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RESTORING TRADE FINANCE DURING A PERIOD OF FINANCIAL CRISIS: STOCK-TAKING OF RECENT INITIATIVES

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RESTORING TRADE FINANCE IN PERIODS OF FINANCIAL CRISIS: STOCK-TAKING OF RECENT INITIATIVES

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<u>Abstract</u>

The paper discusses the efforts deployed in 2008 and 2009 by various players, Governments, multilateral financial institutions, regional development banks, export credit agencies, to mobilize sufficient flows of trade finance to off-set some of the "pull-back" by commercial institutions in the period of acute crisis that has characterized the financial sector in the past two years. Given that 80 to 90% of trade transactions involve some form of credit, insurance or guarantee, one can reasonably say that supply-side driven shortages of trade finance have a potential to inflict further damages to international trade. As an institution geared towards the balanced expansion of world trade, the WTO had been concerned with occurrences of market tightening throughout this period.

While a number of public-institutions mobilized financial resources for trade finance in the fall of 2008, this has not been enough to bridge the gap between supply and demand of trade finance worldwide. As the market situation continued to deteriorate in the first quarter of 2009, G-20 leaders in London (April 2009) adopted a wider package for injecting additional liquidity and bringing public guarantees in support of $250 billion of trade transactions in 2009 and 2010. Ahead of the Pittsburgh Meetings, experts reported that more than the targeted amount had been mobilized. In the meantime, through the summer and the fall of 2009, the market situation seemed to have eased – although in many countries, access to trade finance by the smaller traders had become either significantly more expensive or had simply disappeared. One can expect the trade finance market to have its up and downs for some time, because lending for trade is a function of the general lending situation of commercial banks. The paper discusses longer-term initiatives aimed at improving the resilience of the trade finance market to short-term and longer-term shocks.

Keywords: Trade financing, cooperation with international financial institutions, coherence, G-20, financial crisis.
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Introduction

The paper discusses the efforts deployed in 2008 and 2009 by various players, Governments, multilateral financial institutions, regional development banks, export credit agencies, to mobilize sufficient flows of trade finance to off-set some of the "pull-back" by commercial institutions in the period of acute crisis that has characterized the financial sector in the past two years. Given that 80 to 90% of trade transactions involve some form of credit, insurance or guarantee, one can reasonably say that supply-side driven shortages of trade finance have a potential to inflict further damages to international trade. As an institution geared towards the balanced expansion of world trade, the WTO had been concerned with occurrences of market tightening throughout this period.

While a number of public-institutions mobilized financial resources for trade finance in the fall of 2008, this has not been enough to bridge the gap between supply and demand of trade finance worldwide. As the market situation continued to deteriorate in the first quarter of 2009, G-20 leaders in London (April 2009) adopted a wider package for injecting additional liquidity and bringing public guarantees in support of $250 billion of trade transactions in 2009 and 2010. A G-20 group of expert was commissioned to ensure that between the London and Pittsburgh Summit, this political commitment be turned into additional financial capacity. Ahead of the Pittsburgh Meetings, experts reported that more than the targeted amount had been mobilized. In the meantime, through the summer and the fall of 2009, the market situation seemed to have eased – although in many countries, access to trade finance by the smaller traders had become either significantly more expensive or had simply disappeared.

One can expect the trade finance market to have its up and downs for some time, because lending for trade is a function of the general lending situation of commercial banks. With the cleansing of international banks roughly half-way-through, as indicated in the IMF's 2009 Global Financial Stability Report, and prudential regulation to be made tighter and less cyclical, the trend in banks, for the time being, tends to be towards capital building/saving, and lending less. While credit insurance is indeed attractive to banks at this particular juncture, it is not necessarily affordable by all en-customers (traders). In short, so long as credit crunch conditions will prevail, banks are unlikely to invest easily in relatively low-remunerative activities, at least they will do so in a more selective manner than previously – which means more stringent credit standards and higher costs for risk.

Section 1 looks at the determinants of the shortages of trade finance and market developments during 2008 and 2009. It argues that the network of trade finance experts established in the aftermath of the Asian financial crisis, and maintained afterwards, has been revived and was extremely useful in understanding what was happening in real time. Section 2 discusses the efforts of public authorities and institutions to develop risk-mitigating instruments and provide liquidity, based on the lessons learned during earlier crises, and the analysis made with trade finance experts. These efforts eventually led to the G-20 Leading deciding on a specific package to support short-term trade finance over a period of two years. The section also summarizes the academic discussion on the trade finance "channel" in explaining the big trade collapse of end-2008 and the beginning of 2009, with outcomes close to those reflected in market surveys undertaken at the time. Section 3 discusses longer-term initiatives aimed at improving the resilience of the trade finance market to sudden deteriorations, including steps taken at the official level to strengthen the developing countries' capacity to handle trade finance instruments under the umbrella of Aid-for-Trade, as well as other measures currently being developed to ensure a more favourable regulatory environment for trade finance under the Basle II framework. Also, efforts aimed at establishing a solid trade finance database are being undertaken by international economic agencies.

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A. Background and lessons learned from earlier crises

1. WTO's involvement in trade finance as an institution

Since 80 to 90% of trade transactions involve some form of credit, insurance or guarantee, trade finance is often pictured as the lifeblood of trade. Producers and traders in both developed and developing need to have access to affordable flows of trade financing and insurance to be able to import and export, and hence integrate in world trade. From that perspective, an efficient financial system, which properly allocates deposits and savings towards efficient uses – including safe and highly collateralized lending such as trade finance, is a key condition to allow trade to happen.

The WTO has been following actively, and at times, directly supporting, initiatives to boost the availability of trade finance in developing and least-developed countries. Since the WTO is not a financial institution, it has been supporting in the past few years partners engaged in this effort such as international financial institutions, export credit agencies, large commercial banks, and regional development banks.

Initially, the WTO has been asked by its members at several points in recent years to examine the issue of availability of trade financing – as a key infrastructure needed by developing and least-developed countries to integrate in world trade. Paragraph 36 of the Ministerial Declaration of Doha requested WTO Members to examine, and if necessary come up with recommendations, on measures that the WTO could take, within its remit, to minimize the consequences of financial instabilities on their trade opportunities. In the context of the newly created Working Group on Trade, Debt and Finance (WGTDF), the interruptions of the flows of trade finance in emerging markets during the 1997-99 Asian and Latin American financial crises were quickly identified as concerns by WTO Members, as well as the chronic difficulties of low income Members to secure more affordable flows of trade financing in the long-run. These concerns were channelled to the WTO Ministerial Conferences in Cancun (2003), Hong-Kong (2005).[2]

During this period of examination, the Heads of the IMF, World Bank and the WTO agreed at the General Council Meeting on Coherence of 2002 to form an expert group including all interested parties, multilateral and regional public institutions, export credit agencies, private banks to examine what went wrong in this segment of financial markets, and how to create an enabling environment in local markets to provide adequate flows of trade finance on a on-going basis.

In chairing one of these meetings, the Director-General of the WTO defined the role of the WTO in this area: encouraging liberalization of this type of financial services under the financial services agreement, being a regulator of export credit and guarantee subsidies under the ASCM, and serving as a forum to discuss WTO-compatible ways of providing support to developing countries. Conclusions by the Working Group were presented at the WGTDF, and later at the General Council.[3] WTO Secretariat work on this topic up to 2003, in particular its contribution to the WGTDF and to the expert group, was summarized in WTO Discussion Paper 2 (2003) and in WTO Working Paper ERSD-2007-04.

