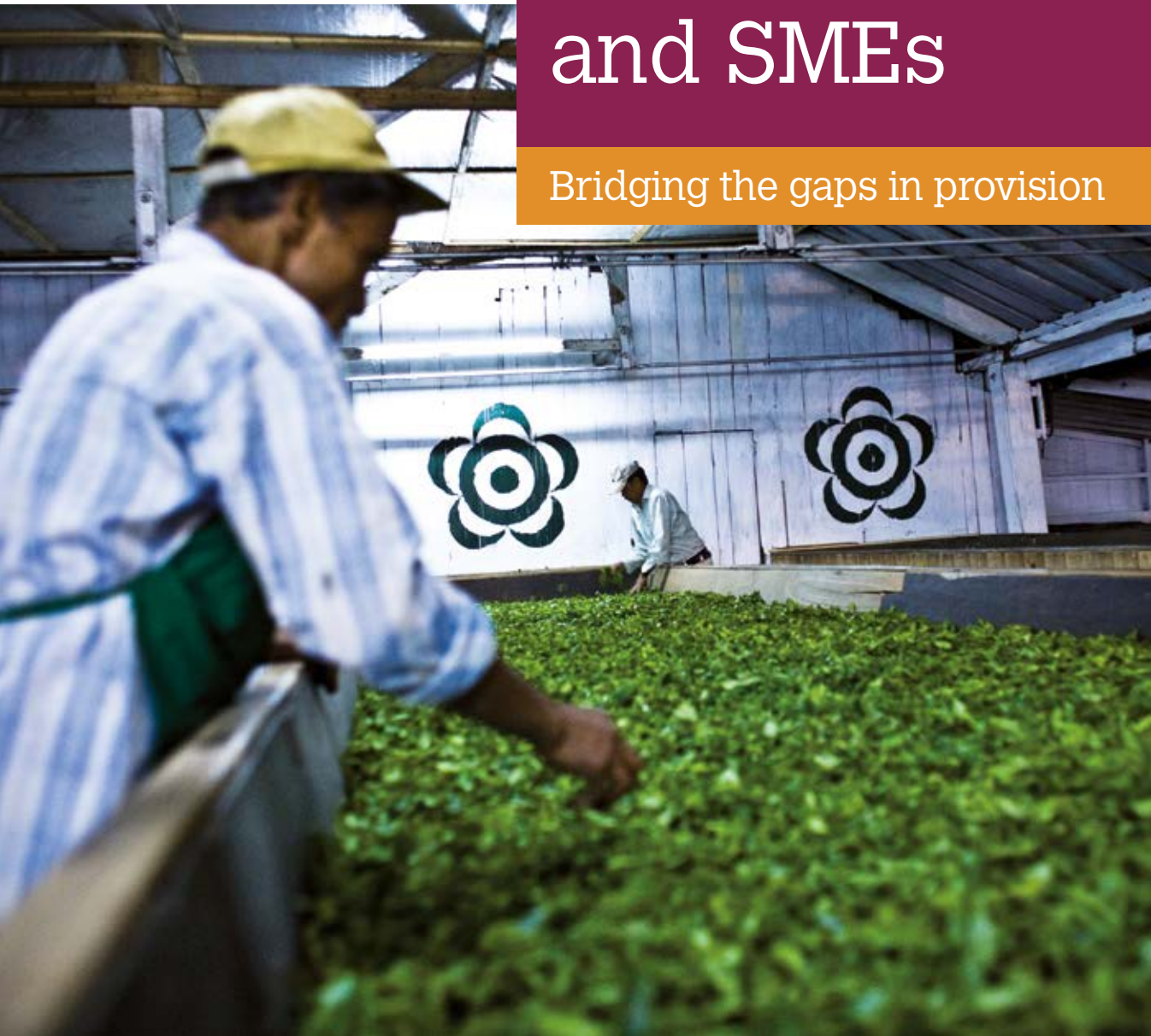




WORLD TRADE  
ORGANIZATION

# Trade finance and SMEs

Bridging the gaps in provision



Cover photo: Makaibari Tea Estate factory in  
Kurseong, Darjeeling.

# Trade finance and SMEs

Bridging the gaps in provision



WORLD TRADE  
ORGANIZATION

## **Disclaimer**

This publication and any opinions reflected therein are the sole responsibility of the WTO Secretariat. They do not purport to reflect the opinions or views of members of the WTO.

# Contents

<b>Foreword by WTO Director-General Roberto Azevêdo</b>	<b>4</b>
<b>Summary</b>	<b>6</b>
<b>Introduction</b>	<b>8</b>
<b>Chapter 1 – Trade finance in brief</b>	<b>10</b>
<b>Chapter 2 – The importance of trade finance</b>	<b>14</b>
<b>Chapter 3 – Quantifying the financing gap in developing countries</b>	<b>20</b>
<b>Chapter 4 – Current efforts to address trade finance issues in developing countries</b>	<b>28</b>
<b>Recommendations</b>	<b>36</b>
<b>Bibliography</b>	<b>38</b>
<b>Abbreviations</b>	<b>40</b>



# Foreword by WTO Director-General Roberto Azevêdo

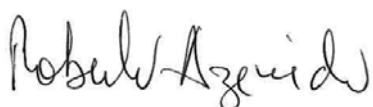
The availability of finance is essential for a healthy trading system. Today, up to 80 per cent of global trade is supported by some sort of financing or credit insurance. However, there are significant gaps in provision and therefore many companies cannot access the financial tools that they need. Without adequate trade finance, opportunities for growth and development are missed; businesses are deprived of the fuel they need to trade and expand.

Small and medium sized enterprises (SMEs) face the greatest hurdles in accessing financing on affordable terms. This is of particular concern as SMEs are a leading driver of trade, employment and economic development. Research shows that SMEs face these hurdles in both developed and developing countries, but the challenges are greatest in lower income countries. This tends to be due to their relatively small banking sectors and the lack of appetite among global financial institutions to do business in those countries – a problem which has increased significantly since the financial crisis.

The availability of trade finance is often cited by businesses around the world – particularly SMEs – as a major barrier to their capacity to trade. We should hear this call and act to improve provision. Indeed, I believe that there are a number of steps we can take.

This report looks at these issues in detail. It brings together recent surveys and research to highlight the scale of the gaps in trade finance provision, it considers the actions that are currently being taken on this front, and it outlines some potential future actions. Such actions could include: enhancing existing trade finance facilitation programmes; helping local banking sectors to grow by improving training programmes; better monitoring of problems with provision; and maintaining a closer dialogue with regulators. The report suggests that setting specific targets could be an effective way of mobilising and coordinating efforts towards closing the gaps in provision.

Inter-institutional partnership and dialogue will be an essential ingredient for success here – and we have a strong track-record of cooperation on which to build. I pay tribute to the work that many organisations are already doing and look forward to enhancing our work with a range of partners to step up our efforts. Together we can ensure that trade finance provision is no longer a barrier to trade but a springboard to growth and development.



**Roberto Azevêdo**  
WTO Director-General



**“Today, up to 80 per cent of global trade is supported by some sort of financing or credit insurance.**



# Summary

- Up to **80 per cent of trade** is financed by credit or credit insurance, but coverage is not uniform. A lack of trade finance is a significant non-tariff barrier to trade, particularly (but not exclusively) in developing countries.
- Small and medium-sized enterprises (SMEs) face the greatest hurdles in accessing affordable trade financing. In some large developed countries, up to **a third of SMEs** face such challenges. SMEs account for 20 per cent of US exports, and 40 per cent of EU exports.
- Globally, over **half of trade finance** requests by SMEs are rejected, against just 7 per cent for multinational companies. Global liquidity tends to be concentrated within the biggest institutions and their clients.
- SMEs in developing countries face even greater challenges in accessing trade finance. The estimated value of **unmet demand for trade finance** in Africa is US\$ 120 billion (one-third of the continent's trade finance market) and US\$ 700 billion in developing Asia. Bridging these gaps in provision would unlock the trading potential of many thousands of individuals and small businesses around the world.
- **Gaps in trade finance** provision are highest in new “frontier” countries for trade, where trade opportunities are increasing as global production patterns evolve.
- Trade financing gaps arise due to a mix of **structural and development factors**. The disinclination of the global financial sector to invest in developing countries after the 2008-09 financial crisis compounds this problem as local banking sectors are often not equipped to fill the market gap.





- With so many businesses deprived of the support that they need to grow, **action is needed** to address these trade financing gaps. This was highlighted in the UN's Financing for Development agenda.

- Various steps are already being taken to tackle this issue on three fronts: first, to **encourage global financial institutions to remain engaged** and to ensure that regulations are not prohibitive; second, to **increase the capacity** of local financial institutions, and third, to provide support measures to **increase the availability** of trade finance via multilateral development banks.

- A number of further steps could be taken, including:

- enhancing existing trade finance facilitation programmes to **reduce the financing gap** by US\$ 50 billion;

- **reducing the knowledge gap** in local banking sectors for handling trade finance instruments by training at least 5,000 professionals over the next five years;

- **maintaining an open dialogue** with trade finance regulators to ensure that trade and development considerations are fully reflected in the implementation of regulations; and

- **improving monitoring of trade finance provision** to identify and respond to gaps, particularly relating to any future crises.

- **A new effort** to support SMEs' access to trade finance, along the lines set out here, could have a very significant, positive impact.

- **Strong inter-institutional dialogue** and coordination will be required to take this work forward, building on a track-record of successful cooperation between the WTO and its partners in this field.



# Introduction



Trade is an important driver of development – but, to be effective, adequate financing and capacity-building assistance is essential. Credit and credit insurance help to oil the wheels of trade by bridging the gap between exporters' and importers' differing expectations about when payment should be made. It is therefore important to identify financing gaps and address them wherever they may appear.

Trade financing is often taken for granted in developed countries because importers and exporters are backed by mature financial industries. Still, even in these countries, small and medium-sized enterprises (SMEs) face hurdles in obtaining financing because they typically have less collateral, guarantees and credit history than larger companies. Hence, trade financing can be an important factor in determining SME contributions to economic growth and development.

Trade finance may be a greater concern for SMEs in developing countries, and particularly in emerging market economies as they account for an ever-increasing share of global trade. Developing country SMEs may face some of the same obstacles as their counterparts in developed countries, such as recognition of creditworthiness, but they also face new challenges, such as smaller, more selective and perhaps less advanced local financial industries. A key challenge in many developing countries is access to the knowledge and skills required for handling trade finance instruments.

Adequate provision of trade finance is essential as developing economies seek to benefit from the trade opportunities offered by shifting patterns of production. Some argue that the

problem can gradually be solved through local financial sector reform, as has been the case in emerging markets where the financial sector's ability to support the trade sector has gradually increased. However, the development of the local financial sector would typically benefit from the presence of global banks and other actors and the transfer of pertinent knowledge – but in the post-financial crisis era global banks are less inclined to invest in many developing countries. This harms the prospects for the supply of trade finance in the very locations where the trade potential is the greatest. As a result, there are large financing gaps, particularly in Africa and Asia, which need to be addressed.

**Adequate provision of trade finance is essential as developing economies seek to benefit from the trade opportunities offered by shifting patterns of production.**



# Chapter 1



**Trade finance is often described as a lubricant of trade.**

# Trade finance in brief

## Trade requires credit or payment guarantees

Only a small part of international trade is paid cash in advance, as importers generally wish to pay, at the earliest, upon receipt of the merchandise in order to verify its physical integrity on arrival. Exporters, however, wish to be paid upon shipment.

