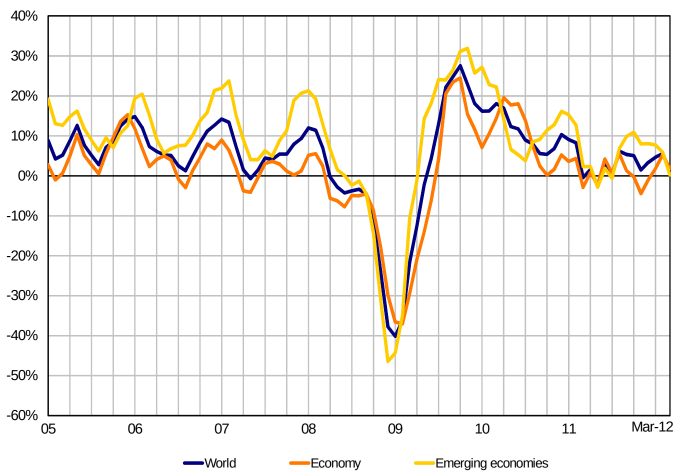
No. 108
January 2013

TRÉSOR-ECONOMICS

The shortage of international trade finance during the 2008 crisis: findings and perspectives

- International trade finance facilitates more than 80% of flows of trade in merchandise, and is central to the smooth functioning of world trade at a time when manufacturing processes are fragmented across many different countries.
- In 2009, trade volumes declined for the first time since 1982, as a result of the economic and financial crisis. One of the explanations advanced to account for this contraction, apart from weaker global activity, is the reduced availability of trade finance, itself a consequence of a worldwide dearth of liquidity and of a sudden, steep rise in risk aversion in the markets between the end of 2008 and the beginning of 2009.
- When risk aversion does rise sharply, trade finance, traditionally seen as a low-risk activity, is subject to especially heavy discrimination because the parties concerned are located in different countries, and because it frequently concerns short-term (less than 90 days) dollar-denominated transactions, which imposes hefty capital charge on the banks. This situation may advocate internationally coordinated public intervention.
- Several initiatives to attenuate the dearth of trade finance were taken in response to the 2008 financial crisis. At the G20 meeting in London, in April 2009, it was decided to make available USD 250 billion of public financing in the form of guarantees or insurance mechanisms, via the multilateral development banks (MDBs) and export credit agencies.
- In the developed countries, temporary support via insurance and guarantees or credit facilities provided by the export credit agencies has helped reduce the shortage of trade credit.
- Other more structural measures have been introduced recently in order to improve the flow of finance for normal international trade. These measures could subsequently be completed by European Community-level reforms or institutional reforms in the developing countries.

Merchandise import volumes, annualised quarterly variations



Source: CBP.

MINISTÈRE DE L'ÉCONOMIE ET DES FINANCES

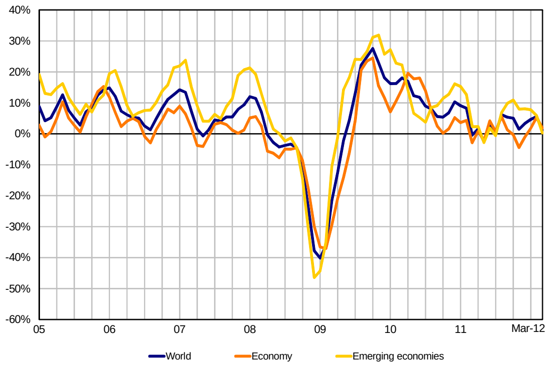
MINISTÈRE DU COMMERCE EXTÉRIEUR

1. Trade finance is a channel through which financial crises are transmitted to the real economy, via its impact on trade

1.1 Import-export finance is vital to keeping international trade flowing smoothly

Trade volumes slumped between the third quarter of 2008 and the first quarter of 2009 in the wake of the economic and financial crisis (Chart 1). Apart from the demand shock caused by weaker global activity, one explanation put forward to account for this collapse was the role played by the reduced availability of trade financing instruments. This shrinkage of trade finance stemmed from the loss of global liquidity in the financial markets and the sudden rise in risk aversion in the markets in late-2008 and early-2009.

Chart 1: Volume of merchandise imports, annualised quarterly variations



Source: CBP.

