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TRADE FINANCE, GAPS AND THE COVID-19 PANDEMIC: A REVIEW OF EVENTS AND POLICY RESPONSES TO DATE

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Abstract

Developments in trade finance in 2020 were largely driven by the impact of the COVID-19 pandemic. Twelve years after the great financial crisis of 2008-09, the issue of trade finance re-emerged as a matter of urgency. While the current pandemic-related crisis did not have a financial cause, one of its results has been that many countries are experiencing difficulties in accessing trade credit. This is occurring notably in countries – particularly developing countries – in which structural trade finance gaps were high even before the pandemic. As the health crisis developed and persisted, banks experienced an increase in failures by traders to fulfil payments, including in industries and sectors beyond those initially impacted by lockdowns, such as airlines, aeronautics and tourism. It quickly became evident that one-off extensions of terms of payment by creditors would be insufficient to alleviate the trade finance crisis. Based on the experience of the 2008-09 crisis, governments, export credit agencies and international financial institutions, including multilateral development banks, rapidly intervened to support private markets. Multilateral development banks have provided record amounts of trade finance guarantees and liquidity in developing countries, while governments have implemented payment deferral schemes. Large central banks have supplied foreign exchange resources to other central banks through swap agreements. Efforts to date have been substantial, but challenges remain in 2021, connected first with how to support the importation and exportation of vaccines against COVID-19, and then with how to encourage the recovery of trade flows. Recent events, policy responses and upcoming challenges are discussed and analysed in this paper.

Keywords: trade credit, financial and economic crises, trade.

***JEL* classification**: F13, F34, G21, G23

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I. INTRODUCTION

The expansion of international trade through the great financial crisis of 2008-9 has been silently supported by an equally expanding and globalizing financial industry which delivered liquidity and guarantees to importers and exporters across the main routes of international trade. By the time of the Asian financial crisis in the late 1990's, and even more so during the great financial crisis, flows of trade finance have been brought to a near stoppage, leading analysts and policy-makers to realize how important the supply of finance for trade was. Much had to be learned about this relatively under-rated form of finance (at least within the financial industry), its mechanisms, composition, instruments, forms of supply, and economic effects.

After the 2008-9 global financial crisis, trade finance markets reverted to more normal conditions in the main routes of trade but chronic shortages in developing and emerging economies continued to materialize. Trade finance gaps have therefore been monitored by the Asian Development Bank (ADB) in collaboration with the WTO, multilateral development banks, private banks and other providers of trade finance. In addition to estimating global trade finance gaps, ADB global surveys pointed to structural changes in global trade finance markets, such as the shift away from documentary credit in favour of supply chain finance, and the move towards digitization of paper-based processes.

An important development since the global finance crisis has been the retrenchment by systemically important international banks of their trade finance distribution network, as measured by a 20% reduction in the number of their correspondent banking relationships (CBRs) with the rest of the world. This reduction reflected an overall reduction of exposure to smaller countries and smaller clients, with a view to improve profitability and meet new financial transparency rules. Another important structural shift has been the growing reallocation of trade and production to "new" emerging markets (Vietnam, Cambodia, Bangladesh, Myanmar, Ethiopia, etc) which trade volumes gradually exceeded the capacity of their local financial sector to support them. The combination of these two developments (reduction of big banks' exposures in a concentrated market, and the emergence of new traders "under-served" by international markets) has been the source of further and persisting trade finance gaps.

The COVID-19 epidemic broke out in this overall context for trade finance. This paper aims at discussing and evaluating the consequence of such outbreak for trade finance, and, given the linkages between trade and trade finance, for trade as well. Section 2 reviews our knowledge of trade finance markets at the onset of the COVID-19 outbreak; Section 3 reviews trade finance developments since the beginning of the COVID-19 pandemic, and discusses the (ongoing) policy response by national and international public agencies; Section 4 look at some upcoming challenges for trade finance in the period of recovery (vaccine financing, limited trade finance capacity in view of expanding trade demand).

II. WHAT DID WE REALLY KNOW ABOUT TRADE FINANCE MARKETS AT THE ONSET OF THE COVID-19 OUTBREAK?

1. A great paucity of "hard" trade finance statistics

All institutions and individuals having worked on trade finance have noted the absence of a globally consistent set of statistics. Unfortunately, at the onset of the COVID-19 outbreak, the statistical situation had not improved much relative to the 2008-9 global financial crisis (GFC), despite problems being well identified (Auboin, 2014).

Already in 2003, the IMF was writing: "Data on trade credit are not readily available, complicating efforts to carry out comprehensive empirical analysis. In the cases where data are available, they are often only partial. As a result, many participants of trade finance suggested a systematic effort involving country authorities, multilateral institutions as well as the private sector be launched to collect data to facilitate future empirical research" (IMF, 2003).

The data situation had not improved much in 2014 when the Bank of International Settlements (BIS) made a general assessment of trade finance supply (BIS, 2014). Relying on the relatively basic distinction between bank-intermediated trade finance and non-bank financing (including inter-company lending/credit), the Bank of International Settlements wrote that "there are no readily available data covering the global bank-intermediated trade finance market". Mixing several sources of data, the BIS estimated that annual flows of bank-intermediated finance to be anywhere between $6.5-8 trillion. Data on non-bank financing was not easier to find, as noted by the BIS (2014, page 5)". The BIS recently reverted to the topic, acknowledging that no new database had emerges from what was already known, particularly in the expanding area of supply chain finance.[2] The BIS estimate of bank-intermediated finance had been revised upwards by the International Chamber of Commerce (ICC), at around $9 trillion in 2019 (ICC, 2020).

Until 2004, a series of trade finance statistics was derived from balance of payments and BIS banking statistics, under the combined efforts of four international agencies, i.e. the IMF, World Bank, BIS and OECD. Apparently, the cost-to-quality ratio of these statistics led the agencies to discontinue this effort. This left the international community with no comprehensive and reliable source of information on trade credit at the time when information on trade finance had proved to be important for the analysis of constraints affecting international trade.

Cross-border trade credit and trade payment guarantees have historically been defined and compiled by international statistics agencies, either in the context of the balance of payments (IMF), or in the context of cross-border banking statistics (BIS).

Despite continuous progress regarding guidance regarding definition and compilation under these institutions most recent statistical manuals, compilation at both national and international levels has been lagging. Statistical information about the source of finance underlying trade transactions has been “lost” in many countries, when they abandoned foreign exchange controls, particularly in the 1990’s and 2000’s. In these countries, specific

[2] Boissay, F, Patel, N and Song Shin, H. (2020).

reporting on trade credits had to be provided to customs, treasuries and central banks for the purpose of monitoring and operating exchange controls – providing a good account of financial conditions of individual physical transactions. When foreign exchange controls were removed, much of such "declarative" information was lost in many countries. Cross-border trade lending flows were still supposed to be declared by banks for statistical purposes, but short of specific software put in place for that purpose, the information was largely melted with other cross-border lending flows – most trade finance being of average tenor of 90 days; as a result, trade finance disappeared into the bulk of international flows of money market-based, cross-border inter-bank lending. With banks moving to "high-frequency" liquidity provision to their clients involved in international supply chains, short-term trade credit transactions (or supply-chain related differed payment arrangements), when unspecified as "trade-related", could not be distinguished from other interbank lending movements.[3]

Using the little international data available, economists have been able to show relatively early after the global financial crisis that, while mostly demand-driven, the supply of trade finance had significant effects on trade flows across cycles, not only in periods of crisis.

In recent years, with support from the WTO, professional associations of trade finance suppliers (the Berne Union, the International Chamber of Commerce, Factoring International, SWIFT) achieved progress in collecting trade finance data, by mobilizing their growing respective memberships. Each set data does not necessarily apply the same methodology, may involve the same products and players, hence at times may overlap; however, they provide a very useful complement to lacking official statistics.

For example, the Berne Union, the association of trade credit and investment insurers (including so-called export credit agencies), has been collecting data on insured trade credit, covering both insured bank-intermediated trade credit or commitments to pay (letters of credit), and insured inter-company credit (supplier and buyer's credit). Annual flows supported by the Berne Union members were in the order of $2.5 trillion ($2.2 trillion for short-term flows) in 2019. Three-quarters of short-term flows were supported by private sector firms, while one quarter was supported by export credit agencies. Export credit agencies had a higher "market" share in the longer tenors.

The SWIFT payment network collects data about the number and total value of payment messages. Message MT 700 is specifically devoted to transactions regarding documentary credit (letters of credit and the like) between banks mostly. The specific MT 798 message is a message for corporate-to-bank documentary trade flows. Message MT 400 is about collections (an advice of payment sent by the collecting bank to the remitting banks), documentary collections being most often related to trade. The total annual value of trade related messages is over $ 2 trillion annually.