In order to bridge the gap between the time at which exporters wish to be paid and the time at which importers will pay, a credit or a guarantee of payment is required. Trade finance provides the credit, payment guarantees and insurance needed to facilitate the payment for the merchandise or service on terms that will satisfy both the exporter and the importer. As such, trade finance is often described as a lubricant of trade. Most trade credit, payment guarantees and insurance are short-term, with a standard maturity of 90 days. In certain cases, trade credit can be extended for longer periods of time, particularly for categories of goods subject to longer production and delivery cycles such as aircraft and capital equipment.

A key aspect of trade finance is that it helps mitigate the risk of cashless trade transactions.

There are two main forms of trade finance:

- **Inter-company credit**

The credit is directly accorded by the buyer to the seller ("buyer's credit"), or inversely by the seller to the buyer ("seller's credit"), depending on the ability of one or the other to extend credit, and the moment at which the two parties agree that the final payment is due. Such a simple transaction can nevertheless become complex given the shape of modern trade, characterized by large "eco-systems" of supply-chain relationships. In such supply chains, the

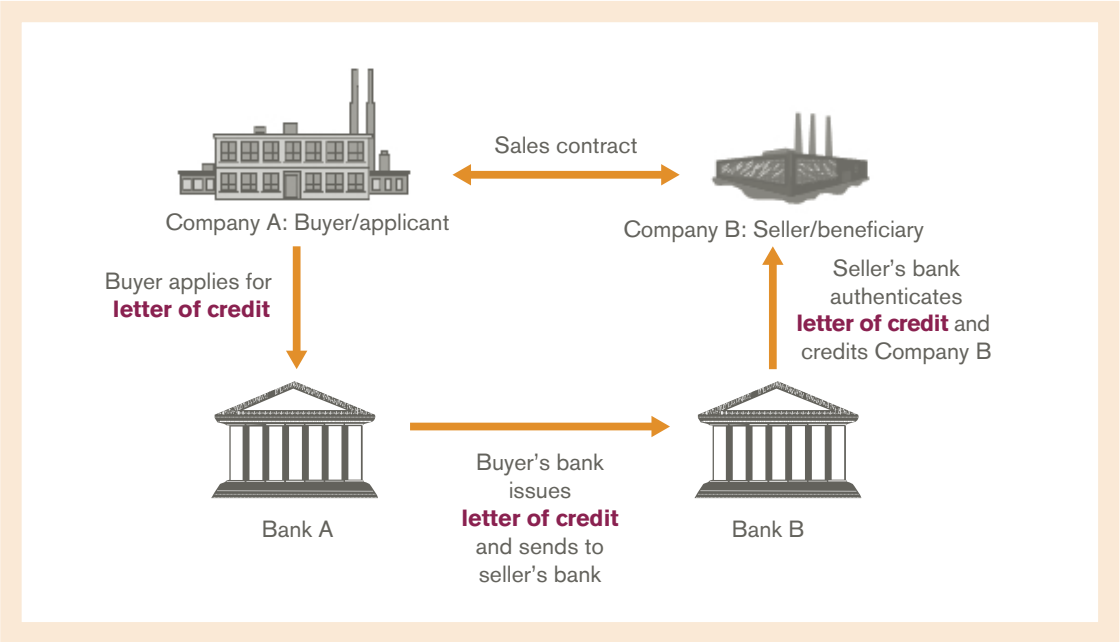
ability of firms (i.e. large suppliers) to extend credit to their trading counterparties (buyers) is enhanced by opportunities to discount their receivables (receiving cash immediately against documentation such as the export contract, a process called "factoring"), or to mitigate payment risk by purchasing trade credit insurance. Long-standing relationships between buyers and sellers may lead the two parties to choose to settle transactions on "open account", meaning that the credit for delayed payment is automatically granted by one or the other party.

- **Bank-intermediated finance**

Letters of credit are widely used in commodity trading, including between developing countries. They are written commitments to pay typically issued by the bank of the buyer (importer, company A) on its behalf to the seller (exporter, company B) or its bank (see Chart 1.1). The letter of credit provides the seller with a guarantee that the purchase will be paid, and carries a number of obligations for the seller (delivery conditions, submission of documentation) and the buyer (notably the guarantee that if the buyer is unable to pay, the bank will cover the outstanding amount).

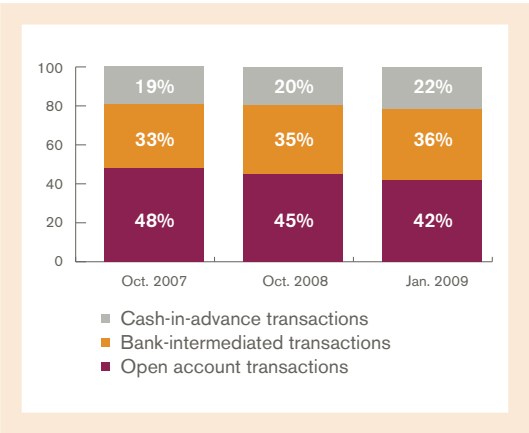
Most letters of credit are governed by rules known as Uniform Customs and Practice for Documentary Credits, promulgated by the International Chamber of Commerce. Letters of credit are typically used by importing and exporting companies for large purchases, and will often negate the need for the buyer to pay a deposit before delivery. In effect, a letter of credit substitutes the creditworthiness of a bank for the creditworthiness of the buyer. Letters of credit are not the only form of bank-intermediated trade finance. Outright lending by banks can involve pre-shipment export finance

Chart 1.1: Letters of credit



either in the form of working capital for the exporter to purchase the raw material needed for subsequent manufacturing of final goods, or on a with-recourse basis, against either a confirmed export order from the buyer or a letter of credit.

Chart 1.2: Change in the composition of trade finance business (percentage of respondents), 2007-09



Source: IMF-BAFT (2009), p. 10.

As highlighted in the following section, it is difficult to determine the exact share of the two main forms of trade finance, inter-company credit by open account and bank-intermediated finance. According to global surveys by the International Monetary Fund (IMF) and the Bankers' Association for Finance and Trade (BAFT), the shares of these two forms are relatively comparable (see Chart 1.2); although some banking institutions argue that the share of open account transactions is dominant in global supply chain transactions.

### Estimating the size of trade finance markets

The Bank of International Settlements (BIS) has noted that there is no single, comprehensive source of statistics allowing for an evaluation of the exact composition and size of trade finance markets (BIS, 2014b). However, it found that the market for trade finance, considered in its widest definition, is very large – certainly well above US\$ 12 trillion annually out of US\$

18 trillion of exports (or imports).<sup>1</sup> For bank-intermediated short-term trade finance, the BIS determined that “a flow of some US\$ 6.5-8 trillion (...) was provided during 2011, of which around US\$ 2.8 trillion was L/Cs [letters of credit]”. It added that “about a third of global trade is supported by one or more bank-intermediated trade finance products”, and that “[t]he remainder was financed by inter-firm trade credit” (non-bank-intermediated).

## Trade finance and risk

While the commercial risks involved in an international trade transaction seem in principle to be larger than in a domestic trade transaction – non-payment, loss or alteration of the merchandise during shipment,

fluctuating exchange rates – trade finance is considered to be a particularly safe form of finance since it is underwritten by strong collateral and documented credit operations.

The low risk nature of short-term trade finance is supported by data collated in the International Chamber of Commerce's (ICC) Trade Finance Loss Register, established in 2011. According to the ICC's “Global Risks – Trade Finance Report 2013”, the average transaction default rate on short-term international trade credit is no more than 0.021 per cent, of which 57 per cent is recovered through the sale of the underlying asset, the merchandise.<sup>2</sup> Table 1.1 provides more detailed risk characteristics across specific categories of short-term trade finance instruments.

**Table 1.1:** Risk characteristics of short-term trade finance products, 2008-11

Category	Transaction default rate	Implied maturity (days)	Recovery rate <sup>1</sup>	Defaulted transaction loss rate <sup>2</sup>	Specific transaction-level loss rate
Import letters of credit	0.020%	80	71%	42%	0.008%
Export confirmed letters of credit	0.016%	70	40%	68%	0.011%
Loans for import	0.016%	110	45%	64%	0.010%
Loans for export: Bank risk	0.029%	140	32%	73%	0.021%
Loans for export: Corporate risk	0.021%	70	51%	57%	0.012%
Performance guarantees	0.034%	110	18%	85%	0.029%
<b>Total</b>	<b>0.021%*</b>	<b>90</b>	<b>52%</b>	<b>57%</b>	<b>0.012%**</b>

1 Observed recoveries as a percentage of defaulted exposure across products.

2 Estimated economic loss rate as a percentage of defaulting exposure after discounting and costs.

\* Over 2008-11, the average observed annual issuer-weighted corporate default rates for Aa-rated customers was 0.14%.

\*\* The total average and the product-level annual transaction-level loss compare favourably with the average observed annual credit loss rate for Moody's customers over the same period of 1.49%.

Source: ICC (2013), pp v, 23.

1 The trade transaction would not be financed twice. In the case of an inter-company credit, there is a seller's credit or a buyer's credit, not a credit on both the export and the import.

2 This would imply a transaction-level economic loss rate of approximately of 0.012% (i.e. 0.021% x 57%) for short-term trade finance transactions. By comparison, the average level of non-performing loans for main banks in the US over the past 20 years has been 3 per cent (World Bank data).



# Chapter 2



**Trade finance is  
universal and vital  
for trading activities.**

# The importance of trade finance

## Trade finance and the trading system

Although trade finance is routine, it is universal and vital for trading activities. Until the financial crises of the 1990s and 2008-09, trade finance was easy to take for granted. During the Asian and Latin American financial crises, credit crunches at the country level affected both exports and imports to the point of stoppage, as experienced by Indonesia after trade credit supply or confirmation had been suspended (WTO, 1998). This led the international community to reflect on issues related to the availability of trade finance during periods of crisis and beyond. The IMF (2003) and the WTO (2004) identified elements of market failure, herd reactions by banks, confusion of counterparty and country risks, gaps between perceived and actual credit risk, as well as other disruptive behaviour. The IMF recommended a number of measures to help foster confidence between importers, exporters and their banks, notably the use of multilateral programmes to facilitate the financing of trade during crisis and calm periods alike.

During this period, WTO members reported to the fifth WTO Ministerial Conference in Cancún in 2003 that “based mainly on experience gained in Asia and elsewhere, there is a need to improve the stability and security of sources of trade financing, especially to help deal with periods of financial crisis. Further efforts are needed by countries, intergovernmental organizations and all interested partners in the private sector, to explore ways and means to secure appropriate and predictable sources of trade finance, in particular in exceptional circumstances of financial crises” (WTO, 2003).

Despite the lessons of the Asian financial crisis, in the heat of the 2008-09 financial crisis trade finance markets were subject to severe shortages due to the contagion of crises in other segments of banking. Even though the G20 implemented a package of US\$ 250 billion (including US\$ 130 billion for developing countries) in the form of credit guarantees and traders’ insurance, the situation did not return to normal in main trading routes until 2012, and it appears to have deteriorated in poor countries ever since in part due to the downsizing of global bank networks (WTO, 2013). This message has been consistently advanced by the Expert Group on Trade Finance, a group of multilateral institutions and private sector banks which observes trends in trade finance markets. Their reports are made available to and discussed by WTO members (see in particular WTO, 2014b).