Exporters and importers use a wide array of financial instruments (see Box 1). They include account-to-account inter-company transfers, letters of credit or documentary credits, insurance, supplier credit, factoring, etc. The main actors in this market are companies themselves (via cash transactions, private banks, as well as public and semi-public agencies such as export credit agencies and regional development banks. **This finance generally takes the form of short-term instruments, which are considered to be low-risk, recoverable and reimbursed at face value.** Almost all transactions of this type are denominated in dollars, except in Europe, where a substantial portion is denominated in euros. However, a distinction is made between short-term trade finance, chiefly used for trade in commodities, and in intermediate and consumer goods, and medium-term finance, used to finance projects and trade in capital goods. The market for trade finance represented an estimated $12-13 Trn in 2008 (see Table 1) annually, covering 80% of international trade flows ($15.9 Trn)[1].

International trade is an important growth driver for many economies, and for the emerging economies in particular. Therefore any barrier to the development of trade can affect global growth adversely. A fortiori, the fragmentation of production processes across many different countries, which has been the pattern for global trade since the 1990s, has doubtless reinforced this interdependence: any local disruption to the production systems is liable to have a chain effect on trade flows as a whole.

Table 1: Main sources of international trade finance

Cash payment 19%-22%	Bank lending 35%-40% 5.5-6.4 Trn	Inter-company	
		Covered by Berne Union export insurance $1.25-1.5 Trn	Inter-company uninsured
Global trade in merchandise $15.9 Trn (World Bank estimate 2009)			

Source: IMF / BAFT surveys.

1.2 Available survey data confirm that the number of transactions falls substantially and that the cost of rises in times of financial crisis

A major hindrance to the study of trade finance is the shortage of data on this type of financial instrument (see Box 2). However, the rare extant figures, mainly derived from ad hoc surveys, clearly show a significant drop in the number of trade finance transactions in times of crisis. The contraction of financing may result from the fall in trade transactions, or vice versa. For example, during the Asian crisis of 1997-1998, bank finance for trade in Korea and Indonesia fell respectively by 50% and 80%[2]. Similarly, Brazil and Argentina experienced contractions amouting to 30% - 40% in this type of finance during the crisis of 2000-2001[3].

Rather more refined data, from a variety of sources, are available for the 2008-2009 crisis[4]. Using figures provided by Dealogic, Chauffour and Farole (2009) find that medium/long-term structured trade finance contracted by 40% over a year in Q4 2008. According to figures provided by the Society for Worldwide Financial Telecommunication (SWIFT)[5], there was a 4.8% fall in the number of messages concerning short-term trade finance (these figures cover collections and cash letters, and documentary credits). Data gathered by various surveys of international private banks (Table 2) conducted jointly by the IMF and the Bankers' Association for Finance and Trade (BAFT) show that bank lending to finance trade held up well until Q4 2008, even though trade itself was collapsing.

It was only from the beginning of 2009 that trade finance provided by the banks grew scarcer, at the very moment when trade suffered its steepest fall (down 32% between October 2008 and January 2009).

(1) Marc Auboin (2009), "Boosting the availability of trade finance in the current crisis: Background analysis for a substantial G20 package". CEPR Insight no. 35, June.

(2) Auboin, M., & Meier-Ewert, M. (2008), "Improving the Availability of Trade Finance during Financial Crises", Geneva: WTO.

(3) Allen, M. (2003), "Trade Finance in Financial Crises: Assessment of Key Issues (December 9)", Policy Development and Review Department, International Monetary Fund.

(4) Chauffour and Farole, (2009), for an in-depth analysis of these different data see: "Trade Finance in Crisis: Market Adjustment or Market Failure?", World Bank.

(5) SWIFT is a banking cooperative that provides standardised interbank transfer message transmission services and interfaces to more than 7,800 institutions in more than 205 countries. Its main clients are banks, broker/dealers, clearing houses and securities exchanges worldwide. SWIFT performs the equivalent of a notarial deed on all transactions carried out, regardless of the amount involved.

