

CHAPTER 1

Trade profiles of the Mekong-3



A worker checks circuit boards at an electronics factory in Hung Yen Province, Viet Nam.

Key findings

- The Mekong-3 – Cambodia, the Lao People's Democratic Republic (PDR) and Viet Nam – form one of the most dynamic and trade-led group of countries in the world. In 2022, the value of trade flows surpassed GDP in all three economies. The trade-to-GDP ratio was particularly high in Cambodia and Viet Nam at over 210 and 185 per cent, respectively – several times higher than the global average of 62 per cent.
- China and the United States have grown to become the main export destinations from the Mekong-3, jointly accounting for over 40 per cent of the region's total trade.
- Trade growth in Cambodia and Viet Nam has followed a two-speed trajectory. Exports to China and the United States have grown by a factor of five since 2012, while exports to other regions also grew, albeit at a slower pace. East Asia and Pacific countries continue to account for most of imports into Cambodia and the Lao PDR at over 58 and 70 per cent in 2021, respectively. Although intra-regional trade among the Mekong-3 has grown in value, its relative importance has declined.
- The growth of Viet Nam's electronic industry and Cambodia's textile exports are primarily driven by foreign investors. In 2021, multinational enterprises contributed to around 70 per cent of Viet Nam's total imports and exports. Large and mega firms contributed more than 80 per cent of exports from the country.
- The Mekong-3 rely significantly on the import of intermediate goods and inputs, which more frequently require letters of credit. As a share of total imports in 2020-2022, intermediate goods comprised 64 per cent in Cambodia, 45 per cent in the Lao PDR and 60 per cent in Viet Nam.
- Cambodia and the Lao PDR are diversifying fast. They have both expanded imports considerably, connecting with new markets. From 2012 to 2021, the number of products imported by Cambodia and the Lao PDR increased by more than 13 and 10 per cent, respectively. There has been significant growth in chemical products imported in Viet Nam, as well as machinery components in all of the Mekong-3.
- Exporters in all of the Mekong-3 have improved their performance. The expanded global footprint of Mekong-3 exporters can be attributed to distinctive developments within each country – including excess capacity from trade diversion, high-value exports along these routes and significant improvements in the productivity of their exporters.
- Trade costs remain a challenge for the Mekong region. While Cambodia witnessed reductions in trade costs of 13-22 per cent to its top ten partner economies between 2008 and 2018, trade costs for Viet Nam fell only for exports. The Lao PDR experienced a sharp rise in average costs for exports of more than 35 per cent and 15 per cent for imports – both of which from a high initial base.



This chapter provides a summary of key trade dynamics in the Mekong-3 that are relevant to trade finance, starting with trade flows in the region and an overview of what is traded and with whom. The chapter then explores: product diversification; the trade of goods at different stages of processing; the competitiveness of exporters in the Mekong-3 and the trade costs incurred; participation in global value chains; and the role of multinational enterprises and firms of different sizes as drivers of growing demand for trade finance.

Trade dynamics in the Mekong-3

Export-oriented nations depend disproportionately on trade, and by extension on trade finance, as a driver of prosperity (see Box 1.1).

The Mekong-3 have established themselves as one of the most integrated and trade-led regions of the world, with a trade-to-GDP ratio surpassing 100 per cent in all three economies and over 210 and 185 per cent in Cambodia and Viet Nam, respectively (see Figure 1.1). This is over three times higher than the global average of 62 per cent and has turned Cambodia and Viet Nam into trade leaders in Southeast Asia.



Cambodia and Viet Nam have become trade leaders in Southeast Asia.

Cambodia and Viet Nam

While a high trade-to-GDP ratio is common in smaller economies, its growth over the last decade points to accelerating internationalization, with trade flows steadily outpacing GDP growth of between 5 and 8 per cent annually – well above the average for East Asia and Pacific. Viet Nam exemplifies and leads this trend for the region as a whole. Since 2012, the value of total trade flows more than tripled to US\$ 754.8 billion in 2022 – and is now valued at more than 185 per cent of GDP (see Figure 1.1).

Cambodia has followed a similar trajectory, tripling the value of its trade since 2012 to US\$ 60.2 billion and surpassing 210 per cent of GDP in 2022 (see Figure 1.1). For comparison, Malaysia and Thailand, two notable economies in the region, have trade flows that exceed GDP at 146 and 123 per cent,

Trade-to-GDP ratio in 2022



respectively. These economies have also tended to depend less on trade over time, while Cambodia and Viet Nam have consistently increased trade flows relative to GDP.

Lao People’s Democratic Republic

The Lao PDR presents a separate case within the Mekong-3. Unlike Cambodia and Viet Nam, it has only recently experienced a sizeable increase in its trade-to-GDP ratio, surpassing 100 per cent of GDP for the first time in 2022 (see Figure 1.1). Since 2014, trade as a share of GDP had fluctuated around 75 per cent, which is still above the global average of 62 per cent and is a reflection of the continued importance of imports and exports for the country’s development.

The two-speed growth of trade

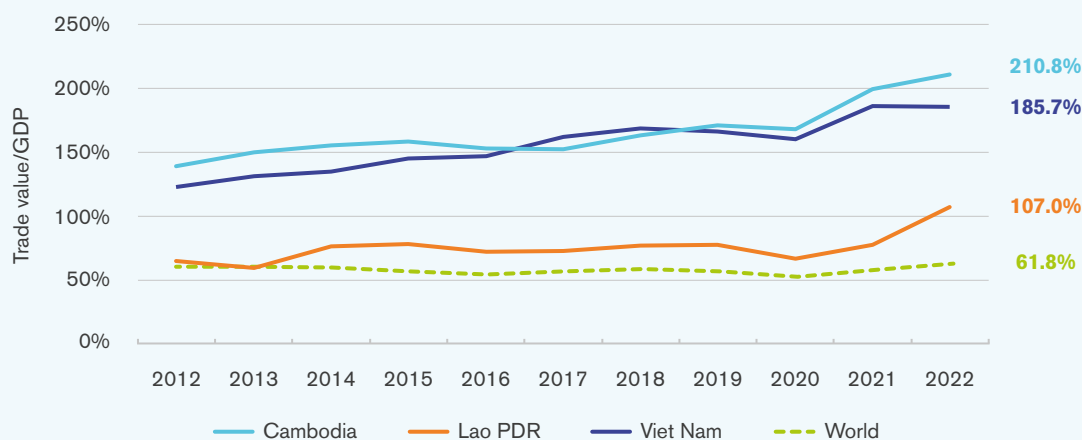
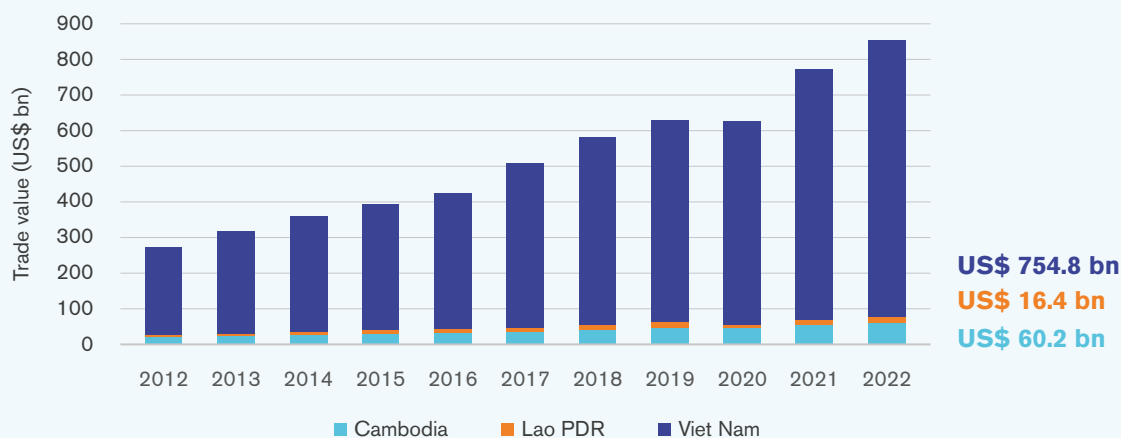
To comprehensively gauge the requisites and provisions of trade finance in Mekong-3, the dynamics of trade across origins, destinations and beneficiaries are examined. The structure of imports and exports from the Mekong-3 has undergone significant changes in the past decade – driven not only by local development but also by the global geopolitical landscape.

China and the United States began mutually escalating tariffs on hundreds of billions of dollars’ worth of trade flows in 2018. The study by Fajgelbaum *et al.* (2021), revised in 2023, argues that, while the two economies largely taxed each other

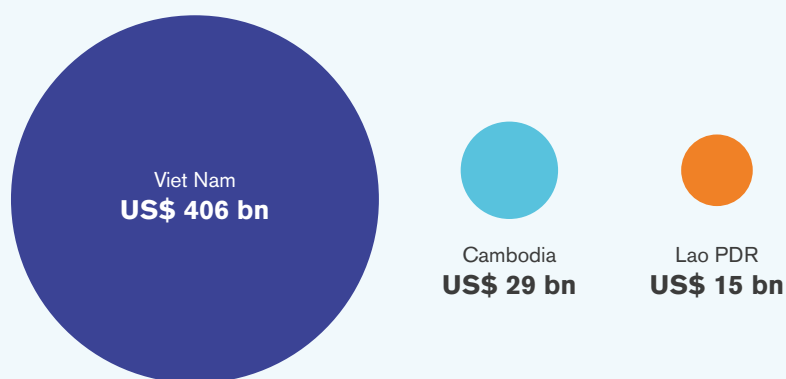
FIGURE 1.1

Trade flows and GDP in the Mekong-3

(in current US\$ billion and as a share of GDP, and total GDP in 2022)



GDP in 2022



Source: IFC–WTO calculations using WTO–UNCTAD estimates for goods trade and IMF WEO and Balance of Payments for GDP and services trade, respectively.

