VI. The global crisis: A wake-up call for trade finance capacity-building in emerging Asia

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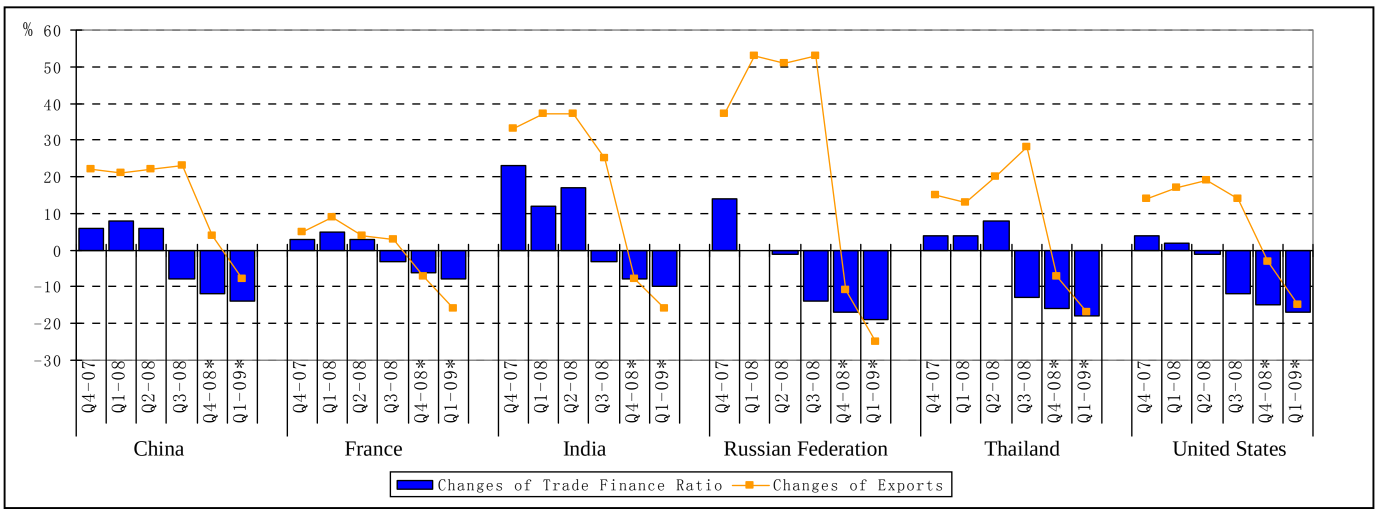
Introduction

The global economic crisis has attracted renewed attention to the issue of trade finance as exporters in some countries, particularly SMEs, struggle to secure much-needed short-term financing and protection against rising commercial risks at a time when demand for their products has fallen dramatically (figure 1). The higher costs and limited availability of trade finance has prompted action by international financial institutions, as the threat it poses to regional economies is significant. A recent empirical analysis (Liu and Duval, 2009) indeed suggested that a 10 per cent decline in trade finance could lead to a drop in total trade of US$ 129 billion in developing Asia, representing 3.6 per cent of their total trade.

Figure 1. Sharp drop in trade finance
(Change in the ratio of insured export credit to export)[a]



Source: Liu and Duval, 2009, based on Joint BIS-IMF-OECD-World Bank Statistics on External Debt and CEIC database.

[a] The ratio is calculated as Berne Union members' direct insurance or lending in a country to total export value of that country. The "Change" refers to percentage change from same quarter of previous year.

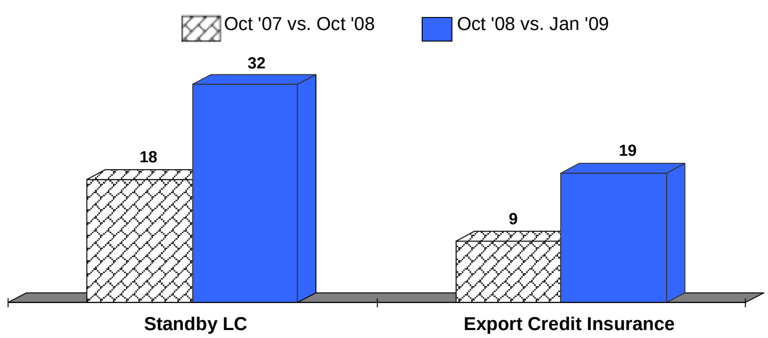
* The ratios of insured export credit for Q4-08 and Q1-09 are estimated based on an adjusted trend of the last two quarters for which data are available.