Box 1: **The different types of trade finance instruments**

Categorys	Product	Description
Inter-company finance	Account to account transfers (or customer accounts) with deferred payment	An exporter and an importer enter into a contract without third party intervention and with no risk management arrangement. One of the two parties (usually the exporter) extends credit to the other by accepting deferred payment (generally 30-90 days).
FConventional bank finance	Capital investment credit	Medium-term finance to cover production costs (e.g. financing for plant and equipment).
	Working capital creditt	Short-term finance to cover day-to-day expenses, including payment of suppliers, production and transport costs, etc. Also used to cover late payment and currency fluctuation risks, etc.
	Pre-export finance	Similar to financing for ordinary expenses, but the bank takes a stake in the merchandise being shipped with the right to receive direct payment from the importer. Typically used for commodities..
Payments and liquidity mechanism	Letter of credit or documentary credit	Documentary credit (also Letter of Credit or L/C) is a bank's commitment to pay a defined amount to the supplier of a good against remittance, within a stipulated time limit, of documents listed proving that the merchandise has been shipped, or that the services have been provided. The purpose of these documents is to prove the proper fulfilment of the exporter's obligations. These documents are then transmitted by the bank to the buyer against reimbursement, so that the latter can take possession of the merchandise.
	Supplier credit	Supplier credit allows the buyer to spread payment for imports of merchandise or services over a period of time. The supplier provides the credit, with the bank discounting bills representing the credit as and when shipments are made.
	Buyer credit	A term loan enabling the buyer to pay the supplier in cash.
	Countertrade	Supplies liquidity (particularly access to the currency market and hence especially important for emerging economies) to facilitate exchanges of equivalent merchandise (barter, buybacks or counter-purchases).
	Factoring and forfaiting	Factoring is a financial service that buys up a vendor's invoices or accounts receivable at a discount, then bears the risk of non-payment. Forfaiting is similar to factoring but caters to vendors of capital goods or commodities where credit cycles are long.
Risk management	Advance payment guarantee	This is a security (in the form of an insurance contract) supplied to the buyer when the vendor asks for a receivable to be discounted, generally of roughly the same amount, repayable on demand.
	Performance bond	An insurance contract issued to the supplier, repayable / payable in case of non-performance by the vendor (to compensate for costs of financing, new bidding round, etc.)
	Refund garantees	An insurance contract issued to the buyer when the latter is required to make a payment during the vendor's production phase, payable in the event of non-delivery of the merchandise.
	Hedging	Hedging Insurance contract (via a financial instrument financier issued by a bank) to compensate for a market risk, including currency, interest-rate or commodity price risks.
Export guarantee/insurance	Export insurance	Insurance contract to exports against all kinds of risks, including non-payment, interest-rate fluctuations, political risks, etc.
	Export guarantee	Instrument to protect the banks that provide trade finance instruments. Facilitates bank financing of certain exporting companies (e.g. SMEs with an insufficient track record)..

Table 2: Change in merchandise exports and trade finance (%)

	T4 2008 vs TA 2007		Jan. 2009 vs Oct. 2008		T4 2009 vs TA 2008		T4 2009 vs TA 2008	
	Merchandise exports	Trade finance	Merchandise exports	Trade finance	Merchandise exports	Trade finance	Merchandise exports	Trade finance
Industrial countries	−12.4	2.4	−31.0	−9.2	−13.5	−9.1	2.6	0.4
Sub-Saharan Africa	−11.2	1.4	−43.2	−8.1	−13.2	−3.0	4.9	6.5
Emerging Europe	−14.9	4.3	−33.0	−11.1	−11.8	−10.4	9.2	0.7
Central Europe/Central Asia	−8.1	−4.3	−54.5	−13.2	−30.6	−7.8	−3.4	0.2
Emerging Asia, China and India	−0.4	9.1	−29.0	−9.7	−18.0	0.0	3.8	6.1
Developing Asia		4.2	−8.8	−9.1	0.8	−3.8	10.1	1.8
Middle East and North Africa		2.2	−20.4	−5.3	1.4	−5.3	11.1	4.4
Latin America	−10.4	4.8	−37.4	−9.5	10.4	−13.7	1.9	2.2
Global	**−10.3**	**3.4**	**−32.2**	**−11.1**	**14.7**	**−7.5**	**2.9**	**2.2**

Source: FMI/BAFT-IFSA Trade Finance Surveys (mars 2009, juillet 2009 et Mars 2010).

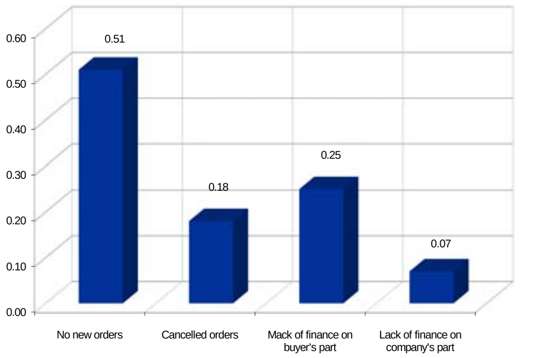
Note: l'échantillon interrogé change d'une enquête à l'autre.

In two World Bank surveys, one covering global buyers and vendors, the other specific to the developing countries, companies questioned considered that one third of the fall in trade flows observed over the period Q3 2008 - Q2 2009 can be explained by the diminished availability of trade finance (Chart 2). Figures for insurance transactions supplied by the Berne Union, the international organisation for private and public export credit insurance providers, show that there was an increased in new insurance commitments in the industrial countries in the last quarter of 2008, whereas there was a hefty fall in the emerging and developing economies[6].