Another useful source of data comes from the factoring and reverse factoring professional associations, particularly data collected by Factor International (FCI). According to FCI, cross-border factoring transactions from 70 countries, totalled over $500 billion in

[3] Auboin, M., Escaith, H. and Maurer, A. (2011).

2019. The average transaction was estimated to be around $50,000, with such transactions being largely undertaken by small and medium sized enterprises (SMEs).

Private sector association's statistics help understand, at a more granular level, the direction and type of trade finance instruments used, for example in the development of supply-cain finance solutions. As indicated earlier, it would not be wise to aggregate these statistics due to double-counting and overlap. However, the annual Trade Finance Surveys of International Chamber of Commerce (ICC), and the Asian Development Bank's (ADB) annual trade finance gap surveys have been using these sources of information (Berne Union, FCI, SWIFT) as inputs, to draw a global picture of global trade finance trends and gaps. The ADB Trade Finance Gap Surveys have proved to be particularly useful to document the persistence of large imbalances between supply and demand of trade finance, mainly in developing countries, and to provide survey-based information on the reasons for these gaps. In turn, progress on the understanding of global trade finance trends have helped fine-tuning and focus policy action, particularly towards certain regions affected by gaps and categories of traders (SMEs).

Box 1. Trade finance data: what is available?

Trade Credit data (BIS): partial reporting to central banks of locational trade credit data provided by banks (around $500 billion per annum in flows). More information is available at www.bis.org/statistics.

Insured Trade Credit data (Berne Union): annual flows supported by the Berne Union members are in the order of $2.5 trillion, most of which are short-term. Private insurers dominate the short-term segment, while export credit agencies have a larger share in the medium-to-longer segment. Flows may overlap with other sources of data such as trade credit or letters of credit, when they are insured or re-insured. The same goes for inter-company credit (supply chain finance), if insured with a private or public insurer. More information is available at https://www.berneunion.org/DataReports.

Letters of Credit data (SWIFT): reporting of letters of credit and documentary collections based on payment messages (MT 700, 798, 400). Flows are in the order of $2 trillion annually but are declining. Information on SWIFT messaging is restricted, but occasional reporting is available in ICC Annual 'Global Surveys' on trade finance and Financial Stability Board's recent reports on the reduction of correspondent banking relationships.

Trade Receivables (Eurostat); available for a few countries only.

Factoring and reverse factoring (Factoring International): total factoring flows are recorded by the FCI based on aggregate information collected from its members. Based on 2019 flows, total factoring flows recorded by FCI were in the order of $3 trillion in 2019, with annual international flows exceeding $500 billion. More information is available, at https://fci.nl/en/industry-statistics.

A logical way to obtain comprehensive, on-going reporting could/should be through the balance of payments. Here, confidentiality is less of an issue than for private association's data, as data is collected on an aggregate basis and according to the resident, non-resident criterion of the balance of payments. Although short-term trade credit should be captured under the IMF's 6th Manual on Balance of Payment Statistics, it has always proven difficult to collect the information at the national level due to the high cost of information technology needed by statistical compilers and by the declaring financial institutions to capture such information. BIS locational cross-border banking statistics should also be improved, but this would equally require additional pressure at national level by central banks on banks and

other financial institutions to distinguish trade-related operations from other short-term credit and payment transactions.

2. Trade finance trends before COVID-19

2.1. Persistent gaps in provision in a very large global market

As indicated earlier, for decades, trade finance had supported the expansion of international trade, and, to some extent, had been taken for granted. Financial crises, particularly the Asian and Latin American crises of the late 1990's and the great financial crisis of 2008-9, revealed that trade finance could be subject to serious disruptions, by contagion of other segments of the financial industry. Academic interest in the role of trade finance has developed in and around these periods. Several researchers were able to find robust evidence that shortages of trade finance during the great financial crisis had been one factor (albeit not the main) behind the "big trade collapse" of late 2008 to late 2009.[4] More generally, they raised the likelihood of a wider link between financial conditions, trade credits and international trade flows (Amiti and Weinstein, 2011; Bricogne et al., 2012; Manova, 2013; Petersen and Rajan, 1997).

As noted in the above section, the size of the market for trade finance is very large. It is difficult to estimate the amount of trade finance due to the paucity of data on these flows, and also because it is difficult to estimate the share of trade which is paid "cash-in-advance" (paid cash, in advance of the delivery of goods). In 2003, it had been reported by the IMF, based on its then IMF-BAFT regular survey, that some 20% of trade was paid cash-in-advance, an estimate which had never been updated since. It appears possible that, with the expansion of the world's share of trade from developing countries, this share has increased.

Several factors may have contributed to this. In developing countries, the share of traders not supported by formal banks is higher than in developed countries: banks are more selective, reject a larger number of requests for trade finance (a 50% rejection rate according to the Asian Development Bank's trade finance gap studies), and offer less trade finance facilities (in many countries, supply chain finance is still not available).

Another very important evolution globally is the fast increase in e-commerce transactions, which in effect require customers to pay for orders cash-in-advance (credit card payment is required upon order – payment on delivery is rare). E-commerce having grown faster than traditional trade, one could assume from this development that the cash-in-advance share of trade payments has therefore increased (without a full certainty, given the weak statistical base for it).

But even if the share of cash-in-advance transactions in international trade was 30% instead of 20%, the remaining 70% or 80% of trade supported by trade finance would still amount to $14 to $16 trillion in flows, based on trade flows in goods of $20 trillion recorded in 2019 (not counting the $5 trillion in trade in services, of which little is known regarding financing).

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[4] Eaton et al.(2011) find that demand shocks can some three-quarters of the decline in trade and for some countries, like China and Japan, this share is a lot smaller. Hence, a significant share of the trade collapse remained to be explained.

Such an order of magnitude is not inconsistent with the last plausible overall estimate for bank-intermediated trade finance provided by the Bank of International settlement ($6.5-8 trillion in 2011, against global trade estimated at $17 trillion for that year). The figure did not include non-bank intermediated trade finance, notably the large flows of inter-company supplier and buyer's credit which are, for example, insured by Berne Union members, or which are subject to factoring and reserve factoring (FCI-recorded flows). It is generally agreed that non-bank intermediated payment arrangements have increased in recent years much faster relative to bank intermediated finance. Alternative trade finance, such as trade finance and commodity finance funds, has also gained in importance in recent years.

However, the statistical efforts by the private sector, mentioned above, helped in recent years confirm and measure two features of trade finance markets: trade finance markets are rather "safe" from a risk perspective; trade finance markets are characterised by large gaps in provision.

First, trade finance is a high-volume, low-cost, and low-risk source of cross-border finance. This has been documented by the annual Trade Register Reports published by the International Chamber of Commerce, based on proprietary commercial data collected from banks. Unfortunately, this data cannot be used for statistical purposes other than for aggregate risk calculations, due to their commercial sensitivity. The risk of default on trade finance facilities is small, with a global average of less than 0.5%, and little difference across countries and regions.

Table 1: Risk characteristics of short-term trade finance products, 2008-18

CATEGORY	Default Rate	Implied maturity (days)	Recovery Rate
Import and export letters of credit	0.21%	80	71%
Loans for import/export	0.8%	120	45%
Performance guarantees	0.37%	110	18%
Total	**0.45%**	**90**	**52%**

Source: Author, based on ICC Trade Register Reports' averages (2013; 2015: 2018)

Second, there have been persistently large "structural" gaps in provision, in the years preceding the COVID-19 pandemic. The gaps have been estimated by the ADB to be around US$ 1.5 trillion annually, between 2013 and 2019. Trade finance gaps represents the amount of trade finance which had been requested by importers and exporters, and thus rejected. According to the ADB survey, more than 40% of trade finance applications rejected by banks came from SMEs. Half of the rejected SMEs abandoned the transaction as they were unable to find appropriate alternative financing. In about 20% of the cases, SMEs resorted to "informal" funding and only in 15% of cases they found "formal" alternative financing.

Rejections are explained by a variety of factors, mainly lack of collateral, lack of proper information available during the application process, and lack of profitability for banks. The adoption of new technologies was generally low in developing countries, as most surveyed actors complained about the high cost of it, and the lack of global standards for digital finance (lack of "interoperability" of digital platforms). Just before the COVID-19 pandemic broke out, the 2019 survey had reflected some pessimism about short-term prospects for reducing the trade finance gaps: 60% of respondent banks were expecting the gap to increase rather than decrease in the future.

Over the years, it was estimated that half of the gap was in developing Asia and Africa. In a survey by African Development Bank (complementing for Africa that of the ADB), it was estimated that the trade finance in Africa stood at some US$100 billion annually, that is about one-third the total value of the market in the continent. In a separate survey, the World Economic Forum (WEF, 2018) estimated that the global trade finance gap would further expand in the future, reaching US$ 2.5 trillion dollars by 2025, as supply chains would continue to be reallocated to developing countries with non mature financial systems.