While the liquidity became more abundant in financial markets as of 2002 and until the recent turmoil created by the crisis of the sub-prime mortgage markets, trade finance remained an issue for concern for WTO Members, in particular the poorest, which is for many of them the only inflow of private capital in their balance-of-payments. It also remained an issue for emerging economies which are sensitive to changes in market sentiment, and hence credit rating. Despite the rapid development

[2] WTO Documents WT/WGTDF/3 and 5.
[3] WTO Documents WT/WDTDF/W/22 and 23, and WT/GC/W/527.

of "trade finance facilitation" schemes run by regional development banks and the IFC, with immediate success in low income countries, the issue of availability of trade finance came back among other "supply-side" constraints identified by the Aid-for-Trade Task Force, after the WTO Ministerial Meeting in Hong-Kong.[4] While the mandate of the WTO under the Aid-for-Trade is essentially one of evaluation and monitoring, it may be in cases one of advocacy. Based on the work being carried out since 2002, and after consultation with partners (regional development banks, multilateral institutions, export credit institutions,...), input by the WTO Secretariat to boost the availability of trade finance for developing countries under the Aid-for-Trade umbrella was welcomed by Members.[5] Lack of trade financing and guarantee infrastructures were identified as one of the barriers to integration of low income countries in world trade by each of the three regional Aid-for-Trade Reviews.[6] It was acknowledged that the current Aid-for-Trade Initiative could provide the extra leverage to convince WTO partners to deliver more plentiful of trade credit and guarantees to WTO members that need it the most.

Since the beginning of the crisis of the international financial system in 2007, Members have used the WGTDF to channel their concerns about the deterioration of the conditions of access to trade financing from foreign banks, not only in developing countries, but also in mature economies, which had also been hit by the scarcity and higher cost of trade finance, to a point where supply seemed to have fallen far short of demand. The Secretariat debriefed the Group on the initiative of the Director-General to reconvene the Expert Group on Trade Finance (“the Expert Group”) as early as 25 April 2008.[7] As the financial crisis spread internationally, the Working Group had an opportunity to discuss further elements linked to the lack of trade financing throughout 2008, and feed the General Council with information and orientation, which allowed the Executive Body to meet in an informal mode on November 12, 2008, to launch a clear warning that the shortages observed in trade finance markets around the world had the potential to precipitate the fall in world trade that was taking place in parallel. On the same day, the Director-General held a press conference to call on the international community to mobilize the necessary resources, instruments, and institutions, including public institutions, to meet some of the growing market gaps.

In the course of 2009, it became evident that the Working Group was the focal point in the WTO for the examination and the follow-up of initiatives taken in support of trade finance. Members supported the focus of the Working Group’s activities, which were generally seen as having contributed both to awareness-building in the institution and to support for the Director-General's initiatives.[8] At the Working Group’s meeting on 31 March 2009, the Secretariat reported in WTO Document WT/WGTDF/W/44 on a number of elements gathered at the preparatory meeting of G-20 experts on trade finance, held in Washington, D.C. on 25 March 2009. These elements were being considered as the basis of a trade finance package to be adopted by the Heads of State and Government at the G-20 Summit in London on 2 April 2009. A Secretariat paper was issued just

[4] WTO Document WT/AFT/1, page 2.

[5] WTO Document WT/COMTD/AFT/W/1.

[6] In their common report (Mobilizing Aid-for-Trade: Focus Latin America and the Caribbean, November 2007), the WTO and Inter-American Development Bank identified trade finance as one of the four key priorities to be addressed in an effective aid-for-trade program for the region ("expanding the scope of initiatives on trade finance was identified as a priority for the region", p.7.). A similar conclusion was drawn during the Asia-Pacific review, which identified trade finance as one of the 4 cross-cutting priorities for the development of trade (Asian Development Bank and WTO, Mobilizing Aid-for-Trade, Focus Asia and the Pacific, Report and Recommendations, November 2007, p.7); likewise for Africa, as the common report by the African Development Bank, the United Nations' Economic Commission for Africa and the WTO emphasized that "particularly critical was the availability of efficient and competitive private-service suppliers in areas ranging from trade finance and risk insurance to trucking and warehousing." (African Development Bank, Economic Commission for Africa, WTO, Mobilizing Aid-for-Trade, Focusing Africa, November 2007, p.7).

[7] WTO Document WT/WTGTDF/W/38.

[8] WTO Document WT/WGTDF/M/18, p. 4.

ahead of the G-20 Summit to shape up what a support package could look like.[9] In parallel, the Working Group had been instrumental in opening the discussion over the prudential treatment of trade finance, which some WTO Members found discriminatory relative to other (more risky) forms of lending. Brazil provided a written submission to this respect (WT/WGTDF/W/39). The Chairman of the Working Group invited the Deputy-Secretary General of the Basel Committee on Banking Supervision to look at various issues related to that treatment, in particular the issue of cyclicality and maturities, which dominated the discussion. This dialogue between WTO Members and a representative of the Basel Committee was the beginning of a dialogue that has subsequently reached the G-20 and the Committee of Governors of the Bank of International Settlement for review.

While the Working Group had made some headways into some of the key constraints to trade finance, it has been well understood by the Working Group, as concluded several times by the Chairman, that some of the issues raised in the context of trade finance could not be solved by the WTO, nor would they be even within the remit of the institution.[10] But within its existing mandate the Working Group could continue to consider the issues of contagion, availability of trade finance, etc. in terms of their potential impact on the real economy and the global trading system.

Taking stock of the work undertaken in the context of the Working Group in the past two years in particular, WTO Members reported to the institution's executive body (the General Council) ahead of the 7th Ministerial Conference that since the Hong Kong's Ministerial Conference, work on trade finance at the WTO has proceeded along two paths:

(a) long-term efforts to boost trade finance for developing countries through better infrastructure for supplying trade finance – such as the development of competitive banks and export credit agencies – have been carried out under the Aid-for-Trade initiative. The mobilisation of partners from the Expert Group has allowed for an increase in technical assistance provided to Members in this field; for example, the Berne Union has helped to set up export credit agencies (ECAs) in low-income countries; and multilateral development banks (MDBs) have provided technical assistance to local banks in developing countries willing to set up trade finance departments; and

(b) efforts have been made from early 2008 onwards to assess the deteriorating situation in the trade finance market (arising from a lack of liquidity and a reassessment of counterparty risk) in order to find ways of improving the supply of trade finance and to encourage public and private sector entities to work co-operatively to mitigate some of the heightened risk in the trade finance market through risk-co-sharing agreements.

In conclusion to their report, WTO Members indicated that they "wished to continue exchanging views on trade finance in relation to market developments after the 7th Session of the Ministerial Conference, including on internationally agreed initiatives", thereby providing a mandate to the institution to continue its efforts to raise-awareness within the institution about the difficulties met by many Members with respect to availability and affordability of trade finance in periods of crisis, and support the Director-General's initiatives.[11]

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[9] WTO Document WT/WGTDF/W/45 of April 1, 2009: "Restoring Trade Finance: What Can the G-20 do?".

[10] WTO Document WT/WGTDF/M/18.

[11] WTO Document WT/WGTDF/8.

2. Lessons from the Asian Financial Crisis

When looking at the public management of the present crisis, it seems that some important lessons of the Asian financial crisis had been learned. At the time, the credit crunch linked to the sudden collapse of national financial sectors had reduced access to trade finance – already in the short-term segment of the market, hence adversely affecting trade, which is normally expected to the vector of balance-of-payments' recovery. New trade credit lines from foreign creditors had been interrupted as local banks were temporarily incapable to pay or provide enough guarantees on behalf of their customers. Already, a number of ad hoc arrangements had been found by public institutions (Box 1), be it regional development banks, national central banks, government-run export credit agencies to maintain key lines of credit for strategic supplies (in particular to cover nascent "supply-chain" financing).

Box 1: Risk-Mitigation instruments for financing trade used during the Asian financial crisis

The tightening of trade finance, if not stoppage, in crisis-stricken countries, has delayed the recovery of these countries, which had to rely on trade to redress their balance-of-payments. In the case of Indonesia, the high import content of exports (over 40 per cent) explained why the growth of exports was for some months seriously affected by the difficulty of financing imported inputs for use in its export sectors. To alleviate the problem, the Indonesian Government and Central Bank extended guarantees to foreign banks for letters-of-credit opened by Indonesian banks, and encouraged the Steering Committee of private borrowers and lenders to find an arrangement to maintain trade finance facilities and settle arrears. In the wake of the crisis, ASEAN Members agreed on the principle of reducing their dependence on the U.S. dollar as a currency of payment and promoting the use of local currencies in intra-regional trade (Shang-Mai Agreement).