Finally, the World Bank's study of the developing countries shows that the most powerful constraint on financing, for SMEs especially, was not difficulties with access to letters of credit, but lack of pre-export financing.

(6) This difference in the reaction of insurers in the developed and the developing countries can be accounted for, among others, by the role played by export credit agencies (see Part 5).

Chart 2: What explains the drop in your exports?

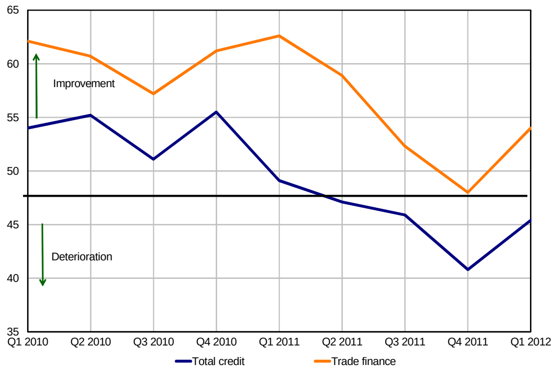


Source: World Bank 2009 Survey. Number of respondents: 190.

The rise in the cost of trade finance during the financial crisis confirms that part of the observed fall in volumes stems from reduced supply of this type of lending. Based on anecdotal evidence gathered directly from export finance practitioners, the cost of 90-day letters of credit in 2008 is reckoned to have been around 300-400 basis points above LIBOR, or 2 to 3 times higher than the previous year[7]. These cost increases are confirmed by the IMF/ BAFT survey, which reveals a general increase in the cost of trade finance instruments relative to the banks' cost of funding.

Since Q1 2010, the Institute for International Finance has run a quarterly survey of banks with operations in the emerging economies concerning credit market trends, including a section on international trade finance. These figures show that the supply of trade finance has been pretty resilient since 2010, even if terms tightened slightly in the last quarter of 2011 (Chart 3).

Chart 3: Diffusion index - lending conditions (50 = neutral)



Source: Institute for International Finance.

Box 2: **Data are scarce, drawn mostly from ad hoc surveys**

Data on bank lending are scarce and are not published continuously. The chief reason is that these figures concern transactions that are not conducted on organized markets and involve a variety of institutions whose relations are often confidential. Figures on inter-company trade finance are harder still to obtain, owing to the complex and individual links between companies and attaching to this type of transaction.

After the Asian crises of 1997 and until 2004, a series of statistics on trade finance derived from balance of payment figures and BIS data was compiled under a joint initiative of four international organisations, namely the IMF, the World Bank, the BIS and the OECD. This effort was ultimately abandoned because the quality did not justify the cost. Data available today derive mainly from:

(i.) **Surveys commissioned by the IMF and the Bankers Association for Trade Finance (BAFT) of commercial banks in the developed and emerging economies**[a]**.** There are 4 extant ad hoc surveys, which were carried out between December 2008 and the end of 2009. These qualitative questionnaires ask the banks to assess trends in their trade finance activity at the time of the questionnaire relative to the previous year, and their expectations for the coming year.

(ii.) **International Chamber of Commerce**[b] **surveys of 122 banks in 59 countries.** The International Chamber of Commerce also contributes to the compilation of a long-term database on default rates for documentary credits and other trade finance instruments provided by banks, with a view to improving the regulatory framework specific to these financial products

(iii.) **Ad hoc surveys by the World Bank.** In 2009, the World Bank conducted a survey of 60 global purchasing managers and suppliers, including questions about their difficulties in gaining access to trade finance[c]. Two other World Bank studies have also tackled these questions, covering 400 companies and 80 banks in the developing countries[d].

(iv.) **The Berne Union database**, which mainly contains data on export credit insurance volumes for contracts written by one of its member institutions in more than 40 countries[e].

(v.) **Since the first half of 2010, the Institute for International Finance** has published a quarterly survey of credit market conditions with a particular focus on international trade finance, among banks located in the developing countries. This source of periodic data provides a useful handle on recent trends regarding the available of trade finance in the emerging countries..

