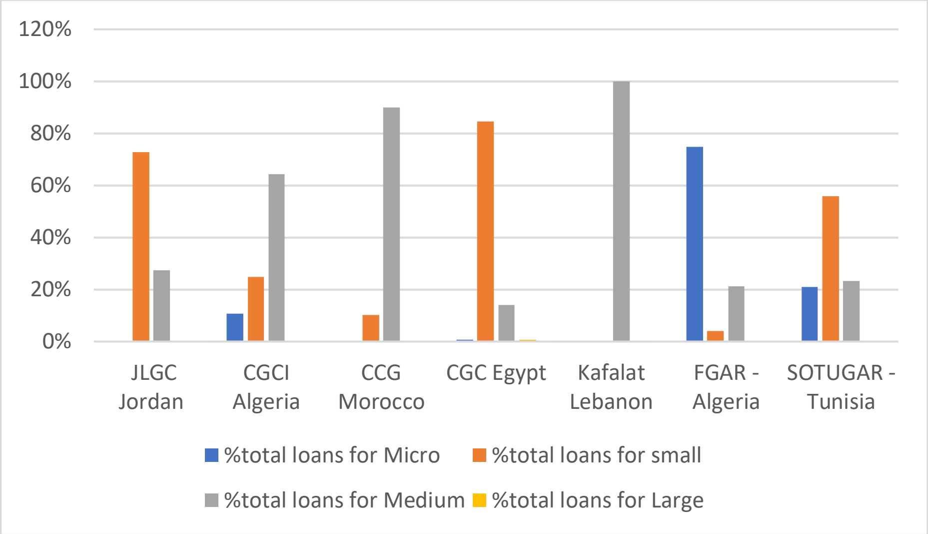
Table 4 shows that Morocco issued the highest number and amount of guarantees in 2018, followed by Algeria and Egypt. Given the importance of credit constraints for companies in the region, small companies dominate CGS portfolios, particularly in Jordan, Egypt and Tunisia (Figure 4). The figures show that Morocco, Lebanon and CGCI Algeria tend to extend guarantees more to medium companies than to smaller ones. Figure 5 shows a significant growth in the number of guarantees issued per million people between 2009 and 2018, with the exception of Kafalat Lebanon.

Table 4. Southern Mediterranean CGS outreach in 2018

	Number of guarantees issued in 2018	Number of guarantees issued in 2018 per million people	Guarantees in 2018 ($ million)
Jordan Loan Guarantee Corporation - Jordan	1,919.00	189.12	106.41
Caisse de Garantie des Crédits d'Investissements PME - Algeria	8,731.00	202.81	165.37
Egypt Loan Guarantee Facility – Egypt	-	-	-
Caisse Centrale de Garantie – Morocco	10,900.00	298.88	1,401.70
Credit Guarantee Corporation – Egypt	17,141.00	169.83	880.4
Kafalat Sal -Lebanon	305	44.46	29.3
Fonds de Garantie des Crédits aux PME – Algeria	387	8.99	1,310.14

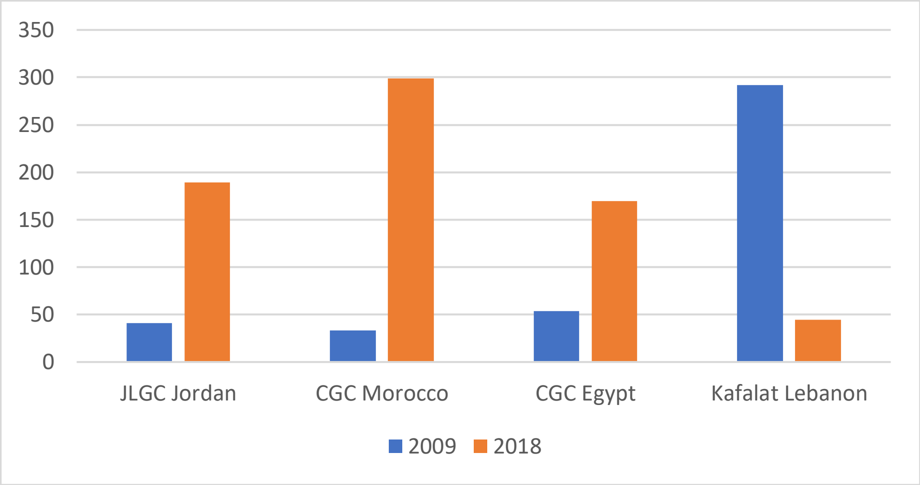
Source: Authors' calculations based on EMGN Survey

Figure 4. Southern Mediterranean CGS % of total loans by type of enterprise (2018)



Source: Authors' calculations based on EMGN Survey

Figure 5. Southern Mediterranean CGS Number of guarantees issued per million people (2009 Vs 2018)



Source: Authors' calculations based on EMGN Survey

D. DESIGN ISSUES

i. Approach

CGS have the choice between three approaches to extending guarantees, each bearing positive and negative points. The first and most intuitive approach is the **individual** one, under which the guarantor approves each loan application on a single basis. The candidate borrower applies, presents its project to the guarantor who screens the project[2]. Based on the outcomes of the screening, it usually issues a letter of guarantee to the borrower who then applies for a loan in a partner bank. The guarantor does not enter into the loan negotiation process, which rests entirely between lender and borrower. The second way to extend guarantees is the **portfolio** approach, under which the guarantor negotiates with the lenders the criteria for loan approval, as well as the total amount that will be guaranteed. Under this setting, the lender discretionarily approves the loans to borrowers, fulfilling the criteria previously agreed and informs the guarantor of its decision (Beck et al., 2008). Figure 6 illustrates relations between lenders and borrowers under these two approaches. A third and intermediate arrangement, the so-called **hybrid,** also exists. , Under this, for certain types of loans, a portfolio approach applies, whilst for others an individual approach applies.

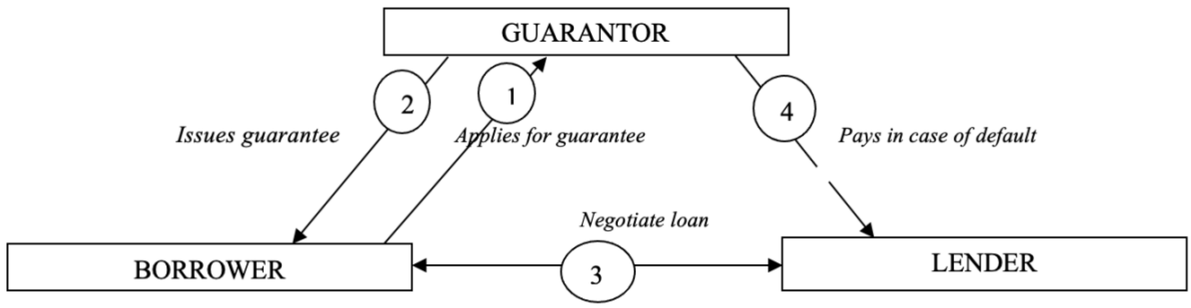
Arguments in favour of an individual approach relate to project screening benefits: when assessing the viability of loan applications one by one, losses are likely to be smaller. On the other hand, a portfolio approach can be seen as a much more effective means to extend credit rapidly to constrained groups, since it allows administrative costs to stay low, whilst providing lenders with certainty over the maximum losses incurred[3]. Such characteristics allow lenders to engage in risk management activities to keep losses within acceptable boundaries but, at the same time, it requires lenders to adopt a more risk-taking approach under which they have to consider the financial volatility of borrowers, instead of focussing exclusively on the security of not losing (Ruiz Navajas, 2001). In addition, if lenders adopt a conservative approach, the size of the portfolio negotiated between lenders and guarantor is likely either to be too small, or subject to restrictive criteria, thus jeopardising the CGS objectives.