Episodes of credit crunch in Asia and later in Latin American raised suspicion of a confusion by private markets – in absence of reliable information about risk, between country risk and individual company or bank risk. Standard economic theory in such extreme circumstances would indicate that solvable demand for credit emanating from companies with good credit rating should meet supply at a higher prises. However, it seems that in periods of acute crisis, this supply simply did not exist in certain countries, raising suspicion of market failure. In Indonesia the total value of trade finance bank limits fell suddenly from $6 billion from 400 international banks, down to $1.6 billion from 50 banks.

In order to avoid a prolonged interruption of regional and international trade flows, targeted intervention by public or semi-public entities took place in the middle of the crisis to restore a minimum of confidence on trade markets, even before exchange rate stabilized. The ad-hoc solutions proposed by regional development banks were regarded by market participants to have been successful, in terms of having suffered no default or losses while keeping minimum cross-border trade finance available. Both the Inter-American Development Banks and the Asian Development Bank extended guarantee facilities to international banks confirming local banks' letters of credit. Some export credit agencies from developed countries provided short-term insurance for credit extended during the crisis period on bilateral trade. Urgency trade finance schemes, which were initially largely inspired by the EBRD "trade finance facilitation programme", have developed and become more standardized after the Asian crisis. While the trade finance market recovered with the exceptional expansion of trade and the world economy from 2002 onwards, "trade finance facilitation programmes" have found their "market" in the niche left by export credit agencies and private banks in small countries, which have little access to international finance while being safe and sound.

In the immediate aftermath of the currency crisis, a large amount of outstanding credit lines had to be rescheduled by creditors and debtors, to re-ignite trade-related lending. While this process is relatively well defined (trade claims tend to receive prime attention if not treatment relative to other claim, precisely to re-ignite lending and hence trade) – government-guaranteed claims being treated by the Paris Club and private claims by the London Club, the process takes time, not the least because of the need to identify and certify the amount of outstanding debt, for a grouped "treatment". In other words, default on trade credit lines have a strong cost in economic terms, as during the interim "restructuring" period, the country may be in difficulty to import, unless it is supported by an IMF-World Bank facility which would receive endorsement by international banks.

So, one clear lesson from the Asian financial crisis is that, in periods prone to herd behaviour and a lack of trust and transparency, all actors – including private banks (which account for some 80% of the trade finance market), export credit agencies, and regional development banks – should pool their resources as much as practicable (WTO, 2003); not only to prevent default, but also to maintain the flow of essential imports. Strong links among the various players are also important because of an absence of comprehensive and reliable data on trade finance flows. This means that the main channel for making a reasonable assessment of the market situation is via the collection of informed views and partial statistics from various institutions. This has been a key aspect of the activities of the WTO Expert Group when it met up until 2004, in the aftermath of the Asian financial crisis, and this has been a key reason that explained that the same players asked the WTO to gather experts again from 2007 onwards: assess the market situation as it deteriorated rapidly and listen to the analysis of market practitioners on the reason on that deterioration, examine the types of instruments and cooperative arrangements that worked during the previous crisis and that would fit with existing conditions, plan contingencies, and mobilize both private and public-sector institutions in favour of partnership, so that institutions that have excess capacities meet the needs of those with insufficient funds.

The existence of this prior network of trade finance professionals/experts, who had worked together in the aftermath of the Asian financial crisis, has helped under the WTO Expert Group in the management of the present crisis, not least in serving as an "early warning system" of possible market developments, and has also helped considerably to improve the reactivity of institutions. Already during the Asian financial crisis, regional development banks had interacted with commercial banks and export credit agencies. Interlocutors knew one another and a common interest had emerged rapidly, particularly as trade bankers were seen in the Group as "defending" trade, and could find the kind of support in the Group that sometimes they could not find in their own bank.

B. Turbulences in finance market and trade finance at the turn of 2008

1. Rising tensions in the course of 2008

Despite the relatively good resilience of trade finance markets in the course and winter of 2007, the Director-General of the WTO gathered the advisory group of Trade Finance Experts, at senior practitioners' level, in the Spring of 2008. Several indicators were pointing out at tensions in the market for trade finance. Senior practitioners in the market – be it senior commercial bankers, heads of export credit agencies or regional development banks – asked to meet at the WTO to discuss the market situation and eventually envisage contingencies, as conditions seemed to deteriorate rapidly. One point of specific concern was that an increasing share of letters of credit and other types of trade bills would not be endorsed by commercial banks – despite the routine character of such operations. Trade credit are deemed to be the safest, most-collateralized and self-liquidating forms of credit in the entire credit markets (Box 2).

Box 2: Trade Finance instruments

The rapid expansion of world trade in the 2000's (at least 2008) could not have taken place without the equal expansion of sources of trade financing, both long and short-term. While short-term finance, like any form of credit, involves a commercial risk – for example the exporter being unable to secure payment for his merchandise in case of insolvency of the importer or the importer bearing risks of alteration of goods or delayed delivery – and other risks (transportation, exchange rate, political risk), it is still considered as relatively routine and secure operations given the short maturities and the supporting documentation involved. Trade finance is providing fluidity and security to the movement of goods and services worldwide. Financial instruments and actors are relatively well identified; instruments of financing that involve banks are commonly known as letters of credit, which are exchanged/endorsed/confirmed by such banks on behalf of their customers, and reflect a commitment to pay an export or an import based on the presentation of stipulated documents such as shipping and insurance documents or commercial invoices – the so-called documentary credits. Banks may extend short-term or long-term loans, discount letters of credit or provide advance payment bonds for the exporter for example, to ensure that the company has sufficient working capital for the period before the shipment of goods and that the company can bridge the period between shipping the goods and receiving the goods from the importer (pre- and post-shipment financing). Other forms of credits do not necessarily involve a banking intermediary, such as supplier's credit, bills of exchange or promissory notes. Export credit agencies (ECAs) and/or private sector insurance companies can provide insurance and re-insurance against all sort of risks, including non-payment, freight-related losses, political risk, and foreign exchange risk. Traditional actors and instruments are summarized in WTO (2003).

In relation with the expansion of "supply-chains", i.e. the fragmentation of output in different countries and though different suppliers, many large corporations have decided to leave the management of their import and export financing operations to their banks (including receivables and payables), as part of general treasury management, or to specialized intermediaries which provided automated services to minimize the opportunity cost of holding cash or extending unsecured credit. This "open account" management of trade finance has become a fairly popular way of rationalizing trade finance, and to automate as well as net out the large flow of receivables and payables involved in complex outward-processing, supply-chain operations. By the start of the financial crisis, it is believed that open-account operations had become a large source of trade finance than secured lending, in the form of letters of credit, for example. Surveys conducted by the ICC and the BAFT seem to suggest, though, that since the beginning of the financial crisis and the increase in risk, banks and multinational companies have tended to re-securitize trade lending, by reducing the share of open account transactions in favour of securitized lending.

Regional development banks and the IFC reported that they had increased by 30 per cent the amount of guarantees for trade finance operations (+50 per cent in the number of transactions) in the past twelve months, particularly in Africa and Latin America. Demand for trade finance facilitation programs, which covered the payment risk of an import/export between two countries (and hence helping the issuing and receiving banks to obtain AA or AAA financing terms on the trade credit involved), was roofing up because of the liquidity shortage and increased spreads in banking markets. At that stage, the only region relatively immune from a tightening of funding conditions was Africa, because the continent had not been involved in the sub-prime crisis so was not subject to the same constraints; however, in that continent the risk came from the inflation of commodity prices, which required pre-shipment financing of unknown scale until now. All in all, demand for trade financing was reported to be larger than what the private sector was able to cover at the rising cost. Already, the longer maturities (three years and more) were no longer proposed by banks. The question already arose as to who would cover the gap – with Government-backed institutions indicating that there might be scope for stepping in more aggressively – at market price.