The scarcity of data on international trade finance hampers rigorous analysis of this financial activity. Consequently, it would be worthwhile securing the necessary resources to gather and build more refined empirical data series, on a regular basis and over a long period.

a. See for example IMF-BAFT (2009), "IMF-BAFT Trade Finance Survey: A Survey Among Banks Assessing the Current Trade Finance Environment".
b. ICC. (2009), "Rethinking Trade Finance 2009: An ICC Global Survey", ICC Banking Commission Market, 31 March and IFC Ltd. (2009), "Strategic Assessment of Trade Finance in Emerging Markets (March 2, 2009)", International Trade Department, The World Bank.
c. Arvis, J-F, Shakya, M. (2009), "Integration of Less Developed Countries in Global Supply Chains: A Global Buyers' and Producers' Perspective", World Bank. Mimeo.
d. Malouche, Mariem (2009), "Trade and Trade Finance developments in 14 Developing Countries post-September 2008", World Bank
e. This database is not publicly available but has been supplied to the World Bank and has been analysed by Chauffour, Saborowsky and Soylemezoglu (2010), "Should Developing Countries Establish Export Credit Agencies ?" World Bank working paper.

(7) Chauffour and Farole (2009), "Trade Finance in Crisis: Market Adjustment or Market Failure?", World Bank.

1.3 The empirical literature suggests that the drying up of trade finance does have an impact on trade finance during periods of financial crisis

Two factors can account for the slump in trade volumes in 2008-2009: (i.) the mechanical effect of weaker demand in the industrial countries and the distinct slowdown across all of the emerging and developing economies; (ii.) the impact of the financial shock, with global liquidity drying up, a sudden surge in risk aversion, and a widespread banking crisis, leading to a clampdown on the supply of trade finance. Due to the lack of data directly measuring the availability of trade finance, most empirical studies on the subject have had to rely on indirect indicators and specific econometric methods to measure the impact of a squeeze on trade finance in a financial crisis.

1.3.1 Multi-country horizontal studies

Using the method described by Rajan and Zingales (1998)[8], Iacavone and Zavacka (2009) look at sectoral data over the period 1980-2006 for 21 countries, with a level of disaggregation equivalent to 81 industries. They find that exporting companies in those sectors most dependent on external financing are those that suffer the greatest falls in their exports in periods of financial crisis. Moreover, according to their findings, these financing shocks are indeed additional to and independent of the demand shocks that accompany a banking crisis. An interesting extension to the study's findings is that the impact of financial crises differ according to the source of trade finance: companies that finance their exports via intercompany financing suffer less, relatively, than those that rely on bank financing. Similarly, companies with a significant proportion of physical assets that can be used as collateral are relatively less hard hit in times of crisis.

Using a different methodology, based on a standard international trade equation[9], Thomas[10] (2009) and Ronci[11] (2004) also find that financial crises have a significant explanatory impact on variations in import and export flows in the emerging economies. After having isolated the effect of demand shocks, they find that an emerging economy suffering from both a domestic banking crisis and a sudden, sharp halt to capital flows will experience a drop in imports of between 5 and 10% and a slightly smaller fall in exports.

Finally, a study by the OECD[12], based on quarterly data on 43 countries covering the period Q1 2005 - Q1 2009 and using a dynamic panel estimate, estimates that slightly under a third of the collapse in trade between Q2 2008 and Q1 2009 can be ascribed to the reduced availability of trade finance. According to this study, in addition to the impact of trade finance, 36% of the trade collapse can be explained by the slump in demand, and the remainder by other factors not spelled out in the study.

1.3.2 Country studies

Using the same methodology as Iacovone and Zavacka (2009), Bricogne, Fontagné, Gaulier, Taglioni and Viacard[13] (2009) look at the case of French exporting firms during the 2008-2009 crisis. They use the monthly data provided by French exporters, disaggregated by product and by destination (the level of disaggregation is extremely fine, with more than10,000 product categories). They too find that the firms that least dependent on external financing are those that suffered least during the 2008-2009 crisis, by comparison with those in sectors where external financing plays an important role in their total financing[14].

Conversely, in an article dealing with the United States, Levchenko, Lewis and Tesar[15] (2009), using the same type of data, find that trade finance had no significant impact on US exports during the crisis. But the measurement of dependence on credit used by these authors is ambiguous[16].

In an NBER working paper[17], Amiti and Weinstein (2010) use **Japanese data** linking companies with their banks over the period 1990-2010. In particular, this database allows them to overcome the problems of identification and endogeneity associated with this type of study. Based on their econometric model, they find that, for the period between March 2008 and March 2009, 6 percentage points out of the 19% fall in Japanese exports, or around a third of the total reduction, can be attributed to the financial shock experienced by banks working with exporters. The authors also find that a deterioration in the financial health of banks has far more acute consequences for exports than for domestic sales, which implies that financial shocks affect exports and domestic sales differently.