## Vulnerability of small businesses in accessing trade finance

Small and medium-sized enterprises (SMEs, i.e. companies defined as employing 250 or fewer workers) constitute the vast majority of companies registered in both developed and developing countries. Their role in economic activity, generating growth and innovation cannot be overstated. According to the World Bank, SMEs contribute to over 60 per cent of total employment in developed countries and 80 per cent in developing ones, including the estimated informal sector (World Bank, 2013). Also, according to Organisation for Economic Co-operation and Development (OECD) figures, SMEs account for 40 per cent of exports of OECD countries,<sup>3</sup> and a somewhat smaller share in developing countries,

where concentration of exports is highest among the largest firms (World Bank, 2013).

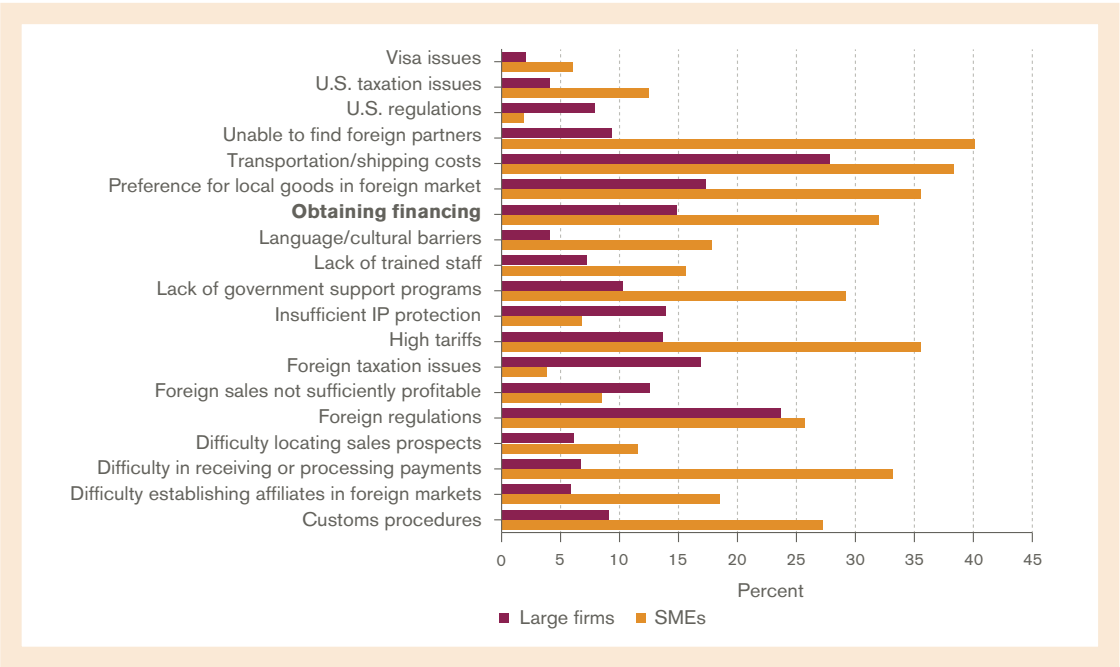
Recent research suggests that an absence of, or weak access to, finance can strongly inhibit formal SME development, regardless of the level of per capita income of countries. Market failures, notably in financial markets (be they financial crises or “information asymmetries”), fall disproportionately on SMEs, resulting in more credit rationing, higher costs of “screening” and higher interest rates from banks than larger enterprises (Stiglitz and Weiss, 1981; Beck and Demirgüç-Kunt, 2006).

Credit constraints are particularly reflected in access to trade finance. A survey of 2,350 SMEs and 850 large firms by the US International Trade Commission (USITC) showed that 32 per cent of SMEs in the manufacturing sector and 46 per cent of SMEs in the services sector considered the process of obtaining finance for conducting

cross-border trade “burdensome”. Only 10 per cent of large firms in the US manufacturing sector and 17 per cent in the services sector experienced the same difficulties. The USITC study also revealed that lack of access to credit is the major constraint for SME manufacturing firms and one of the top three constraints for SME services firms seeking to export or expand into new markets (see Charts 2.1 and 2.2). Even some sectors showing significant levels of creditworthiness and collateral (transport equipment, information technology and professional services) considered that securing finance was an “acute” problem (USITC, 2010).

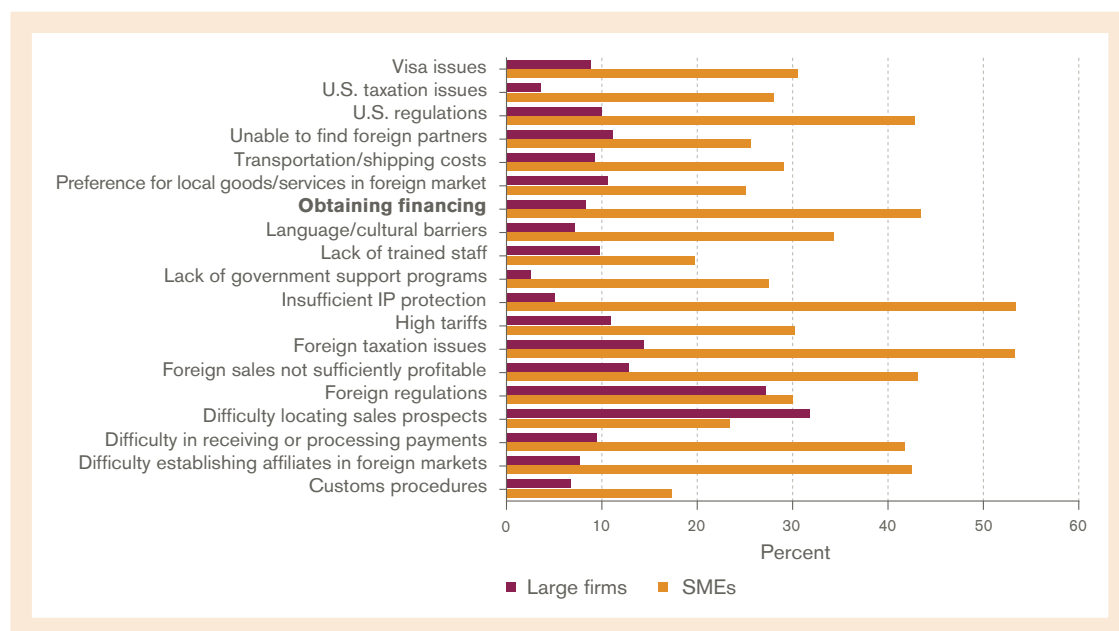
The USITC study also highlighted that while US banks consider the SME market segment in general as possessing a large potential for profitability, SMEs are not their preferred borrowers in view of the higher transactional and informational costs of dealing with such

**Chart 2.1:** US manufacturing SMEs cite obtaining finance as a leading impediment to engaging in global trade



Source: USITC (2010), p 6-12. USITC staff calculation from questionnaire data.

**Chart 2.2: US services SMEs view obtaining financing as the third leading impediment to engaging in global trade**



Source: USITC (2010), p 6-11. USITC staff calculation from questionnaire data.

companies relative to larger corporations. In turn, SMEs complain about banks' excessive oversight, failure to meet their specific borrowing needs, and lack of flexibility regarding the use of alternative financing sources.

Other surveys found similar results in Europe and Japan. In a study covering 50,000 French exporters during the financial crisis of 2008-09, credit constraints on smaller exporters were found to be much higher than those placed on larger firms, to the point of reducing the range of destinations for business or leading the SME to stop exporting altogether (Bricongne *et al*, 2009).

In Japan, SMEs were more likely to be associated with troubled banks, hence exporting SMEs were more vulnerable in periods of financial crisis (Amiti and Weinstein, 2011). In general, credit-constrained firms – mostly likely to be found among SMEs – were also less likely to export (Bellone *et al*, 2010; Manova, 2013).

In less capital intensive or less-developed economies, or economies with lower savings rates, local banks are even more conservative about supporting developing countries' exporters and importers. In developing countries, local banks may lack the capacity, knowledge, regulatory environment, international network and/or foreign currency to supply import- and export-related finance. Equally, traders may not be aware of the available products, or of how to use them efficiently. Other obstacles in developing countries include banking or country risk, particularly in the context of regional and global financial crises. Exports from Asian countries, in particular during the Asian financial crisis, suffered from the contagion of regional financial crises, in certain cases causing interruptions of imports and exports due to the lack of trust of confirming banks in letters of credit issued in crisis-stricken countries (WTO, 2004). More recently, exports from sub-Saharan and other low-income countries have been particularly affected by the global

financial crisis because they are more dependent on bank-intermediated finance than other regions (German Development Institute, 2015). Chapter 3 of this report discusses recent multilateral development bank studies seeking to quantify the shortage of trade finance required for all trade transactions in developing countries, where the risk capacity or likelihood to support SMEs is even lower than in developed countries.

## Challenges stemming from the concentration of global trade finance markets

The above-mentioned study by the Bank of International Settlements (BIS, 2014b) revealed that a large share of international trade is supplied by a relatively small group of globally-active international banks. This group of about 40 banks accounts for some 30 per cent of international trade finance, with local and regional banks supplying the remainder. In a seminal article, Amiti and Weinstein (2011) demonstrated that bank health influences the trade finance conditions offered to companies, and thus their export growth. Hence, the availability of trade finance is largely influenced by the strength of international banks at any point in time (WTO, 2013; BIS, 2014b).

The main trade finance banks are also dominant in other segments of financial services: as such, they have been both responsible for and victims of the recent global financial crisis. Since then, they have been subject to more stringent capital and lending rules, and have had to recalibrate their balance sheets accordingly. As a result, their ability to provide trade finance globally and locally has been affected (WTO, 2013). In other words, the downsizing of global banks after the financial crisis has probably had a negative effect on the ability of traders in developing countries to receive credit, have their letters of credit confirmed and access US dollars, the most widespread currency in international trade (BIS, 2014b).

International bank deleveraging is therefore adding to the structural difficulties faced by traders in

developing countries seeking affordable and accessible trade finance through their own banks. In view of the difficulties regularly reported by the WTO Expert Group on Trade Finance about a drying up of trade finance at the “low end” of the markets – a coded phrase for SME financing – since the end of the most recent financial crisis, some partner institutions have decided to quantify the financing gap in developing countries to understand the lost opportunities, with a particular focus on SMEs (see Chapter 3).

A case study illustrating the difficulties faced by SME traders in new “frontier” countries for trade is shown in Box 2.1 It describes the above-mentioned challenges: international banks’ unlikelihood to approach new and promising markets; local banks’ lack of ability and knowledge to support new traders; and resorting to second-best solutions that either keep producers and traders downstream or carry significant opportunity costs in terms of using scarce cash resources.

Still, thousands of SMEs have integrated in global value chains, not only as suppliers of components in vertically integrated manufacturing networks, but also as innovative partners in bio-agriculture, electronics and high-value services. Bank-based instruments are complemented or replaced by other arrangements such as inter-company loans, including open-account payment and factoring. Still, these alternative techniques require costly or complicated risk management by SMEs. Usual risk mitigators for inter-company lending such as trade credit insurance or factoring is most often unavailable in the poorest countries. Lack of contract enforcement does not make things easier. This is why bank-intermediated finance remains popular in developing countries, although the rate of use of letters of credit varies from country to country: it also depends on the distance between traders, the type of goods traded and availability. The existence or absence of an appropriate regulatory system is important. Collateral requirements, which may be up to 100 per cent of the value of the good, could be major hurdles.