According to the ADB, the persistence of large gaps in provisions is the outcome of a combination of factors, from weak savings, to capacity issues in the financial sectors of least developed countries, including lack of know-how in managing risk and trade finance products. Other factors included a high perception of corporate and counterparty risk in the countries concerned, a reduction in the number of correspondent banking relationships and a lack of alternative trade finance solutions.

2.2 Work aimed at improving the trade finance supply "infrastructure" in selected developing countries in which demand for trade finance was high

For several years now, the WTO has worked with a strong coalition of institutions to try address supply issues and call the attention of the international community over trade finance shortages. The strategy has been taking the following directions: supporting multilateral development banks' trade finance facilitation programs by way of advocacy and mobilization; reducing the knowledge gap regarding trade finance products, by increasing training; opening a dialogue with trade finance regulators and supporting capacity-building activities in this field. Work proceeded in recent years in each of these areas.

Multilateral development banks have continued to expand the spectrum of available trade finance products (supply chain finance, working capital, trade guarantees, critical commodity finance, warehouse financing), under so-called trade finance facilitation programs, in the poorest parts in the world, with a special focus on SMEs. For example, in the context of its trade finance facilitation program, the Asian Development Bank had doubled the number of its trade transactions involving SMEs in the years 2017-2019 (from 2,000 to 4,000 SMEs). In the context of its COVID-19 response, the ADB further increased the number of transactions supported by 50%. The African Development Bank and African Import and Export Bank have also been supporting trade finance in the context of preparations for the African Continental Free Trade Area. In August 2018, the Islamic Trade Finance Corporation launched a sovereign energy trade-finance Fund, which will invest primarily in structured trade, export and import finance, supply chain financing and project finance assets of sovereign entities across the energy value chain in member countries of the

Organization of Islamic Countries. The IFC and EBRD have continued to support trade finance transactions in some of the most challenging markets in the world.

Regarding capacity-building and dialogue with regulators, the Director-General of the WTO, Roberto Azevedo, and the Chief Executive Officer of the International Finance Corporation (IFC, private arm of the World Bank Group), Philippe Le Houérou, worked with the Chair of the Financial Stability Board since 2017 on the links between the reduction of correspondent banking relationships and trade finance. Several avenues for cooperation have been agreed, including joint technical assistance activities. The 2019 publication entitled "Trade Finance and the Compliance Challenge: A Showcase of International Cooperation" provided concrete examples of this mobilization, notably after a joint meeting of international agencies (WTO, IFC, FSB, IMF, and other multilateral development banks) at the 2018 Fall Meetings of the IMF and World Bank.

This joint WTO-IFC publication highlighted joint capacity building activities undertaken in Rwanda, Madagascar, Zimbabwe and Zambia. It also showcases similar activities organized by the European Bank for Reconstruction and Development (EBRD), the Asian Development Bank (ADB) and the Islamic Development Bank (IsDB). Since then, the WTO Secretariat participated in more capacity-building activities in the African continent, and for EBRD countries of operation. Capacity-building activities addressed the issue of how best to incorporate the trade finance dimension in the implementation of new financial transparency regulations, such as anti-money laundering (AML) and know-your-customer (KYC) regulations.

In this vein, the WTO and its partners have been encouraging the use of tools and "utilities" that could facilitate and cheapen the adoption, in the trade finance field, of AML-KYC guidelines at a reasonable cost for developing countries' financial institutions. In doing so, the Secretariats of the WTO and Financial Stability Board have been encouraging the development of synergies between legal identifiers provided by the Global Legal Entity Identifier Foundation and the World Customs Organization. The WTO and FSB also supported the Asian Development Bank's "scorecard" project, aimed at developing tools such as harmonized "suspicious activity report" to facilitate compliance in trade finance.

Finally, the WTO works at integrating more systematically trade finance in the trade diagnostic studies (DTIS) of least developed countries. This had been done successfully in the recent DTIS of Myanmar and Cambodia, and work is underway to include trade finance in other countries' diagnosis. Improved, country-level diagnoses help least-developed countries focus on trade finance as part of the overall trade strategy of the countries concerned and help address trade finance gaps, with multilateral and local partners (Auboin and Gonzalez Behar, 2020).

III. TRADE FINANCE AND THE COVID-19 CRISIS

3.1. Summary and analysis of events

Since the beginning of the COVID-19 crisis, importers and exports have experienced major difficulties in obtaining trade finance, in support of trade transactions. The nature of the difficulties evolved in phases, through 2020 until now.

In a first phase ("the great lockdown" of the early spring of 2020), successive regional lockdowns resulted in significant operational challenges; legal documents necessary for the processing of trade finance transactions (customs documents, invoices, bills of lading) were either delayed or not transmitted at all. Interim and creative solutions emerged in the most advanced countries, notably with the use of scanned documents and e-documents (such as e-bills of lading). However, in other countries, particularly the poorest ones, the replacement of confirmed documents by substitutes was not so easy. During this phase, the demand for trade was reduced due lockdowns. Still, there was a surge in the specific demand for COVID-19 related goods and protective equipment, as well as for essential foods, as questions about food security and stockpiling arose. In a context of closing borders and restrictions on the free movement of persons and, to a lesser extent, of goods, trade finance transactions for the exportation of strategic exports of many developing countries and for the importation of essential medical supplies required emergency support from government bodies and multilateral development banks. The reduction in demand for goods had been compounded by liquidity shortfalls in the poorest countries. For example, in Africa the tightening of liquidity had been immediate as several international and regional banks had either been cutting their funding lines to African financial institutions for trade transactions or increasing the cost of it. In other developing countries, including in Latin America, Northern Africa and Central Europe, liquidity also dried up, notably in US dollars.

As operational issues were gradually resolved with the reopening of economies, the deterioration of the credit risk and its perception thus came at the forefront of trade finance concerns, in a second stage (from the spring to summer of 2020). International banks showed increased risk aversion as the overall credit and sovereign risk deteriorated. With the health crisis lasting, banks had been expecting increased payment failures from counterparties beyond sectors initially impacted by the lockdowns (airlines, aeronautics, tourism, and to some extent the automotive sector). One-off extensions of the terms of payment by creditors would be insufficient to alleviate the crisis, thereby requiring longer debt deferral schemes. In many developing countries, the sovereign risk deteriorated along with the corporate risk, resulting in increased caution from financial institutions.

A third stage began with the uptake of trade demand and some recovery of trade finance markets. While several important suppliers of trade finance had reduced exposure in the way, generally the international financial system has been supporting the recovery of trade demand in the third quarter of 2020 and at the beginning of the fourth. Government and MDB schemes have contributed to stabilize the markets. Since then, traders and trade financiers, as many other actors in the economy, have been adapting to the "stop-and-go" pace of demand, linked to fluctuating levels of circulation of the coronavirus and related restrictions and re-openings decided by governments. On the whole, though, both trade and trade finance supply are showing an exceptional level of resilience, adapting to sudden changes in health regulations, to the "immobility" of persons (by contrast to the mobility of goods), and to changes in transport and supply conditions of trade. Looking ahead, 2021 will be marked by continued challenges in the management of supply chains (and supply chain finance), along with high risk perception which could affect the recovery as vaccination progresses; challenges to finance the transportation and international distribution of vaccines. These challenges are in part reduced by the large expansion of e-commerce, which, contrary to the traditional commerce it replaces, does not require the same amounts of trade finance.

The section below looks at the details of each phase.

Phase one: Lockdowns in the first half of 2020

Previous economic and financial crises, such as the 1997-99 crisis of emerging economies in Asia, Latin America and Central Europe, and later the global financial crisis of 2008-9, taught that existing shortfalls appear when the perception of risk increases well beyond its actual level. International banks tend to "re-shore" lending, focusing on "safer" customers. This has indeed happened at the very beginning of the COVID-19 crisis. However, this crisis being like no other, the very first "symptom" of the crisis on trade finance have been linked to the operational difficulties of ensuring a proper circulation of documents underlying documented trade finance. Box 2 explains the mechanisms at play, and how the industry coped. However, for a number of legal and technical reasons, it was not possible to waive completely regulations which, in many countries, rely on physical documents which are essential for verifying the reality of the transaction and avoid fraud.

Box 2: Trade finance and digitization of documents during the COVID-19 outbreak

The physical movement of goods and the trade finance/payment process by banks are normally intertwined, as they rely on the same set of legal documents (invoices, bills of lading, customs, etc). Obtaining such documents, as often required by local legislation, proved to be challenging during the lockdown. Operators have used interim/alternative solutions relying on digitization during the COVID-19 outbreak, raising the need for further digitalization in the future. Here is an example with letters of credit.