[2] Alternatively, the guarantor can refer to an external/independent body to perform the screening.

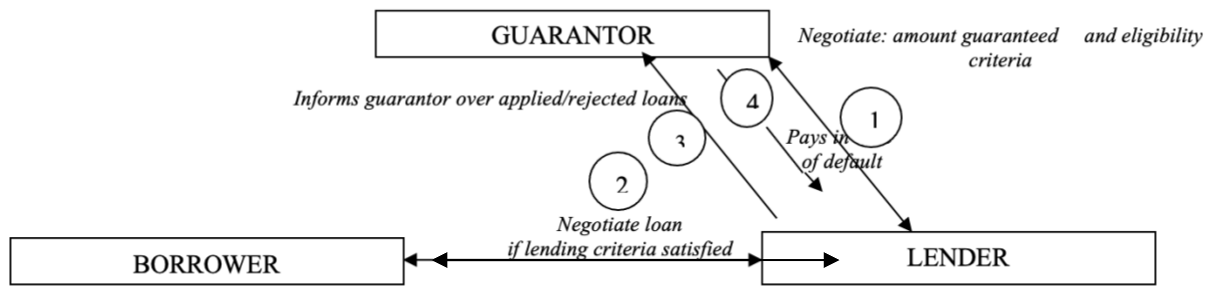
[3] In this case, losses are equal to the size of the portfolio.

Figure 6. Borrower/lender/guarantor relations under individual and portfolio approaches

5.1: Individual approach



5.2: Portfolio approach



Source: own compilation.

In the Southern Mediterranean, the majority of guarantee schemes (Kafalat Lebanon, Egypt Loan Guarantee Facility, SOTUGAR Tunisia, and JLGC Jordan) have opted for an individual approach, whereby the guarantor screens the applicant's project and issues a guarantee, leaving the loan negotiation process between the borrower and lender (Saadani et al., 2011). A potential positive outcome of such an approach lies in the fact that it can contribute to developing credit information in the region. As new borrowers apply to the guarantor, the latter's screening mandate can result in generating information that was previously non-existent. The information on new borrowers, that is later shared between guarantor and lender, can contribute to increasing the depth of credit information, provided it is later again shared with established credit registries. As such, beyond additionality, CGS can contribute to financial development through deepening credit information. On the other hand, CGC Egypt, CCG Morocco and CGCI Algeria use a hybrid approach and FGAR Algeria uses a portfolio approach.

ii. Eligibility

Eligibility refers to the criteria adopted by the guarantor or negotiated with the lender that the applicant must fulfil to apply for a guarantee. Broadly speaking, several Southern

Mediterranean countries' CGS guarantee loans are not only geared to small companies but also to individuals and households under different programmes (such as housing and student programmes). The eligibility criteria is an important factor determining CGS outreach and, ultimately, additionality: the broader the criteria for eligible loans, the broader the likelihood of greater additionality. As far as SMEs are concerned, guarantee programmes should ensure that they only target credit rationed companies, whilst providing some degree of flexibility for avoiding threshold effects (excluding firms just above the threshold, even if credit constrained) (Saadani et al., 2011).

Southern Mediterranean countries' CGS vary widely in 5 eligibility criteria. In terms of the size of loans guaranteed, the CCG Morocco and Egypt loan guarantee facilities do not have a ceiling. On the other hand, Kafalat Lebanon has a modest ceiling of $320,000 and CGC Egypt is considered a high guarantor, at $2,048,000.

A somewhat similar classification applies for loan maturity with:

- Long term guarantors, such as Tunisia, whose CGS cover loans with maturities of 15 years.
- Medium term guarantors, Egypt, Jordan, and Lebanon, with guarantees ranging from 8 - 10 years maturity.

Eligibility criteria for SMEs also witness disparities that stem partly from the lack of a homogeneous employment threshold for classifying companies relative to their size:

- Jordan adopts the EU's upper bounds definition, providing guarantees to companies with up to 250 employees.
- Lebanon uses a more stringent definition, guaranteeing loans to companies with a maximum of 40 employees.
- Other countries do not use employment thresholds.

As regards industry eligibility, in Egypt, companies of all sectors can be eligible for a guaranteed loan. However, CGS in Jordan, Algeria, Morocco and Lebanon exclude certain sectors.

Egypt, Jordan, Morocco and Algeria apply lower fees to support certain development goals and to foster economic policies, additionally, CGS in Lebanon, Egypt, Tunisia and Morocco provide special support to projects that contribute to energy efficiency and cleaner production (sustainable finance), in the form of higher coverage and/or longer duration. All South Mediterranean countries' CGS are prone to guarantee loans for both investment purposes and working capital, the exception being FGAR Algeria, which excludes the latter category from guarantees. Exclusion of working capital from loans eligible for a guarantee loans can be problematic: since small companies are relatively more vulnerable to business cycles than larger ones, access to finance can alleviate cyclical downturns that could otherwise result in suspension of activity or staff layoffs. This is especially the case since international evidence on the effect of

CGS shows that companies that had access to guaranteed loans tend to have higher survival rates (Oh et al., 2009; OECD, 2011)4.

Whilst all CGS allow start-up companies to apply for guaranteed loans, the Egypt Loan Guarantee Facility and FGAR Algeria do not. CCG Morocco also provides equity guarantees for innovative start-ups.

Table 5. Eligibility criteria and coverage ratios of Southern Mediterranean CGS

	Start-up	Firm size (max)	Loan size ceiling (USD million)	Loan maturity ceiling (years)	Top Eligible sectors	Working capital coverage	Mean coverage ratio (loan amount %)	Scalability
Jordan Loan Guarantee Corporation – Jordan	Yes	5-250 employees	0.3525 for small / 1 for Medium	8 years	Manufacturing Wholesale and retail trade Hotels and restaurants	Yes	70-85%	No
Caisse de Garantie des Crédits d'Investissements PME - Algeria	Yes	-	-	-	Agriculture & fishing Manufacturing Construction	Yes (only in agriculture)	60-80%	The CGS apply differentiated coverage between physical investment and working capital loans
Egypt Loan Guarantee Facility - Egypt	No	-	-	-	Manufacturing Construction Wholesale and retail trade	Yes	65-70%	No
Caisse Centrale de Garantie - Morocco	Yes	-	-	-	Manufacturing Construction Wholesale and retail trade	Yes	70-85%	More coverage is provided to micro enterprises (credit less than 100 000 USD) and for women-run enterprises / also the CGS apply differentiated coverage between physical investment and working capital loans
Credit Guarantee Corporation - Egypt	Yes	$12.8 Mill (revenues))	2.24	10 years	Agriculture & fishing Manufacturing Construction Wholesale and retail trade	Yes	63%	No

[4] The OECD reports the example of Japan, where guaranteed loans have actually been extended to distressed SMEs allowing them to operate without decreasing their size.

SOTUGAR - Tunisia	Yes	$5.2 Mill	-	15 years	Agriculture & fishing Manufacturing Technology, Media, Telecommunication	Yes	-	No
Kafalat Sal - Lebanon	Yes	40 employees	0.32	10 years	Agriculture & fishing Manufacturing Hotels and restaurants Technology, Media, Telecommunication	Yes	76.50%	No
Fonds de Garantie des Crédits aux PME - Algeria	No	-	-	-	Agriculture & fishing Manufacturing Construction Hotels and restaurants Transport, storage and communications Technology, Media, Telecommunication	No	59%	At creation, the guarantee rate is between 10 and 80% of the amount of bank credit. At extension of MSM Company, the FGAR covers 60% of the amount of the bank loan.