What is trade finance and why it matters?

International trade is an important driver of productivity, jobs and development – but, to be effective, adequate trade finance is essential. Trade finance, an umbrella term including a variety of financial instruments, helps to oil the wheels of trade by bridging the gap between exporters' and importers' differing expectations about when payment should be made. Trade finance includes loans and working capital facilities needed by exporters to process or manufacture products and by importers to buy inputs, raw materials and equipment. Insufficient trade finance increases the risks of the trade transaction (i.e. not receiving payment or delivery) and trade costs (i.e. opportunity costs of using scarce cash resources).



Trade finance at high interest rates or with expensive fees is also a trade cost.

Trade finance is important for businesses because access to finance at affordable rates is an important element of a business's competitiveness and its integration into global markets. Trade finance thus matters for societies as a whole by enabling producers to create better paid jobs and to diffuse technologies for a range of purposes, including, for example, lowering greenhouse gas emissions and adapting to climate change (for a recent review, see Engel *et al.*, 2021). Trade finance can also enhance the benefits of trade for a wide range of market participants, such as smaller enterprises and younger entrepreneurs, which can be exposed to greater risks in cross-border transactions.

More generally, trade finance matters for trade because it is not just demand driven. Research finds that an increase in the supply (or cost) of trade finance is associated with an increase (or decrease)

of global trade volumes (Auboin and Engemann, 2014). The share of merchandise trade supported by trade finance is relatively low in many developing countries: 40 per cent in Africa as a whole and only 25 per cent in West Africa, as opposed to 60-80 per cent across high-income economies.

Rejections rates for trade finance requests in developing countries can be high. In particular, small and medium-sized enterprises (SMEs) are disproportionately affected by high rates of rejection. As a result, even though trade finance is one of the largest sources of cross-border capital flows (valued at over US\$ 10 trillion annually), major gaps still persist. The Asian Development Bank reports that the global trade finance gap – the difference between requests and approvals for financing to support trade – grew to US\$ 2.5 trillion in 2022, and mostly in developing countries.* Hence over time, trade finance has taken a more prominent position in the development agenda.

Global trade finance gap in 2022 estimated at US\$ 2.5 trillion

In IFC–WTO studies, local banks are surveyed to estimate the amount of trade finance supported by the local financial sector in each country and how it relates to trade flows.

Although the surveys do not capture financing by foreign banks provided outside the country, they nevertheless provide an important measure of the ability of local financial institutions to support the country's participation in international trade. The surveys examine the following elements:

- the trade finance instruments used;
- the cost at which trade finance is available;
- the rejection rate of trade finance requests.

Using general equilibrium analysis from the WTO Global Trade Model, these metrics are then used to explore the trade impacts of any potential

improvements to accessing local trade finance. For example, how much more trade would be generated by: (i) greater availability of trade finance (a higher share of trade finance covering trade); (ii) a reduced rejection rate for trade finance; and (iii) reduced interest rates and fees to align closer to international benchmarks. In this way, a combination of trade effects of these counterfactual scenarios can be explored.

As shown in Chapter 3, most of the trade effects are generated by an increase in the availability of trade finance. In certain countries where the uptake of trade finance is very low, a reduction in rejection rates only impacts the few traders who seek trade finance and thus only marginally increases the coverage of trade by trade finance.

* See <https://www.adb.org/news/global-trade-finance-gap-expands-25-trillion-2022>.



Money to service a microloan, Lao PDR.

and depressed their bilateral trade flows relative to non-taxed products, bystander countries increased their exports to the United States and the rest of the world. Cambodia and Viet Nam have been two of the major beneficiaries in a relocation process that started before 2018, owing to an increase of production costs in China.



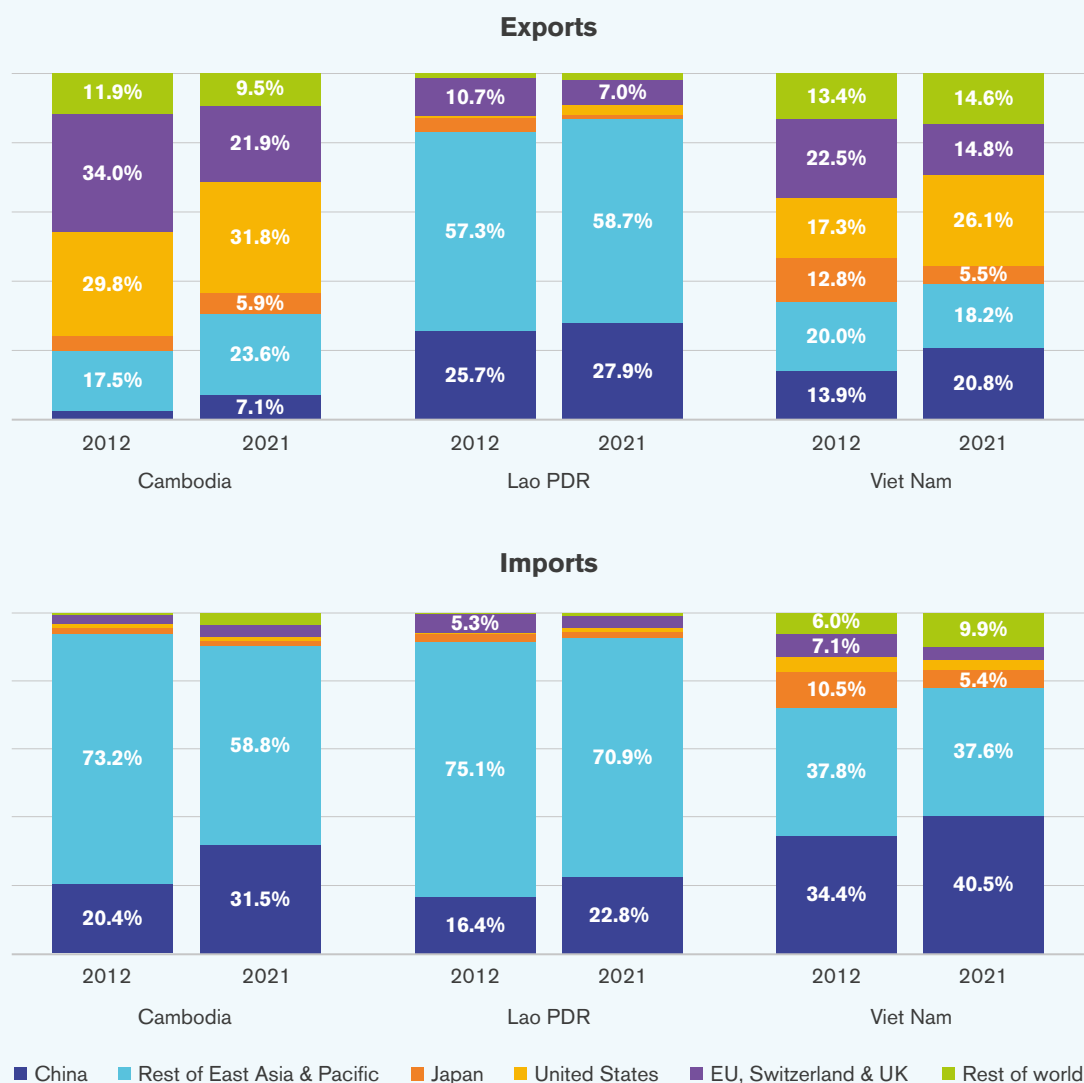
China and the United States have become the top export destinations from the Mekong-3.

Over the past decade, China and the United States have emerged as dominant destinations for exports from the region. In 2021, the United States was the primary export destination for Cambodia and Viet Nam, representing more than 31 and 26 per cent of the total value of exports, respectively (see Figure 1.2, Exports). The Lao PDR, on the other hand, remains heavily oriented towards China and the rest of East Asia and Pacific in both trade directions.

The share of Mekong-3 exports to Europe and Japan has dropped by over 10 percentage points for Cambodia, 6 percentage points for the Lao PDR and 15 percentage points for Viet Nam; while intra-regional exports, excluding China, have been stable in relative terms at one fifth of the total value over the last decade.