This paper describes the effect of the global crisis on trade finance cost and access in Asia as well as some of the measures taken at the national, regional and global levels to ensure that trade finance did not further compound the problems associated with reduced demand in developed country markets. It then highlights the lack of trade finance-related institutions in many of the less developed countries of Asia, and introduces options for regional cooperation to reduce the trade finance capacity gap between countries of the region.

A. Crisis has reduced access to trade finance

Reliable and comprehensive information on trade finance is scarce, but various surveys of financial institutions or exporters conducted at the national, global and regional levels in late 2008 and during the first half of 2009 have confirmed that there has been an increase in the price of letters of credit – a trade finance instrument whereby the bank of the importer guarantees payment to the exporter or its bank upon satisfactory delivery of a shipment – and export credit insurance (figure 2). Banks surveyed expected little improvement during 2009.

Figure 2. Rising cost of trade finance
(Average basis point increase over costs)



Source: IMF-BAFT, Trade Finance Survey (March 2009).[1]

Countries with high risk ratings have suffered the most from the drying up of trade finance, as financial institutions have looked for quick ways to reduce the overall risk of their trade finance portfolios by reducing coverage of transactions considered as high risk. Since “country risk” is the basis for setting minimum premium rates for transactions covered by many export credit agencies, a country’s sovereign default risk directly affects an individual exporter’s ability to get trade financing. Least developed countries such as Afghanistan, Lao People’s Democratic Republic, Myanmar and Nepal are classified in the highest country risk category.[2] Transactions with those countries have traditionally been associated with higher risk premiums, and the recent global crisis has made this worse.

[1] Results based on responses from 44 banks in 23 countries. Accessed 24 July 2009 at http://baft.org/content_folders/Issues/IMFBAFTSurveyResults20090331.ppt.
[2] Organization for Economic Co-operation and Development, www.oecd.org/dataoecd, accessed on 25 March 2009.

Some countries in the region have attributed the more difficult access and higher cost of trade finance to a general liquidity shortage in their economy, but many have pointed to the increased risk aversion of financial institutions towards enterprises and to the higher perceived counterparty risk of banks as key factors (Asia Pacific Economic Cooperation, 2009). Strong interventions by central banks have markedly improved the situation in many economies; however, a general lack of information about trade finance has contributed to uncertainties about the solvency of counterparties in foreign markets and increased the perceived risk of trade finance products relative to other products.

Increased capital requirements have also become more important factors in the rising cost of trade finance[3] and there is a clear possibility that national authorities will impose even tighter controls on banks' international operations (Koeppen, 2009). Indeed, cross-border financial flows have declined for the first time in 30 years. The International Chamber of Commerce has pointed to the implementation of the Basel II charter[4] as having particularly adverse consequences for trade lending to SMEs and counterparties in developing economies (International Chamber of Commerce, 2009). A review of these regulations may therefore be needed to ensure that they do not unduly constrain the provision of trade finance, particularly to the less developed countries of the region.

B. Many trade finance facilitation measures taken

Serious concerns that constraints on the supply of trade finance as an essential trade enabler would further reduce the capacity of enterprises to trade prompted international financial institutions and the G20 to take a number of trade finance facilitation measures in the last quarter of 2008 and the first quarter of 2009. At the global level, the G20 committed to ensuring availability of at least US$ 250 billion over the following two years to support trade finance through their export credit and investment agencies and trade finance schemes of international financial institutions, including the International Finance Corporation Global Trade Liquidity Pool.[5]

At the regional level, the Asian Development Bank has agreed to a significant expansion of its trade finance programme, which is expected to generate up to US$15 billion in support until 2013 to help counter an export slump that has been exacerbated by the lending difficulties of commercial banks. At the national level, many countries have also implemented new or enhanced trade finance schemes in response to the crisis, most often focusing on providing export credit insurance and guarantees to help enterprises and banks to manage their risks (figure 3). These global, regional and national initiatives will certainly contribute to increased availability of trade finance in the near term, and it

[3] See IMF-BAFT Survey results (reasons for increased pricing of trade finance).
[4] Basel II is a set of banking regulations put forth by the Basel Committee on Bank Supervision, which regulates finance and banking internationally.
[5] The new International Finance Corporation Global Trade Liquidity Pool that should provide up to US$ 50 billion in trade liquidity support over the next three years, with significant co-financing from the private sector (as part of the global effort to ensure the availability of at least US$ 250 billion of trade finance over the next two years).

is heartening to see how quickly they have been agreed upon and implemented across the region.