**Box 2.1: Case study: trade finance challenges in Myanmar**

Myanmar is a new “frontier” country for trade. According to the local garment industry association, two new garment factories financed by an array of local, Chinese and Indian investors open each day. New export-oriented investors have also appeared in the agro-food and consumer products sectors. Still, SMEs face difficulties in financing their imports and exports, resulting in lost trading opportunities. They are symptomatic of constraints found in countries with similar levels of development. Such constraints may include: reduced capacity for the local banking sector to support the trade sector; a dearth of information about trade finance products offered by the local banking sector; and a lack of awareness by local regulators about appropriate regulation for trade finance products. For example, in Myanmar, outdated regulations prohibit importers from paying for foreign goods with cash in advance, or local exporters from being paid after export. Moreover, many foreign banks have shown limited interest in penetrating the domestic market, in part due to the current re-sizing of their global networks. Under local law, those willing to do so have been confined to dealings with foreign-owned customers.

In such a difficult environment, Myanmar’s main traders have thus far resorted to second best solutions, mainly circumventing local laws by paying imports from bank accounts located overseas, or by opening letters of credit through brokers in offshore centres such as Singapore and Hong Kong, China. Still, only the largest companies can afford to do so. New small garment exporters do not hold off shore cash reserves with which to pay their suppliers, nor do they have sufficient credit records for brokers to find foreign banks to open letters of credit. They can only rely on Myanmar’s local banks, which have limited risk management capacity, still charge a US\$ 1,500 fee for opening letters of credit, and require a minimum of 30 per cent collateral. No open account facility is available in Myanmar, and trade credit insurance is not allowed. The lack of efficient and affordable trade financing tends to relegate new exporters of garment and food products to downstream operations that do not require purchase of imports or credit on export receipts. Being limited to accepting service fees for assembly operations means that companies cannot move up the value chain and access better quality and better paying jobs.

The Government of Myanmar is reform-minded. Reforms in the financial sector are gradual, and it might indeed take some time for trade finance regulation to change, as well as for local banks to take more risks and propose a wider range of competitive trade finance products to local clients.

Externally, the Myanmar trading and financial sectors suffer continuing negative effects from prior international financial sanctions which have now mostly been lifted. Many global banks are in the process of reducing international networks and correspondent relationships, deleveraging balance sheets and reducing costs. As compliance efforts increase, the perception of reputational risk is highest on “know-your-customer” (KYC) and anti-money laundering rules. Despite efforts to upgrade standards, the local financial sector is still regarded as lagging behind requirements, which does not help with its international integration.

Myanmar currently receives technical assistance on upgrading its trading and financial systems from the international community. Recently, the diagnosis for trade finance has improved, with joint missions and reports by several international organizations, including the International Trade Centre, the World Bank and the Enhanced Integrated Framework.

Source: WTO Secretariat, input chapter, DTIS of Myanmar, Enhanced Integrated Framework (forthcoming)

3 Data is available at <http://www.oecd.org/std/its/trade-by-enterprise-characteristics.htm>.

# Chapter 3



**Financing gaps are the greatest in the poorest countries, notably in Africa and developing Asia.**



# Quantifying the financing gap in developing countries

## Converging quantitative estimates

Determining the quantitative gap in trade finance is difficult because global, regional or country trade finance statistics are limited or partial, even in developed countries. Most of the evidence is survey-based and hence of a qualitative nature. Nevertheless, surveys provide useful information about trends, notably when they are conducted on a regular basis. The ICC and the World Economic Forum (WEF) conduct annual surveys, and the Centre for the Promotion of Imports from developing countries (CBI), the Dutch Ministry of Foreign Affairs research group, conducts a triennial survey. These studies are methodologically rigorous and benefit from a large and global coverage (almost 300 banks in over 100 countries for the ICC; thousands of small and medium-sized exporters for the CBI).

Financing gaps are the greatest in the poorest countries, notably in Africa and developing Asia. There are two recent surveys covering the African continent, the most recent and “conservative” from the African Development Bank (AfDB, 2014). The other study was funded by the European Union for the African, Caribbean and Pacific group of states (ACP), and is on the higher end of gap estimates (ACE International Consultants, 2013). The results of both studies are described below.

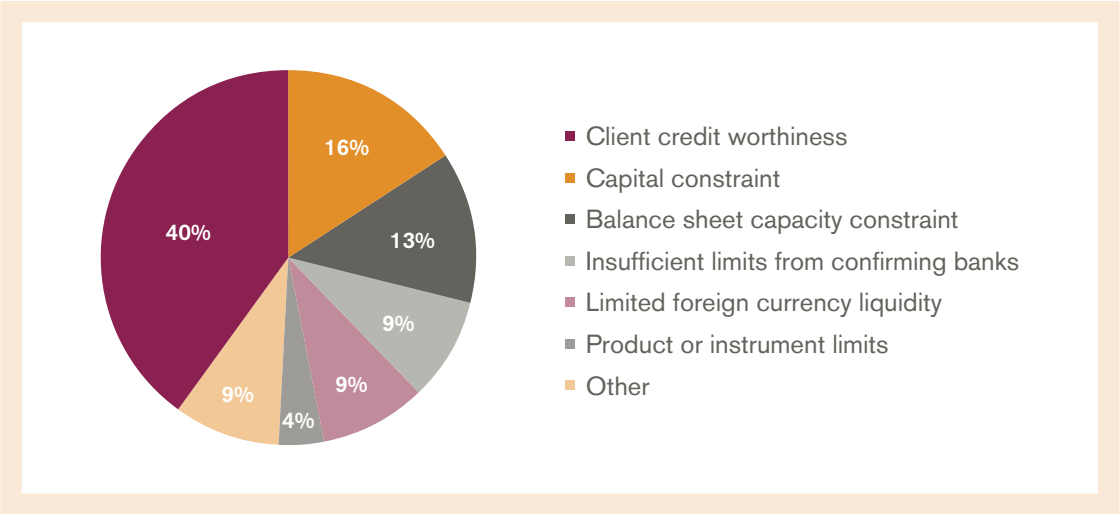
In the recently released report “Trade finance in Africa”, the African Development Bank surveyed the trade activities of 276 African commercial banks operating in 45 African countries. It found that the market for bank-intermediated trade finance was between US\$ 330-350 billion, but could have been higher had a significant

share of the financing requests from traders not been rejected. Based on an estimate of rejected requests, the conservative estimate for the value of unmet demand for trade finance in Africa was US\$ 110 billion in 2011 and US\$ 120 billion in 2012 (AfDB, 2014).<sup>4</sup>

The main reasons for rejecting financing requests were a lack of creditworthiness or credit history, insufficient limits granted by endorsing banks to local African issuing banks, small balance sheets and limited capital of African banks, and insufficient US dollar liquidity (see Chart 3.1). Some of these constraints are structural and can only be addressed in the medium-to-long run: the African banking sector is not very concentrated, hence limiting the financing capacity of individual banks; the lack of US dollar availability is chronic; and many African banks are risk-averse in view of the limited collateral guarantees presented by small traders. In the light of such constraints, the survey argued that the African Development Bank’s Trade Finance Facilitation Program, as well as those of other development finance institutions, are needed and are particularly well-suited to addressing some of these obstacles.

**The estimated value of unmet demand for trade finance in Africa was US\$ 120 billion in 2012.**

**Chart 3.1:** Reasons for African banks' rejection of letters of credit applications



Source: AfDB (2014), p 29.

The 2013 ACP survey is on the higher end of the financing gap estimate in Africa. The study sought to estimate the unmet demand for trade finance. The trade finance gap in sub-Saharan countries was evaluated at US\$ 225 billion a year unmet by the financial system (part of this gap may have been met by informal trade financing). The study concluded that the main constraints in filling such gaps are the cost and maturity of facilities, notably during the periods of crisis; a strong dependency on external sources of trade finance; a vulnerability to external shocks; the limited institutional capacity of local suppliers; and limited financial inclusion stemming from a limited use of bank accounts (ACE International Consultants, 2013).

Prices for trade-related lending provide another useful proxy for the trade financing gap. Just as market prices reflect supply and demand, evidence of gaps in certain regions is logically translated into the price of trade finance instruments. Based on the spreads for emerging market trade credit instruments published by Omni Bridgeway – a leading firm in trade finance restructuring – a large

number of African countries have encountered extremely high spreads on trade financing, consistently high over the years as evidenced in Table 3.1. For instance, in 2014, interest rates on trade loans peaked at 49 per cent per annum in Kenya and 70 per cent in Angola.<sup>5</sup> Apart from a few countries for which political risk may be the main factor, such prohibitive terms on African countries reflect disconnect between perceived and actual commercial risk.

Using both a survey and econometric calculations, the Asian Development Bank estimated that unmet global demand for

**Unmet global demand for trade finance may have been as high as US\$ 1.4 trillion in 2014.**

trade finance may have been as high as US\$ 1.4 trillion in trade in 2014 (ADB, 2015).<sup>6</sup>

In Asian developing economies alone, the estimated shortage might have been as high as US\$ 700 billion combined for the largest countries – such as China and India – and the poorest developing countries: Bangladesh, Cambodia, Indonesia, Malaysia, Myanmar, Nepal, Pakistan, Sri Lanka and Viet Nam.

Small and medium-sized enterprises (SMEs) are the most credit-constrained: estimates project that half of their trade finance requests are rejected, compared to only 7 per cent for multinational corporations. With 68 per cent of surveyed companies reporting that they did not seek alternatives for rejected requests, trade finance gaps appear to be exacerbated by a lack of awareness and familiarity among companies

– particularly smaller ones – about the many types of trade finance products and innovative alternatives such as supply-chain financing, bank payment obligations and forfaiting. Indeed, a large majority of firms stated that they would benefit from greater financial education. Finally, firms cited price constraints as the key systemic bottleneck to obtaining trade finance. The survey confirms that multilateral development bank trade finance programmes help fill persistent trade finance gaps in Asia and elsewhere.

## Converging qualitative surveys

Qualitative surveys can help position the lack of trade finance relative to other structural supply-side problems faced by exporters in

**Table 3.1:** Africa trade credit pricing (annual interest rate)

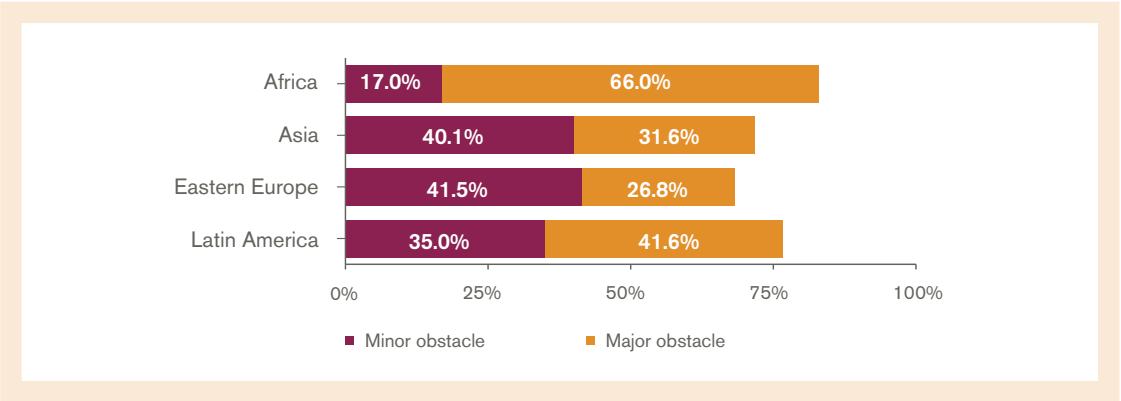
Country	Price range as of May 2011		Price range as of April 2014	
	LOW	HIGH	LOW	HIGH
Angola*	60%	65%	65%	70%
Cameroon	14%	20%	18%	24%
Congo	22%	26%	22%	26%
Democratic Republic of the Congo	16%	20%	22%	27%
Ghana	78%	82%	74%	78%
Kenya*	39%	49%	39%	49%
Mozambique	20%	26%	20%	26%
Senegal	12%	16%	12%	16%
Sudan	15%	19%	9%	14%
Tanzania	10%	13%	25%	35%
Uganda	14%	16%	16%	18%
Zambia	13%	20%	13%	20%

Note: Trade credits and their documentation differ from case-to-case and price ranges should therefore be considered as benchmark only. Price ranges are based on a monthly compilation of sources and analytics. Liquidity on most instruments is very limited and trading may not have taken place for some time.