The global liquidity situation deteriorated throughout the year 2008 for the largest suppliers of trade finance, and along with a general re-assessment of counter-party risk, and an expected increase in payment defaults on trade operations. In the second part of the year, the situation spread also to developing countries' markets. In September 2009, a market gap was clearly identified in Wall Street and London, as key US and UK banks – particularly those with deteriorated balance sheets – could not off-load/refinance on the secondary market their excess exposure in trade credits. As a result, some banks were unable to meet the demand from their customers for new trade operations, leaving a "gap" estimated to be around $25 billion.

Further, the liquidity problem, although cooling a bit in some part of Asia, had spread to other developing countries' money markets: Asia, Latin America, and Africa, the former and the later being particularly affected. This adds to the specific problems faced by local banks in certain developing countries in normal circumstances: relative lack of depth of money markets, lack of capacity to handle large volumes of trade credit, lack of reliable information on the creditworthiness of customers, all of which lead, in periods of crisis, to difficulties in finding partners in developed countries to accept the counterparty risk.

According to the joint IMF-BAFT (Banker's Association for Trade and Finance) survey – undertaken in the context of the WTO Expert Group Meeting on November 12, 2008 and presented at the Expert Group Meeting on March 18, 2009[12] –, flows of trade finance from developing countries' banks had fallen by some 6 per cent or more year-on-year (end 3rd quarter 2007- end 3rd quarter 2008). This was more than the reduction in trade flows from and to developing countries during the same period, hence implying that the lack in supply of trade financing is indeed an issue for these countries. Expectations in late 2008 were that trade finance flows for the same categories of banks would further fall by 10% in 2009.[13] According to the survey, that meant that the market gap was well over the $25 billion estimate mentioned above, in fact in the order of $100 billion to $300 billion. This number was also consistent with the amount of letter of credit and other trade bills (such as bankers' acceptances) that market participants were no longer rolled over on the secondary markets, which had gradually shut down ($20 billion per month). One methodology or another, estimates – including that of the World Bank – were converging on a market gap of that order of magnitude.

In advance of the G-20 Summit in London, the IMF and the BAFT provided for an update of their survey, indicating that decreases in value of trade finance accelerated between October 2008 and January 2009 in almost all regions in the world. While more than 70% of the respondents attributed this further decline in the value of transactions to the fall in demand for trade activities, six-in-ten respondents attributed it to restrained credit availability, thereby also describing an increase in the banks' own difficulties to supply trade credit due to the general liquidity squeeze faced by them and the increased risk aversion to finance cross-border trade operations.[14] Spreads (prices) on the opening up of letters of credit were up from a 10 to 15 basis points above the London Inter-Bank Overnight Rate (LIBOR) to 300 basis point in some emerging economies (with some banks reporting 600 basis points for particular destinations).

Results from the survey undertaken by the International Chamber of Commerce, also released for the WTO Expert Group of March 18, 2009 and further updated before the G-20 Summit in London, broadly confirmed the conclusions drawn by the IMF-BAFT survey, albeit relying on a wider panel of banks and countries (122 banks in 59 countries).[15] Trade decreased as a result of the

[12] See in particular WTO Document WT/WGTDF/W/44, available on www.wto.org

[13] IMF (2009), Survey of Private Sector Trade Credit Developments, available at www.imf.org/external

[14] IMF and BAFT Trade Finance Survey (2009), Survey Among Banks Assessing Current Trade Finance Environment, available at www.baft.org

[15] See in particular: ICC Banking Commission (2009), An ICC Global Survey for the WTO Group of Experts Meeting on March 18, 2009, ICC Document 470-1118 WJ 1/ March 09; and ICC Banking Commission (2009), Rethinking Trade Finance 2009, ICC Global Survey sponsored by the Asian Development Bank, Coastline Solutions, the European Bank for Reconstruction and Development, the Inter-American Development

recession and due to tight credit conditions. About half of the banks had confirmed a decrease in volume and value in letters of credit volume and value of aggregate transactions – a trend that was particularly clear looking at 4th quarter 2007 to 4th quarter 2008 data. This was particularly true for developed countries' market (even more so for least developing countries'), with large scale financing projects being deferred or difficult to finance.[16] The main reasons provided by banks for the decrease in credit lines, and increase in spreads[17] – apart for the reduction in the demand for trade – were the application of more stringent credit criteria, capital allocation restrictions, and reduced inter-bank lending. The ICC also pointed out that intense scrutiny of documents (within a general movement of re-intermediation of trade finance, away from open account transactions and in favour of letters of credit) by some banks were leading to higher rates of rejection of letters of credit. Prospects for trade financing were negative in 2009, with the general view that "tight credit conditions may further reduce access to trade finance".

2. Statistical problems

Why did the international community rely on surveys and not on a comprehensive set of international statistics for trade finance? Up until 2004, a series of trade finance statistics was available in BIS statistics, under the combined efforts of four international agencies, i.e. the IMF, World Bank, BIS and OECD. Apparently the cost-to-quality ratio of these statistics led the agencies to discontinue this effort. At present the only available and reliable source of statistics concerning trade finance comes from the Berne Union database, which provides data on the amount of business of export credit agencies (mainly trade credit insurance). Survey-based data on banks activities provided great value at the heat of the crisis, but are only of limited use for regular reporting. The reasons include the very large amount of transactions carried out by banks, the variability of trade finance instruments used by banks over time, and, more importantly, the difficulty to obtain from the largest banks commercially sensitive-information.

The only way to obtain comprehensive information on an on-going basis would be through the balance of payments or *BIS* cross-border banking statistics. Here, confidentiality is less of an issue as data is collected on an aggregate basis and according to the resident-non resident criterion of the balance of payments. Although short-term trade credit should be captured under the IMF's 5th Manual on Balance of Payment Statistics (and soon to be 6th Manual), it has always proven difficult to collect the information on a global basis due to the very high cost of information technology needed for statistical compilers to be able to do so. Even the richest countries find it difficult, with the highest level of reporting, to guarantee a high level of accuracy to very short term capital movements (in the form of short term trade credit) which may cross the resident to non resident border several times a year. However, *BIS* banking statistics may be of the greatest help, should declaring banks and central banks be able to differentiate this sub-item among short-term, cross-border international capital movements. Knowing that short-term credit account for about 80% of total trade credit flows, distinguishing trade credit from within the $22 billion in total short-term cross border movements would be a significant progress for all statistical compilers, not only those interested in trade credit. Given the likelihood that trade credit flows be a significant proportions of these total international short-term cross-border credit (up to a third), a detailed reporting of it would help clarify a major share of the "black-hole" of such short-term movements.

Bank, the International Financial Corporation, the International Financial Services Association, and SWIFT, ICC Document 470 -1120 WJ 31 March 09; both available at www.iccwbo.org

[16] SWIFT data pointed to a deterioration particularly visible in the Asian Pacific Area.

[17] Some 40% of the respondent banks indicated that spreads had increased significantly over the past year, and were not expected to fall anytime soon.

C. Trade finance shortages: a demand or supply problem?

1. Short-term factors

As indicated above, while overall flows are not subject to comprehensive statistical compilation but only to measurement by surveys we are not able to appropriately gauge changes in trade finance flows. However, the overall increase in spreads requested for opening letters of credit is pointing to a shortage in supply despite the reduced demand due to the overall fall in trade transactions.

Disagreement persists as to the causes of the shortage of trade finance. While the public sector in general maintains that trade finance gaps in extreme circumstances are a result of market failure, the private sector traditionally argues that they result from the cost of (new) rules, in this case the implementation of the Basel II Accord. These arguments have been developed in WTO (2003), and to some extent can be applied to the current circumstances (ICC 2009).