For a documentary letter of credit (LC), the sequence of events is broadly as such: after the importer and exporter agree on the terms of the sale, the importer approaches its bank to open a LC. The LC is a commitment by the importer's bank to pay the exporter's bank upon execution of the contract. The importer's bank thus seeks endorsement of the LC by the exporter's bank, leading that bank to advance the payment to the exporter; in turn the exporter must present his bank all documents certifying the execution of the contract, including that certifying the physical movement of goods (transportation, shipment verification, shipment loading and unloading in ports). Legally, these documents provide the exporter's bank with the final control over the merchandise, as a collateral in case of non-payment by the importer's bank. The documents will eventually be sent to the importer's bank, which will pay the exporter's bank upon its own verification of conformity.

During the lockdown, the flow of original documents was severely disturbed, with delays or no transmission at all. Without documents, transactions could not be processed, and deliveries could not be made; many national laws still require the original documents for verification. The International Chamber of Commerce (ICC), the standard setting body in the field of letters of credit, issued a guidance note allowing for some relaxation of procedural requirements, such as the 5-days deadline for the presentation of compliant documentation. It also issued a request for governments and central banks to void existing prohibitions on the use of electronic documentation.

Where it was possible, interim solutions have been found by the parties tied to a specific transaction, despite the legislation still requiring physical documents and signatures. According to the Global Trade Review (GTR), one large commodity trader extended credit facilities to exporters and importers of foods using a e-signing process organized by a renowned international legal firm, enabling parties to sign several documents implementing a range of electronic signing methods, complying with different legal stances in different jurisdictions. The electronic bill of lading, while not recognized in most of the world' jurisdictions, has been brought to market by several trade e-platforms, which lean on contract law to create a club of players who all commit to recognize the validity of the e-bill of lading. However, in such a case, every ship owner and customs authority need to agree to accept the document, which is not a frequent occurrence. The same platforms also help digitize warehouse warrants and certificates of origins. Other platforms use application programming interfaces (APIs) to connect banks and other parties with users able to create, edit and manage letters of credit and guarantees. Blockchain and distributed ledger technologies (DLT)

has also been experimented for letters of credit.

The case for digitization of trade and trade finance transactions was made more pressing during this period. Still, under most advanced countries' laws, the use of digital negotiable financial instruments is invalid. Moreover, the use of electronic trade documents is still prohibited in many jurisdictions, notably in developing countries, in which the presentation of physical documentation is regarded as a guarantee against fraud. In other countries, the level of cyber protection is not considered to be sufficient to move towards digitization. There is also currently no international coordination as to the recognition of e-signature processes – actually, recognition in individual jurisdictions is rare. There are initiatives, though, helping to clarify the complex legal and process issues that could lead to progress, such as the International Chamber of Commerce's Digitization Working Group and the United Nations Commission on International Trade Law's Model Law of Electronic Transferable Records.

Source: Global Trade Review, April 1, 2020. https://www.gtreview.com/news/fintech/trade-finance-pressured-to-digitalise-amid-covid-19-chaos/; International Chamber of Commerce, https://iccwbo.org/media-wall/news-speeches/icc-banking-commission-launches-working-group-digitalisation-trade-finance/

Liquidity dried up in certain areas of the world, but differently and certainly more selectively than in 2008-9. Unlike then, the global financial system was certainly in a better shape to sustain a shock than it was when it was over-leveraged in the 2000's. Nonetheless, central banks from large countries intervened in March 2020 to ensure liquidity in national financial systems. In a fundamental difference with 2008, the demand for trade in 2020 declined as a result of lockdowns, before that of its financing – hence supply of trade finance seemed to be affecting trade flows less dramatically. In 2008, global trade flows were still expanding when the global financial broke out, so on-going export/import orders could not be fulfilled as a result of sudden interruption of funding (following, for example, the closure of the secondary market for letters of credit).

In 2020, the availability of liquidity depended greatly on the geographical location concerned. Since the market was already in a situation of "structural" shortages in the poorest countries, these countries were the first and the most affected: in Africa, for example, the tightening of liquidity had been immediate as several international and regional private banks had been either cutting their funding lines to African financial institutions for trade transactions or increasing the cost of it. For a short period of time, transit trade was affected so landlocked countries could not receive essential imports. Demand for trade finance facilities of multilateral development banks immediately roofed up. In other developing countries, including in Latin America, Northern Africa and Central Europe, the liquidity in US dollars had also been drying up quickly. While trade finance markets appreciated the rapid reactivation of swap agreements between the Federal Reserve and a selected number of central banks, US dollar shortages affected countries which usually relied on regional financial centres ("nesting") to provide the US dollars.

At the meeting of the expert group on trade finance of March 30, 2020 (see WTO Document WT/WGTDF/W95), the representatives of the trade finance community discussed market developments and "cracks". The representatives acknowledged both the operational and liquidity challenges, but they appreciated the rapid reaction from monetary authorities around the world. They recognized the difficulties for such additional liquidity to reach

countries at the periphery of the global financial system – at a time during which domestic demand for funding increased as well.

They noted that, in other regions of the world, trade credit/payment guarantees were in greater need than liquidity. A number of financial institutions and multilateral development banks argued that the perception of the payment risk was deteriorating rapidly. While financial intermediaries could handle one-off extensions of terms of payments, the uncertainty related to the duration of the crisis had led to a heightened perception of the risk of not being paid back, this perception of risk increasing with the remoteness of transactions.

The vast majority of participants requested increased guarantees to be provided by export credit agencies and by multilateral development banks (guarantees on letters of credit and on short term trade credit). One participant wondered whether a moratorium on extended payment or period of grace of three months covering entire supply chain was feasible and practical. While such "blanket" measure would require a global agreement between private and public financial institutions, other participants insisted on a full-scale intervention of export credit agencies and multilateral development banks, increasing quickly their guarantee mechanisms.

Phase two: some recovery in the late spring and summer of 2020

When meeting again on May 19, 2020, the expert group on trade finance (WTO document WT/WGTDF/W96) signalled a significant improvement regarding the operational and legal issues which had been mentioned at the previous meeting. The situation regarding the expedition and reception of trade-related documents had returned almost to normal, allowing banks to proceed with scheduled financial settlements. There had been no or few cases of "force majeure" invoked in trade finance transactions. Improvements owed to the acceleration of document's digitization, the relaxation of certain requirements (such as those of the International Chamber of Commerce regarding the presentation of compliant documentation) and greater flexibility provided by local authorities. The digitization process was uneven though, across types of documents (shipping documents being less digitized), and countries (digital divide).

Banks also acknowledged that government sponsored schemes (such as trade loan extension, repayment holidays, undertakings and credit guarantee schemes) had been deployed very quickly, based on the experience gained in 2008-9, and had offered significant relief, particularly on the main routes of trade. Credit insurance schemes were determinant in supporting receivable finance and other forms of trade finance which were used in supply chain trade, notably by SMEs, thereby contributing to avoid the collapse of such supply chains. However, liquidity issues and the deterioration of credit risk remained at the forefront of trade finance concerns as the demand for trade was likely to pick up with the reopening of economies. Financial institutions showed risk aversion as the overall credit risk had deteriorated in previous weeks and months. With the health crisis lasting longer than had been originally anticipated, banks had been expecting increased payment failures from counterparties, beyond sectors initially impacted by the lockdowns (airlines, aeronautics, tourism, and to some extent the automotive sector). It was clear that one-off extensions of the terms of payment by creditors would be insufficient to alleviate the crisis. In many developing countries, the sovereign risk had deteriorated along with the corporate risk, resulting in increased caution by international banks to engage into cross-border trade finance. Importers' banks in poor and even middle-income countries would not find

counterparties for the financing of many types of goods, ranging from energy commodities to consumer goods. Domestically, the high demand for large banks' balance sheets also explains the greater reluctance to engage in cross-border trade operations.

Banks noted that capital adequacy had also become an issue as losses on domestic and international credit inevitably materialized. It was difficult, in the middle of a crisis, for banks to raise additional capital from shareholders and investors; hence, existing capital buffers of banks were tested. In this background, the appetite for granting new loans, particularly cross-border loans – which capital "cost" for banks was relatively high as the risk weight was increasing– was lower than in a normal period.

While government programs did a lot of good to stabilize the payment situation in international trade, potential losses and claims had been averted in some cases, and simply delayed in other. In its report on the first semester 2020, the Berne Union President commented in the second half of 2020 that "the fact that we have not yet seen a significant increase in claims payments is in large part due to protection afforded by various forms on fiscal support from governments as well as by the quick reaction of lenders and insurers in restructuring deals when necessary. The consensus amongst the industry is that we can expect to see a more obvious change in claims trends towards the end of the year (2020)."[5]

In sum, trade finance suppliers were under no illusion that the trade finance situation would be fully restored soon; instead, it was likely to remain challenging in the months to come, as country and corporate risk would bottom out, as delayed defaults (of payment) materialize, and at the same time as the demand for trade (hence for trade finance) picks up. One of greatest challenge was to maintain if not boost supply in developing countries, as multilateral development banks were using most of their resources for the poorest countries, but also faced significant demand from middle-income countries.