Figure 3. New or enhanced trade finance facilitation measures implemented in the Asia-Pacific region*

Source: Survey by the Asia Pacific Economic Cooperation Senior Officials' Meeting, Chair's Office (17 July 2009, Singapore).
* This figure indicates the number of Asia Pacific Economic Cooperation member economies that have taken different types of measures in response to the trade financing problem. Schemes under "Others" included equity financing, bonding and surety, SME funding schemes, rediscount of trade bills, less conservative capital adequacy ratio, documentary credit guarantees, trade finance advisory service, multi-currency trade finance, indirect exporter finance scheme, SME assistance guarantee scheme and industry restructuring guarantee fund scheme.

C. Less developed countries have limited trade finance capacity

However, many of the smaller and less developed countries in the region have very limited capacity to address trade finance shortages on their own, and may not fully benefit from global and regional schemes as they lack the required national trade finance institutions and infrastructure. Government-backed export credit insurance and guarantee institutions and/or export-import (EXIM) banks are still inefficient or missing in many developing countries of the region (Auboin and Meier-Ewert, 2003).[6] These institutions can be particularly useful in times of crisis when financial markets may not be functioning efficiently and worthy borrowers are finding it difficult to secure financing

[6] Cambodia is planning to conduct a feasibility study for establishment of and export-import bank in 2009 (McLeod, 2009).

and insurance from commercial institutions. Similarly, they can play an important role in facilitating South-South trade (box 1).

Box 1. Role of national export-import banks: The case of EXIM Thailand

The success of Thailand's economic development efforts during the second half of the 1980s prompted many economists to believe that Thailand could extend this success by adopting an export-led growth strategy that would provide SMEs with an opportunity to participate in international trade. To support this strategy, Thailand consolidated and/or created a number of institutions specializing in foreign trade, among them the Export-Import Bank of Thailand (EXIMT).

EXIMT was established in 1993 as a 100 per cent government-owned corporation to provide financial services to support imports, exports and foreign investment beneficial to the Thai economy. Its start-up capital of Baht 2.5 trillion (US$ 100 million) came from the Bank of Thailand (BoT) and the Ministry of Finance, and its Board of Directors comprised high-level representatives from all the trade-related ministries as well as private sector representatives.

The Bank was mandated and authorized to provide a wide array of financial services, ranging from export refinancing to export credit insurance. Packing Credit Facilities (subsidized pre-shipment and post-shipment financing facilities provided to exporters mostly through commercial banks) previously provided by BoT were transferred to the newly-formed EXIMT, which complemented this facility with a standard pre-shipment (unsubsidized) facility directed at small and new exporters. EXIMT subsequently discontinued its subsidized packing credit facility in order to comply with World Trade Organization rules as well as because the facility had become unnecessary due to the high level of market liquidity and falling interest rates.

An Amendment to the Export-Import Bank of Thailand Act promulgated in 1993 further broadened the mandate of EXIMT to allow it to support export-related domestic investment. As a result, the Bank added to its product portfolio a credit facility for business expansion. EXIMT's number of products and services has increased over time and become more sector-specific with a focus on SMEs. Foreign investment advisory services as well as export advisory services began to be offered in 1999. In recent years, the Bank has developed an SME Financial Service Centre offering streamlined products and services and a faster response time.

The current global crisis has prompted the Bank to further emphasize its development banking role, providing entrepreneurs with complete business solutions, ranging from loans and export credit insurance to financial advisory services, with a special focus on three sectors: (a) logistics services; (b) the energy sector, especially alternative and biomass energy sources and technology; and (c) infrastructure and public utilities.

As of February 2009, EXIMT was expected to receive a capital injection of Baht 5 billion from the Ministry of Finance for use in providing additional export credit insurance facilities to struggling Thai exporters. Its Buyer/Bank Risk Assessment Service also became particularly popular, as exporters were increasingly concerned of the possibility of defaults. The Bank also adopted a more pro-active role in regional and South-South trade facilitation and promotion, opening a branch in Moscow and planning to establish specialized country and industry focus desk units in Cambodia, India, Indonesia, the Lao People's Democratic Republic and Viet Nam.