FIGURE 1.2

Trade in value in the Mekong-3 as a share of total exports and imports, 2012 and 2021 (in per cent)



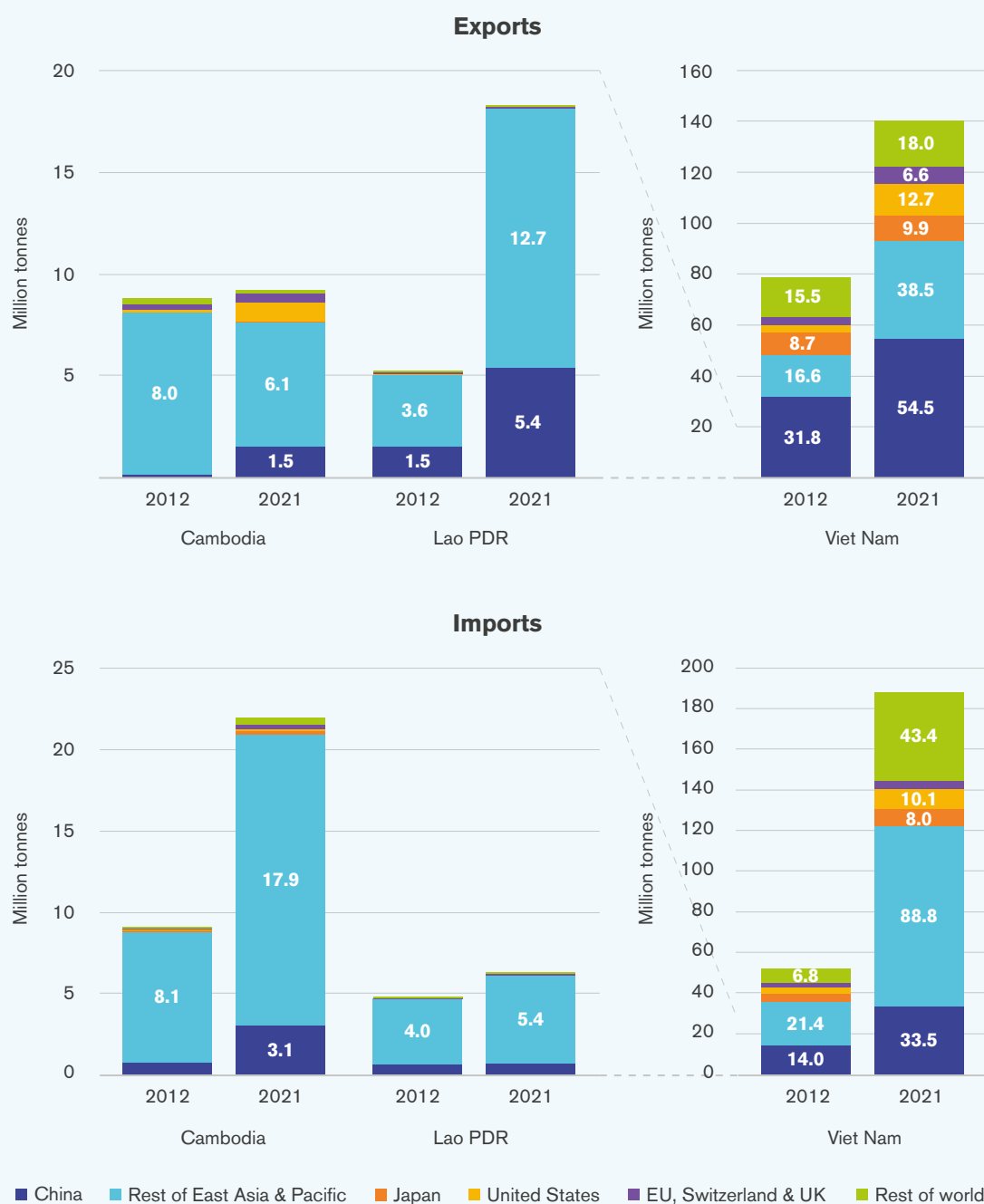
Source: IFC–WTO calculations based on World Bank WITS data.

In quantity terms, shipments to all countries and regions have grown. China and the rest of the East Asia and Pacific region account for over 70 per cent of the total export volumes from the Mekong-3. Despite the decrease of their relative importance, Mekong-3 exports to Europe and Japan remain significant in volume and continue to grow (see Figure 1.3, Exports).

Trade flows among the Mekong-3 have also grown over the last decade, although they still rank low relative to other destinations. Exports from Cambodia and the Lao PDR to Viet Nam increased by a factor of three to four since 2012, albeit from a low base. Trade flows from Viet Nam to Cambodia at least doubled and marginally increased to the Lao PDR.

FIGURE 1.3

Trade volume in the Mekong-3, 2012 and 2021 (in million tonnes)



Source: IFC–WTO calculations based on World Bank WITS data. Missing volumes are imputed using average unit values. Average unit values of trade are calculated by dividing trade values in US dollars by the net weight values in kilograms, for observations with records of both value and quantity in kilograms. The averages are calculated by HS2 sector, origin, destination and year. Average unit values are then used to estimate the volumes where quantity is not reported, or reported in units different than kilogram, by dividing the value reported by its corresponding average unit value. Existing data in the net weight values in kilogram are unaffected by the process.

Two-speed growth trajectory of Cambodia and Viet Nam

Trade growth in Cambodia and Viet Nam exhibits a two-speed trajectory. Exports to China and the United States have grown by a factor of five since 2012. This growth has outpaced exports to all regions, which have also grown – albeit at a slower pace. Notably, exports to Europe have more than doubled in value and volume over the last decade, which indicates expanding market opportunities. Exports to Japan have grown similarly in both value and volume as trade ties with the Japanese market strengthen.

It is worth noting that while the value of exports from Cambodia and Viet Nam to the United States is high, it still represents less than 10 per cent of export volume. This indicates that these shipments are relatively more expensive than exports to other destinations. The same holds for shipments from China to the Mekong-3, where the value of imports has outpaced the growth in volume, suggesting high relative unit values of imported intermediates (see Figures 1.2 and 1.3, Imports). Combined, these two observations point to the rise of global value chains (GVCs) in the region whereby high-value intermediate components are imported, assembled and shipped to the United States as expensive final goods. Shipments from Viet Nam to China and Japan have also grown in value by more than volume; albeit not at the scale observed for shipments to the United States.

The two-speed growth trajectory has also been clear in imports to Cambodia and Viet Nam. While trade from China and to the United States has been growing significantly faster than trade with other regions, imports to Cambodia and Viet Nam from all regions have increased in volume (see Figure 1.3, Imports). China and the rest of East Asia and Pacific collectively account for 65 per cent of the total import volume into Viet Nam. However, imports from China and the United States tend to be considerably more expensive than imports from other sources. This disparity in aggregate statistics conceals moderate growth of the second-tier routes and trade flows.

Imports to the Mekong-3 from China and East Asia and Pacific

China has become the largest supplier of imports to the Mekong-3, at par with the imports from all other regions combined. By 2021, the total value of imports from China was three times its 2012 level. Although East Asia and Pacific continues to represent the largest share of imports into Cambodia and the Lao PDR, the share has dropped since 2012. In Cambodia, imports from Viet Nam in 2021 increased in value by a factor of three since 2012; although the country's



China has become the largest supplier to the Mekong-3.

relative importance has declined behind Chinese imports, which grew much faster.

The consequences of increasing reliance on imports from China have a nuanced impact on trade finance markets. According to interviews conducted in the Mekong-3, imports from China often involve payment arrangements that bypass the local banking system. These arrangements, together with the robust competition among Chinese producers in the global market, are some of the unique characteristics of Chinese trade. Moreover, payment terms often depend on relationships, favouring importers with established, long-term partnerships, which can yield more advantageous import terms.

Net trade in the Mekong-3 and comparator countries

Viet Nam's increasing participation in GVCs has cemented its status as a net exporter, with the value of exports consistently surpassing imports since 2016 (see Figure 1.4). This trend highlights the role of trade as a financing mechanism for the country's development. Viet Nam's trade performance follows the trajectory of more advanced economies in the region, such as Malaysia and Thailand. Meanwhile, Cambodia and the Lao PDR maintain a relatively balanced trade, with marginal net imports, as their trading activities steadily expand.

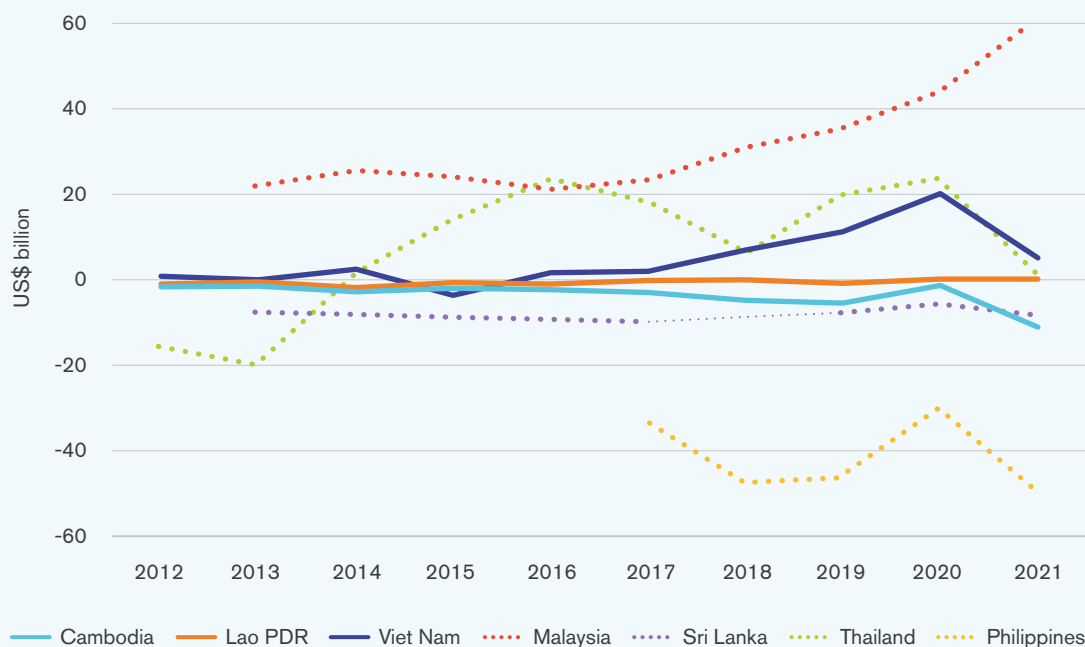
Product diversification

The diversification of the product mix crossing borders has an impact on trade finance markets. Research shows that different products vary in the coverage by bank-intermediated finance when traded across borders (Crozet *et al.*, 2022). In addition, young traders expanding into new markets have a greater need to mitigate risks with new clients, making them more prolific users of trade finance (Antràs and Foley, 2015).