\*Spreads are corrected for inflation.

Source: Omni Bridgeway (2011, 2014).

**Chart 3.2:** The extent to which access to trade finance forms an obstacle to a company's exports, broken down by region

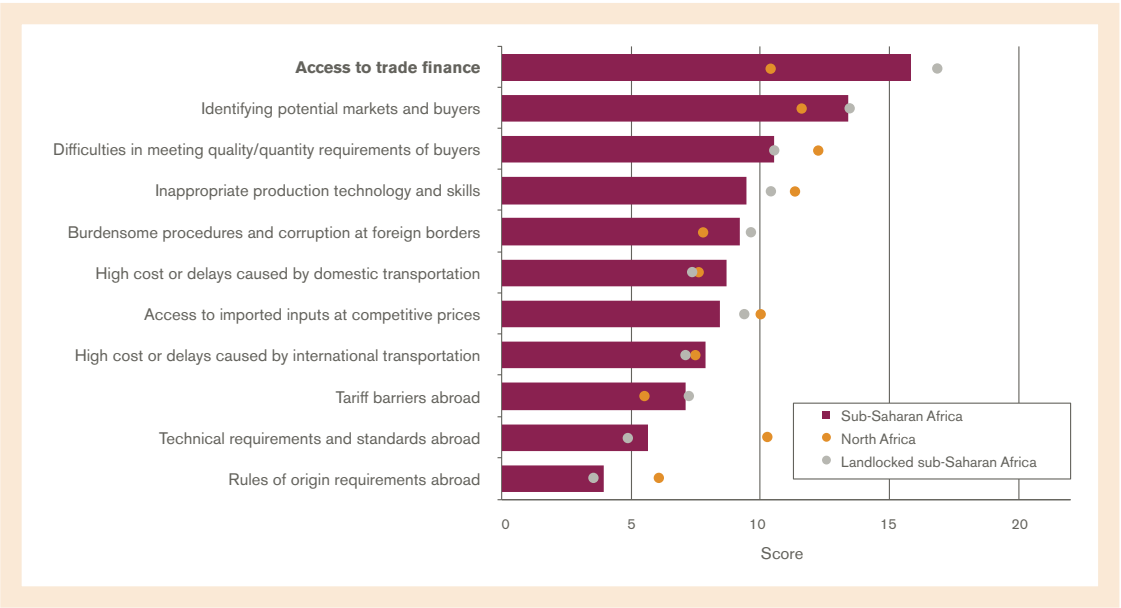


Source: CBI (2013), p 23.

poor countries. Unsurprisingly, lack of access to finance is the primary concern when operating in international markets. A variety of sources indicate that it is a major obstacle for traders in Africa, but also in other regions.

The Netherlands' Centre for the Promotion of Imports from Developing Countries took stock of the difficulties faced by 3,000 SME exporters in 52 countries in accessing trade finance. Respondents considered the lack of access to

**Chart 3.3:** The most problematic factors for exporting in Africa



Note: From the list of factors above, respondents were asked to select the five most problematic ones for trading in their country and to rank them between 1 (most problematic) and 5. The bars in the figure show the responses weighted according to their rankings.

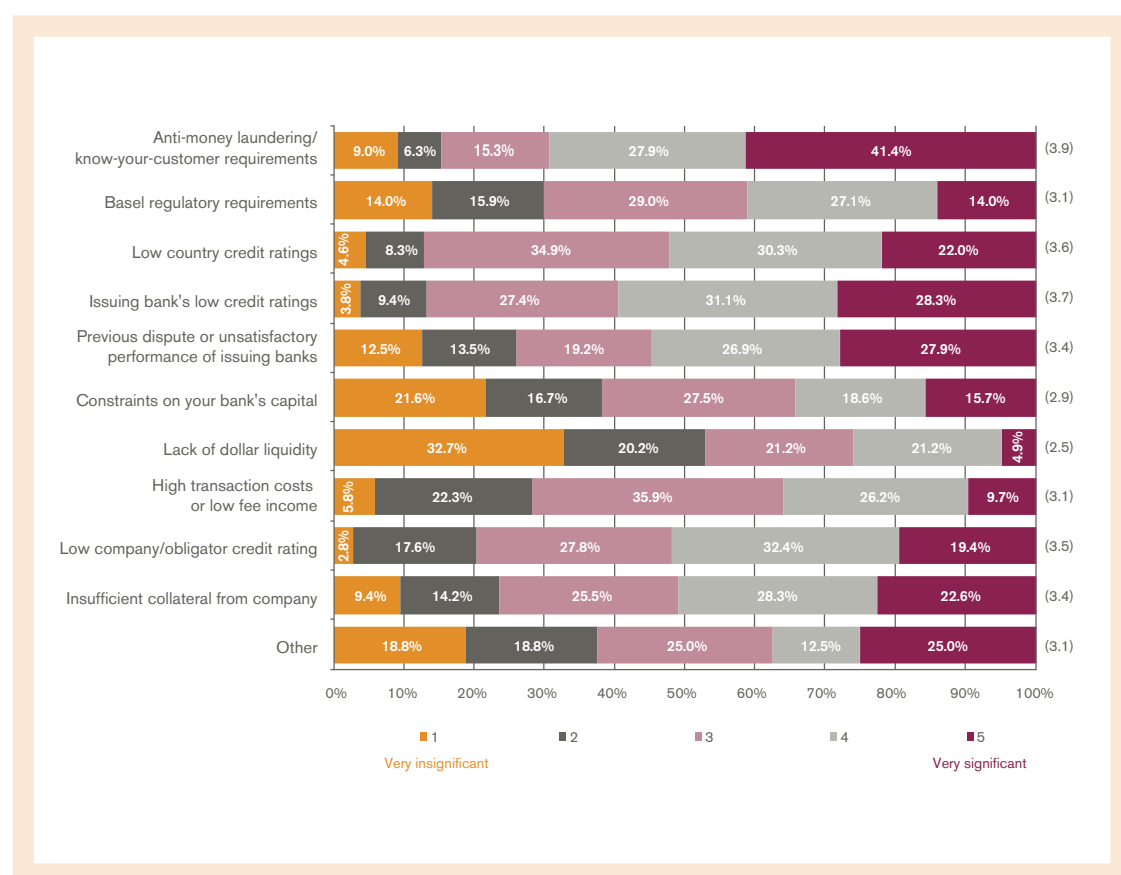
Source: WEF (2013), p 54.

trade finance to be troublesome, particularly for SME exporters. Trade finance shortages affected both exports and turnover, as a result of foregone sales to foreign customers. Respondents noted that local financial sectors were often unable to support modern international transactions such as trade receivable financing. SME exporters were asked whether access to trade finance was a more serious, equally serious or less serious obstacle than three years earlier. The results showed that for one-third of exporters it was a larger obstacle, though for more than half the situation was unchanged (CBI, 2013).

As shown in Chart 3.2, the extent to which access to trade finance deteriorated differed across regions. Africa remains the most affected region in the world, followed by Latin America and Asia. The survey is currently being updated.

These results are corroborated by the 2014 WEF Global Enabling Trade Report. Published every two years, the report assesses the quality of institutions, general infrastructures and services available for trade. In this and other reports, the WEF ranked the lack of access to trade finance as one of the most problematic factors for exporting in Africa (see Chart 3.3).

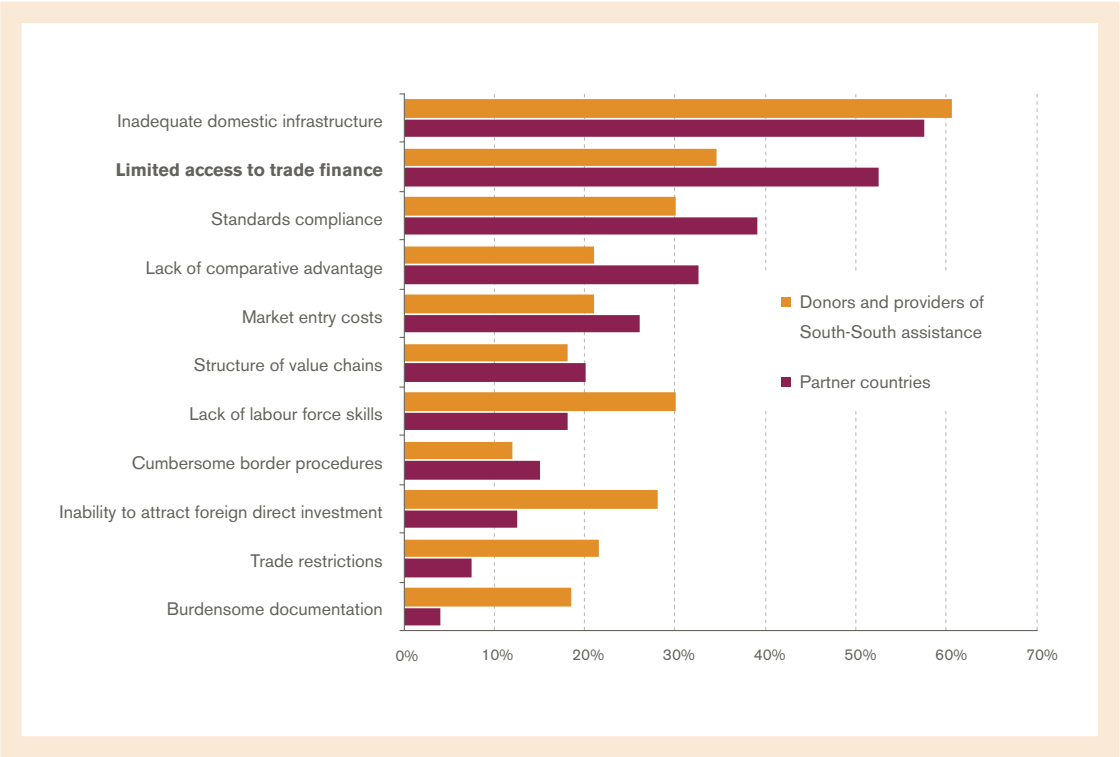
Chart 3.4: Impediments to trade finance according to respondent banks



Note: Numbers in brackets are weighted averages of ratings. The closer the average rating is to 5, the higher the level of significance. An average rating close to 1 indicates a low level of importance.