Source: Based on EMGN Survey

iii. Coverage

Coverage refers to the share of the loan that is guaranteed by the CGS, hence determining by how much lenders and guarantors share the risk inherent to a loan. Determining a CGS coverage ratio is illustrative of the attractiveness-sustainability trade-off faced when designing a loan guarantee programme. The coverage ratio can be set by the guarantor, negotiated with lenders or determined by the market (Box 2.) A high coverage ratio can be very attractive to lenders, since they would be immune from credit risk. At the same time, by being highly covered, they would not have an incentive to engage in proper monitoring activities, leading to excessive risk taking, thus endangering the schemes' sustainability whilst deterring its potential additionality. On the other hand, if the guarantor bears only a small share of the risk, lenders might simply disregard the programme. Moreover, the determination of a CGS coverage ratio must also take into account the potential informational advantage the lender/guarantor can have over the borrower. If the guarantor has an informational advantage over the borrower, due to better skills, a high coverage ratio might not necessarily lead to increased moral hazard, since the guarantor would only cover credit worthy borrowers. However, a study of CGS invalidated these theoretical prescriptions and found that most guarantee programmes worldwide neither set coverage ratios in accordance with informational advantages, nor with incentives of guarantors, since most schemes covered up to 80% of the value of a loan. The only risk mitigation mechanism found was a ceiling on the amount guaranteed for SME loans (Beck et al., 2008).

In contrast, Southern Mediterranean CGS coverage ratios are balanced with loan purposes and borrowers' size (Table 5.). Two groups of CGS can be identified:

- Undifferentiated coverage ratios are applied by Jordan, Egypt, Tunisia and Lebanon, who guarantee above 60% of the loans' amounts without distinguishing between working capital or physical investment credits.
- Scalable coverage ratios are used by Algeria and Morocco. For example, CCG offer higher coverage ratios for micro and women owned businesses. FGAR offers higher guarantees for companies at the creation stage and CGCI applies differentiated coverage between physical investment and working capital loans. Whilst these countries' practices in loan coverage can be seen as going against the prescription of linking the coverage ratio to the borrowers' riskiness (Saadani et al., 2011), rather they can be understood as an incentive provided by the guarantor to the lender in order to extend credit to smaller and younger companies.

Box 2. Market determined coverage ratios: the case of Chile's "Fondo de Garantia para Pequenos Empresarios" (FOGAPE)

FOGAPE is Chile's state fund aimed at guaranteeing SME loans. The fund is operated by a public commercial bank, "Banco Estado" and has adopted a portfolio approach, under which banks choose the loans they want to guarantee, with FOGAPE only verifying the compliance with the eligibility criteria previously set. The fund's originality rests on an auction-based determination of its coverage ratios. To allocate guarantees, FOGAPE conducts auctions several times a year, in which banks are invited to bid on the amount of guarantees they want to receive, as well as on the maximum coverage ratio. The guarantee fund selects the bids, starting with the lowest coverage ratios, until the total amount to be guaranteed has been allocated. Banks experiencing high default rates are excluded from future auctions, which provide them with an incentive to monitor their borrowers, whilst fostering competition between them (Schmukler et al.; 2007). Coverage ratios determined by the auction process range between 70% and 80% and evidence exists on the funds' success in extending loans to small companies and generating additionality (Llisteri et al.; 2006, p.99)

iv. Collateral and down payment requirements

Even in the case where lenders issue guaranteed loans, they demand collateral from the borrower, since collateral requirements are important to mitigate moral hazard. By providing collateral, the borrower signals to the lender its willingness to act diligently and repay the loan. It can be viewed that collateral requirements from lenders undermine the very purpose of a CGS but, in the absence of such a mechanism, the scheme's sustainability could be endangered by high moral hazard between the lender and the borrower. In addition to collateral requirements, lenders also usually demand a down payment from the borrower. Down payment requirements decrease loan terms, thus ensuring a lesser weight of the borrower's financial commitments to the lender, thereby ultimately raising repayment prospects.

Southern Mediterranean guarantors are no exception, since they allow lenders to have recourse to both mechanisms when issuing a guaranteed loan. Collateral requirements are not only widespread in the region but are not capped by guarantors. Lebanon's Kafalat and Algeria's CGCI and FGAR emerge as the only exceptions. As regards down payment obligations, most lenders in the region require the borrower to provide a certain percentage of the loan's value as the down payment, however JLGC Jordan and SOTUGAR Tunisia set a cap for the down payment required by lenders. Lack of ceiling on collateral requirements by lenders can run counter to the objectives of the scheme and result in awarding credits to borrowers that would have had access to finance anyway, especially given the high collateral requirements in the region.

v. Repayment rules

When a guaranteed loan defaults, the guarantor is liable to the lender for covering the losses incurred, up to the extent agreed. Even if the coverage ratio is designed to mitigate ex ante moral hazard in the lender/guarantor relationship (in this case moral hazard arising before the loan defaults), it does not protect the guarantor from ex post moral hazard (i.e., after the loan defaults). To prevent opportunistic behaviour from the lender, loan repayment rules need to be designed to encourage the lender to exhaust all available means for recollecting the loan before the guarantor pays him. Here, the design of a CGS faces a trade-off between credibility – the scheme's reputation in fulfilling its mandate by covering losses - and sustainability. A scheme that puts too heavy a burden on the lender to recollect the loan before its repayment, might not be credible, which is hence unappealing to lenders. On the other hand, a programme that systematically covers losses when they arise might prove unsustainable.

In order to build its credibility, a scheme must - first and foremost - handle claims quickly and in a predictable and transparent manner, by specifying when the loan is considered as defaulting (Green, 2003). Second, the scheme must devise a payment rule that will give banks incentives to ensure, to the extent possible, the loan recollection. Third, when designing a repayment rule, the scheme must take into account the institutional environment within which it operates. . In countries where the legal system is inefficient and the enforcement of contracts is weak, the guarantor must assume taking a more proactive role in repayment. In operational terms, four repayment rules can be devised (Saadani et al., 2011), under which the guarantor pays all the losses to the lender:

a. once the borrower's default is recognised
b. after the latter initiates legal action against the defaulting borrower
c. once default is recognised, with the remainder once judicial processes are terminated
d. once judicial procedures against the borrower are terminated

Rule (a) does not provide sufficient incentives for the lender to recover the loan whilst rule (d) does not seem adapted to weak institutional environments. In the South Mediterranean region, countries are quite heterogeneous. CGSs in Tunisia and Morocco provide a certain percentage of the payment once default is recognised and the remainder after the exhaustion of judicial procedures. Meanwhile, Jordan and Egypt have adopted a type (b) rule, whilst CGS in Lebanon and Algeria pay the lender once the borrower's default is recognised.