Phase three: stop-and-go, challenges for a firmer recovery

The third phase is one of fragile, "stop-and-go" recovery of trade in late 2020 and early 2021, subject to significant and unpredictable restrictions to economic activities linked to virus transmission. This third phase is delicate, as it would take place in a context in which some regions have experienced a deterioration of corporate and sovereign debt situation, in which the financing of the transport and distribution of vaccines would be a priority, and in which continued support by government and multilateral development banks would be necessary.

Global trade flows bottomed out at the end of the second quarter of 2020, and since then an uneven recovery has been underway. With the virus progressing throughout the fall, restrictions reappeared before and after end-year breaks.

Since mid-2020, supply chain finance has been recovering, as firms seek out early payment and trade demand has been picking up

That has been most visible in the main routes of trade, where the financial infrastructure is the most developed. For example, Asia's trade finance experienced a strong rebound in the summer and fall of 2020, according to large banks' assessment reported in a

[5] Berne Union, quote of the September 2020 Press Release: «2020 H1 data: no increase in claims paid but contraction in new commitments », available at www.berneunion.org

article of the Global Trade Review.[6] Such a recovery concerned both core trade finance instruments such as import letters of credit in Hong Kong, China, Singapore, Malaysia, Indonesia, Thailand and Vietnam, as well as for supply chain finance arrangements. In the beginning of the second half of 2020, the number of trade transactions grew strongly, although the size of orders have not, reflecting a hesitant demand for tradable goods by final consumers. Banks signalled a strong uptake of SME suppliers joining supply chain finance programmes, suggesting a general search by Asian companies of working capital (cash being one of the companies most precious "commodities" in times of crisis), while at the same time a certainly ability by well-funded banks to supply lines of credit available to them to draw down on their pending invoices. The sectors most involved in increased supply chain finance activity are retail, telecommunications, and other high-technology sectors.

With payment delays increasing by 15 to 30 days and even longer, companies have also been seeking ways to boost their working capital. Early payment schemes have proved to be popular, including in the United States and in Europe, as the need for liquidity is vital for small firms. Many supply chain platforms recorded a substantial increase in invoices traded for early payment, as suppliers' demand for cash surged. At the same time, ratings agencies have cautioned that existing risks are likely to be exacerbated by the pandemic.

Supply chain finance schemes are not available everywhere indeed, since they require legal and other conditions (recourse, authorization by central banks) to be operated safely, including a certain level of transparency and sophistication regarding book-keeping and liquidity risk management. Such schemes, if misused by companies to obscure payment obligations, can carry risks for the corporate and financial sectors.

Some international bank's exit is temporary leaving gaps in certain market segments (commodities)...

There is no indication, though, of an increase in trade finance availability in areas and markets where it dried up at the very beginning of the crisis, that is, in the least developed economies. Anecdotal evidence seems to be going in the opposite direction. For example, during the summer of 2020, several large European banks announced a partial or total withdrawal from commodity trade finance (box 3). Developments during the COVID-19 crisis have compounded a trend of retreating financial institutions in recent years, linked to falling revenues. Market analysis seem to point to: no major impact on large traders and large commodity exporters; but some effect on smaller traders and commodity exporters.

In July 2020, French bank BNP Paribas decided not to accept any new clients, thereby gradually phasing out its activities in commodity finance; Société Générale decided to close its commodity finance business in Singapore, after losses incurred from the collapse of a large trading house; ABN-AMRO decided to exit the sector, leaving a gap of about 20 billion in annual financing, mostly for mid-size trading houses, which in turn funded commodity exports (and imports) of low income countries.[7]It is yet unclear who will fill this gap. Through their large international networks – established over decades, these large banks have

[6]Global Trade Review (GTR), « Asian trade finance stages a V-shaped recovery while supply chain finance demand surges », by Eleanor Wragg, dated September 9, 2020, available at www.gtreview.org

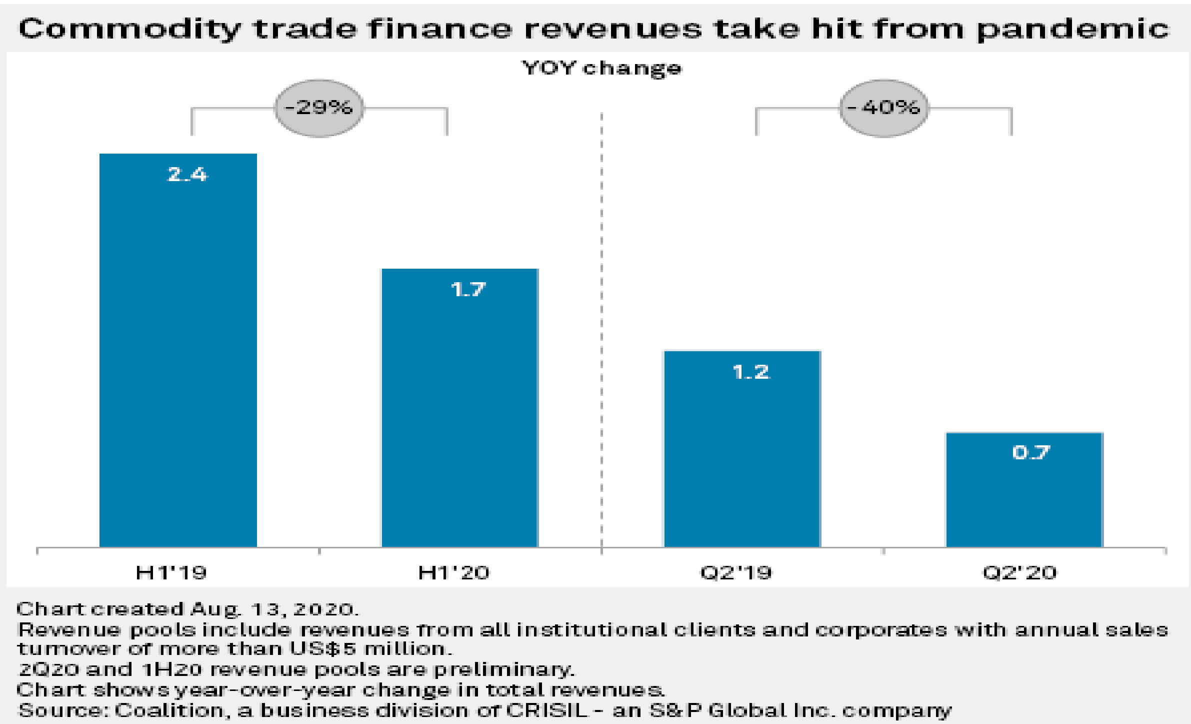
[7]A combination of reasons explains these decisions, including factors that may be specific to each of these institutions. However, they come in a context of deteriorating risk, resulting in an increase in capital required to support lending. Also, the commodity sector has been affected by frauds which have affected the profitability of banks in the sector.

been major actors in commodity supply chains across the world. Market analysts seem to suggest that the commodity market will further concentrate, possibly at the expense of smaller players.

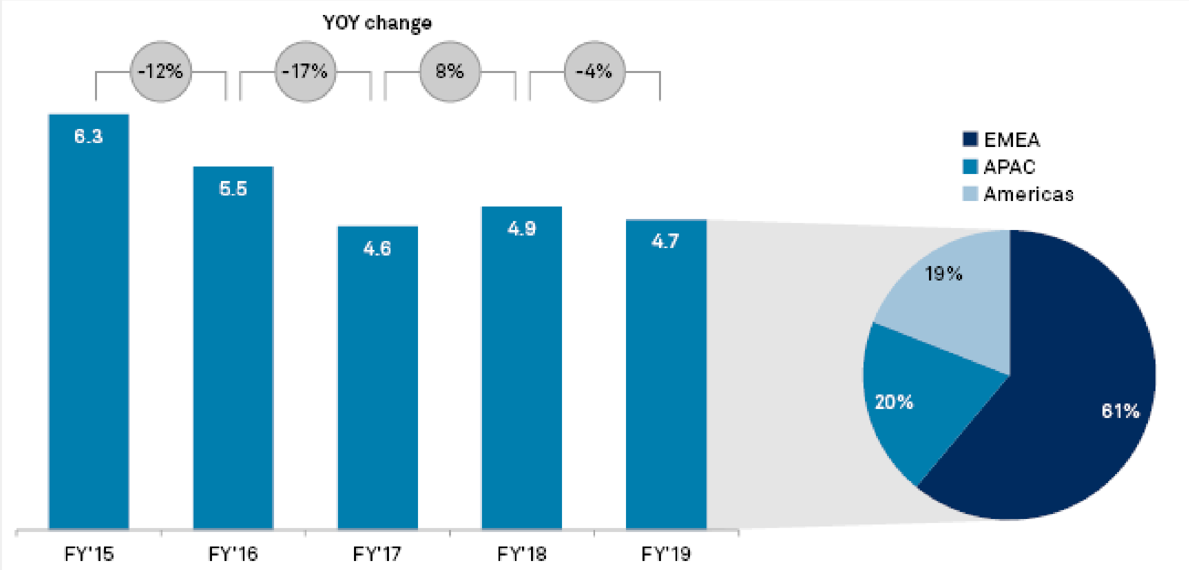
Box 3: Bank retrenchment from commodity trade finance markets