After more than 15 years of operation, including during the Asian financial crisis of

1997/98, a review of EXIMT's experience indicates that:

(a) An EXIM bank can be effective in stimulating the development of trade finance, by introducing new products and services (such as export credit insurance) and by disseminating relevant information to potential exporters. Once an EXIM bank has good experience in evaluating SMEs export potential, the bank may use this experience to offer longer-term credits supporting business expansion;

(b) An EXIM bank's credit rating will typically have sovereign credit rating, because it is backed by the government. Such a rating may make it easier for the bank to access international credit markets as compared with domestic banks;

(c) An EXIM bank should focus on complementing the services offered by commercial banks, and provide credit to small and new exporters, including SMEs with export potential. It should also provide additional credit lines to large exporters who are unable to obtain the full credit they require from commercial banks;

(d) An EXIM bank can help regulate the cost of trade finance services offered by commercial banks, especially when there are few commercial banks offering international banking services;

(e) An EXIM bank, while not expected to finance a large share of exports and foreign investment under normal circumstances, can be an effective source of backup financing during major financial crises (EXIMT's activities doubled during the Asian crisis); and

(f) An EXIM bank should be managed as a self-sustaining organization, with no subsidies of interest rates, but with a modern and creative risk assessment and management programme to support small and new enterprises with export potential. Offering a wide array of products and services makes it easier for the bank to market its services, satisfy the needs of its clients and be profitable.

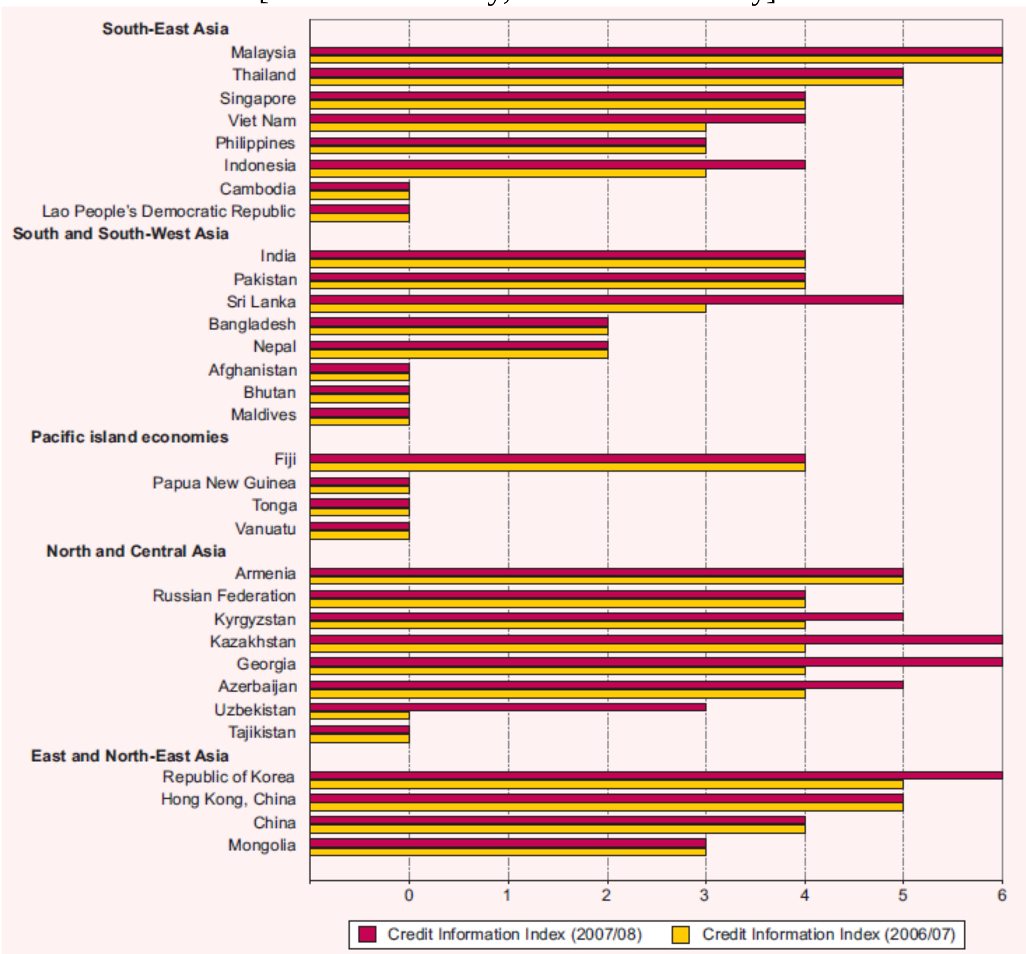
Sources: www.exim.go.th; ESCAP, *Current Issues on Industry, Trade and Investment*, No. 2 (United Nations publication, Sales No. E.04.II.F.6, ST/ESCAP/2298), 2003; and interviews with EXIMT officials (April 2009).