As the demand for finance rises, banks may be hesitant to assume these risks for activities or participants with which they may be less familiar. By expanding trade into uncharted territories, there is thus a greater need for market intelligence and adaptable instruments to support importers and exporters active in these markets.

FIGURE 1.4

Net trade in the Mekong-3 and comparator countries, 2012-2021 (in US\$ billion)



Source: IFC–WTO calculations based on World Bank WITS data. Net trade corresponds to the total value of exported goods and services minus the total value of imported goods and services.

The economy in Viet Nam is more diversified than Cambodia and the Lao PDR, both in terms of imports and exports. Viet Nam's range of products traded has thus remained relatively stable, with only a marginal annual growth rate in the number of products exported (see Figure 1.5). However, the value of Viet Nam's exports has been surging at growth rates of 15 per cent annually, which would suggest an ongoing process of qualitative improvement in similar product categories. The same applies to Viet Nam's imports, indicating a steady and diversified influx of goods from various sources.

Value of exports, Viet Nam

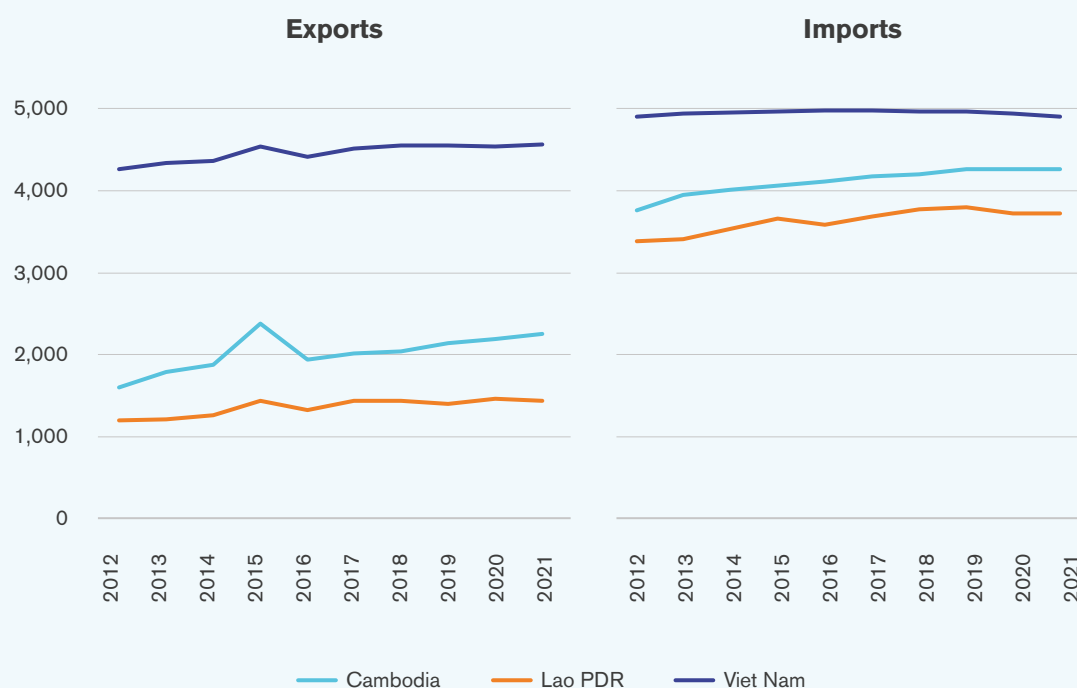
+15% per annum

With regard to the types of product traded by the Mekong-3, electronics, machinery, textiles and food form the bulk of both imports and exports in Viet Nam (see Figure I.1 in Annex I). Just three products – integrated circuits, telephones and rubberized fabrics – have consistently accounted for around 20 per cent of Viet Nam's imports from China since 2016; while broadcasting equipment substantially increased its share in the value of exports to the United States, from around 2 per cent in 2012 to approximately 18 per cent in 2021.

Cambodia relies heavily on its garment and textile industry, which comprises nearly half of its exports, with machinery and other consumer goods making up the remaining portion (see Figure I.1 on Annex I). A handful of key products and services, including garments, footwear, rice, cassava and tourism in services, dominate the export basket of the country (World Bank, 2021).

FIGURE 1.5

Number of products traded by the Mekong-3 (HS 6-digit products)



Source: World Bank WITS (mirror data). Figures from different sources show similar trends, although the number of products exported/imported seems higher when based on World Bank WITS (mirror data).

The Lao PDR primarily exports energy resources, while heavily relying on imports for various other products. Notably, gold has emerged as a significant import commodity for both Cambodia and the Lao PDR, possibly accounting for previously underreported trade flows.

Cambodia and Lao PDR are diversifying fast

Cambodia and the Lao PDR have considerably expanded their imports, connecting with new markets. In 2021, Cambodia and the Lao PDR imported more than 13 and 10 per cent of additional products since 2012, respectively (see Figure 1.5). Similarly, exported products have grown remarkably, expanding from 1,597 to 2,250 for Cambodia (an increase of over 40 per

cent) and from 1,204 to 1,440 for the Lao PDR (an increase of nearly 20 per cent). Starting from a highly diversified base, the expansion of Viet Nam's export basket has been more moderate than Cambodia or Lao PDR. However, among the categories that have experienced significant growth over the extensive margin are chemical products in Viet Nam, as well as machinery components in the Mekong-3 (see Table 1.1).

The dynamics of these sectors highlight the growing capabilities of the manufacturing base in the Mekong-3, albeit from considerably different starting points. This expansion of opportunities for new traders in new markets generates expectations of demand for trade finance that requires adaptation, as it concerns clients active in markets with which the financial system may be less familiar.

TABLE 1.1

Top five HS2 sectors in the Mekong-3 as a share of new products exported, 2012-2021

	Difference (2012-2013 vs 2020-2021)	Share of total difference (%)	Harmonized System 2
Cambodia	66	12.5	Machinery and mechanical appliances; nuclear reactors, boilers
	36	6.7	Electrical machinery and equipment and parts thereof
	35	6.5	Optical, photographic, cinematographic, medical instruments
	24	4.4	Plastics and articles thereof
	20	3.8	Iron or steel articles
Lao PDR	25	10.1	Machinery and mechanical appliances; nuclear reactors, boilers
	24	9.5	Plastics and articles thereof
	15	6.0	Electrical machinery and equipment and parts thereof
	13	5.2	Paper and paperboard
	12	4.6	Iron or steel articles
Viet Nam	48	18.2	Organic chemicals
	27	10.1	Inorganic chemicals
	13	5.0	Machinery and mechanical appliances; nuclear reactors, boilers
	11	4.2	Chemical products n.e.c.
	11	4.0	Meat and edible meat offal

Source: IFC–WTO calculations based on World Bank WITS.

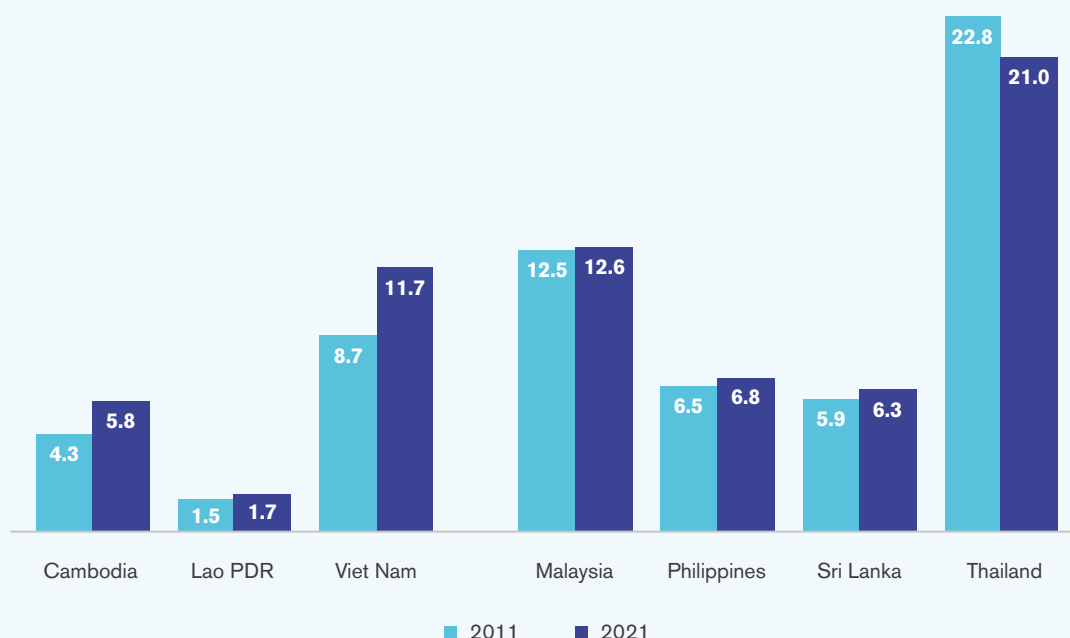
The Mekong-3 are expanding their access to new export markets

Cambodia and Viet Nam have made remarkable strides in expanding their reach of export markets, achieving significantly higher export penetration. Exporters in Viet Nam in particular have achieved a level of market access on par with their counterparts in Malaysia and Thailand (see Figure 1.6). The Lao PDR has also managed to increase its export penetration – albeit from a modest base.