In the summer of 2020, market intelligence media and firms commented on the decisions of key European banks to exit or reduce their exposure to commodity trade finance. S&P Global Market Intelligence explained that banks had suffered substantial reduction in revenue under the combined effects of lower volumes of traded commodities and high loan losses in the context of high-profile cases of fraud. As shown in the first panel below, commodity finance revenues for banks had dropped 40% year-on-year in the second quarter of 2020, according to figures from Coalition, a S&P research company. The second panel shows that the trend in falling revenues from commodity finance has been on-going for several years.

S&P emphasizes that the withdrawal from ABN-AMRO, and the freeze in the acceptance of new customers by French banks, would leave a funding gap that could prove "painful" for midsize companies. The cost of funds is also expected to increase. "Winners" may end up being the largest commodity trading houses, who have access – and concentrate – very large bank resources, and, according to one analyst, are "increasingly acting as banks by financing their own trades". According to other analysts, it takes about 18 months or so to "exit" a commodity trade finance portfolio, after which it will be clearer how the market restructures, in terms of increased prices, reduced available quantities of finance or new entry by new suppliers.



Commodity trade finance revenues in decline
Global revenue pools for commodity trade finance (US$B)



As of Aug. 13, 2020.
Revenue pools include revenues from all institutional clients and corporates with annual sales turnover of more than US$5 million.
Source: Coalition, a business division of CRISIL — an S&P Global Inc. company

Source: S&P Global Market Intelligence, "Hit by 40% Revenue Slump, Commodity Trade Finance Faces Bank Retreat, Reshaping", by Sanne Wass, dated August 14, 2020, available at: https://www.spglobal.com/marketintelligence/en/news-insights

If sustained, a gap in the commodity sector's financing could only have a knock-on effect on overall trade finance markets, given that commodities account for some 15% of world trade, and that commodities are inputs to many goods produced and exported across the world. If these gaps were not offset by new supply, thus the cost of funds would raise across the board, adding on to the other costs of already disturbed supply chains.

....and certain regions are struggling to receive trade finance (Africa, Central Europe, Developing Asia)

The commodity financing issue may simply be the symptom of a wider trend visible in the last decade of international banks exiting Africa and other low-income regions. In a report released in September 2020 joint by the African Development Bank(AfDB) and the African Import-Export Bank, the two institutions warned about "the urgent need for financing to re-energize Africa's trade in the wake of the COVID-19 pandemic" (AfDB and Afreximbank, 2020). The report observed that a smaller number of local and international banks had been engaging in trade finance activities since the global financial crisis of 2008-9, a trend reinforced since the beginning of the COVID-19 pandemic. As a result, "SMEs among the most significant contributors to African economies have witnessed a high share of

their trade finance applications rejected by banks,[8] even as the risk profile of their trade finance assets has improved".[9]The AfDB study found that, in 2019, 71% of the surveyed banks had supplied trade finance in Africa, compared with 92% in 2011. In the face of increasing costs, the market tended to concentrate at the expense of SMEs. As a result, the role of multilateral development institutions had become more important, as 60% of banks active in trade finance in Africa said that they were using their facilities and services.

The African Development Bank and the African Export Import Bank conclude that "already facing a growing trade finance gap and higher rejection rates for SMEs seeking trade finance, African trade must now navigate the Covid-19 pandemic, which has caused social and economic chaos around the globe. Increasingly, it was becoming clear that the ongoing COVID-19 pandemic was adding to the burden of risks facing African trade and trade finance. The pandemic had already resulted in sharp falls in the prices of most of Africa's top export commodities. As export revenues fell and firms and banks' balance sheets deteriorated, access to foreign exchange liquidity and banks' willingness to engage in trade finance transactions would be reduced".

In a bid to free liquidity, the AfDB approved a US$10bn COVID-19 Response Facility (CRF) in April 2020. The Bank is also providing up to US$ 1 billion in trade finance liquidity and risk mitigation support to local African banks in member countries. Meanwhile, Afreximbank had announced a US$ 3 billion trade finance response in March 2020, to support trade in member countries.

3.2 Policy Steps and measures

A strong policy response, but no G20 coordination this time

There was no major, coordinated plan for government intervention mainly because governments and inter-governmental bodies had drawn the lessons of the 2008-9 G-20 plan and acted swiftly. The gist of 2008-9 policy intervention was to pool available resources from national export credit agencies and multilateral development banks, as well as having these institutions working in partnership (risk sharing) with a view to further leverage resources.

In parallel, central banks had injected liquidity in money markets to refinance short-term facilities, including trade finance, while the Federal Reserve Board of the United States had established swap agreements with 14 other central banks to supply US dollars for dollar-denominated transactions, including trade transactions. Other initiatives such as the reopening of "discount windows" by the central banks of Japan and the UK, allowed traders to receive cash against selected trade bills directly from central banks for a limited period of time.

The G-20 plan ultimately aimed at combining export credit agency coverage and funding along with multilateral facilities to provide an additional $250 billion in "capacity" to trade markets over two years. The implementation of the plan had been monitored by an ad-hoc G-20 expert group, which reported to the G20 Summit in Toronto and Cannes. Although some $140 billion out of the $250 billion available had ultimately been used according to the working group's estimates, the impact on markets could be measured in terms of restoration

[8]The share of SME trade finance application rejected by banks increased from 20% in 2013 to 40% in 2019.

[9] In 2017-2019, the average default rate in Africa was 7.5% on trade finance facilities, compared with 11% for overall average non-performing loans for the same period.

of confidence, as for the first time the international community had recognized the specific needs of the trade finance community, and that of developing countries in this field. Further lessons from this experience had later been drawn by international organizations such as the World Bank and the WTO, involved in the design and implementation of the plan.[10]

In 2020, the scenario of policy intervention was somewhat different, but very similar in substance. Meeting at the onset of the COVID-19 outbreak (30 March 2020), representatives of the trade finance community present at the meeting of the WTO expert group on trade finance were "unanimous in requesting[11]:

a. More international coordination of measures which have to date been taken at the national or regional level, with a view to protecting international supply chains – particularly at the low end of the chains, in developing countries.

b. More coordination between public sector actors, such between the WTO and multilateral development banks, among multilaterals; and with ECAs.

c. Measures adapted to international trade, with a mix of guarantee programmes by ECA mitigating the increased perception of payment risk; MDB programmes oriented towards developing countries' preservation of trade structures; and SME based programmes guaranteeing – close to the architecture agreed at the G20 London Summit and monitored at the Toronto and Cannes Summits".

By that time, though, many governments, central banks and international institutions had already started to provide emergency support in the context of national lockdowns and emergencies to produce and import health-related material and equipment; as well as to avoid a collapse of corporate finances though inter-company debt linkages.

Central banks of many countries in the world, including in the main financial centres, had extended exceptional liquidity facilities to banks, to ensure the liquidity of the financial system. Governments also activated many schemes and distressed funds for SMEs facing challenges in repaying loans and dealing with debts during the COVID-19 period, including arrangements delaying repayments of loan and interest, extending loan terms, and supporting banks to supply of trade finance facilities in favour of SMEs. The US Federal Reserve reactivated its swap agreements with selected central banks, as in 2008-9, to make US dollars available for trade transactions.

Governments also felt that the specific needs of exporters and importers needed to be taken into account. Specific schemes have been implemented by national development banks, export credit agencies (when existing) and by banks. They included various arrangements such as trade guaranty schemes, supply chain finance, commercial factoring, and pledged account receivables[12]. They also acted through their export credit agencies. The Berne Union summarized the crisis response from export credit insurers into four broad categories of support, aimed at:

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[10] See in particular Chauffour, J.P, Malouche, M.(2011), and Auboin, M. and Engemann, M. (2014).
[11] WTO Document WT/WGTDF/W/95, 15 April 2020, available at www.wto.org
[12] WTO Document WT/WTGDF/W/39 of August 30, 2020.