The market failure argument rests on the inability of private sector operators to avoid herd behaviour, in particular when credit risk and country risk are being confounded (for example in cases of rumour of sovereign default). Also, non-cooperative games are played by global suppliers, with the best run institutions refusing to refinance on the secondary market letters of credit from banks in a less favourable liquidity situation. On the regulatory side, commercial bankers have long complained about the implementation of Basel II rules, which are regarded as having a pro-cyclical effect on the supply of credit. When market conditions tighten, capital requirements for trade finance instruments tend to increase more than proportionally to the risk when the counterparty is in a developing country. Both western banks and developing countries have recently been complaining that ratings from international rating agencies maintain a bias against developing countries' risk. Several developing countries made that point in the WTO Working Group on Trade, Debt and Finance, among others. They argued that they neither have been involved in the elaboration of recommendations of Basel II rules by the Basel Committee on Banking Supervision, nor have they any control over ratings by international rating agencies. Before and during the 20 Summit in London, it was agreed that all G20 countries would become members of the Financial Stability Forum (now Financial Stability Board) and its components, including the Basel Committee on Banking Supervision and various other coordinating bodies on financial regulation. Therefore, they would be able to participate in the review of Basel II rules.

2. Longer-term factors

Conditions for a structural gap exist in the trade finance market, between, on the one hand, modern financial and non-financial actors (such as banks, multinational corporations, other non-banks actors) in developed markets (generally located in the main international trade centres such as New York, London, Geneva, Dubai, Singapore, Shanghai, Tokyo), and, on the other hand, players in developing countries, which generally have less institutions technically and financially able to participate in these markets, handle complex trade finance instruments, and provide credible guarantees for counterparty risk.

This gap is described in Auboin (2007). In developing countries, the largest banks, also called Tier 1 banks, concentrate the know-how and customers to handle trade finance operations, do provide finance only on the basis of strong collateral requirements and the "reputation" (credit record) of companies. Emerging companies (particularly in new businesses sectors) that are creditworthy but are not as "reputable" as the well-established companies face higher interest rates, higher fees on letters of credit, which overall impedes the development of such new business and the diversification of the economy. In least-developed countries, at best only the largest bank can handle or afford a trade finance department, able and fit to handle trade finance instruments (for example, at the world level, the International Chamber of Commerce reports that 75% of letters of credit in the world are subject to a first rejection due to the lack of proper handling, documentation, formatting, etc. This ratio is higher for letters of credit issued by developing countries banks). Hence, many companies in such countries were not using banks' services to finance trade transactions. In a study, Rajan and Petersen (1997) had provided evidence that firms used trade credit between themselves when they could not obtain loans from financial institutions at all, or at affordable rates. In areas or countries where the perceived risk of lending for trade is assessed to be too high (due to lack of available documentation, legal system, collateral, etc.), banks simply rationed credit to avoid excessive rates to be charged.

The World Bank (2005) had in the past surveyed the constraints faced by traders and banks in Africa specifically, which can be summarized as follows:

- Many banks in Africa are conservative, an unsurprising attitude given the relatively poor repayment culture (albeit improving) developed from years of failed government credit projects and donor subsidies. As the other end of the market, bank insolvencies in the 1990's are responsible for some public distrust in formal financial institutions, so small business are often relying on informal sources of finances such as through family and social networks. These factors limit the financial sector ability to tap the commercial potential of small and medium size enterprises (SMEs) and help them expand their market share through the provision of adequate trade finance;

- The banks' lack of effectiveness in handling small, medium or long-term credit risk (lack of training of loan officers, lack of information on borrowers, absence of a reliable credit registry, etc.) result in the small entrepreneurs being burdened with high requirements, such as up to three years of financial statements, enough collateral to cover the principal and interest (including a cash deposit that may be up to 30% of the loans' net present value), and show every detail of the international trade transaction in question. Lease and hire purchase products are not developed enough and adapted to accommodate the complexities associated with SME's development on both the domestic and international markets – the result being limited access to finance and investment in general in the agricultural and agro-industry sub-sector.

All in all, the World Bank had engaged in trade finance "clinics" with active capacity building programs for export and import financing in Africa. Exporters and importers are being informed of the various innovative products and mechanisms to finance and insure their trade, including through dissemination of best practices by private sector banks, products offered by the Africa Trade Insurance Agency (ATI), and the Global Trade Finance Program of the IFC. It remains that, the bulk of the financing of international trade coming from private sector banks and ECAs, demand for funding and guarantees in Africa continues to outweigh supply.

Box 3: Trade Finance in Africa

Studies suggests that trade finance in Sub-Saharan Africa has become considerably more expensive, involving shorter maturities and contractions in scale. According to a survey by the African Development Bank, trade finance transactions have collapsed by over 50% (year-on-year) since the beginning of 2009 in Africa (out of total annual turnover of $100 billion), Nigeria being the hardest hit. Nigerian banks have demanded that importers pay in foreign exchange, making funding even more expensive and imposing constraints on local importer's working cash balances. Ghanaian banks on the other hand have charged local importers even more to facilitate various trade transactions and have observed a shift toward the use of pre-paid letters of credit at a time where shortages in foreign exchange in the domestic market have reached their peak. These banks also charge for documentary collection and collateral management arrangements.

The problem with domestic banks in many low income countries, including Sub-Saharan Africa is that they have limited, if at all, international reputation. In light of the current financial crisis, international banks now do not confirm clients' letters of credit unless they are prepaid, have cash or any other tangible collateral. International banks no longer focus on with second tier banks and have shifted their attention to their longstanding relationships with renowned and internationally accredited local banks. Additionally, international banks now either do not sign off on or simply cancel funded overdraft facilities without pervious warning. Here, local banks that have limited international reputation are forced to seek access to trade finance through first-tier competitors and hence, restricting their access to trade finance. As a result, demand for trade credit is barely met, considering the increasing prices for opening letters.

These structural impediments to the development of larger and more liquid market for trade credit and insurance have been recognized in the context of the Aid-for-Trade Initiative. Increased technical assistance and capacity-building is foreseen, to allow more least-developed countries' banks to participate in the trade finance markets. Remedying the knowledge and technology gaps concerning the use of traditional instruments of trade finance is one of the objectives of "trade finance facilitation programmes (TFFPs)", developed by regional development banks and the International Financial Corporation (the IFC, a subsidiary of the World Bank Group). TFFPs not only provide short-term guarantees to international and regional banks (confirming banks) covering both the commercial and political risks of international trade credit transactions emanating from local banks (issuing banks), as well as providing directly to specified companies and banks revolving credit facilities, all of which at little cost; in doing so, these programmes try to address the lack of availability of trade finance for countries with little access to international markets and/or no or low international ratings, and for small transactions. These programmes also aim at increasing the capacity of local banks and traders to handle themselves trade finance operations. To this aim, donor technical assistance funds are being used to train local experts through seminars. In addition, the Berne Union of Export Credit and Investment Agencies is delivering technical assistance to countries asking for the establishment of new export credit agencies.

Clearly, countries and regions with the weakest trade finance infrastructure have been hit the hardest by both the financial crisis and the collapse of trade. These difficulties have been aggravated by the structural weaknesses of the local financial system described above.

II. Restoring the availability of trade finance: What has been done?

A. Efforts by public and private players to boost the supply of trade finance in the second half of 2008.

The response of public-backed institutions since the fall of 2008 had been more than positive, actually of a magnitude unseen in recent history. Capacities in three types of activities were enhanced significantly:

- All regional development banks and the IFC have doubled on average capacity under trade facilitation programmes between Mid-2008 and the G-20 Meeting (Box 4). In response to requests by commercial banks of direct co-lending with IFIs, nearly all of them have opened a "liquidity window", in addition to their traditional risk mitigation activities (trade insurance). As such, such region-specific liquidity windows will usefully complement the IFC's new liquidity pool by way of private to public sector partnership in the industry.

- Export credit agencies have also stepped in essentially with programmes for short-term lending of working capital and credit guarantees aimed at SMEs. For certain countries, the commitment is very large or unlimited in amount (Germany, Japan). In other cases, very large lines of credit have been granted to secure supplies with key trading partners (the USA with Korea and China) In other cases, cooperation is developing to support regional trade, in particular chain-supply operations (establishment of an Asia-Pacific Trade Insurance Network to facilitate intra- and extra- regional flows).