While the number of exported products from Viet Nam has not experienced a substantial growth, exporters have succeeded in diversifying their market reach. This trend suggests that the surplus capacity built in Viet Nam from global trade reconfiguration has led to an expansion of trade beyond the routes from China to the United States. A striking example of this development is evident in the export of broadcast equipment, a dominant category in Viet Nam's exports to the United States: exporters in this sector found their way to 113 global markets in 2010, expanding to 130 markets by 2021 – a 15 per cent increase in market access.

FIGURE 1.6

Index of Export Market Penetration, 2011 and 2021



Source: World Bank WITS. The index follows Brenton and Newfarmer (2007) by comparing for each exported product, the number of countries to which the country exports that product relative to the total number of countries which import that product, and then sums across all products exported. The ratio yields the Index of Export Market Penetration (IEMP), which measures the extent to which a country is exploiting the market opportunities from the existing set of export products.

Trade of goods at different stages of processing

Goods at different stage of processing vary systematically both in the utilization of trade finance instruments they require and in the demand itself for coverage (see Box 1.2 for a description of trade finance instruments). An analysis of letters of credit usage, independently of transaction timing or destination, reveals that capital and intermediate goods are more often covered by this type of finance instrument when they cross borders, compared to consumer goods or raw materials (see IFC/WTO, 2022, based on Crozet *et al.*, 2022). While variations exist across categories, this pattern suggests that overall dependence on bank-intermediated trade finance is, to an important extent, associated with the structure of trade and its dynamics.



The Mekong-3 rely significantly on the import of intermediate goods.

The Mekong-3 rely significantly on the import of intermediate goods, which utilize letters of credit more intensively. Imports into Cambodia and Viet Nam largely comprise intermediate goods, surpassing global and regional average shares (see Table 1.2, Share of total imports). Viet Nam, in particular, imports intermediate and capital goods in proportions comparable to more advanced economies in the region, such as Malaysia and Thailand.

TABLE 1.2

**Share of trade in the Mekong-3 by stage of processing,
2020-2022 (including comparator economies and the world)**
(in per cent)

Share of total imports

	Primary	Consumer	Intermediate	Capital	Other
Cambodia	9	16	64	9	2
Lao PDR	11	19	45	22	3
Viet Nam	9	15	60	14	1
Malaysia	16	17	52	14	1
Philippines	8	25	51	14	2
Sri Lanka	13	15	57	14	1
Thailand	13	14	58	15	1
East Asia & Pacific	19	18	45	15	3
World	14	21	44	15	5

Share of total exports

	Primary	Consumer	Intermediate	Capital	Other
Cambodia	6	83	10	1	0
Lao PDR	34	19	47	0	0
Viet Nam	5	45	37	13	0
Malaysia	19	12	55	14	0
Philippines	15	14	46	25	0
Sri Lanka	5	67	25	3	0
Thailand	7	25	42	23	3
East Asia & Pacific	10	21	46	20	3
World	19	19	43	14	4

Source: World Bank WITS (mirror data).

Trade finance instruments

Trade finance instruments can be broadly categorized as the following:

- instruments that enable cross-border payments;
- instruments that guarantee payments over time;
- credit that enables production;
- mixed instruments with more than one of the above objectives.

In the absence of any intermediation, payments for goods that cross borders are made in advance of shipment, with the full risk of default borne by the importer. These cash-in-advance payments therefore represent the highest risk benchmark for any service provided by banks in this type of intermediation.

Payment methods

In order from least secure to most secure for the importer, payment methods include the following:

1. Cash-in-advance payments require the importer to pay for goods well in advance of receiving them – sometimes by as much as a year. This provides the exporter with payment certainty but leaves significant delivery risk for the importer.
2. Letters of credit are the most widely used instrument within the category of documentary trade finance. In its simplest form, a letter of credit is a written commitment to pay and is typically issued by a bank on behalf of the buyer (importer) to the seller (exporter) or its bank. Letters of credit carry a number of obligations to the buyer (delivery conditions, submission of documentation) and the seller (notably the guarantee that if the buyer is unable to pay, the bank will cover the outstanding amount).
3. Documentary collections refer to the handling of documents by banks according to instructions received, typically by an exporter or their bank, in order to obtain either direct payment or acceptance of deferred payment. This differs to a letter of credit in that the bank

faces no liability in the case of payment default or non-conformity of final goods.

4. Open account payments usually indicate payments that occur following shipment or receipt of goods. While cash-in-advance payments provide full certainty to the exporter, open account payments provide certainty to the importer against any risk. Similar to cash in advance, these payment arrangements are not bank intermediated.

Payment guarantees

In addition to payments, there are a number of trade finance instruments that guarantee future payments to the seller/exporter or the delivery of goods or services. Payment guarantees and stand-by letters of credit are bank guarantees to pay the exporter on delivery of the goods. Bid bonds and performance bonds also fall into this category and help the recipient to mitigate counterparty risk in the delivery of goods or services.

Capital loans

Trade finance also includes instruments to enable production for an overseas destination in the form of capital loans, such as: (i) pre-export finance, which finances expenditures before export deliveries take place; (ii) post-shipment/import finance to enable the importer to pay the exporter at a subsequent stage once the goods have been sold; and (iii) working capital loans, which are more flexible ways to pre-finance imports and exports.

Supply chain finance

Purpose-defined categories such as supply chain finance (SCF) refer to the open account payments discussed above combined potentially with risk mitigation practices to optimize the management of working capital and liquidity invested in supply chain processes. SCF can refer, for example, to supplier finance or reverse factoring. These are financing solutions in which suppliers can receive early payment on their invoices.

Reverse factoring refers to an arrangement whereby the supplier receives early payment based on the credit rating of the buyer. The term SCF can also be used generically to describe a broader range of

supplier financing arrangements, including solutions such as dynamic discounting, in which the buyer enables suppliers to access early payment on invoices in exchange for an early payment discount.



An entrepreneur visiting a bank in Vientiane, Lao PDR.

The Lao PDR imports a higher share of all other categories – consumer, capital and primary goods – which is likely a reflection of its stage of economic development. With regard to intermediate goods, the Lao PDR mirrors the import patterns of its neighbouring countries.

Similarly, the composition of exports from the Mekong-3 reflects the level of development of the three countries (see Table 1.2). Exports from Viet Nam encompass a wide range of products, including intermediate and consumer goods, showcasing the country's growing industrial capabilities. Cambodia primarily exports consumer goods (over 80 per

cent of total export value), while the Lao PDR focuses heavily on exporting primary products (34 per cent of the total) and energy to China. Both economies lag behind in exports of intermediate and capital goods combined compared to more advanced economies in the region, such as Malaysia, the Philippines and Thailand.

This dynamic, however, has been changing. In 2020, there was a slight shift in Cambodia, with a marginal increase in intermediate goods exports. Exports of intermediate goods from the Lao PDR steadily increased from 30 per cent of total exports in 2012 to more than 50 per cent in 2021.

Competitiveness and trade costs

Trade finance and competitiveness in international markets are inherently intertwined. In a mutually reinforcing cycle, an economy's competitive edge in international markets reflects its capacity to sustain and expand trade flows, which in turn impact the demand for trade finance. Moreover, a strong trade position enhances exporters' returns and creditworthiness, facilitating access to favourable terms for trade finance.

Exporters in the Mekong-3 have improved their export performance, despite adverse conditions. They have significantly enhanced their global presence throughout the last decade – outperforming counterpart economies in the broader East Asia and Pacific.

Analysis based on the World Bank Measuring Export Competitiveness (MEC) Database,¹ updated through 2021, shows that the expanded global footprint of Mekong-3 exporters is not primarily driven by an upsurge in global demand for the products they specialize in, nor is it driven by stronger demand across the board in their primary export destinations (see the sectoral and geographical effects, respectively, in Figure 1.7). Rather, this expansion can be attributed to residual performance associated with distinctive developments within each of the three countries – broadly captured as “performance” or “competitiveness effect”. This residual performance includes possible excess capacity from trade diversion: that is, the shift of production away from China; high-value exports along these trade routes; as well as improvements in the productivity of local exporters (see ILO, 2022).²



Although trade diversion effects can be short-lived, improvements in productivity underpin a more resilient export growth trajectory for Cambodia and Viet Nam.