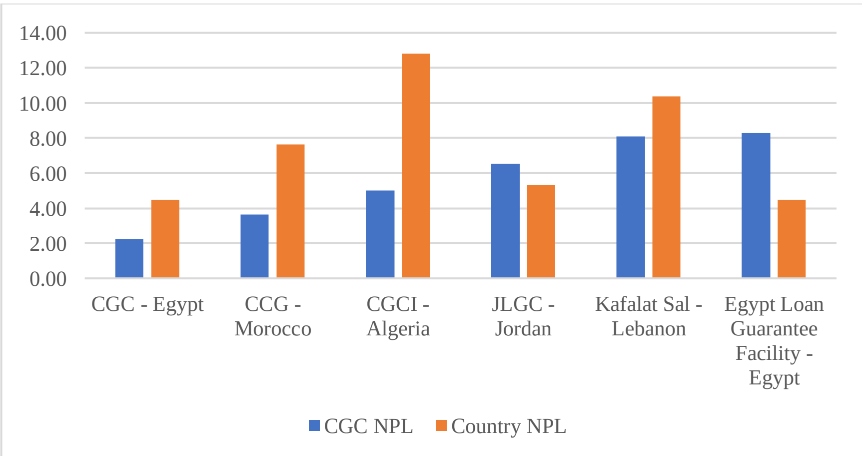
vi. Risk management

CGS can reduce both ex ante and ex post risk through risk management practices. Ex ante risk can be mitigated through the use of credit scoring models and the conduct of due diligence to assess borrowers' creditworthiness. Ex post, CGS may have recourse to several methods, such as loan portfolio securitisation, loan sales and more general forms of reinsurance, amongst which are counter guarantees (Box 2). The latter methods are dependent, however, on capital markets' development. Since capital markets in the region are underdeveloped, Southern Mediterranean CGS are constrained to only conducting ex ante risk management (Saadani et al., 2011).

Despite the low level of credit information in the region, CGS have improved their risk management capabilities, thanks to the use of credit scoring models and recent upgrades in the region's financial information infrastructure (Saadani et al., 2011). Southern Mediterranean CGS efficiently manage the risk they are exposed to, their net losses – measured by the ratio of outstanding claims over outstanding guarantees – were comprised between 0.1 and 1% from 2007 to 2009. However, there has been an increase between 2017 and 2019, particularly in Lebanon with a 5% average. Jordan, Algeria and Egypt maintain low net losses ratio below 2%.

To gauge CGS management of credit risk, CGS non-performing loans (NPLs) need to be compared with the banking sector's NPLs. Here, the comparison between the CGS NPLs and the NPLs in selected countries reveals important discrepancies (Figure 7)[5].

Figure 7. Comparison between selected countries NPLs and CGS NPLs (average for 2017-19)



Source: Author's calculation based on EMGN survey / World Bank development indicators / CEIC data

[5] The comparison has been restricted to Egypt, Lebanon, Algeria, Jordan, and Morocco due to data availability

Despite incentives provided by the scheme to engage banks in lending to riskier borrowers, it rather seems that guarantees have been used by lenders to extend credit to the safest borrowers. In such an hypothesis, banks' lending practices would go against the objectives of the CGS, hindering their potential additionality, whilst pointing towards the capital importance of credit information, legal rights, macroeconomic stability, regulatory framework appropriateness and distance from government in extending credit to the private sector in general and to riskier borrowers in particular.

It is worth mentioning here, the Southern Mediterranean guarantees are eligible as a Basel II risk mitigation instrument, with applicable weight affecting bank's provisions and minimum capital requirements against the guaranteed part.

vii. Fees and sustainability

The provision of a guarantee for a loan is a financial service and, even if most guarantee schemes worldwide are not- for-profit organisations, they all charge a fee either on the borrower or on the lender. For CGS, fees are doubly important, since they can cover the administrative and loan processing costs of the scheme, whilst mitigating moral hazard. By paying a fee to the guarantor, the lender will be discouraged from extending credit to safer borrowers. Alternatively, the fees charged on the borrower, by either the lender or the guarantor, will provide him with an incentive to act diligently and repay the loan - provided the fee is sufficiently high and indexed on his risk. Here again, similarly as with the determination of the coverage ratio, the determination of fees faces a trade-off between the scheme's sustainability and attractiveness. Too high fees may discourage both borrowers and lenders from using guarantees; and, conversely, too low fees appeal to lenders and borrowers at the expense of higher risk-taking and the scheme's sustainability. Fees are usually charged as a percentage of the loan amount. Fees charged by Southern Mediterranean CGS are linked to certain characteristics of the loan, i.e., risk weight, credit purpose, size and maturity of loan. However, Kafalat Lebanon and CCG Morocco apply a flat guarantee fee.

5. AVENUES FOR IMPROVEMENT

A. CAPACITY BUILDING

Figures show that, despite the existence of CGS in the Southern Mediterranean, lenders seem to disregard the provision of guarantees for SMEs, having a noticeable preference for financing important medium to long term investments of safer borrowers. Yet, the review of the region's CGS shows that incentives to extend lending to small companies do exist. Hence, to explain their low preponderance in CGS portfolios, other factors need to be explored. First, small companies may have a preference towards internal modes of finance, such as relationship lending, retained earnings or informal credit. Should that be the case, the figures would only represent a low demand, from both SMEs and lenders, for such mechanisms. Second, lenders may not consider lending to small companies simply because returns on SME loan portfolios are lower than returns from other assets, such as public debt, credit to state owned companies, or lending to long established businesses. In such cases, policy should address the costs associated with small company lending and ensure that a set of preconditions is met to kick-start SME lending. Third, it can also be the case that the majority of SMEs applying for a guarantee are rejected, for a number of reasons (unclear financial projection, lack of skills, etc.). Fourth, lenders may also lack the skills to efficiently process loans to small companies. Notwithstanding the necessity to ensure a set of favourable conditions for lending and the apparently good design of guarantee programmes in the region, nevertheless, some recommendations can be put forward to strengthen their functioning.

i. Addressing capacity building on the supply side: increasing the banking sector's ability to deal with SME loans

On the supply side of credit rationing in the Southern Mediterranean, some banks report that, besides high interest rates and lack of SME transparency, their lack of skills in dealing with SMEs prevents them from entering this market (Rocha et al., 2011). Addressing this bottleneck could be done through the provision of capacity building initiatives to loan officers and relevant staff in banks and CGS. In this regard, the EU's cooperation frameworks with the region – the European Neighbourhood Policy (ENP) and the Union for the Mediterranean (UfM) – can act as coordinating platforms, under which staff from EU banks and CGS would engage in such initiatives with their Southern Mediterranean counterparts. Such initiatives could be linked to cooperation programmes funding SME support organisations, as part of a comprehensive package aimed at creating an enabling environment for small companies in the region (Ayadi and Fanelli, 2011).

ii. Addressing capacity building on the demand side: linking CGS and SME support organizations

Being well aware of the fact that the lack of transparency of small companies is an obstacle, governments in the region have established SME support organisations to address this demand side obstacle to accessing finance. When surveying the aims of these organisations, it appears that besides the provision of training for SME managers-owners, they sometimes broadly share the same objectives as CGS (Table 6). CGS in Egypt, Morocco and Algeria engage in training, technical assistance, or other support activities targeting small companies. Engaging in such partnerships can be beneficial, since companies having had recourse to capacity building measures that, for example, strengthen their accounting, management and marketing skills can be better positioned to successfully apply for a loan. Against this backdrop, policies can be designed under which weaker SMEs applying for a guarantee would be asked to have recourse to a support organisation before obtaining the definitive agreement by the guarantor. The same mechanism could also apply to small companies whose loan application was rejected. This would allow them to review and fine tune their project; improve their reporting skills; identify new markets etc., hence potentially increasing their profitability and the likelihood of getting a guaranteed loan. Such linkages can prove particularly beneficial for start-up companies, whose access to funds is a recurring objective of South Mediterranean CGS. For these companies, the experience and modus operandi of Korea's guarantee fund, KOTEC, can be of particular interest (Box 3).