Credit rating institutions are also weak or absent in many developing countries in the region, and the current crisis has shown how important these institutions are in ensuring the proper functioning of financial markets. One recent study estimated that improving the quality and availability of credit information in China and India to the average level achieved in Organization for Economic Co-operation and Development (OECD) could ultimately increase their exports by 7 per cent or more (Duval and Utoktham, 2009). Reliable information on importers' or exporters' creditworthiness is indeed essential for trade finance providers to accurately assess the risk associated with a given transaction and offer affordable trade finance products.

Unfortunately, as shown in figure 4, serious deficiencies in credit information are apparent in most of the least developed countries, regardless of the subregion. Interestingly, North and Central Asian countries, with the exception of Tajikistan and Uzbekistan, appear to be relatively well equipped in this area, and credit information in that subregion improved significantly between 2006 and 2008.

Figure 4. Availability and quality of credit information in selected Asian and Pacific economies

[0 = no availability; 6 = full availability]



Source: ESCAP based on Doing Business Data (www.doingbusiness.org).

Note: The credit information index measures the scope, accessibility and quality of credit information through either public or private bureaus in a country. The index ranges from 0 to 6, with a higher value indicating that more credit information is available to facilitate lending decisions.

Establishing or strengthening national trade finance institutions should be given serious consideration, as the absence or ineffectiveness of such institutions puts traders at a relative disadvantage, particularly in times of crisis. The focus may be placed on establishing government-backed but self-sustainable organizations that offer particular risk assessment and management programmes to support and build the capacity of SMEs with export potential in this area. In addition, governments may focus on strengthening the quality and availability of credit information by supporting the development of domestic credit rating services.

In the long term, as the bulk of trade finance is provided by commercial banks operating in the domestic market – often as part of short-term, multi-purpose loans (non-trade specific working capital) – a strong, credible and well-developed banking and insurance sector is the key to ensuring access to a full array of trade finance instruments.

Good and stable macroeconomic fundamentals, prudential regulations and a pragmatic approach to financial sector liberalization will be essential in achieving this goal. This is certainly a tall order in many developing countries – and one that goes beyond the responsibilities of ministries in charge of trade – but empirical studies have repeatedly confirmed the significant effect of financial sector regulations and development on trade. In addition, many of the trade finance facilitation schemes launched by regional and global development banks rely on domestic financial institutions to channel the funds to traders and SMEs, making it important to build the capacity of these institutions to perform this function efficiently.

D. A role for trade finance cooperation

Given the large gap in the availability of trade finance services between countries of the region, deepening cross-border cooperation on trade finance and pooling resources and expertise in this area may be an effective way to tackle bottlenecks in trade financing. Options include: (a*)* strengthening cooperation and networking among and between export-import banks and Development Finance Institutions; (b) expanding multilateral clearing arrangements and related international payment services – possibly based on those offered by the Asian Clearing Union;[7] (3) reviewing the effectiveness and possibly further strengthening the Asian Development Bank trade finance facilitation programme; and (d) establishing a multilateral export credit insurance company and/or a new regional capital market fund for South-South trade and investment finance.

Developing cooperation among banks and governments on the collection and sharing of credit information could also be explored as it would allow for more accurate cross-border transaction risk assessment and, ultimately, lower trade finance costs. Countries with established trade finance expertise and institutions may initially support the establishment of regional communities of practice on trade finance and credit rating, which would facilitate the transfer of expertise to countries in need of developing or upgrading their national trade finance infrastructure.

E. Conclusion

Trade finance is an essential enabler of international trade and requires the continuous attention of trade policy makers. There is a clear dearth of information and reliable analysis in this area and many questions remain unanswered:

(a) Which models of export credit insurance and guarantee organizations are most appropriate for developing countries of the region?

(b) How are SMEs financing their imports and exports, and what are their needs and priorities in this area?

[7] The Asian Clearing Union is the simplest form of payment arrangements whereby the members settle payments for intraregional transactions among the participating central banks on a multilateral basis. The main objectives of a clearing union are to facilitate payments among member countries for eligible transactions, thereby economizing on the use of foreign exchange reserves and transfer costs as well as promoting trade among the participating countries. See www.asianclearingunion.org/.

(c) What are country and regional needs in trade finance statistics? Is there scope for establishing a trade finance monitoring system?

(d) What kind of regional trade finance cooperation mechanisms would be most effective in improving trade finance capacity in less developed countries of the region?

Research institutions in developing countries of Asia and the Pacific, in consultation with trade policy makers, may assist in filling the existing trade finance knowledge gap. Consideration should be given to the establishment of a regional trade finance database to facilitate information exchange and share experiences, as this could support the development of more relevant and effective capacity-building programmes on trade finance in the region.

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