• Supporting exporters – through increased flexibility and relaxation of terms for policyholders (exporters) or their clients; expedited processes (approvals / claims processing); some concessions, waivers or flexibility on fees and premium payments.

• Maintaining industry capacity to support trade – through increasing capacity, easing restrictions and augmenting private market capacity through new direct cover, reinsurance or top-up by public insurers (ECAs).

• Reducing pressure on cash-flow and supporting the supply chain – through increased support for finance indirectly related to exports: e.g. cover for working capital; pre-shipment finance; bonds; domestic suppliers to exporters; import guarantees.

• Minimising defaults on existing loans – through directly, or in conjunction with the banking system, facilitating favourable restructuring: deferred payment schedules; extended repayment period; waivers of some interest and fees.

Berne Union insurers partnered with the World Bank to help small businesses in poorer nations (Berne Union Press release of 23/06/2020). AXA XL and Liberty are among a group of six private insurers joining the scheme providing up to US$5bn in loans to help enterprises hit by the impact of the coronavirus. The scheme mobilized US$2 billion in credit capacity under the IFCs Managed Co-Lending Portfolio Program (MCPP). The initiative allowed IFC to increase its medium- and long-term lending to commercial banks and non-bank financial institutions in emerging markets by up to US$5 billion.

Multilateral development banks also provided immediate emergency trade finance support. A summary of measures is presented in the Annex of Box 4. In most cases, trade finance has been an integral part of individual institution's crisis response facilities. For example, the IFC's US$ 6 billion trade and working capital initiative accounted for 40% of the World Bank Group's entire crisis response facility. The EBRD has increased its own total exposure limit of its trade finance facilitation program to euros 3 billion, a 50% rise from the previous limit of euros 2 billion for 2020. The Asian Development Bank increased the number of trade transactions supported by 50% in 2020, increasing significantly the amount of trade supported in its main countries of operations such as Bangladesh (+50% as well) and Vietnam. The African Development Bank and the Islamic Trade Finance Corporation increased trade finance commitments by US$ 1 billion each, while the African Export Import Bank (Afreximbank) increased its total loans and advances by one third under its Bank's Pandemic Trade Impact Mitigation Facility, launched in March 2020. To meet the demand from many of its SME clients, Inter-American Development Bank's Invest (IDB Invest) increased its guarantee and lending program by US$ 1.5 billion, for a total of US$ 3 billion under its trade finance facilitation program.

All in all, while demand for multilateral development bank's facilities still outweigh supply, in view of the consequences of the withdrawal of international banks from many low income countries, multilateral development banks have been able to increase supply considerably and in many ways: supporting SMEs in global value chains with supply chain finance, SME exporters with commodity finance facilities, importers of medicine and medical equipment with trade loans and guarantees, as well as other essential goods.

WTO teamed up with multilateral development banks and private sector organizations to support cooperation in trade finance during the crisis

The Director-General of the WTO raised the profile of trade finance, as one of the many pressing issues requiring international support and cooperation. On July 1, 2020, in partnership with six other heads of multilateral development banks, he issued a joint statement with six other heads of multilateral development banks, pledging greater coordination in providing support to trade finance markets, particularly towards developing countries (Box 4). Of interest in this statement is the description by multilateral development banks of their crisis response, based mainly on a ramping up of trade finance facilitation programmes.

Box 4: Joint Statement by Heads of multilateral development banks and the WTO on supporting trade finance during the COVID-19 crisis, July 1, 2020

"The COVID-19 pandemic has provoked the deepest economic downturn of our lifetimes. In addition to the ongoing shocks to supply and demand, international trade has been affected by a reduction in the supply of trade finance. Risk perceptions about non-payment in international trade are at the highest levels in a decade; banks are increasingly reluctant to take on payment risks in many countries where economic conditions are deteriorating. Insufficient trade finance threatens to compromise otherwise-viable trade transactions. We share the concerns being expressed in markets, and will work within our respective remits to make trade finance available through this difficult period, just as we did during the global financial crisis of 2008-10. In many developing countries, particularly the poorest, shortages of trade financing can prevent commercial imports of essential goods like foods, drugs and medical equipment, on the import side. On the export side, it can prevent the sale abroad of crops and other products that provide livelihoods for the poor and are a key source of foreign exchange. Trade finance scarcity disproportionately affects micro, small, and medium-sized enterprises (MSMEs), which account for the bulk of employment.

Since the beginning of the COVID-19 outbreak, multilateral development banks have stepped up trade finance programs to support essential imports and key exports (see Annex), as international correspondent banks have cut lending across many developing country regions. Facilitating trade in medical supplies has been a significant part of these support packages. More support will almost certainly be necessary in the weeks and months ahead, as the steep decline in the real economy starts to impact the financial system through loan defaults and corporate bankruptcies. Many developing countries were experiencing significant trade finance gaps even before the COVID-19 crisis; they face even tighter access to trade credit. A further decline in trade finance supply would, in the short term, make it harder for imports of food and medical equipment to reach economies where they are urgently needed. In the medium-term, it would impede the ability of trade to help drive economic recovery. We, the World Trade Organization (WTO), International Finance Corporation (IFC, World Bank Group), European Bank for Reconstruction and Development (EBRD), Asian Development Bank (ADB), African Development Bank Group (AfDB), Islamic Trade Finance Corporation (ITFC, part of the Islamic Development Bank Group), and the InterAmerican Development Corporation (IDB Invest, part of the Inter-American Development Bank Group) will continue to assess market developments as needs evolve and each of us will act within our respective mandates to reduce trade finance gaps that emerge during this crisis. We prioritize our support to areas in the world where such support is needed most, particularly the poorest countries. We also call on other relevant financial institutions to support essential trade finance transactions.

Annex

Since the beginning of the COVID-19 outbreak, multilateral development banks have stepped up trade finance programs to support essential imports and key exports, as international correspondent banks have cut lending in many countries in Africa, Latin America, Eastern Europe and the CIS, the Middle-East, the Southern and Eastern Mediterranean (SEMED) region, and developing Asia. Facilitating trade in medical supplies has been a significant part of these support packages, which include the following:

- As part of the World Bank Group's $14 billion COVID-19 crisis response facility, the International Finance Corporation (IFC) launched a $6 billion trade and working capital finance initiative which comprises $2 billion from each of the Global Trade Liquidity Program/Critical Commodities Finance

Program and the Working Capital Solutions program, as well as an allocation of $2 billion from the existing $5 billion Global Trade Finance Program.

- On April 13, the Asian Development Bank (ADB) launched a $ 20 billion comprehensive support package to assist its developing member countries in their fight against COVID-19 through measures such as quick disbursing budgetary support with affordable terms and conditions. As part of this $20 billion package, ADB ramped up its $2.45 billion trade and supply chain programs. Over an eleven-week period from April 1 onwards, ADB supported 1,700 transactions valued at $1.2 billion, addressing shortages and expanding the supply of essential goods, including COVID test kits, medicines and personal protective equipment, through its trade and supply chain programs.

- Responding to the coronavirus pandemic, the European Bank for Reconstruction and Development (EBRD) launched two Solidarity Packages which include a massive increase in trade finance support. In the first five months of 2020 alone, the EBRD has provided amplified financing for trade with a record EUR 1.5 billion.

- With the approval of its $10 billion Covid-19 Rapid Response Facility CRF) in April 2020, the African Development Bank (AfDB) is providing up to $1 billion in trade finance liquidity and risk mitigation support to local banks in all 54 eligible African member countries.

- The International Islamic Trade Finance Corporation (ITFC) launched a US$850 million intervention, part of the Islamic Development Bank (IsDB) Group's $2.3 billion 3Rs (Respond, Restore, and Restart) COVID-19 Economic Recovery Program. The ITFC Response combines financing and technical assistance for governments, financial institutions and SMEs.

- As far as the Inter-American Development Corporation (IDB Invest) is concerned, in March of 2020, the Trade Finance Facilitation Program (TFFP) of IDB Invest has recorded a demand increase of 245% year-on-year. To support clients and the underlying MSMEs that often benefit from trade finance in times of credit shocks, IDB Invest will increase its guarantee and lending program by $1.5 billion for a total of $3 billion under the TFFP.

Source: Statement available at https://www.wto.org/english/news_e/news20_e/trfin_01jul20_e.pdf

In parallel, the Director-General of the WTO pledged to work with the private sector (the International Chamber of Commerce and the B20) to the same aim of pooling resources and support to trade finance markets (Box 5). The presence of public actors in markets is visible, and it provides for a stabilizing effect of markets. The situation will be monitored carefully by the WTO through the expert group on trade finance, which remains a useful forum of dialogue between all the parties involved in supporting trade finance.