Source: ICC (2014), p 97.

**Chart 3.5:** Public views of the main barriers in connecting firms to value chains (percentage of responses)



Source: WTO-OECD (2013), p 24.

The ICC Global Survey 2014, based on data from 298 banks in 127 countries, confirms such findings. Forty-one per cent of respondent banks acknowledged the existence of a shortfall in global trade finance supply, with an emphasis on SMEs and Africa. Among the main obstacles limiting SME access to trade finance are the increasing compliance and regulatory burdens as well as low country and local bank credit ratings (see Chart 3.4). Seventy per cent of respondent banks recognized a role for multilateral development banks in providing access to trade finance.

**Among the main obstacles limiting SME access to trade finance are the increasing compliance and regulatory burdens.**

Finally, with regard to the issue of financing trade in the context of global value chains: a survey conducted by the WTO and the OECD in 2013 as background for the Fourth Global Review of Aid for Trade concluded that lack of access to trade finance was a key obstacle to low-income countries participating in global value chains (see Chart 3.5).

**Lack of access to trade finance is a key obstacle to low-income countries participating in global value chains.**

---

4 Multilateral development banks are working to improve survey methodologies, in particular concerning the question of credit rejection as a proxy of the trade finance gap. There are many reasons why credit can be refused, so refusal alone is not necessarily an indicator of market failure. Follow-up survey questions may help clarify the link between rejected credit and trade foregone. On-going progress in methodology is applied to these large and extensive surveys to improve the quality and granularity of results.

5 In addition to high interest rates, requirements may include up to three years of financial statements and collateral requirements covering from 30 to 50 per cent of the loans' present net value.

6 This figure represents an upper limit since responses do not distinguish the quality of proposals for trade finance and the methodology requires extrapolation from partial data. Precisely, the estimated value of the global gap was calculated in two steps: first, the surveyed banks' rejection rate is drawn from the bank's responses to their approximate total value of proposed transactions and to the average percentage of rejected transactions; and second, this reported gap from the surveyed population is then projected to the global banking environment, obtained by weighting surveyed banks' assets as a proportion of global assets.



# Chapter 4



**Multilateral trade finance facilitation programmes helped facilitate over US\$ 30 billion in trade in 2014.**

# Current efforts to address trade finance issues in developing countries

## Supporting multilateral development banks in establishing a global network of trade finance facilitation programmes

In 2011, the WTO Director-General and World Bank President, along with the heads of multilateral development banks (MDBs), drew attention to trade finance issues. The G20 Seoul Summit Document indicated that:

To support LIC [low-income country] capacity to trade (...) [w]e note our commitment to (...) support measures to increase the availability of trade finance in developing countries, particularly LICs. In this respect, we also agree to monitor and assess trade finance programs in support of developing countries, in particular their coverage and impact on LICs, and to evaluate the impact of regulatory regimes on trade finance. (G20, 2010, para. 44)

In the context of the G20 mandate, the WTO Secretariat has reviewed the efforts already deployed by regional development banks and the World Bank Group (through the International Financial Corporation (IFC), its private sector arm) to support trade finance. These efforts are significant, as summarized in Table 4.1. The Asian Development Bank (ADB), the European Bank for Reconstruction and Development (EBRD), the Inter-American Development Bank (IDB), the International Islamic Trade Finance

Corporation (ITFC), and the IFC operate relatively similar programmes. In early 2013, the African Development Bank (AfDB) opened a permanent programme and has already financed close to US\$ 1 billion in trade transactions in Africa and expects to support more than US\$ 10 billion over the next four years. The various institutions often work in partnership: for example, the ADB has worked with the IDB and the AfDB to include member banks in each other's trade finance programmes, in order to encourage direct cross-continental relationships between banks and alleviate part of the financing gap in trade between developing countries.

Taxpayers do not incur costs from the expansion of trade finance facilitation programmes and similar schemes. These are risk-mitigation instruments run on a private sector demand basis, with a focus on clients in the poorest developing countries. All institutions operating such programmes run net operating profits while facilitating trade in places where private markets do not operate. These programmes strengthen financial and trade inclusion in low-income countries. In effect, they provide risk mitigation capacity (guarantees) to both issuing and confirming banks and allow for rapid endorsement of letters of credit, the main instrument used to finance trade transactions between developing countries, and between developed and developing countries. The MDB guarantee ensures that the bank (typically the bank of the exporter) agreeing to confirm a letter of credit (typically issued by the bank of the importer) will be paid even if the issuer defaults.

The guarantee ensures that the exporting bank is paid. Such guarantees are rarely activated, but are valuable because they reduce the perceived risk of conducting trade operations in low-income countries: they close the “confidence gap” between perceived and actual risk. Demand for these programmes increased during the 2008-09 financial crisis and has remained high.

In addition, the Islamic Development Bank, though its trade finance subsidiary, the International Islamic Trade Finance Corporation (ITFC), supports trade finance transactions among Organization of Islamic Cooperation member countries. The ITFC model is focused on providing direct financing to partner banks, institutions, governments and the private sector through Sharia-compliant structures. The programme is very effective in providing direct financial support, including pre-export financing. In 2013, trade transactions funded

directly by the ITFC totalled US\$ 5 billion, up from US\$ 3 billion in 2011. In 2015, this amount was further increased to US\$ 6 billion. The main beneficiaries are mainly SMEs in member countries across Africa, Central Asia and the Middle East. The ITFC's trade finance programme is a growing and very effective tool to support trade in those regions, and it fully complements the programmes of other multilateral development banks.

All-in-all, multilateral trade finance facilitation programmes helped facilitate over US\$ 30 billion in trade in 2014 in the markets with the biggest gaps in provision. Almost one-third of IFC's total operations took place in sub-Saharan Africa and the ADB's risk-mitigation support mainly caters to the poorest regions in Asia, *inter alia* Pakistan, Bangladesh, Viet Nam, Sri Lanka, Nepal and Uzbekistan.

**Table 4.1:** Overview of the main MDB trade finance facilitation programmes

	<b>EBRD</b>	<b>IFC</b>	<b>IDB</b>	<b>ADB</b>
	<b>Trade Facilitation Programme (TFP)</b>	<b>Global Trade Finance Program (GTFP)</b>	<b>Trade Finance Facilitation Program (TFFP)</b>	<b>Trade Finance Program (TFP)</b>
Number of countries in operation	23	96	21	18
Programme commencement	1999	2005	2005	2004
Number of transactions since commencement (year ending 31.12.2012)	15,508	31,600	4,457	8,338
Value of transactions in 2013	EUR 1.2 billion	US\$ 22 billion	US\$ 1.21 billion	US\$ 4.03 billion
Number of confirming banks	800+	1,100	297	124
Claims to date	2 – no losses	zero	zero	zero

Source: ICC (2014), p 75.

## Creating new initiatives to meet the needs of low-income countries

A 2014 WTO-OECD survey found that the lack of integration of low-income countries into global value chains is a major obstacle to development. In such countries, the local financial sector's ability to provide for supply chain finance arrangements is limited. Local access to factoring is almost non-existent and SMEs are largely excluded from private supply chain financing systems. To address this challenge, MDBs are extending receivable financing arrangements through local banks to help integrate small manufacturers from promising countries into international supply chains. As part of its Global Trade Finance Program, the IFC recently developed two types of trade financing products. Warehouse finance products extend working capital to small farmers and agricultural producers in food supply chains by leveraging their production, and supply chain products provide short-term financing to exporters in emerging markets that sell to large international companies on open account. The ADB and the EBRD also operate similar supply chain products. These welcome developments have the potential to spark greater private sector involvement in extending receivable financing as well as in mobilising additional trade financing and facilitating the integration of SME exporters or producers into supply chains.

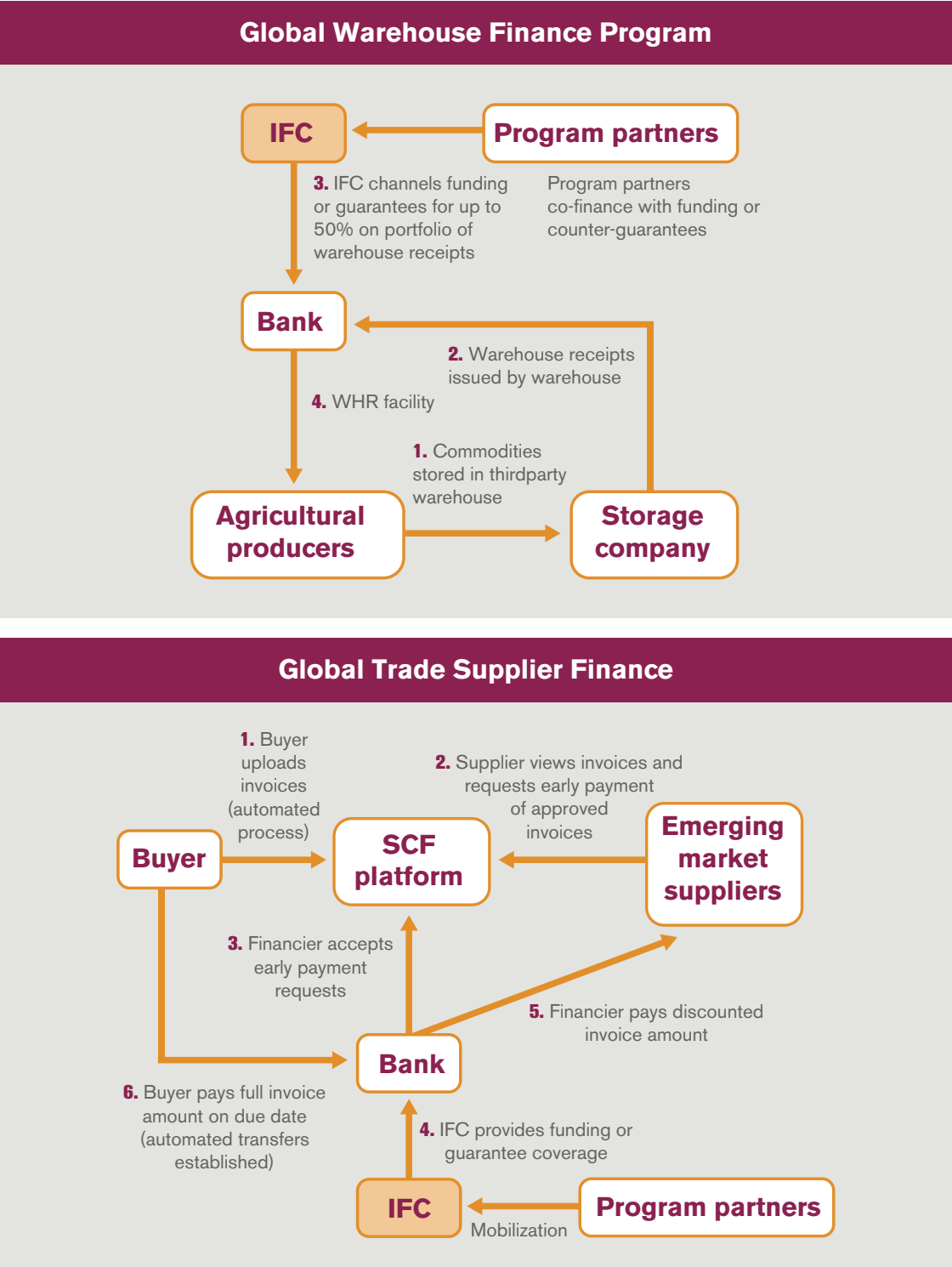
## Private markets are innovating to make trade finance more readily available to SMEs.