- One problem often under-estimated in developing countries is the difficulty for banks and importers to find foreign exchange, for example in cases where the main currency of transactions (say, the Euro or the US dollar) has become scarce because of the depreciation of the local currency, or because of the fall in receipts from remittances and exports. As a result, central banks with large foreign exchange reserves have been able to supply foreign currency to local banks and importers generally through repurchase agreements. Since October 2008, Brazil's central bank has provided $70 billion to the local market. The Korean central bank has pledged $10 billion of its foreign exchange reserves to do likewise. The central banks of South Africa, India, Indonesia, and Argentina are also engaged in similar operations. Unfortunately, however, many developing countries do lack foreign exchange reserves and are unable to use similar facilities.

Box 4: Trade Finance Facilitation Programmes – Mid-2008 to Mid-2009, comparative Tables

Mid-2008

IFI	Started (year)	Number of transactions	Trade credit lines/guarantees extended ($ billion)	Issuing banks	Confirming banks	Countries covered
EBRD	1999	7,000	6.7	109	644	21
IFC	2005	1,900	2.1	100	500	50
IDB	2005	303	0.58	31	175	14
ADB	2004	828	0.34	38	71	9

Mid-2009

IFIs	Started (year)	Number of transactions	Trade credit lines/guarantees extended ($ billion)	Issuing banks	Confirming banks	Countries covered
EBRD	1999	8,100	6.8	115	657	19
IFC	2005	5,720	4.4	146	522	74
IDB	2005	694	0.86	51	215	20
ADB	2004	1,293	0.70	59	420	9

In part due to the stronger demand for guarantees during the crisis, in part also to the increase in the capacity allowed by the Boards of Directors of the International Financial Institutions (IFIs) concerned, the number of cumulated transactions under TFPs increased by 43% from 2008 to 2009. In value, corrected by exchange rate changes, the increase is close to 40%. The number of issuing and confirming banks reaches close to 2,000 at present. Countries covered under the programmes increased by 70% since 2007, most of which are emerging countries.

B. So, why has the market not re-balanced itself?

The effort in favour of mobilizing public-sector institutions to shoulder some of the risk with private sector banks has been at the onset a bit a race against time. While more financing capacity was provided by public institutions, it seemed that the private sector's ability to respond to importers' and exporters' demand for finance, particularly in developing countries had been deteriorating faster, in particular in the last quarter of 2008 and the first quarter of 2009. Also, BAFT members (commercial banks) had complained that the series of measures announced by Export Credit Agencies and regional development banks were hard to track and they lack the available information on who is providing what, and under which criterion. To fill this information gap was of one of the highest priority of the WTO Expert Group Meeting on March 18, 2009.[18]

C. The G-20 support "Package"

1. Decisions of G-20 Leaders at the G-20 Summit in London

The above mentioned developments were to a taken into account and reflected in the trade finance "package" of the G20 Summit's communiqué, on April 2, 2009. Under the heading "Resisting Protectionism and Promoting Global Trade and Investment, the last two bullets points of paragraph 22 of the communiqué say:

> *"we will take, at the same time, whatever steps we can promote to facilitate trade and investment, and, we will ensure availability of at least $250 billion over the next two years to support trade finance through our export credit and investment agencies and through the MDBs (multilateral development banks). We ask our regulators to make use of available flexibility in capital requirements for trade finance."*

The trade finance "package" responded largely to the criteria developed by the WTO Expert Group on Trade Finance; strengthened public-private sector partnerships in the context of existing trade finance facilitation programmes, which will be further enhanced, not only on credit insurance, but also by opening and expanding liquidity windows of regional development banks to allow greater co-lending with banks. The IFC showed the way by reinforcing its global trade finance facility through the introduction of a liquidity pool, allowing immediately to finance with commercial banks, on a 40-60% co-lending agreement, up to $50 billion of trade transactions in the next two years (Standard Chartered Bank and Standard Bank had already signed off on credit lines with several hundreds of millions of dollars for financing Africa's trade). While jump-starting the IFC's Global Trade Finance Liquidity Fund with $5 billion in IFC Funds (raised by both the IFC and several individual donors), to be matched by $7.5 billion in commercial banks funding according to the co-lending formula, the IFC Fund could further increase overtime by attracting more donors and hence more funding by banks.

The objective of doubling the IFC's and donor funding overtime, from $5 to $10 billion was certainly feasible, hence doubling the Fund's total capacity from $12.5 billion to $25 billion, which means financing over than $50 billion in trade transactions.

2. Testing the Trade Finance Channel

As public authorities have been reacting relatively rapidly with the establishment of a G-20 trade finance package in London (2 April 2009) offering increased capacity to financial intermediaries

[18] See WTO Document WT/WGTDF/W/44.

to offer credit or insurance (mostly through public-private partnership), academics started also to provide estimates of the trade finance channel in the collapse of trade.

Amiti and Weinstein (2009), for example, use firm-level data from the 1990s to ascertain the role of credit in the 1997 Asian crisis. With their data, which matches firm's exports to the health of their banks, they establish a causal link between the two. They find, for example, that firms working with banks which suffered greatly saw their foreign sales drop more than their domestic sales.[19] The point estimates also suggest that the trade finance channel accounts for about one third of the decline in Japanese exports in the financial crisis of the 1990's. The authors explain why, as indicated above, exporters, more than any other producers, are more reliant on credit in general, and trade credit and guarantees in particular. Since a small share of world trade is paid cash or in advance, exporters rely on their banks and insurance companies to advance working capital to produce the goods for export and/or assume the payment, counterparty, transport, political, exchange rate and all other risks involved in trade transactions.

These findings are also supported by Iacovone and Zavacka (2009) – a paper that looks at the impact of banking credit on exports more generally during crisis times. Their angle is to exploit the fact that various export sectors differ in their need for external financing. Given this, the most exposed sectors should be hit harder during a banking crisis. Relying on data from 23 banking crises episodes involving both developed and developing countries during the period 1980-2000 the authors separate the impact of banking crises on export growth from that of other exogenous shocks (i.e. demand shocks). Their findings show that during a crisis the export of sectors more dependent on external finance grow significantly less than other sectors. However, this result holds only for sectors depending more heavily on banking finance as opposed to inter-firm finance. The effect of banking crises on exports is robust and additional to external demand shocks. The effect of the latter is independent and additional to that of a banking shock, and is particularly significant for sectors producing durable goods.

Looking at inter-firm credit, though, Menichini (2009) finds evidence that these linkages may help spread shocks when there is a high degree of dependence on orders and supplies, particularly in supply chains.

Bricongne and Fontagné (2009) tested the hypothesis of credit shortage on exporters in France, during the current crisis, using data on monthly exports at the product and destination level for some 100,000 individual French exporters, up to April 2009, and bank credit data for these firms drawn from the Amadeus database. They show, *inter alia*, that credit attrition has affected sectors that rely heavily on external finance – small and large firms evenly. Inversely, exporters in sectors that were less dependent on external finance tended to contract less than those more dependent on such finance.

The policy implications of such research for public authorities is important, and is being carried out to the G-20 trade finance implementation group, which keeps in touch with academia. For example, the work of Amiti and Weinstein is important to the extent that it provides a first quantification of the trade finance channel in period of acute crisis. Econometric work shows that this channel had accounted for between 10 and 30% of the reduction in exports for Japan during the Asian financial crisis; interestingly, the number is close to the rough estimate provided by the President of the World Bank in the fall of 2008 (trade finance would have accounted for between 10 and 15% of the collapse of trade), and which had found its root in early estimates of the World Bank and the WTO staff.

[19] The assumption tested in the paper is that non-performing loans during the 1990's and the Asian financial crisis affected bank health, which in turn affect the ability of banks to provide trade finance – exports being increasing credit sensitive as this mechanism works through.