Box 3. Korea's technological guarantee fund, KOTEC

Korea's guarantee scheme KODIT was first established in 1976. After some 20 years of operation, the government decided to create a special guarantee fund that would exclusively deal with technology intensive SMEs, namely KOTEC. While KODIT dealt with all types of SMEs, KOTEC was set up to deal exclusively with innovative companies. It distinguishes itself from its predecessor by operating a two level approval system for guarantee applications. KOTEC evaluates each applicant not only on the commercial aspect of his/her project, but also performs a technological appraisal. SMEs that want to borrow from a bank, but whose application is rejected, are advised to go to a technology appraisal centre (TAC) where KOTEC's staff screen the borrower's application based on technological criteria. If the borrower's project is approved, the fund issues a letter of guarantee. Since its inception in the 1980s, KOTEC has evolved to support SMEs in different period in their life cycle, with adapted guarantee strategies. It also provides consulting services for mergers and acquisitions, as well as technology transfer.
Source: OECD, 2011; KOTEC's webpage.

Table 6. SME support organisations in the Southern Mediterranean

	Organisation	Main activities[6]	Inception	CGS related objectives
Egypt	Industrial Modernisation Centre, IMC	Services for SME development and support Trainings for SME managers/owners Guidance on sources of finance	2001	Extend access to finance to SMEs.
Jordan	Business Development Centre, BDC	Training and capacity building of Jordanian youth Support of Jordanian SMEs and industries Export development Entrepreneurship training Training of Trainers	2004	Export promotion Support of SMEs
	Jordan Enterprise Development Corporation, JEDCO	Services for SME development and support Training for SME managers/owners Guidance on sources of finance	2008	Export promotion, production expansion, market efficiency promotion, extend access to finance
Lebanon	Euro-Lebanese Centre for Industrial Modernisation, ELCIM	Services for SME development and support Training for SME managers/owners	2001	
Morocco	Agence Nationale pour la Promotion de la PME, ANPME	Services for SME development and support	2002	Support business start-up/expansion/modernisation through provision of finance
Syria	Syrian European Business Development Centre, SEBC. SME support programme	Services for SME development and support Training for SME managers/owners Guidance on sources of finance	1996	Extend access to finance
Tunisia	Agence de Promotion de l'Industrie, API	Services for SME development and support Provision of direct finance to SMEs Training for SME managers/owners	1972	Extend access to finance
	Réseau National des Centres d'Affaires d'Intérêt Public	Services for SME development and support	2005	

Source: Own compilation, based on respective organisations' webpages.

B. COUNTER GUARANTEES

Counter guarantees are a form of reinsurance, providing the guarantor with protection against the losses incurred from extending guarantees to lenders. They can be assimilated to a risk management tool at the disposal of guarantors (Saadani et al., 2011), or as a way to foster a

[6] "Services for SME development and support" is a wide category that includes: industrial modernisation, access to foreign markets, access to suppliers, marketing etc. Such classification has been adopted to allow distinguishing between the three broad categories of services that SME support organisations provide, namely training, guidance/provision of finance.

CGS credibility and outreach. The existence of counter guarantees can potentially result in more moral hazard, which results in their design entailing broadly the same trade-offs between sustainability and attractiveness as CGS. When ensuring the guarantor against the potential losses arising from its guarantee portfolio, the counter guarantee programme must either provide the guarantor with an incentive to effectively screen the guarantee applicants, in the case of a CGS operating under an individual approach, or to induce the guarantor not to negotiate overly permissive eligibility criteria when the CGS rests on a portfolio approach. To mitigate moral hazard arising between the guarantor and the counter guarantor, the latter usually ensures the former only against a share of its losses. The main advantage of counter guarantees is that they provide guarantors with a leverage effect equal to the size of the size of the counter guarantees, hence allowing further extending guarantees and maximising the CGS outreach.

The use of counter guarantees is generally constrained by the level of financial development. Southern Mediterranean countries have not established such institutions, due to the absence of a suitable regulatory framework (Saadani et al., 2011). Some Latin American countries operate counter guarantee programmes via bank-owned insurance companies.

In the EU, the 2007-2013 Competitiveness and Innovation Framework Programme (CIP) enacted the SME Guarantee Facility (SMEG), under which the European Investment Fund (EIF) provides equity guarantees (see Box 1), guarantees and counter guarantees to financial intermediaries located in 15 countries. The EIF provides guarantees to guarantors up to 50% of the losses incurred on each loan they guarantee, in exchange of a fee. A special feature of the Spanish and Portuguese guarantee structure is the existence of national counter guarantees and of a supra-national counter guarantees organised and funded by the EU Commission and managed by the European Investment Fund.

The only country in the Southern Mediterranean that has experience in counter guarantees is Morocco. CCG had a counter guarantee assistance with the European Union / European commission covering up to 50% of the losses with a low commission (as it is a non-profit organisation). The programme was terminated, as it was only for a limited time and the remaining resources were granted to the scheme.

6. CGS during the COVID-19 Pandemic

The Covid-19 pandemic has led to a significant negative impact on MSME income, due to business closures during full or partial lockdowns, curfews and movement restrictions. Hence, MSMEs have an urgent need for liquidity in order to survive, however, increased credit risk discourages bank lending. Consequently, credit guarantee schemes have become one of the most important policy responses to support firms' financing needs during this period. Governments in the Southern Mediterranean provided financial support to credit guarantee schemes channelling them to sectors in need. Table 7 provides actions taken by selected Credit Guarantee Schemes in the region in mitigating the dire socio-economic and financial consequences of this crisis7. Increasing guarantee coverage, lowering fees and accelerating procedures were of the essence.

Table 7. CGS responses to the COVID-19 crisis

Institution	Action
Jordan Loan Guarantee Corporation - JLGC Jordan	Introduced a guarantee programme with a total amount of half a Billion JD and the guarantee fee is reduced to 0.35%. This refinancing facility is provided by the central bank to banks operating in the country at zero interest, with banks relending to SMEs at a maximum interest rate of 2%. The maximum amount of loan is 1 million JD; it could be used for short term purposes including operational costs / working capital. The coverage percentage is 85% of loan value. One condition of this programme is the commitment of the enterprise not to lay off any employees.
Caisse Centrale de Garantie - CCG Morocco	Introduced as the "oxygen guarantee" intended for all sizes of companies not exceeding a turnover of 50 million USD in order to cover operational costs for up to three months which could be extended one time. These special loans could go up to 20% of the working capital line, or 2 million USD at a special rate of 4%. The guarantee coverage is 95% at a symbolic flat fee of 0.1% of the credit amount and could be converted into 5 years' debt upon inability to repay by the end of the year.
Credit Guarantee Corporation - CGC Egypt	Introduced new measures including increased coverage (75-90% depending on the sector), doubled risk appetite, fees reduced (by 35-40% depending on the sector), and accelerated procedures (approval processed within 24 hours for smaller cases, whilst for bigger cases it can take up to 3 days maximum). Additionally, the Central Bank of Egypt provided a letter of guarantee for CGC Egypt to support two initiatives: the Corporate Guarantee Programme and the Tourism Guarantee Programme.

Source: Based on EMGN Survey

During the first half of 2020, CGC Egypt and JLGC report a significant increase in the total amount of guarantees specifically for medium enterprises, compared to the first half of 2019.