Warehouse receipt financing, a collateralized commodity transaction, is a particularly relevant form of pre-export trade finance for emerging market agriculture. It is a lending technique that extends bank loans to farmers, producers and traders of agricultural commodities by pledging their warehouse receipts issued against commodities deposited in licensed warehouses. There are a number of prerequisites for a thriving warehouse receipt market: an appropriate legal and regulatory environment, support from local banks and commodity firms, as well as a well-functioning commodity exchange that guarantees price transparency. Chart 4.1 describes the operation of the IFC's Global Warehouse Finance Program and Global Trade Supplier Finance. Since 2011, the Global Warehouse Finance Program has financed over US\$ 7.5 billion worth of commodity finance transactions in more than 41 countries, including Burkina Faso, Ethiopia, Ghana, Guinea Bissau, Kenya, Malawi, Senegal, Tanzania and Uganda.

Private markets are also innovating to make trade finance more readily available to SMEs. Factoring is the fastest growing source of short-term financing for SME suppliers. It allows suppliers with weak credit ratings to access funding based on the value of their receivables (confirmed invoices), different from traditional lending relationships. According to the 2014 ICC Global Survey, supply chain finance is one of the innovations most likely to change the trade finance industry, with 66 per cent of bank respondents underlining its increasing importance for their institutions. Several developing countries are promoting the use of factoring facilities to further bring the benefits of supply chain finance to smaller suppliers. In Mexico, the “Cadenas productivas” (production chains) programme delivers cash against receivables via a secure online platform. The Reserve Bank of India recently announced a “Trade Receivables Discounting System” or “TReDS”, akin to the Mexican programme.



Chart 4.1: IFC's supply chain solutions



Source: IFC (2012), pp 8, 10.

## Avoiding the unintended consequences of Basel III on trade finance, particularly for developing countries

Traditionally, trade finance – mainly letters of credit and other self-liquidating instruments of payments for trade – received preferential treatment from national and international regulators on grounds that it was one of the safest, most collateralized and self-liquidating forms of finance. This was reflected in the low credit conversion factor (CCF) determined under the Basel I framework for the capitalization of these instruments, which was set at 20 per cent, i.e., five times lower than any on-balance sheet loan. However, as the banking and regulatory communities moved towards internal ratings-based and risk-weighted assets systems under the successor Basel II framework, issues regarding maturity structure and country risk emerged.

After the 2008-09 financial crisis, in the context of prudential re-regulation of the financial system under Basel III, some requested that trade finance, which had suffered casualties by contagion from other segments of the financial industry, not be penalized. The unintended consequences of increased prudential requirements were to be avoided, notably in respect of the ability of developing countries to access affordable trade finance. At the end of 2011, the G20 asked that the WTO and World Bank on the one hand, and the Basel Committee on Banking Supervision (BCBS) on the other, engage in discussions aimed at improving a common understanding of trade finance and identifying any unintended consequences of prudential regulation. This dialogue proved extremely useful. The data collected by the ICC under the pilot trade finance register allowed prudential regulators to improve their understanding of trade finance and verify the

low-risk character and absence of leverage in the industry. The aggregate data delivered covered more than 20 major international banks, over 5 million transactions and revealed less than 1,150 defaults. Since 2011, the WTO and the World Bank have continued to hold discussions with the Basel Committee.

Since then, the BCBS has made three revisions reflecting the low risk of trade finance and improving its regulatory treatment:

- On 25 October 2011, the BCBS agreed to reduce the excessive risk-weighting requirements on low-income countries, and to waive the one-year maturity floors for letters of credit and related instruments. Both measures are of great importance in removing obstacles to trade finance in developing countries (BIS, 2011).
- On 6 January 2013, the new Basel III guidelines on liquidity (concerning the liquidity coverage ratio) proved to be favourable to short-term self-liquidating trade finance instruments. In its Decision, the Committee allowed national regulators to set very low outflow rates – between 0 and 5 per cent, significantly below previous levels – for contingent funding obligations from trade finance instruments. Banks are allowed to hold fewer liquid assets against contingent trade liabilities, thereby increasing the availability of trade finance (BIS, 2013).
- On 12 January 2014, the BCBS reduced the leverage ratio on trade letters of credit and other self-liquidating trade-related instruments from a 100 per cent CCF to a 20 per cent CCF for capital purposes and 50 per cent CCF for trade guarantees (BIS, 2014a). The 2014 modification was hailed by the WTO Director-General: “[this is] of particular significance for the availability of trade finance in the developing world, where letters of credit are a key

instrument of payment. This is good news for developing countries, for the expansion of their trade and for the continued growth of South-South trade flows" (WTO, 2014a).

The situation on the prudential front looks better than it did a few years ago, thanks to the institutional dialogues opened by the WTO and the Basel Committee, and the data support provided by the ICC. There is no doubt that such initiatives have contributed to improving the policy coherence between the prudential and central bank community on the one hand, and the trading community on the other.

Other non-prudential regulatory issues described as "know-your-customer" (KYC) requirements have been subject to discussion within the WTO's trade finance community. The debate does not focus on regulatory requirements, which legitimately aim to increase transparency in financial relations (including various informational requirements to combat illegal financing and tax evasion), but rather on the various ways that they are being structured, defined and implemented by and in different countries and regions. It was argued, albeit not always proven, that the accumulation of these requirements (very detailed information varying across jurisdictions about a customer's identity and the end use of money lent) led banks to terminate banking relations, including trade finance, with developing countries. Therefore more clarity is needed to determine whether a lack of harmonized regulatory requirements discourages trade, particularly in developing countries. Some have suggested that the trade finance industry needs more fact-based evidence of trade foregone, lost correspondent banking relations and other criteria before it can assess the impact of lack of regulatory harmonization in this area (WTO, 2014c). Dialogue on this issue should of course take place within the appropriate governance structures, such as the OECD's Financial Action Task Force (FATF). The WTO remains ready to engage in such dialogue.

## Enhancing the capacity of the local banking sector to support trade

While global lenders tend to focus on their main customers, there are opportunities for local and regional banks to step in when they have the capacity to do so. Tier 1 and 2 banks in the Asia-Pacific region (China, Republic of Korea, Chinese Taipei, Indonesia and Malaysia), in Latin America (Brazil and Columbia) and in the Middle East and Eastern Europe are increasing their market shares in trade finance. Yaw Kuffour, lead trade finance specialist at the African Development Bank, noted that:

"Some of the big players from Nigeria, Kenya and South Africa are trying to do more ... to mobilise resources and channel them to this market... [However] African banks still lack the critical mass and muscle to provide the necessary credit so there is a need for [development finance institution] intervention (Whitehead, 2013)."

According to the AfDB's "Trade finance in Africa" survey (2014), the vast majority of African commercial banks invest in trade transactions, contributing on average for 17 per cent of their earnings. While a large number of confirming banks are based outside Africa, the study acknowledged the growing role of Africa-based confirming banks, though banks in Northern Africa are significantly larger than those of other sub-regions. Yet, African lenders are still constrained by the relatively small size of African banks' balance sheets. For instance, the African Export-Import Bank (Afreximbank), saw demand for products in excess of US\$ 23.8 billion in 2014, but could only process US\$ 2.68 billion worth of transactions.

Efforts are therefore needed to strengthen developing countries' capacity to finance their trade and build knowledge for handling trade finance instruments. From that perspective, trade



finance facilitation programmes can increase capacity for small local commercial banks as well as connect them with global confirming banks. To this end, donor technical assistance funds are being used to train bankers in developing countries through seminars or *in situ* training (in particular through the EBRD and IFC dedicated trust funds for trade finance training). Donors including Austria, France, Ireland, Israel, Japan, the Netherlands, Spain, Sweden and Chinese Taipei have provided funding to such trusts. Under IFC's training programmes, over 2,800 participants from 360 developing country banks received courses and on-site advisory services. The EBRD also trained a large number of participants and teamed up with the ICC to open an e-learning platform. The ICC is in the process of creating an ICC Academy to provide trade finance qualification and certification for up to 2,000 trainees per annum in the medium term. The WTO also has integrated a full trade finance module in the main curriculum of its popular e-training platform.

Export credit agencies (ECAs) have also been very active in institution-building. For example, the Berne Union ECAs (such as the Nippon Export and Investment Insurance (NEXI) in Japan, the Export-Import Bank of the United States (EXIM), Euler-Hermes in Germany, the Compagnie française d'assurance pour le Commerce Extérieur (COFACE) in France, and various ECAs from Nordic countries) have provided technical assistance to set up counterpart ECAs in least-developed countries. Some ECAs have actively supported the creation of regional ECAs in Africa, and provided *in situ* training.

## Efforts are needed to strengthen developing countries' capacity to finance their trade.

<sup>7</sup> Trade finance facilitation programmes carry a maximum "limit" of guarantees and financing for trade that each institution is willing to extend at any point in time. However, these guarantees and direct financing only apply to short-term trade transactions with typical maturities of 60 to 90 days. Hence, within a year the value of trade transactions financed and guaranteed by these institutions is larger than the overall limit, since, for example, guarantees for 90-day transactions can be used four times per annum (90 days multiplied by four equals 360 days).

# Recommendations

## 1. Reduce limitations in existing multilateral programmes

Multilateral development banks should examine institutional limitations in existing trade finance facilitation programmes to provide remedies for geographical disadvantages or working with certain operators. Though each institution's Board of Directors retains sovereignty over its programmes, it could be valuable to review such limitations against a needs test assessing whether relaxing some limitations could help reduce the identified trade finance gaps. Of particular concern is that large developing countries are not eligible for trade finance facilitation programmes. In such countries, available liquidity for trade may only be apparent at the aggregate level, particularly if liquidity is concentrated in the country's main banks, hence benefitting the main traders but not the second- and third-tier banks and companies.

For other programmes, one limitation may be related to the type of operators that are eligible. State-owned banks are common in low-income countries and fulfil an important role in imports and exports. In Ethiopia, for example, a large share of trade finance is handled by the state-owned Commercial Bank of Ethiopia, which cannot be supported by some programmes. With trade expanding rapidly, including via new supply-chain trade in the garment industry, the African banking sector is also rapidly evolving, although some remain state-owned.

## 2. Increase programme size where possible

Some of the largest programmes face pressure to increase trade financing limits when the current ones are reached. There may be scope for programmes – particularly newly established programmes in Asia and Africa – to do more.

## 3. Set a realistic objective for total trade coverage

A realistic yet ambitious objective would be to increase the trade volume supported by all existing multilateral trade finance facilitation programmes from US\$ 30 billion to US\$ 50 billion per annum. This could be achieved through a shared effort between all relevant bodies – and of course how to share the increase would be for MDBs to determine. Though this target would only eliminate a portion of the estimated financing gap, focusing on a specific target would be an effective way of mobilising and coordinating efforts. As such it would be an important and constructive step in the right direction.

## **4. Increase capacity building support**

Economies will graduate from trade finance facilitation programmes as the capacity of local financial sectors to support SME traders grows. Technical assistance must be therefore enhanced with the support of donors – both MDBs and the private sector – to build capacity in the local banking sector, including via training a new generation of trade finance specialists. From this perspective, the ICC Academy's new curriculum on trade finance will be an important complement to the e-learning portals operated by multilateral institutions active in trade finance, including the WTO.