(8) In a widely-cited article, "Financial dependence and growth", Rajan and Zingales describe a "difference-in-difference" econometric methodology that captures the impact of financial development on growth. The main drawback with this kind of study was the problem of endogeneity inherent in the relationship between financial development and growth. Rajan and Zingales overcome this problem of identification by studying data on an industry-by-industry basis and not just on a country basis, and by using an indicator of the degree of dependence on external financing.

(9) An equation that links import and export volumes to a variable of relative prices and incomes serving to calculate the price and income elasticities of international trade. See for example (2008), "Exchange Rates and Trade Balance Adjustment in Emerging Market Economies" in Exchange Rate Analysis in Support of IMF Surveillance.

(10) Alun Thomas, (2009), "Financial Crises and Emerging Market Trade", IMF staff position note.

(11) Ronci, Marcio, (2004), "Trade Finance and Trade Flows: Panel Data Evidence from 10 Crises," IMF *Working Paper*.

(12) Jane Korinek, Jean Le Cocguic, Patricia Sourdin, (2010), "The Availability and Cost of Short-Term Trade Finance and its Impact on Trade", OECD *Trade Policy Working Paper* no. 98.

(13) Bricogne, Fontagné, Gaulier, Taglioni and Viacard, (2009), "Firms and the Global Crisis: French Exports in the Turmoil", Banque de France Working Paper.

(14) Moreover, after controlling for different factors, they find that companies suffered uniformly from the crisis regardless of size, but that the company's sector of specialization was critical (exporters of capital goods suffered most).

(15) Levchenko, Lewis and Tesar (2009), "The Collapse of International Trade During the 2008-2009 Crisis: In Search of the Smoking Gun".

(16) One of the differences vis-à-vis the article by Bricogne et al. (2009) is that the authors chose as their variable representing dependence on trade finance the ratio of down payments receivable on sales, which is a possible indicator of trade finance but more likely to be an indicator of intra-company finance. Bricogne et al. (2009), meanwhile, use an indicator of dependence on external finance (a financial charge on revenue) that may be a better proxy for the bank component of trade finance. This difference in the findings of the two articles would be consistent with the study by Iacavone et al. (2009), which finds that exporters that have greater recourse to intra-company finance suffer more, in a period of financial crisis, than those more dependent on bank finance.

(17) Amiti, Mary and David Weinstein, (2009), "Exports and Financial Shocks", NBER Working Paper no. 15556, December.

2. What counter-cyclical measures can be taken to ease trade finance during a crisis?

2.1 Targeted public intervention in support of trade finance in response to a liquidity crisis is justified by specific market inefficiencies

There is no obvious *a priori* need for specific public intervention to cushion the impact of reduced availability of trade finance, bank lending especially. That is because all lending to the economy is affected in a financial crisis, and measures aimed at supporting credit to the economy as a whole it may therefore be more effective.

Trade finance is a low-risk form of lending, being short term and recoverable. These instruments are often receivables guaranteed or backed by merchandise, they generally perform well, and the risk of convertibility or transfer is relatively low. That is because this type of lending is thought less risky than other short or medium-term cross-border lending: historically, countries confronted by payments difficulties do not suspend their trade finance-linked loans.

Yet market inefficiencies specific to these financial products seem to have an adverse impact on their relative availability in a crisis[18]:

- **On the one hand, the fact that trade finance involves actors located in different countries tends to work against this type of transaction:** when there is a sharp rise in risk aversion, financial institutions set strict quantitative limits on their foreign exposure, without discriminating between types of instrument or their real level of risk. On the other hand, the fact that the vast majority of trade finance is short-term (often 30 to 180-day revolving credits) implies that, in times of financial stress obliging banks to shrink their balance sheets quickly, this type of transaction is the first to be cut, again without discriminating as to the real risk attaching to these instruments.
- **At the same time, it appears that the treatment of trade finance in international prudential regulations (under the Basel agreement) only imperfectly allows for the specific features of this type of financial instruments**[19]. According to Auboin (2010), the weighting assigned to short-term loans for trade finance are over-calibrated relative to the low real risk inherent in this activity. This weighting of assets by ill-suited risk criteria and the pro-cyclical nature of the solvency ratios are thought to impact the availability of trade finance adversely, especially in the developing countries and in times of crisis. Some important advances have been made in recent months (see Part II.3 below).

Moreover, the fragmentation of production processes across many countries since the 1990s, in Asia especially (see Box 3), is making trade still more vulnerable to a halt to trade finance. Any disruption to trade finance at a certain echelon of the production process that prevents an exporter from contributing his share of value added could have a multiplier effect on trade flows throughout the chain. The growing complexity of production processes and the growth in North-South trade via this type of arrangement means there is a greater need to preserve stable and resilient financing circuits in times of crisis.