Local producers progressively develop both the capacity and capabilities to compete internationally, should future geopolitical alignments favour different locations.

Exporters in the Mekong-3 notably secured disproportionately larger shares of the Chinese market in product categories experiencing a simultaneous surge in demand and prices (see Table I.1 in Annex I for more details). Exporters in the Lao PDR experienced the same in the rest of East Asia and Pacific, resulting in a largely positive geographical effect on their export competitiveness. Conversely, Mekong-3 exporters to Japan faced the opposite trends relative to average growth of demand and prices.

With regard to specific sectors, electronics exporters in Viet Nam expanded their footprint in products which had concurrent above-average growth in volume, despite below-average growth in prices for the products exported (see Table I.2 in Annex I for more details). It is noteworthy that, at the onset of the COVID-19 pandemic, both the price and volume effects were positive for Viet Nam's exports in this sector – that is, price conditions were favourable for the products in which Viet Nam had been specializing. Garment exporters in Cambodia managed to expand their footprint in products experiencing a below-average increase in both global demand and global prices. Collectively, the specialization and scale effect in these garment segments outweighed the adverse conditions.

Trade costs in the Mekong-3

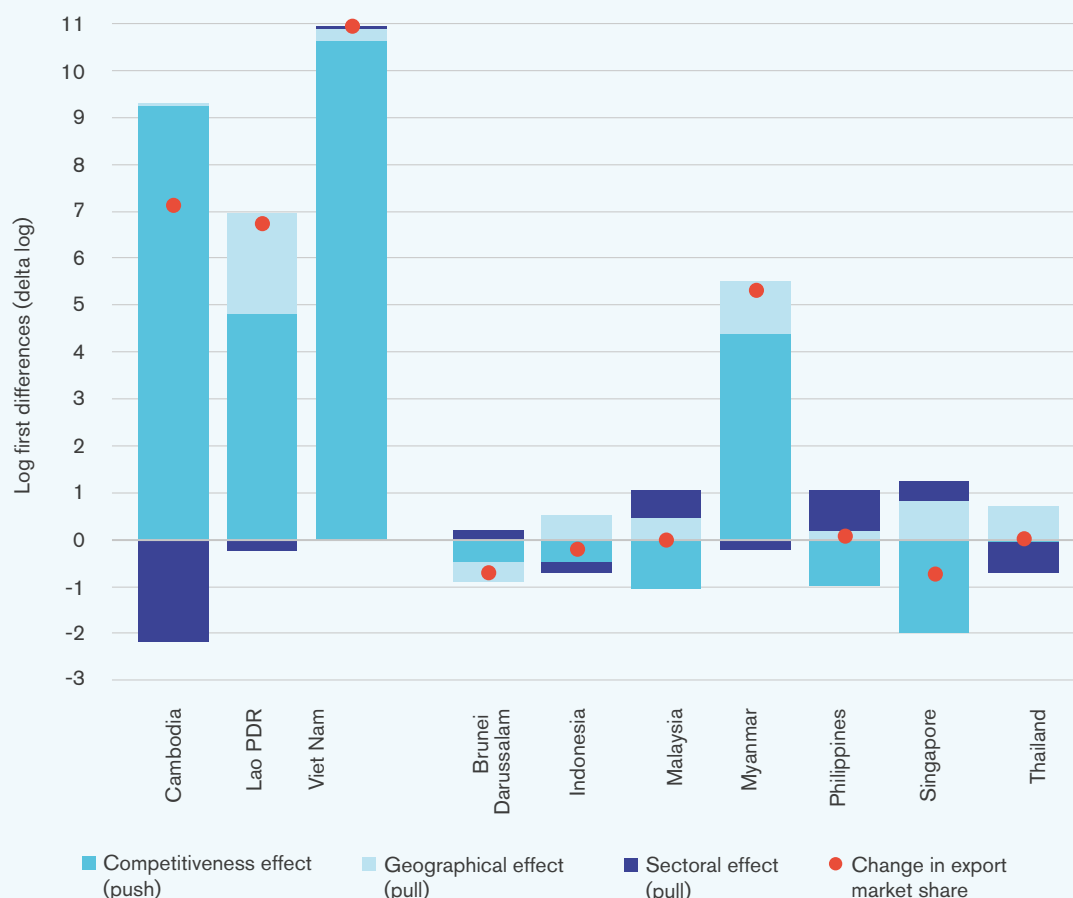
Trade involves various costs arising from transportation, regulatory adherence, currency conversion and trade-related levies such as import tariffs. As an economy's infrastructure strengthens and trade agreements are established, many of these associated costs will tend to diminish. WTO statistics reveal that global trade costs fell by approximately 15 per cent between 2000 and 2018 (WTO, 2021).

In the Mekong-3, however, progress has been less pronounced, with disparities in improvements across countries. In Cambodia, there were substantial reductions of 13-22 per cent in both import and export costs to its top ten partner economies between 2008 and 2018. In Viet Nam, however, trade costs fell only for exports, with costs for imports marginally increasing. Over the same period, the average trade costs in the Lao PDR for exports to its top ten partners rose sharply by more than 35 per cent, and import costs were 15 per cent higher than in 2012 – both of which, moreover, from an already high initial base (see Figure 1.8).

Importing costs from the region generally followed an upward trend during the first half of the last decade but subsequently improved in the latter half. Trade costs with China – the major import partner of the Mekong-3 – on both sides have followed a similar trajectory over the last decade.

FIGURE 1.7

Decomposition of change in export market share (trade values), period averages 2010-2021



Source: World Bank MEC Database. The numbers reported in the tables are log first differences. They represent an approximation of the percentage change in the variable of interest. Strictly speaking, the percentage change in a variable Y at period t is defined as $(Y(t) - Y(t-1))/Y(t-1)$, which is approximately equal to $\log(Y(t) - Y(t-1))$. The approximation is almost exact if the percentage change is small.

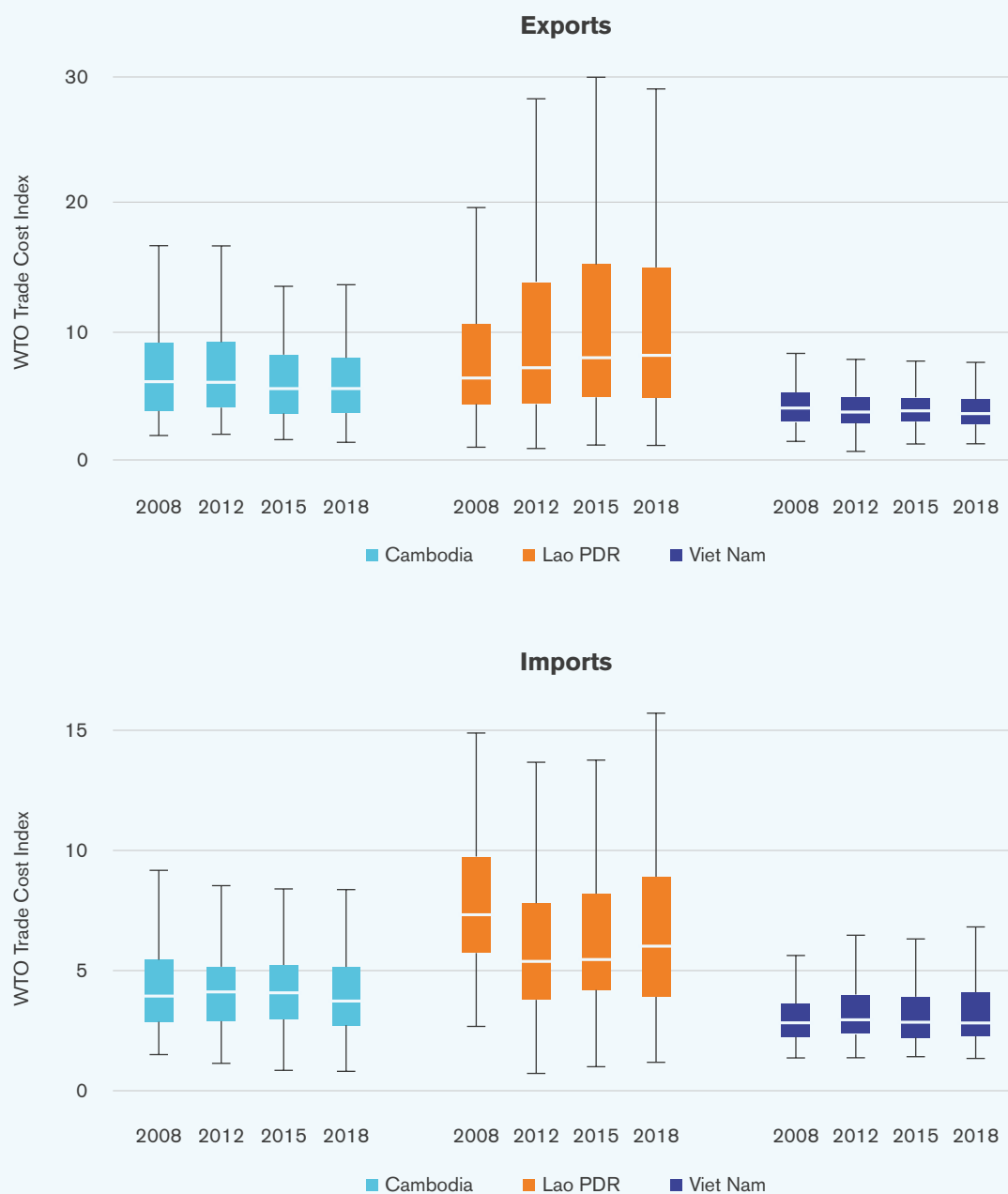


Trade costs are falling slowly in Cambodia and Viet Nam, while increasing in the Lao PDR.