Also, the research, by highlighting the way the lack of credit revolves on the capacity of traders to trade, provides firmer ground for the decisions the G20 leaders made in London on a trade-finance support package (Chauffour and Farole 2009). The literature shows that exporters need pre-shipment credit, working capital (liquidity for production), and insurance – the three of them, albeit not for all companies, at the same time or in the same region. From that point of view, this research tends to back-up the approach decided by the G-20 back in the London Summit, e.g. to mobilise $250 billion in short-term trade finance through a mix of liquidity sharing agreements and risk mitigating instruments, to be provided by export credit agencies (mainly insurance, to a lesser extent liquidity in the form of working capital), regional development banks (liquidity and insurance under trade finance facilitation programmes) and the IFC (liquidity-sharing agreements). This form of "menu" approach has so far worked relatively well: large traders and solvable banks using a lot of trade credit insurance (credit being available to them but risk being the main concern in an environment of rising payment default), which has been particularly helpful in secure supply chains' finance lately; smaller traders have used liquidity and risk mitigating products offered by regional development banks on smaller transactions under so-called trade finance facilitation programmes (below $250.000 by transaction), and the global trade liquidity programme being used for trade with countries having difficulties accessing world credit market at affordable terms.

Another important point coming from Fontagne and Al. is that large firms and smaller exporters are equally touched in period of crisis, both by the scarcity and higher cost of trade credit and insurance. This seems to be confirmed by market signals, which point to the general upwards, re-pricing of risk, at rates that are not necessarily affordable to firm, small or large, depending on their sector's profitability.

3. Verifying the implementation of London commitments: G-20 Summit in Pittsburgh

The BAFT trade finance survey prepared for the G20 Finance Ministers Meeting in September 2009, suggested that trade finance markets were beginning to stabilize although it also pointed out that market dislocations remained and the majority of public-/private- sector partnership programs intended to address this problem had thus far had a beneficial, but limited effect.[20] About 62% of banks surveyed (representatives from 88 banks in 44 countries completed the questionnaire) reported a drop in total value of trade finance activities from the fourth quarter of 2008 to the second quarter of 2009. Eighty-six percent of respondents indicated that the decline was due to a fall in the demand for trade activities. Compared to the previous surveys, notably fewer respondents thought the value of transactions had declined due to credit availability at the banks.

The sense of improving conditions in a generally weak market is also reflected in the latest ICC survey.[21] It stated that there had been evidence that the ability of banks to provide trade credit had improved since the start of 2009, broadly reflecting enhanced capacity and liquidity in the banking sector as a whole. However, many respondents still reported impaired credit lines and capital availability at their own institutions and/or at counterparty banks, albeit to varying degrees. This was particularly true in developing or emerging markets for which risk appetites remain low. The survey indicated that the pricing of trade instruments remained high in the first half of 2009, despite a tendency to stabilize in the second quarter of 2009. Some banks reported further increases in pricing for bank undertakings relative to the fourth quarter of 2008, typically of around 50 to 100 basis points.

At the G20 Summit in Pittsburgh in September 2009, implementation of the trade finance package was found to be reasonably successful in providing the market with additional capacity. The G20 expert group monitoring this initiative found that more than the aimed $250 billion had been

[20] BAFT (2009) "BAFT Releases Report on State of Trade Finance Markets to G-20 Finance Ministers", Press Release, 11 September.

[21] ICC (2009) ICC Trade Finance Survey: An Interim Report - Summer 2009.

mobilised[22], and that some 70% of the capacity mobilised had been used in the first six months of the life of the initiative.[23] The largest members of the international community have been able to mobilise their export credit agencies– the US, EU, Japan, Canada, Korea, China – to help compensate for shortages of trade finance from traditional, commercial bank sources.

Anecdotal evidence collected before and immediately after the G-20 Summit in Pittsburgh indicated that prices for opening letters of credit in the large emerging economies had further been reduced, and were priced around 70 to 100 basis points over the inter-bank rate in India, 50 to 70 basis points in Brazil and between 50 and 125 basis points in China, depending on the type and credit history of customers (against 250 to 600 basis points one year earlier). These prices were not necessarily higher than for customers in the United States or in certain European countries. However, they remained much higher than pre-crisis levels, and were expected to remain higher for some time, both as a reflection of the re-pricing of risk in the medium-run (a healthy development for the market) and as a reflection of greater selectivity of banks on their choice of customers. While liquidity for new lending seemed to be meeting demand from large exporters in international supply-chains, there were still concerns – and evidences – that the package had not yet benefited smaller exporters from Central America, Africa, Eastern Europe, Central Asia and low-income countries in East Asia which, in addition to facing difficulties in accessing trade finance facilities, were also facing an upward re-pricing of risk: not only credit cost remain well above 200 basis points, but insurance costs are estimated to have risen up to 200-400 basis points and to have increased markedly the cost of trade.

In line with the above findings from academia, it is important that the G-20 package be directed to those which need it the most, in particular firms, small and large, in countries which a semester ago had already been marginalized from credit market, either because the perception of risk was (justly or unjustly) downgraded, or because international banks chose to "close" country limits in areas which were not asked in priority by their customers. In emerging countries where domestic banks recovered a high appetite for risk-taking (such as Brazil or China), the local industry has been able to replace the lost capacity from international banks. In other areas of the world where the domestic banking sector is not strong or liquid enough, the case for public intervention remains.

III. Looking into the future: improving infrastructures for sustainable and liquid trade finance market

A. Keeping the trade finance markets under watch for some time

The G-20 trade finance package was designed to offer additional capacity to traders and bankers until the end of 2010, as any other policy measures taken by the G-20. Even if the overall market situation has improved, actions now need to better target towards small and medium-size enterprises, particularly in areas such as Africa, Central America, Eastern Europe, Central Asia and low-income countries in East Asia, as indicated above.

Also, the market is expected to continue experiencing ups and downs for some time, as its conditions are strongly linked to the overall situation of the financial industry, which is undergoing a massive process of de-leveraging. It is putting pressure on banks' balance sheets and is likely to discourage fresh lending, even the safest, for some time to come. Progress has been made in dealing with systemic failures, but IMF estimates that the clean-up process has reached the half-way mark. In addition, balance sheets are also being hit by "second-round" effects of the downturn — that is, the direct effects of poor economic activity on loan repayments, although it seems that on trade finance

[22] Close to US$100 billion in new capacity, when divided by the roll-over factor.

[23] The amount utilised in the six months between London and Pittsburgh is $71 billion (that could be multiplied in principle by four, but it remains to be seen whether it would actually roll-over four times in two years).

the record of default seems (so far) to be lower than expected (claims on export credit agencies have increased by 60% from 2008 to 2009, though). Cross-border lending will remain under stronger scrutiny for some time to come – particularly in the credit committees of banks, particularly until the details of future capital and liquidity requirements, to be adopted in the context of the current international reform of the financial system, are not known yet.

B. Improving the regulatory environment for trade credit

Above and beyond improved surveillance of trade finance markets, it is important to improve "market infrastructures", to allow for better regulation, better statistical information, and better capacity of developing countries to participate in the trade finance markets. With such progress, the sensitivity of trade finance markets to market failures in other segments of financial markets would hence be reduced.

In the paragraph about trade finance, the G-20 Summit in London had introduced that one last sentence: " We ask our regulators to make use of available flexibility in capital requirements for trade finance." While it came relatively unnoticed in a Statement that generally called for a strengthening of financial regulation and supervision, it has its origin in the treatment conferred by the Basle II framework to short-term trade finance.

The Basel II accord, finalized in June 2004, sets out a framework for banks to determine their minimum capital set-aside requirements in order to ensure that sufficient capital is on hand in times of stress. The agreement sets different weightings for various forms of credit risk, with riskier forms of exposure subject to higher set-aside requirements. In the case of trade finance, the credit conversion factor has been determined at the level of 20%, the same as in the Basle I framework. The difference, though, is in the application of such ratios. The Basle II framework is a risk-based, asset-weighted system of capitalization. Should the inherent risk of doing cross-border business increase with the instability of the international financial environment, the capitalization requirements are also set to increase – both with the re-assessment of the banks' internal ratings, but also with the assessment of the counter-party risk. This double weighting tend to increase capitalization for cross-border lending relative to domestic lending.