More can be done in this respect, notably to reduce the information and knowledge gap between developing and developed countries. This includes improving: awareness of what trade finance products are available; the ability to select the best products; and the training of trade finance specialists. Multilateral development banks and the ICC already receive donor funding for their capacity-building initiatives, but such donor efforts could potentially be further leveraged.

The WTO Expert Group on Trade Finance can track the progress achieved by the associated institutions' training efforts. A realistic objective would be for all multilateral institutions (MDBs, the WTO, ICC and the Berne Union, to name a few) to train 5,000 professionals worldwide in basic trade finance over the next five years.

## **5. Maintain an open dialogue with trade finance regulators**

It will be important to enhance dialogue with financial regulators so as to share experience in each domain, leading to improved knowledge and experience for all parties. Know-your-customers (KYC) reporting requirements have been under discussion in the WTO Expert Group on Trade Finance for quite some time. It is vital that KYC requirements achieve their aim of greater transparency in financial relations while, at the same time, not creating unintended consequences for the trade opportunities of poor countries. The WTO has therefore indicated its willingness to facilitate a dialogue – in this case with the OECD Financial Action Task Force (FATF) – with a view to improving the understanding between the two communities and avoiding such unintended consequences.

## **6. Improving the capacity of the international community to read markets and predict problems**

Disruptions in trade finance markets are typically sudden, and there is a lack of aggregate information available. Following the 2008-09 financial crisis, the WTO Expert Group on Trade Finance resolved to improve market intelligence by pooling as much information as possible. In the absence of a complete set of hard statistics collected by public institutions, the ICC has been tasked to pool various sources of information and surveys available in the annual ICC Global Surveys. Multilateral development banks have also begun undertaking large surveys, in part using the ICC network of banks, to quantify the financing gaps mentioned in this report.

These efforts are worthwhile, but could be enhanced and better integrated. First, surveys of financial gaps should be harmonized in order to provide a view of gaps by region. Second, as many MDBs as possible should support these surveys through their own networks of issuing banks, which are often well-grounded in local markets. Third, it is hoped that methodological improvements will follow from increased and better interaction between public institutions, and between multilateral organizations and the private sector. It is imperative to improve early warning and analytical indicators for trade finance before any future financial turmoil.

# Bibliography

ACE International Consultants (2013), "Feasibility study of an ACP investment bank project", March 2013, European Commission Framework Contract Beneficiaries Programme document 2012/290369/1, report by Seck, O., Jacobson, D., Cishek, A. and Spinoit, B.

African Development Bank (AfDB) (2014), "Trade finance in Africa", 3 December 2014, Abidjan: African Development Bank.

Amiti, M. and Weinstein, D. E. (2011). "Exports and financial shocks", *The Quarterly Journal of Economics* 126(4): 1841-1877.

Asian Development Bank (ADB) (2015), "2015 trade finance gaps, growth, and jobs survey", ADB briefs no. 45, October 2015, Manila: Asian Development Bank.

Bank for International Settlements (BIS) (2011), Basel Committee on Banking Supervision, "Treatment of trade finance under the Basel capital framework", October 2011, Basel: BIS, <http://www.bis.org/publ/bcbs205.pdf>.

Bank for International Settlements (BIS) (2013), Press release, "Group of Governors and Heads of Supervision endorses revised liquidity standard for banks", 6 January 2013, <http://www.bis.org/press/p130106.htm>.

Bank for International Settlements (BIS) (2014a), Press release, "Amendments to Basel III's leverage ratio issued by the Basel Committee", 12 January 2014, <http://www.bis.org/press/p140112a.htm>.

Bank for International Settlements (BIS) (2014b), "Trade finance: Developments and issues", Committee on the Global Financial System (CGFS) publication no. 50 by Clark, J., Basel: BIS.

Beck, T. and Demirgüç-Kunt, A. (2006), "Small and medium-size enterprises: Access to finance as a growth constraint", *Journal of Banking and Finance* 30(11): 2931-2943.

Bellone, F., Musso, P., Nesta, L. and Schiavo, S. (2010), "Financial constraints and firm export behaviour", *The World Economy* 33(3): 347-373.

Bricongne, J.-C., Fontagné, L., Gaulier, G., Taglioni, D. and Vicard, V. (2012), "Firms and the global crisis: French exports in the turmoil", *Journal of International Economics* 87: 134-146.

Centre for the Promotion of Imports from Developing Countries (CBI) (2013), "Access to trade finance: First-hand perspectives on bottlenecks and impacts for SME exporters in the South", The Hague: Ministry of Foreign Affairs of the Netherlands.

German Development Institute (GDI) (2015), "Financing global development: The role of local currency bond markets in Sub-Saharan Africa", Briefing paper 11/2015 by Berensmann *et al*, Bonn: GDI.

Group of 20 (G20) (2010), "The Seoul Summit Document – Framework for strong, sustainable and balanced growth", Seoul: G20.

International Chamber of Commerce (ICC) (2013), "Global Risks - Trade Finance Report 2013", Paris: ICC Banking Commission.

International Chamber of Commerce (ICC) (2014), "ICC Global Trade and Finance Survey 2014: Rethinking Trade and Finance", Paris: ICC Banking Commission.

International Finance Corporation (IFC) (2012), "Guide to products: Global trade and supply chain solutions", April 2012, Washington DC: IFC.

International Monetary Fund (IMF) (2003), "Trade finance in financial crises: An assessment of key issues", IMF Policy Development and Review Department, Washington DC: IMF Board Paper.

International Monetary Fund - Bankers' Association for Finance and Trade (IMF-BAFT) (2009), "IMF-BAFT Trade Finance Survey: A survey among banks assessing the current trade finance environment", Washington DC: Fimetricx for the IMF and BAFT.

Manova, K. (2013), "Credit constraints, heterogeneous firms, and international trade", *Review of Economic Studies* 80: 711-744.

Omni Bridgeway (2011), "Debt Prices", *Omni Bridgeway News*, May 2011.

Omni Bridgeway (2014), "Debt Prices", *Omni Bridgeway News*, April 2014.

Stiglitz, J., and Weiss, A. (1981), "Credit rationing in markets with imperfect information", *The American Economic Review* 71(3): 393-410.

United States International Trade Commission (USITC) (2010), "Small and Medium-Sized Enterprises: Characteristics and Performance" Investigation no. 332-510, USITC publication no. 4189, November 2010, <https://www.usitc.gov/publications/332/pub4189.pdf>.

Whitehead, E., "African banks look to fill trade finance gap," *This is Africa*, 26 June 2013, <http://www.thisisafricaonline.com/News/African-banks-look-to-fill-trade-finance-gap?ct=true>.

World Bank (2013), "Evaluation of the World Bank Group's targeted support for small and medium enterprises", Independent Evaluation Group (IEG) approach paper, Washington DC; World Bank.

World Economic Forum (WEF) (2013), "Africa Competitiveness Report 2013", Geneva: WEF.

World Economic Forum (WEF) (2014), "The Global Enabling Trade Report 2014", Geneva: WEF.

World Trade Organization (WTO) (1998), *Trade Policy Review – Indonesia*, Geneva: WTO.

World Trade Organization (WTO) (2003), Document WT/WGTDF/2 - Working Group on Trade, Debt and Finance - Report to the General Council, 11 July 2003.

World Trade Organization (WTO) (2004), "Improving the availability of trade finance during financial crises", WTO Discussion Paper by Auboin, M. and Meier-Ewert, M., Geneva: WTO.

World Trade Organization (WTO) (2013), "Trade finance in periods of crisis: what have we learned in recent years?", ERSD Working Paper by Auboin, M., and Engemann, M., Geneva: WTO.

World Trade Organization (WTO) (2014a), News item, "Azevêdo hails Basel decision on trade finance as 'good news' for developing countries," 17 January 2014, [https://www.wto.org/english/news\\_e/news14\\_e/dgra\\_17jan14\\_e.htm](https://www.wto.org/english/news_e/news14_e/dgra_17jan14_e.htm).

World Trade Organization (WTO) (2014b), Document WT/WGTDF/W/74 – Working Group on Trade, Debt and Finance - Improving the availability of trade finance in developing countries: An assessment of remaining gaps – Note by the Secretariat, 4 September 2014.

World Trade Organization (WTO) (2014c), Document WT/WGTDF/W/75 – Working Group on Trade, Debt and Finance – Report of the Working Group on Trade, Debt and Finance (2014) to the General Council – Draft, 14 November 2014.

World Trade Organization (WTO) – Organisation for Economic Co-operation and Development (OECD) (2013), *Aid for Trade at a Glance 2013: Connecting to value chains*. Paris: OECD.

# Abbreviations

<b>ACP</b>	African, Caribbean and Pacific group of states
<b>ADB</b>	Asian Development Bank
<b>AfDB</b>	African Development Bank
<b>BAFT</b>	Bankers' Association for Finance and Trade
<b>BCBS</b>	Basel Committee on Banking Supervision
<b>BIS</b>	Bank of International Settlements
<b>CBI</b>	Centre for the Promotion of Imports from developing countries, Dutch Ministry of Foreign Affairs
<b>CCF</b>	credit conversion factor
<b>EBRD</b>	European Bank for Reconstruction and Development
<b>ECA</b>	export credit agency
<b>FATF</b>	Financial Action Task Force (OECD)
<b>ICC</b>	International Chamber of Commerce
<b>IDB</b>	Inter-American Development Bank
<b>IFC</b>	International Finance Corporation
<b>ITFC</b>	International Islamic Trade Finance Corporation
<b>IMF</b>	International Monetary Fund
<b>KYC</b>	know-your-customer(s)
<b>LIC</b>	low-income country
<b>MDB</b>	multilateral development bank
<b>OECD</b>	Organisation for Economic Co-operation and Development
<b>SME</b>	small and medium-sized enterprise
<b>USITC</b>	United States International Trade Commission
<b>WEF</b>	World Economic Forum
<b>WGTDf</b>	Working Group on Trade, Debt and Finance (WTO)
<b>WTO</b>	World Trade Organization

.....  
A publication of the World Trade Organization

Designed by: Triptik

Printed by the WTO Secretariat

© World Trade Organization 2016

Photo credits:

Cover: Panos/Sanjit Das

Page 8: iStock/idealistock

page 10: iStock/StHelena

Page 14: iStock/MickyWiswedel

Page 20: iStock/MickyWiswedel

Page 28: iStock/ShutterWorx

.....

Trade finance plays a key role in helping developing countries participate in global trade. Following the 2008-09 economic crisis, small and medium-sized enterprises (SMEs) have found it increasingly difficult to access this vital form of credit. The poorer the country, the greater the challenge. The lack of adequate trade finance is particularly acute in Africa and developing Asia. Easing the supply of credit in regions where trade potential is the greatest could have a big impact in helping small businesses grow and in supporting the development of the poorest countries. This publication takes a detailed look at these issues and emphasises the importance of multilateral agencies working together in response. It provides recommendations for addressing the gap in trade finance provision. This includes bolstering existing trade finance programmes, enhancing the trading capacity of developing countries and improving communication between all parties involved in trade finance.



World Trade Organization  
Rue de Lausanne 154  
CH-1211 Geneva 21  
Switzerland  
Tel. +41 (0)22 739 51 11  
Fax +41 (0)22 731 42 06  
[enquiries@wto.org](mailto:enquiries@wto.org)  
[publications@wto.org](mailto:publications@wto.org)