It is important to recognize that higher trade costs not only impose direct constraints on trade but can also impede access to trade finance. When trade becomes less lucrative and profit margins are squeezed, extending trade finance services to importers and exporters becomes riskier for financial institutions.

FIGURE 1.8

WTO Trade Cost Index in the Mekong-3, 2008-2018



Source: IFC–WTO calculations based on the WTO Trade Cost Database. The index of global trade costs can be interpreted as how many times higher international trade costs are compared to domestic trade costs (WTO, 2021). For example, a value of 2 means that international costs are double the domestic trade costs (*ad valorem* equivalent of 200 per cent). The box plots display a three-number summary of the trade cost distribution across the Mekong-3 and their top partners (top ten origin countries for imports, top ten destinations for exports). The bottom of each box represents the first quartile, the horizontal line the median, and the top of the box the third quartile of trade costs in each year.

Participation in global value chains

Seizing trade opportunities in GVCs through expansion into new products and services requires deeper and more diverse trade finance instruments. Over time, the Mekong-3 have experienced greater GVC integration both in terms of backward participation (i.e. the share of imported intermediates in exports) and forward participation (i.e. the share of intermediate exports from the Mekong-3 in third countries' exports) (see Box 1.3 for definitions). Leading the way in the East Asia and Pacific region, Cambodia and Viet Nam have demonstrated remarkable growth in their participation levels (see Figure 1.9).

Two sectors account for the majority of this development. Since the late 2000s, when Viet Nam made a pivotal entry into GVCs, the country has been recognized as a second-tier global supplier for computer, communication and consumer products. Yet despite its prominent position, Viet Nam's role within electronic GVCs has primarily involved a transition from being a mere integrator of components to engaging in midstream activities that still generate relatively lower value (OECD, 2021). These midstream activities encompass subassemblies such as displays and special parts, as well as finished products such as consumer electronics, communications and computers. An essential aspect of Viet Nam's electronic industry involves significant imports of components and subassemblies, which accounted for about 65 per cent of imports in 2019.

Cambodia's garment manufacturing sector has experienced a flourishing trajectory. A distinctive feature of this sector is the prevalence of cut–make–trim firms, which rely heavily on imported materials for their production processes and often operate along narrow profit margins. This unique model has contributed to the sector's growth and impact on the broader economy.

Foreign investment drives trade growth in Cambodia and Viet Nam

The landscape of Viet Nam's trade is prominently shaped by the activities of multinational enterprises, which contributed to roughly 70 per cent of the merchandise imports and exports in 2021 (see Figure 1.10).³ Large and mega firms (conventionally defined as those employing over 5,000 employees) contributed more than 80 per cent of goods exports from the country. These shares are significant in terms of trade finance, as subsidiaries of multinational enterprises and large conglomerates tend to rely to a greater extent on intra-firm financial solutions and syndicated arrangements with international banks (Nguyen and Almodóvar, 2018).⁴



The growth of both Cambodia's textile exports and Viet Nam's electronic industry is primarily driven by foreign investors.

New evidence from the 2023 IFC survey of traders in the Mekong-3 lends support to the key take-away – that foreign affiliates rely significantly less on local bank-intermediated trade finance than domestic firms or firms of smaller sizes (see Chapter 2).

A closer examination of the electronics sector in 2021 reveals that multinational firms accounted for nearly all of the imports and exports of these goods – domestic firms accounted for 0.5 per cent of imports and 1.6 per cent of exports (see Figure 1.11). Most shipments to Viet Nam (62 per cent) and over 50 per cent of exports were undertaken by businesses with more than 5,000 employees – so-called mega-firms.

A similar structure can be found in Viet Nam's garment sector; although a more considerable share of domestic firms engage in trade and there is a greater presence of large rather than mega firms. Small and medium-sized enterprises (SMEs) are concentrated in other exports (39 per cent) and imports (23 per cent). Combined, these observations help to explain the two-speed trajectories of trade growth in Viet Nam – where large multinational conglomerates outpace smaller, albeit growing, domestic sectors.

The prospects of local bank-intermediated trade finance in the region will likely depend on further integration of local firms into GVCs – a process that has been gaining traction. Tier 1 and 2 suppliers in Viet Nam to Samsung, a manufacturer based in the Republic of Korea, witnessed a ten-fold increase from 2014 to 2022, from 25 local companies to 257.⁵ Furthermore, Samsung has partnered with 400 Vietnamese firms to improve product quality in this supply chain – generating US\$ 72 billion in local revenue.

The situation in Cambodia is similar, although access to firm-level information is more challenging. The garment industry relies heavily on foreign capital, with approximately 90 per cent of garment enterprises under foreign ownership, primarily from: China; Hong Kong, China; the Republic of Korea; and Chinese Taipei (Calabrese and Balchin, 2022). The advantage of these foreign entities lies in their access to capital, expertise, well-established networks and a skilled labour force – resources that are not as readily accessible to their domestic Cambodian counterparts.

Forward and backward participation in global value chains

Economies participate in global value chains (GVCs) by importing foreign inputs to produce the goods and services they export and also by exporting domestically produced inputs to partner economies in charge of further production stages.

Forward GVC participation

Forward GVC participation is the share of domestic value-added content of exports to an economy's total gross exports. This is the supply side in GVCs, where an economy exports intermediate goods to third economies for further processing.

Backward GVC participation

Backward GVC participation is the share of foreign value-added content of exports to an economy's total gross exports. This is the sourcing side in GVCs, where an economy imports intermediates to produce its exports.

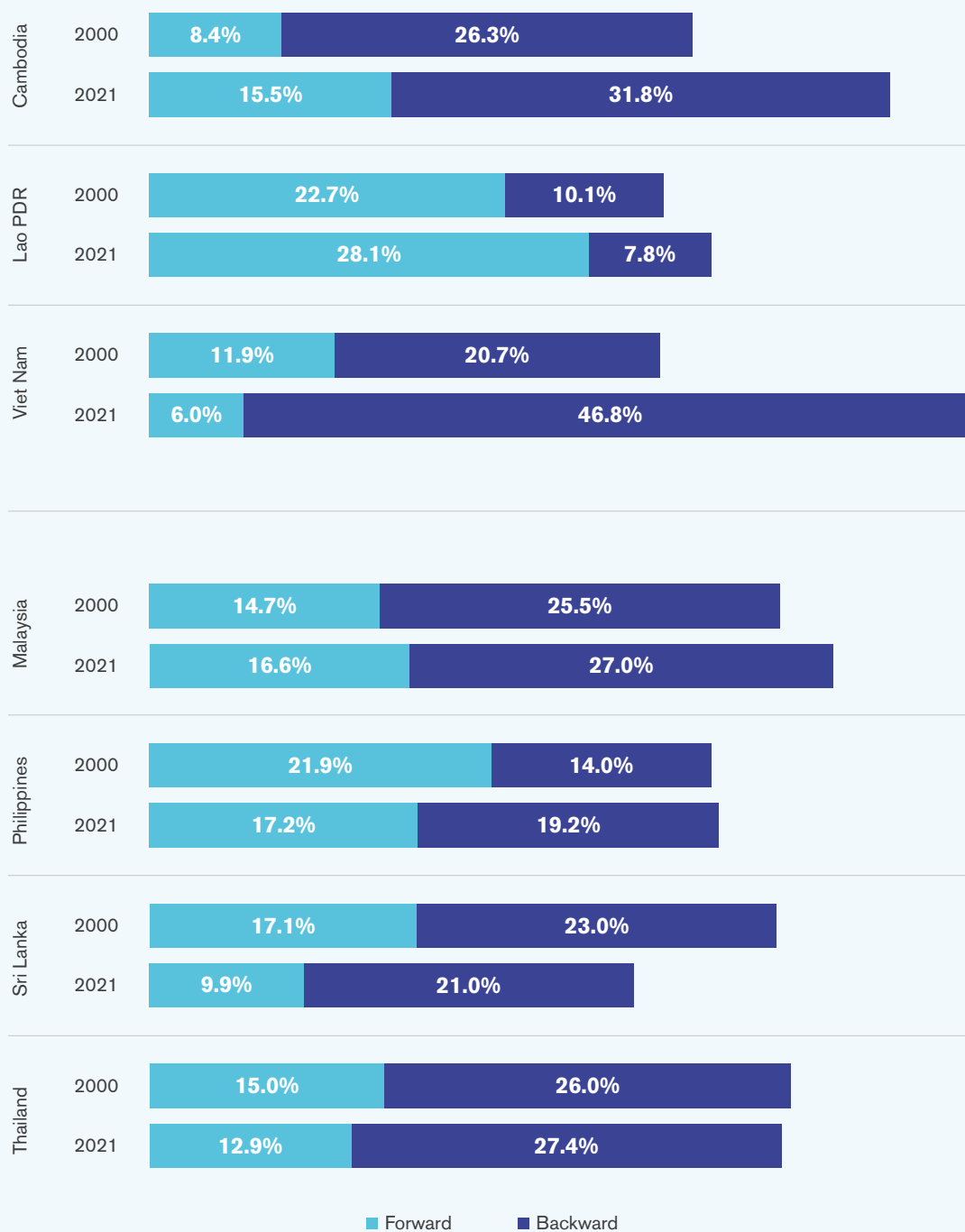
Source: See https://www.wto.org/english/res_e/statis_e/miwi_e/explanatory_notes_e.pdf.