[7] The analysis in this section relies on the results of a survey administered to CGS in Jordan, Algeria, Egypt, Morocco, Lebanon, and Tunisia, in addition to a series of webinars conducted under EMGN.

However, the Egypt Loan Guarantee Facility and CGCI report a decline for all types of enterprise (Table 8). The top sectors eligible during the crisis included: manufacturing, construction, hotels and restaurants, wholesale and trade, and agriculture.

The severity of the economic contraction is anticipated to affect most companies at some stage. Consequently, an increase in the CGS net loss ratio is expected, however, government support during the crisis seems to have eliminated their sustainability concerns.

The importance of digitalisation has been highlighted by the current COVID-19 crisis, as credit guarantee institutions are playing a crucial role in supporting an increased number of MSMEs during the crisis and speed is of the essence. CGGs in the Southern Mediterranean see the potential to create value by digital transformation, for example: the Egypt Loan Guarantee Facility is conducting technical assistance virtually, JLGC granted banks web access to upload the loans data on the JLGC Platform, and CGCI adopted an Electronic Document Management System, covering the functions of scanning, workflow and document consultation.

Table 8. Total amount of guarantees (in million $) March to June 2019 Vs 2020

Type of enterprise	Egypt Loan Guarantee Facility			CGC Egypt			JLGC Jordan			CGCI Algeria		
	2019	2020	Growth	2019	2020	Growth	2019	2020	Growth	2019	2020	Growth
Micro	0	0	0%	$3.4	$3.6	6%	0	0	0%	23.8	12.6	-47%
Small	1.18	0.057	-95%	$274	$293	7%	8.1	1.6	-80%	11.9	11.7	-2%
Medium	6.44	2.1	-67%	$15.5	$87	461%	4.19	132.3	3058%	14.2	13.5	-5%
Large	0	0	0%	0	0	0%	0	0	0%	0	0	0%
Total	7.62	2.157	-72%	$293	$374	28%	12.29	133.9	990%	49.9	37.8	-24%

Source: Author's calculation based on EMGN survey

7. CONCLUSION

Policy makers in the Southern Mediterranean have established credit guarantee schemes (CGS) as a means to alleviate constraints to accessing finance for companies in general and SMEs in particular. The design of such mechanisms provides lenders with the necessary incentives to extend credit to smaller and riskier borrowers. Whilst CGS can be further strengthened by combining provision of guarantees with capacity building measures, in order to meaningfully increase the share of SMEs in bank lending portfolio upgrades within the region's financial infrastructure, banking sector ownership and enhancement of macroeconomic conditions seem of utmost importance. Counter guarantees as a risk sharing instrument, if carefully designed and implemented, have the potential to enhance MSMEs access to finance, thus fostering job creation in the Southern Mediterranean. The use of CGS was accelerated during the COVID-19 pandemic to mitigate the dire economic consequences on SMEs. Further research and policy intervention should shed light on the performance of CGS during the pandemic and their capacity to alleviate access to finance constraints during external shocks.

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ANNEXE 1. EMGN CGS SURVEY

1. Part A - General information

A1 - Type of credit guarantee scheme (CGS):

▬	Public
▬	Private
▬	Mutual
▬	International
▬	Other (please briefly detail:

A2 - CGS approach:

▬	Individual - guarantees extended on a loan-by-loan basis
▬	Portfolio - guarantees extended to a portfolio of loans issued by financial institutions
▬	Hybrid - combination of the above
▬	Other (please briefly detail):

A3 - Does the CGS guarantee:

Loan principal	Yes ▬ No ▬
Interest payments	Yes ▬ No ▬
Equity investments	Yes ▬ No ▬
Other (please briefly describe):	

A3.1 - If the CGS does not provide equity guarantees, does it envisage introducing them?

▬	Yes. Year envisaged for introduction:
▬	No

A4 - What is the scheme's definition of micro, small, medium and large companies, based on employment and turnover thresholds?

	Employment threshold	Turnover threshold
Micro company		
Small company		
Medium sized company		
Large company		

A4.1 - Does the scheme definition overlap with national definitions of micro small medium sized companies (MSMEs)?

▬	Yes
▬	No

A5 - Loan guarantee applications accepted: please provide figures for 2017, 2018, 2019 (or the latest available year):

	Number of guarantees			Total amount guaranteed			Value of corresponding loans		
	2017	2018	2019	2017	2018	2019	2017	2018	2019
Micro company									
Small company									
Medium sized company									
Large company									

A5.1 - Considering MSMEs, what is the distribution of loan guarantees for working capital and investment loans? Are smaller companies more likely to benefit from guarantees for working capital or investment loans?

Please briefly describe:

A5.2 - What is the estimated percentage of borrowers that would not have been able to receive a loan without a guarantee?

Please specify:

A5.3 - What type of companies are most likely to benefit from equity guarantees (if applicable)?

Please briefly describe:

A6 - Amongst the sectors below, please check the <u>top three</u> sectors in terms of outstanding guarantees:

▬	Agriculture & fishing
▬	Mining and quarrying
▬	Manufacturing
▬	Electricity, gas and water supply
▬	Construction
▬	Wholesale and retail trade;
▬	Repair of motor vehicles, motorcycles and personal and household goods
▬	Hotels and restaurants
▬	Transport, storage and communications
▬	Financial institutions and intermediation
▬	Real estate, renting and business activities
	Technology, Media, Telecommunication
▬	Other services

A7 - Please briefly describe the main reasons behind rejection of loan and equity guarantee applications (if applicable) for micro, small and medium sized companies:

Please briefly describe:

A8 - What is the share of rejected applications over total applications?

Please specify:

A9 - Does the CGS engage alone or in cooperation with external bodies in training, technical assistance or other support activities targeting small companies?

▬	Yes
▬	No

A10 - Are all sectors eligible to apply for a loan guarantee:

▬	Yes
▬	No

A10.1 - If no, please briefly describe the eligible sectors:

Please briefly describe:

A11 - Loan guarantee portfolio figures, please provide figure for:

	2019	2018	2017
Outstanding Guarantee Portfolio			
Outstanding Credit Portfolio			
Covered % average			
Outstanding number of beneficiaries			
Leverage			
Non-performing loan %			
Paid out guarantee %			
Average loan size			
Average loan maturity			

A12 - Does the CGS scale coverage ratios depending on company size?

—	Yes
—	No

A12.1 - If yes, please briefly describe the CGS scalability method:

Please briefly describe:

A13 - Does the CGS apply differentiated coverage between physical investment and working capital loans?

—	Yes
—	No

A14 - Does the CGS support business startups?

—	Yes
—	No

A15 - Does the CGS set a cap for the collateral required by lenders?

—	Yes
—	No

A16 - Does the CGS set a cap for the down payment required by lenders?

—	Yes
—	No

A17 - In case of loan default, does the CGS pay the losses to the lender

—	Once after the borrower's default is recognised
—	After the lender initiates legal action against the defaulting borrower
—	A certain percentage once default is recognised and the remainder once judicial processes are terminated
—	Once judicial procedures against the borrower are terminated.
—	Other (Please briefly describe)

A18 - What are the main objectives of the CGS?

Please specify:

A19 - Is the CGS funded under official development assistance?

▬	Yes
▬	No

A19.1 - If yes, please specify official development assistance / other

2. Part B – Governance

B1 - What is the CGS' legal regime (i.e., Public Limited Company, PLC; Limited Liability Company, LLC; etc.)?