2.2 In a liquidity crisis, the authorities can introduce mechanisms to support trade finance, chiefly via the export credit agencies and multilateral development banks

In addition to monetary easing measures to support lending as a whole, it does look as if certain specific measures aimed at international trade finance might prove useful in a liquidity crisis. In particular, the study of crises in the emerging economies and the 2008-2009 crisis has led to the formulation of economy policy recommendations aimed at cushioning the negative impact of scarcer trade finance on trade flows in a financial crisis:

- **In the developed countries, the export credit agencies have succeeded in cushioning the negative impact on trade flows of scarcer trade finance.** These agencies have kept trade flowing by supporting both inter-company and bank finance via insurance contracts and guarantees, as well as by providing new credit lines as a substitute for market financing. Their efforts should therefore be encouraged, and the rapid deployment of temporary and exceptional support until the traditional financing circuits are back working normally can be seen as a counter-cyclical measure to keep world trade flowing. This public assistance clearly depends on the financial constraints weighing on governments, but the limited risk inherent in this type of financial transaction, which export credit agencies either guarantee or substitute for, and the modest size of the intervention required, argue in its favour.
- **These export credit agencies are generally relatively under-developed or non-existent in the emerging and developing economies. Given the institutional obstacles to the creation of effective export credit agencies, the regional development banks appear better-placed to play a role in countries with the least-developed financial markets.** The international financial institutions have encouraged this form of intervention since the Asian crises of 1997-1998 and they acknowledge the effectiveness of regional cooperation in reducing the dependence of these companies' firms on large private sector banks in the industrial countries. Nowadays, all of the multilateral development banks have instituted guarantee funds to support export finance.
- Finally, foreign exchange-rich central banks in some emerging economies have been able to help their domestic banks and importers overcome difficulties in obtaining foreign exchange financing. In 2008, for example, the central banks of Brazil, South Korea, South Africa, India and Indonesia used repurchase agreements to supply their banks with dollars, thus allowing them to continue some of their trade finance activities.

(18) For an in-depth analysis of these market inefficiencies see: Chauffour and Farole (2009), "Trade Finance in Crisis: Market Adjustment or Market Failure?", World Bank.

(19) Marc Auboin (2010), "International regulation and treatment of trade finance: what are the issues?" WTO *working paper.*

Box 3: The impact of the deleveraging of European banks, difficulties in gaining access to dollars, and bank regulation on trade finance in Asia

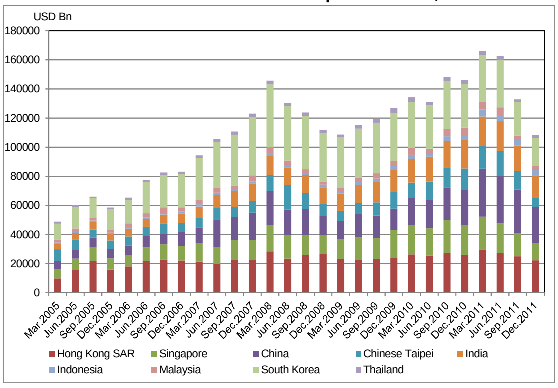
Some large eurozone banks have specialized in lending for trade (both short-term and project finance) with Asia since the late-1990s. These banks were driven to refocus on their domestic activities and reduce their activities-trade finance especially-in Asia by difficulties caused by the eurozone crisis in their domestic market, and by they serious difficulties in raising dollar finance they had been experiencing since 2008 but which had worsened in autumn 2011 with the drying up of financing from the US money market funds. Consolidated BIS data, comprising all French banks' commitments, confirm this rapid shrinking of Asian exposure. Between March and December 2011, French banks' exposure to the Asian region shrank by more than USD 50 billion.

Given the importance of trade in this area and in particular the Asian economies' trading interdependence, a sudden halt to trade finance could have very adverse consequences, potentially. And yet, despite the European banks' substantial retreat since Q1 2011, the supply of trade finance has remained sufficient to avoid any major disruption to trade flows (notwithstanding a slight tightening in Q4 2011, see Chart 5).

The flow of finance to the region remained satisfactory because Asian (especially Japanese and Hong Kong), Australian and UK banks took over from the French banks in this segment. These banks had the necessary resources to take up the slack in Asian markets. However, the local banks that stepped in for the European banks have no dollar deposits, and while their balance sheets are sufficiently solid to qualify for satisfactory access to dollar liquidity, they remain vulnerable to renewed stress in the international lending markets.