As concluded by WTO Director-General Pascal Lamy at the WTO Expert Group Meeting on September 15, 2009, the banks should continue to work with the Basel Committee on Banking Supervision on increasing the flexibility of the Basel II rules, with the aim of coming up with tangible solutions at its next meeting (the Basel Committee is the body of central bankers and regulators responsible for setting up the Basel II accord). The survey of banks prepared by the Bankers' Association for Finance and Trade (BAFT) for that meeting had showed that 43 percent of respondent banks said Basel II had a negative impact on their ability to provide trade finance, with banks in industrialized countries more likely to cite the negative implications of Basel II, with 60 percent of respondent citing it as a hindrance. The BAFT said a "more rational treatment under Basel II of trade finance, given its fixed, short-term, self-liquidating nature, will ultimately have a positive effect on the trade finance markets." In specific, the association called for clarification of trade finance treatment under Basel II's maturity floor for lending facilities.

Another issue comes from the application of maturity floors for letters of credit. The Basle II framework applies a one-year maturity floor for all lending facilities, even though trade finance lending is usually short-term in nature, between 0 to 180 days maturity. Since capital requirements increase with maturity length, the capital costs of trade financing are thus artificially inflated as a result. In principle, national regulators have some discretion to waive this floor, should the evidence be gathered that the maturity structure of these financing instruments is less than a year. The British Financial Service Authority (FSA) had agreed with London-based banks to waive part of the one year maturity floor, but most other regulators have chosen not to do so in spite the G-20 mandate. While the ICC complains that at present “capital intensity of lending to mid-market companies under Basel II is four to five times higher than for equivalent transactions under Basel I,” the earlier 1988 capital accord, in fact regulators are ready to consider the matter but only on the basis on hard facts, not only maturities, but also on the default rates of such lending.

As a result, under the sponsorship of the WTO Expert Group on Trade Finance, the ICC and the Asian Development Bank have launched in November 2009 a pilot project to create an International Trade Finance Loan Default Registry, aimed at collecting individual data on trade finance operations and showing that the default rate on such business is one of the lowest in the industry. At the ICC Banking Commission meeting of November 2009, the main international banks active in trade finance agreed to surrender the necessary data to establish the registry, with the objective of having a data base functioning in the Spring of 2010. Once data is available, bankers and professional associations are expected to approach regulators – and generally the Basel Committee on Banking Supervision, the competent body at the international level, for re-consideration of the way the regulation should be interpreted.

C. Restoring a statistical base for trade finance

Over a year ago, at the time when shortages of finance for trade re-appeared, the trade and trade finance communities had been at pain to measure the magnitude and size of the problem, particularly in crisis-hit regions. Anecdotal evidence from trade finance providers indicated that liquidity constraints had reduced the ability of leading banks to finance deals worth tens of billions of dollars, in particular at a time when the secondary market for trade bills had become inactive. To fill the information gap, the BAFT and ICC market surveys provided great value at the time when it was needed the most.

However, looking into the future, partial survey-based data on bank activities are of limited use for regular reporting and for policy surveillance. At the present moment, only trade insurance credit data is compiled regularly by the Berne Union, and integrated in the *BIS* database on cross-border lending. Data from banks and corporations are missing, and account for the bulk of transactions in the trade credit market. Already, a better definition of trade credit, given the explosion of open account transactions in the past ten years, would be welcome. The implementation of the new manual of the Balance-of-Payments, edited by the International Monetary Fund, will provide progress in this respect. Secondly, the *BIS* is examining the ways and means by which it can improve the collection of commercial credit – under whatever form, in its own central bank-based data based (there are efforts made by the IMF and *BIS* data on short-term cross-border lending to make respective data compatible). An acceleration of the work is expected in the months to come, under the G-20 effort to "close" the statistical gaps in the world's flows of short-term capital.

Finally, the ICC and SWIFT, have committed to cooperate to an enhanced effort for the systematic collection of trade credit statistics – above and beyond punctual surveys. SWIFT, which is the sole inter-bank network by which such letters of credit are processed electronically and given legal status, based on ICC standards, was to date collecting the number of "messages", i.e. the number of letter of credit issued and endorsed around the world. SWIFT is now developing a system allowing to collect the total value of letters of credit and, will hence soon be able to calculate the average unit value. This would be a significant progress. Besides, SWIFT has started to develop a processing device for "open account" trade finance, whenever it involves an "obligation to pay" (processing such operations through SWIFT actually create such a legal obligation, like letters of credit). Should this pilot project be widely accepted by ICC members, data on open account transactions would also be available in the future.

In short, progress in the setting up of an integrated database on the world trade finance flows are expected in the months to come.

D. Long-term action in developing countries in the context of Aid-for-Trade

The poorest countries have been hit hard by the crisis. In particular, capital flows to developing countries have contracted sharply as a result of the global credit crunch, from 9 per cent of their GDP on average to a mere 2.5 per cent, according to the World Bank's Global Development Report of the fall of 2009. For many least developed countries, inflows of trade finance (trade credit extended by non-residents) is the only access of the country to foreign capital. It is hence important that these countries do not lose access to capital markets because at the same time there is a danger that, without adequate financing, they loose access to products markets. In the short run, there is certainly a role for international financial institutions to close some of the financing gap. The second WTO global review on Aid for Trade held this year concluded that an increasing share of international aid was directed towards trade-capacity building of the poorest WTO members. In the medium term, this effort should be maintained to make sure that the poorest countries keep up with the infrastructural requirements for trade, in particular trade finance, which is one of the five areas detected at an early stage by the Task Force on Aid-for-Trade.

It is hence important that regional and international development agencies that operate trade-finance facilitation programmes continue to receive from donors funds for technical assistance, that would allow to continue issuing banks in the poorest countries to establish competent trade finance department able to offer the services that are needed by producers willing to engage in international trade. The IFC is one leader in this effort, which is important because the IFC is mainly operating in Africa. Other institutions, such as the EBRD, have for years deployed resources to provide in-situ technical assistance in their area of operation.

Of importance too is the solidarity between export credit agencies. During the financial crisis, several developing countries have requested the assistance of the international community to set up export credit agencies (Vietnam, Cambodia, Costa Rica, for example). Generally, one or several Member of the Berne Union volunteer to provide assistance, both financially and technically. The WTO Expert Group on Trade Finance is a useful channel allowing for the "demand" and "supply" to be met in this domain.

More generally, while there is a trend in favour of the "re-securitization" of trade credit operations worldwide (away from open account, in favour of letters of credit and the like), on-line and supply-chain trade financing will not go away. They might actually be made more secure than in the past, in particular if SWIFT or any other comparable network, allow for greater legal security for these types of transactions. These innovations are not only available in North-North trade but are made available to the rest of the world through the SWIFT international banking communication systems, which offer standard messaging services linking up financial intermediaries involved in trade transactions, and, as indicated above, providing a bias in favour of more straight-forward open account transaction against letters of credit. However, new technologies are not necessarily available to all banks in the world, and the increased sophistication of the electronic treatment of letters of credit may here also create a "digital divide". In a financial sector in which lending is more selective and aims at being more secure, investing in new technologies may become itself a condition of the competitiveness of banks and their customers. Under the Aid-for-Trade initiative, the technology drive should not be allowed to increase the marginalization of poor countries in trade transactions – particularly as South-South trade transactions, are expected to drive international trade in the near future. Remedying the knowledge and technology gaps are an integral part of reducing the cost of trade transactions that facilitate access to international markets. Adequate funding should aim at increasing the capacity of local banks and traders to handle themselves trade finance operations electronically. The "trade finance facilitation programmes" also fit nicely with this requirement of the Aid-for-Trade Initiative.

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