Please specify:

B1.1 - Please specify the CGS year of establishment, legal basis and any further amendments:

Year of establishment	
Legal basis (reference to legal texts)	
Further amendments to legal basis, if applicable (reference)	

B2 - Starting with the biggest shareholder, please specify the CGS shareholding structure and shareholders' actual ownership rates (if applicable):

Shareholder	Actual ownership rate

B3- Please specify CGS Board structure (Chairman/ Board member)

Members	Executive/Non	Field of Expertise

B3.1 - What are the main Committees from the Board and how frequent do they meet?

B3.2 - How is the Board of Directors appointed?

Please briefly describe:

B3.3 - Are there any explicit or implicit arrangements that allow certain shareholders to appoint directors?

Please specify:

B3.4 - What are the responsibilities of the Board of Directors? Please describe top 3-5 responsibilities:

Please briefly describe:

B3.5 - Does the Board of Directors have the power (formally or informally) to guide the allocation of guarantees?

▬	Yes
▬	No

B3.6 - If yes, can the Board allocate decisions directly?

▬	Yes
▬	No

B3.7 - Can the Board set the general principles on risk-taking and review the risk-management practices?

Please briefly describe:

B4 - Does the Board of Directors have a role in selecting the chief executive officer (CEO) and other senior management positions?

▬	Yes
▬	If no, please provide details:

B4.1 - What are the main 5 responsibilities of the CEO?

Please briefly describe:

B5 - Does the CGS have an official internal audit function?

▬	Yes
▬	No

B6 - Are external audits compulsory for the CGS?

▬	Yes
▬	No

B6.1 - Has the CGS been subject to an external audit over the last five years?

—	Yes. Please specify year of last audit:
—	No

B6.2 - Who selects the external auditors?

Please specify:

B7 - Does the CGS publish periodic reports?

—	Yes
—	No

B7.1 - If yes, at what frequency?

—	Quarterly
—	Yearly
—	Other. Please specify:

B7.2 - If no, does the CGS envisage conducting and publishing periodic reports on its activities?

—	Yes. Please specify date envisaged for first report:
—	No

B8 - Is the CGS rated by an external agency?

—	Yes
—	No

B9 - Does the CGS have a compliance Department?

▬	Yes
▬	No

B9.1 - If yes, to whom does it report?

Please specify:

3. PART C – SUPERVISION

C1 - What bodies/agencies supervise the CGS?

Please specify:

C2 - Is there a minimum regulatory capital ratio applicable to the CGS (i.e., tier 1 capital ratio)? And what is it?

Please specify:

C2.1 - What is the actual regulatory capital ratio in the CGS?

Please specify:

C2.2 - Is the actual regulatory capital ratio in line with Basel II (or Basel III when applicable) requirements?

▬	Yes
▬	No

C3 - Are accounting practices in line with International Financial Reporting Standards (IFRS)?

▬	Yes
▬	No

C3.1 - If no, does the CGS plan to align on IFRS in the future?

4. PART D – FINANCIAL SITUATION

D1 - Does the CGS benefit from a periodic contribution from the government?

▬	Yes
▬	No

D1.1 - If yes, please specify amount of contribution and periodicity:

Amount of allocation	
Periodicity	

D1.2 - If yes, is the CGS liable to make repayments on these amounts?

▬	Yes
▬	No

D2 - Does the CGS benefit from periodic or occasional capital contributions from international institutions?

▬	Yes
▬	No

D2.1 - If yes, please describe briefly the terms of these capital contribution(s):

Please briefly describe:

D3 - Please provide figures for the following balance sheet and income statement items for the years 2017, 2018, 2019:

	2017 2018 2019
ASSETS	
D3.1 - Cash and central bank reserves	
D3.2 - Financial assets held to maturity through guarantees	
D3.3 - Other receivables due from financial institutions	
D3.3 - Other receivables due from other customers	
D3.4 - Total assets	

LIABILITIES	
D3.5 - Public guarantee fund	
D3.6 - Due to financial institutions	
D3.7 - Due to other customers	
D3.8 - Provisions for contingencies on guarantees	
D3.9 - Total liabilities excl. equity	
EQUITY	
D3.10 - Capital (i.e., own funds)	
D3.11 - Profits (i.e., retained earnings)	
D3.11 - Equity reserves (i.e., legal and supplementary)	
D3.12 - Total equity	
Off balance sheet funds	
INCOME & EXPENSES	
D3.13 - Commissions on issued guarantees	
D3.14 - Other commissions	
D3.15 - Total revenues	
D3.16 - Personnel expenses	
D3.17 - Total expenses	
D3.18 - Net profits before taxes	
D3.19 - Net profits after taxes	

D4 - Is the CGS subject to a different taxation regime than other financial institutions?

▬	Yes
▬	No

D5 - Does the CGS apply a lower fee percentage to support certain development goals / foster economic policies (e.g. health care, agriculture, promote loans to women or minority populations,..)?

▬	Yes
▬	No

D6 - Does success in the repayment of loans lower the price of future guarantees?

▬	Yes
▬	No

D7 - Does CGS apply flat or variable guarantee fee %?

▬	Yes
▬	No

D8 - Does the guarantee fee percentage depend on:

▬	Risk Weight	▬	Loan Maturity
▬	Credit Purpose	▬	Size of Loan

5. PART E – RISK MANAGEMENT

E1 - Does the CGS use counter guarantees?

—	Yes
—	No

E1.1 - If yes, is it a:

—	Local counter guarantee
—	External counter guarantee

E1.2 - If yes, what is the scope of the counter guarantees? For example, are they applicable for a specific class of guarantees (i.e., size or sector of recipient); or are they applicable broadly for any guarantee issued?

Please specify details:

E1.3 - If no, are there plans to use counter guarantees in the next future?

—	Yes. Please specify year envisaged for introduction:
—	No

E2 - Does the CGS use insurances against losses incurred by guarantees?

—	Yes
—	No

E2.1 - If yes, does the CGS ensure itself against losses arising from:

—	Any guaranteed loan
—	A class of loans (please specify):

▬	Other risks (please specify):

E2.2 - If yes, please provide figures for:

Amount ensured in latest year:	
Insurance expense in latest year:	

E3 - Are guarantees eligible as a Basel II (or Basel III when applicable) as a risk mitigation instrument with applicable weight affecting bank's provisions and minimum capital requirements against the guaranteed part?

▬	Yes
▬	No

E4 - Does the CGS have credit risk appetite and credit risk tolerance framework?

▬	Yes
▬	No

E5 - Does the CGS have a scoring system?

▬	Yes
▬	No

E5.1 - If yes, is it:

▬	Internally developed
▬	Externally acquired

E6 - Does the CGS comply with IFRS9?

▬	Yes
▬	No

E6.1 - If no, is there an intention to do this?

▬	Yes

▬	No

6. PART F – EVALUATION

F1 - Irrespectively from the publication of annual reports, does the CGS conduct evaluations of its programmes?

▬	Yes
▬	No

F1.1 - If yes, when was the last evaluation conducted?

Please specify:

F1.2 - If no, does the CGS plan to introduce evaluations?