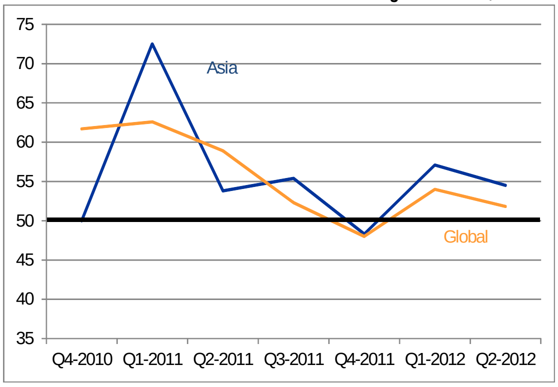
Moreover, the Asian Development Bank (ADB) has helped maintain a sufficient flow of lending through its trade finance support programme, again by stepping in to replace the European banks, sometimes directly. For example, the ADB carried out a total of USD 3.5 billion in transactions in 2011, more than 40% of which concerned trade between countries in the Southern hemisphere.

Chart 4: French banks' exposure to Asia, consolidated data



Source: Bank for International Settlements.

Chart 5: Diffusion index - Lending conditions (50=neutral)



Source: Institute for International Finance.

Japan's, China's and South Korea's very well-funded public and semi-public banks have also taken over from the European banks in the field of project finance.

The ongoing shrinking of eurozone banks' balance sheets in the coming years, along with volatility in the markets for dollar financing, will no doubt pose a risk to trade finance in that part of the world. Greater vigilance will be required on the part of the multilateral and regional institutions in order to avert a drying up of trade finance.

2.3 Structural measures would ease the supply of trade finance in a crisis

Aside from the *ad hoc* measures recommended for dealing with a liquidity crisis, the literature on trade finance has identified a number of avenues for structural reforms to make trade finance more readily available in a financial crisis, namely:

- **In the short and medium term, measures could be taken at the European Community level to make trade finance more readily available in a financial crisis.** In particular, as part of the European Community's discussions now in progress aimed at revising disclosure on short-term export credit, member states and the Commission are considering the possibility of introducing a counter-cyclical mechanism enabling governments to step in, though their export credit agencies notably, to support lending for regular trade in a crisis.
- **Improving the institutional framework in the emerging economies.** Fostering capital markets and improving legal systems in the emerging and developing economies should help minimise the adverse impact of an international financial crisis on the availability of trade finance in these countries. Developing domestic financial markets would help to overcome some of the limits inherent in a situation where much of the lending is provided by large foreign banks: among other things, this would avoid systematic discrimination against lending for trade in the emerging and developing economies in a crisis, even though these transactions are still low-risk.
- **Finally, there is a need for continuing thinking on the treatment of trade finance instruments in international banking regulations.** According to the banks and to certain international institutions[20], such as the WTO and the International Chamber of Commerce, discrimination against this type of instrument under the Basel II rules would reduce the availability of trade finance in a financial crisis.

(20) Marc Auboin (2010), "International regulation and treatment of trade finance: what are the issues?", WTO *working paper*.

For regulation to be as effective as possible, international negotiations on the new body of prudential rules (Basel III) ought to make allowance for the specific characteristics of trade finance. Some progress on this theme has been made in recent months[21] under the existing rules (Basel II). Under the French presidency of the G20 the Basel Committee has eased the prudential rules applicable to bank lending for ordinary trade transactions (90 to 115 days) with a capital requirement equivalent to the duration of the contractual payment time (i.e. a reduction in the capital requirement of around 30%). Moreover, the Basel Committee has agreed to rate non-sovereigns separately from sovereigns, so as to ensure export finance is not withheld from otherwise satisfactorily rated non-sovereigns simply because the sovereign has been downgraded. Over and beyond these improvements to the Basel II rules, problems have arisen in Basel III, notably over the off-balance treatment of certain trade finance-related products. Further debate is therefore needed between trade finance practitioners and the prudential authorities, in order to frame rules well-suited to the specific nature of this type of transaction.

Arthur SODE,

(21) "The treatment of bank finance under the Basel capital framework", Basel Committee on Banking Supervision, October 2011.

Publisher:
Ministère de l'Économie, et des Finances et Ministère du Commerce Extérieur

Direction Générale du Trésor
139, rue de Bercy
75575 Paris CEDEX 12

Publication manager:
Claire Waysand

Editor in chief:
Jean-Philippe Vincent
+33 (0)1 44 87 18 51
tresor-eco@dgtresor.gouv.fr

English translation:
Centre de traduction des ministères économique et financier

Layout:
Maryse Dos Santos

ISSN 1962-400X

Recent Issues in English

http://www.tresor.economie.gouv.fr/tresor-economics