A local footwear manufacturing plant, Cambodia.

FIGURE 1.9

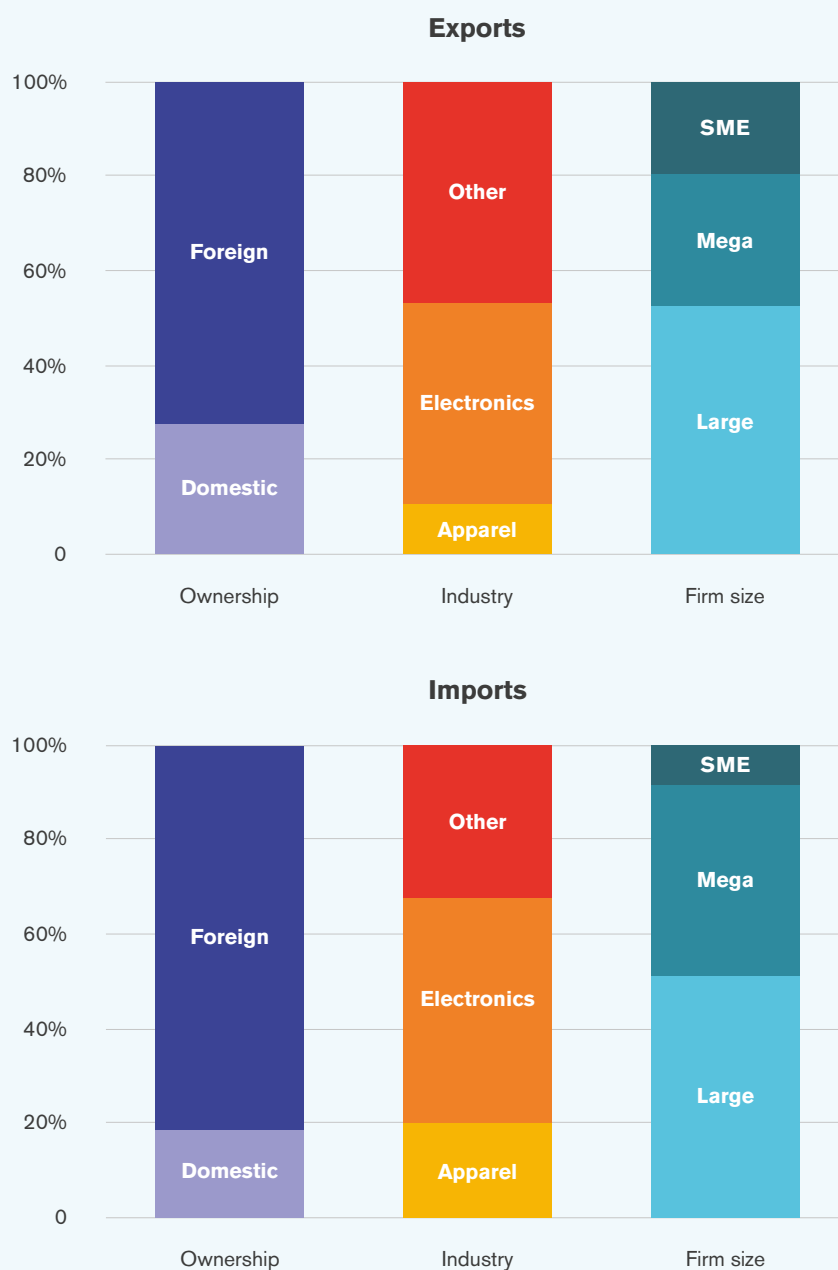
Forward and backward GVC participation in the Mekong-3, 2000 and 2021 (in per cent of trade)



Source: World Bank WITS, GVC Trade Table.

FIGURE 1.10

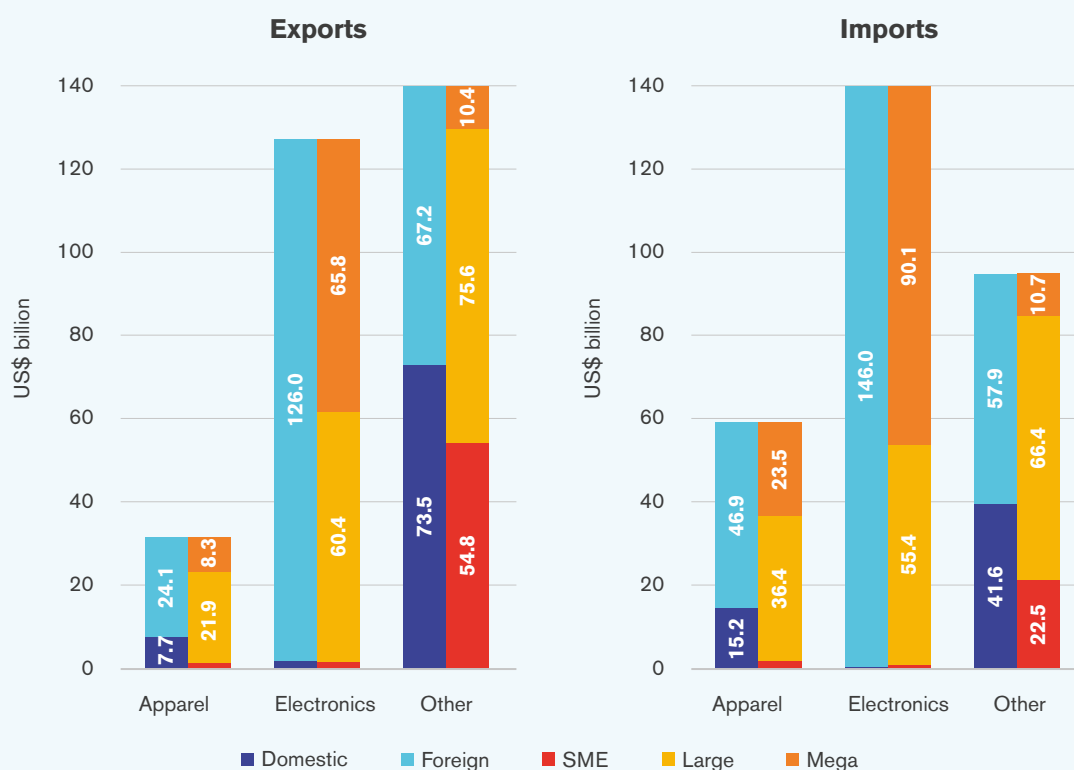
Viet Nam: Share of exports and imports by ownership, industry and firm size, 2021 (in per cent)



Source: IFC–WTO calculations based on 2021 Vietnam Enterprise Survey and Custom data from the General Statistics Office of Vietnam, excluding data from the services sector, except wholesale and retail. Foreign – firms with at least 10 per cent foreign ownership; SME – 1–100 employees; large – 101–4,999 employees; mega – 5,000+ employees. Electronics includes ISIC Rev. 4 divisions 26 and 27 and apparel includes divisions 13–15.

FIGURE 1.11

Viet Nam: Share of exports and imports in apparel and electronics industries by ownership and firm size, 2021 (in US\$ billion)



Source: IFC–WTO calculations based on the 2023 IFC firm-level survey of trade finance. Foreign – firms with at least 10 per cent foreign ownership; SME – 1-100 employees; large – 101-4,999 employees; mega – 5,000+ employees. Electronics includes ISIC Rev. 4 divisions 26 and 27 and apparel includes divisions 13-15.

Endnotes

1. See Gaulier *et al.* (2013) for more details on methodology and indicators of the shift-share analysis.
2. The International Labour Organization (ILO, 2022) notes that from 2010 to 2019, Viet Nam experienced the fastest growth in the average annual real minimum wage in Southeast Asia (11.3 per cent); exceeding the annual productivity growth over the same period by a factor of two. The ILO (2022) concludes that: "While this may signal lower competitiveness for low-cost manufacturing activities, Viet Nam's average minimum wage is still lower than other competitor production countries in the region. It also reflects that labour productivity can be raised to match higher wages by increasing the value-added of production activity".
3. The Centre d'Études Prospectives et d'Informations Internationales (CEPII) reports similar results for 2019 (Fouquin and Caponnière, 2020).
4. The United States Census Bureau's Related Party Trade database reveals that 31 per cent of the total US\$ 101 billion goods imported into the United States from Viet Nam in 2021 were between related parties, with the electronics goods category representing the overwhelming majority (90 per cent, equivalent to US\$ 28 billion). A share (possibly high) of these intra-company flows is likely to be financed by large global banks outside Viet Nam and not captured in this publication.
5. See <https://vir.com.vn/vietnamese-suppliers-to-become-part-of-samsungs-global-value-chain-99735.html>.