▬	Yes
▬	No

Annexe 2. Southern Mediterranean CGS summary tables

1. GENERAL INFORMATION

CGS	Country	Objectives	Publish periodic reports	Rated by an external agency	Bodies/agencies that supervise the CGS	Minimum regulatory capital ratio applicable to the CGS	Is the CGS subject to a different taxation regime than other financial institutions
Jordan Loan Guarantee Corporation - Jordan	Jordan	Provide the necessary guarantees to facilitate SMEs access to finance to enhance human and economic development and increase employment	Yes	No	Companies Control Department Amman Stock Exchange Jordan Securities Commission	Yes, Tier (1): >=15% Tier (2): > =20%	No
Caisse de Garantie des Crédits d'Investissements PME - Algeria	Algeria	Facilitate bank financing decision-making in favour of SMEs Improve the financing ratio of banks Allow holders of good projects who lack conventional guarantees to be financed	Yes	No	-	Yes, Net shareholders' equity / sum of commitments greater than or equal to 8.33%	No
Egypt Loan Guarantee Facility - Egypt	Egypt	Development of the SMEs Sector	Yes	Yes	HQ	No	No
Caisse Centrale de Garantie - Morocco	Morocco	Play a major role in improving access to financing for SMEs Support seed funding and innovation Improve individuals' access to financing Optimise management resources	Yes	No	The Central Bank and the Ministry of Finance	Yes, Basel 2	No
Credit Guarantee Corporation - Egypt	Egypt	Enabling MSMEs' growth by supporting FIs through attractive guarantee products	Yes	Yes	Ministry of Investment / Central Bank of Egypt / Funding Agencies	No	No
SOTUGAR - Tunisia	Tunisia	Facilitate MSMEs' access to finance	No	No	The Court of Auditors / General Financial Control / General	No	Yes

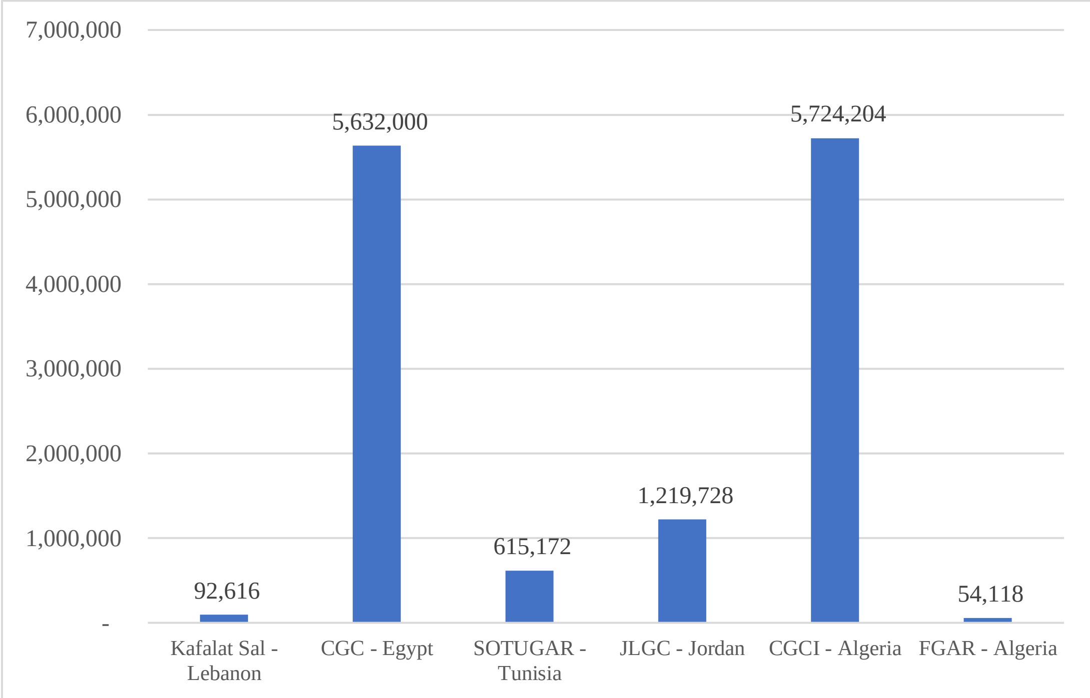
					Control of Public Services		
Kafalat Sal -Lebanon	Lebanon	To assist SMEs in accessing commercial bank funding	Yes	No	Banking Control Commission	No	No
Fonds de Garantie des Crédits aux PME - Algeria	Algeria	Facilitate SMEs' access to finance and provide other types of support including technical assistance to enhance the development of the sector	Yes	Yes	Ministry of Energy and Mines	No	Yes

2. CGS AND DEVELOPMENT ASSISTANCE PROGRAMMES

CGS	Development assistance
Jordan Loan Guarantee Corporation – Jordan	The Central Bank Initiatives
Caisse de Garantie des Crédits d'Investissements PME - Algeria	
Egypt Loan Guarantee Facility - Egypt	Development Financial Corporation (DFC)
Caisse Centrale de Garantie - Morocco	
Credit Guarantee Corporation - Egypt	Trust funds to be leveraged and generate guarantees

SOTUGAR - Tunisia	The first fund was set up with the technical and financial support of the European Union. A second energy efficiency fund has been set up with financial support from the World Bank. The French Development Agency and the Intergovernmental Organisation of La Francophonie also participate in certain funds.
Kafalat Sal -Lebanon	
Fonds de Garantie des Crédits aux PME - Algeria	Staffing of guardianship

3. CGS PROFITABILITY (NET PROFITS BEFORE TAX, 2018)



ABOUT EMEA

The Euro-Mediterranean Economists Association (EMEA) is a Barcelona-based regional think-tank established in 2012 that serves as a leading independent and innovative policy research institution; a forum for debate on the political and socio-economic reforms in Mediterranean and Africa; and promoter of actions and initiatives that fulfill objectives of sustainability, inclusiveness, regional integration and prosperity. It strives to contribute to the rethinking of the Euro-Mediterranean and Africa partnerships in view of the new dynamics of an emerging multi-polar world and amidst of protracted crises. EMEA has a large network of economists, high-level experts and institutional partners (research institutes, think tanks and universities) in the Euro-Mediterranean and Africa. EMEA builds on the collaborative research network MEDPRO (funded by the EU's Seventh Framework Programme (2009-13) and provides forward-looking thinking and political and socio-economic integrated analyses on the Euro-Mediterranean region. EMEA is also the promoter and co-funder of the Euro-Mediterranean Network for Economic Studies (EMNES), co-funded by the European Commission (DG NEAR) between 2015 and 2019. EMNES is a regional network composed of 30 institutions and more than 100 experts and researchers in the Mediterranean region. From January 2020, EMEA coordinates EMNES.

The Euro-Mediterranean Network for Economic Studies (EMNES) aims to provide a renewed vision for socio-economic development in the Mediterranean region, mainly focussing on employment creation, social inclusion, sustainable development and regional integration. It performs economic and policy research, exploring the pillars of inclusive and sustainable economic models in the Euro-Mediterranean region. EMNES is a network of research institutions and think tanks from Algeria, Belgium, Egypt, France, Germany, Greece, Italy, Jordan, Morocco, Slovenia, Spain, Tunisia, Turkey and the UK. Between 2014-2019, EMNES was co-funded by the European Commission – under Grant Contract N° ENPI/2014/354-488 and EMNES Partners and Associates. EMNES is built on four core principles: independence, excellence, policy relevance and a deep knowledge of Euro-Mediterranean affairs.

EMEA co-promotes the Euro-Mediterranean Guarantee Network (EMGN) , which a network of credit guarantee schemes from the Euro-Mediterranean launched in 2012. EMGN aims to promote access to finance to entrepreneurs and to Micro-Small and Medium-sized entreprises in the region. EMGN is co-promoted with the European Institute of the Mediterranean (IEMED) , with the support of Deutsche Gesellschaft fur Internationale Zusammenarbeit (GIZ).

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