Box 5: Joint WTO-ICC-B20 Statement on Trade Financing and COVID-19

"We are writing to draw attention to the significance of the growing trade finance gap and suggest possible avenues for private and public sector actors to work together to reduce it. The restoration of cross-border trade will undoubtedly be vital in driving a global economic recovery in the wake of the COVID-19 pandemic. A return to trade-led growth will hinge on creating enabling conditions for businesses to import, export and service international markets. A critical element of an enabling trade environment is the availability of trade finance. Globally, a significant share of trade is financed by some form of credit, guarantee or insurance – meaning that most businesses will need cost effective trade-related credit to support the recovery of both imports and exports. This will be a challenge; the ICC conservatively estimates that financing capacity ranging from a lower end estimate of USD2trillion to an upper end estimate of US$5trillion will be needed to meet this demand. This comes in a context of a structural shortfall of trade finance: in recent years, the Asian Development Bank estimated the global trade finance gap to be in the order of US$1.5 trillion, with developing

countries and MSMEs being the most affected by the shortfall. As the greater need for trade finance materializes with increased demand for trade transactions, providers of trade finance will face a deterioration of the risk and of its perception, which in turn could further deteriorate supply and lead to increased gaps in provision.

We are concerned that further gaps will have a disproportionate effect on actors in the global economy hardest hit by the economic effects of COVID-19: micro-, small- and medium-sized enterprises (MSMEs) and businesses in developing and least-developed countries. In this respect, we welcome the joint statement of heads of international institutions of 1 July pledging increased trade finance support to developing countries and smaller businesses. Such support will help the private sector share the risk of operating in economies most in need during the recovery. Finally, the trade finance situation would be eased if the trade finance industry could further move away from labour intensive paper-based transactions, which are not practical in the COVID-19 context. In many jurisdictions, this will require greater clarity on the use of electronic equivalents in national legal systems. The private sector is committed to work with national governments towards such clarification. We acknowledge that the private sector is the main provider of trade finance. Despite current challenges, trade finance suppliers are encouraged to support trade globally bearing in mind its favourable risk profile, even in period of crisis. We also welcome the many positive emergency measures that many central banks, governments, development banks and regulators have taken since crisis unfolded, and which helped stabilize the situation in trade finance markets. Given the scale of the shortfall, the public and private sectors should work together to:

1. Enable a rapid transition to paperless trading by: (a) making progress in removing legal requirements for trade documents to be in hard-copy paper format; and (b) fast-tracking the adoption of the UNCITRAL Model Law on Electronic Transferable Records to provide a sound legal basis for the use of e-documents in the processing of trade finance transactions.

2. Exchange views on how regulatory authorities could help mitigate constraints hindering the deployment of essential trade finance— particularly to MSMEs.

3. Share risk to support trade finance during this period, especially among export credit agencies, multilateral development banks, and private sector banks, including in the short-term segment of the market.

4. Further scale development bank schemes to provide risk mitigation and liquidity for trade finance transactions, especially in countries that need it the most. Given the scale of financing required to support a rapid rebound in global trade flows, we encourage all actors to take proactive steps to prime the trade finance market to ensure it can play a central role in driving a post COVID-19 recovery. Timely interventions will be especially vital to ensure that MSMEs have continued access to reliable, adequate and cost-effective sources of trade financing—not only to weather the crisis, but hopefully to emerge from it stronger than ever".

Source: Statement available at https://www.wto.org/english/news_e/news20_e/trfin_08jul20_e.pdf

IV. LOOKING INTO THE FUTURE

Looking ahead, 2021 will be marked by continued challenges, such selectivity of risk, and a high demand for trade finance linked to the transportation and international distribution of vaccines. One important observation is that, since the beginning of this crisis, supply chain and receivable finance has played a very important role in keeping working capital flowing through value chains. Hence, continued support by private and public-backed institutions in ensuring liquidity and guarantee programs is important, until markets fully recover. At the

same time, the fast expansion of e-commerce, which, contrary to traditional trade, does not require the same amounts of trade finance, may act as a "cooling" factor, particularly on the demand side.

4.1 Vaccines and trade finance gaps

The view among trade finance experts in multilateral development banks and the WTO is that purchasing COVID-19 vaccines and channelling them to low income countries may add to current trade finance gaps. Only a part of vaccines purchases would be covered by the COVAX Facility, other purchases may have to be covered from other, yet undefined sources of finance. Multilateral development banks will participate in the international effort to either purchase a part of the "missing" vaccines and/or facilitate their imports through trade finance facilitation programs, although it is not clear yet if existing resources would cover all needs. For example, the Asian Development Bank (ADB) launched in December 2020 an Asian-Pacific Vaccine Access Facility to help the Bank's low-and middle-income member countries in the procurement and delivery of COVID-19 vaccines. To be eligible for the facility, vaccines must be procured via the COVAX initiative and receive pre-qualification from the WHO.

In complement, the ADB will provide a $500 million Vaccine Import Facility, which will support the private sector's importation of vaccines and other related equipment, through the Bank's Trade Finance Program which extends guarantees and loans to banks supporting such trade. "The import facility will work with the banks, providing guarantees to mitigate the risk of non-payment in imports of vaccines" said the President of the Asian Development Bank. The ADB already funds imports of COVID-related equipment in several low-income countries. For example, it entered a risk participation agreement with Standard Chartered Bank for the extension of a $25 million trade loan to Sri Lanka state-owned People's Bank, which in turn enabled the State Pharmaceutical Corporation of Sri Lanka to purchase medical supplies as part of the Government's effort to fight the COVID-19 pandemic.

4.2 Limited trade finance capacity to support the recovery

From day-one of the COVID-19 pandemic, multilateral institutions have supported large flows of essential goods and medical equipment, as the availability of trade finance had shrunk faster than the flow of trade. As importers and exporters use new and sometimes more complex supply routes and modes of transportation, financing periods for the trade cycle have become longer, importers have kept higher stocks, and many foreign exporters, previously paid on open account, have reverted to more secure modes of payment, such as documentary credits, hence increasing the demand for trade finance guarantees. Many importers and exporters are also requesting extensions of guarantees on tenors of payment in order to respond to this problem. With the deterioration of the business climate and risk outlook in 2020, some private sector banks have retreated from the market. In its countries of operation, the EBRD, for example, extended tenors of its guarantees (for example in support of foodstuffs imports from Kazakhstan to Uzbekistan, where shipments have been delayed), supported imports of medical supplies into Lebanon from Italy, medical equipment into Greece from Germany, ambulances from Switzerland into Jordan.

Looking ahead, the IFC, Afreximbank, EBRD, ADB are expecting that the trade

finance situation is expected to remain challenging for the months to come, as a combination of increased commercial risk and deteriorated sovereign risk still deters many private sector banks to expand financing.

In its new publication, the IFC (2020) sent a message of caution in the short run. It notes that: "while trade finance is short-term, the infrastructure required to facilitate it is decidedly long-term. This infrastructure needs to continue to deepen and grow in order to reduce the trade finance gap, yet there is significant pressure to retrench at present. Thus, without perfect markets—especially in emerging markets and developing economies —trade finance has displayed a persistent and significant gap for a long time. This gap existed prior to the 2008-2009 crisis and has continued to face sustained periods of expansion, punctuated by brief periods of contraction. As of early November 2020, demand for trade finance appears to be increasing in some countries, and we expect this demand to spike globally across EMDEs sooner than supply does. The pandemic has further reduced the capacity of institutions to provide trade finance services, putting both the supply of such services and the enabling global network of cross-border banking relationships under even greater stress than before the pandemic. Thus, we expect the trade finance gap to continue to expand, and particularly when the pandemic comes under control and a widespread macroeconomic recovery is underway. Specifically in Africa, we agree with the Pulse Check view: While a return of market activity may be possible in a few months, subject to several COVID-19-related factors, 2020's "lost growth" is not expected to be recovered…We expect the trade finance gap to continue to expand in the medium and long term".

Boissay, Patel and Shin (2020), from the BIS, also wrote: "as the Covid-19 pandemic hits economic activity, the vulnerabilities of longer and more geographically extended trade credit chains are coming to the fore, especially those related to international trade". Covid-19 may hit the real economy much harder than the GFC did, posing a proportionately greater policy challenge. While the evidence suggests that central banks' corporate bond purchase programmes may help to inject liquidity into trade credit chains through large firms, more direct support in the form of grants and loan guarantees may be needed to cushion the impact of the shock, especially for smaller firms in the supply chain. In addition, government-guaranteed bank loans could be used to purchase trade receivables and inject cash into supply chains. Such loans could even be securitised and financed by a central bank facility. Governments could also provide infrastructure to facilitate financial contracting among private parties. Credit insurers, who are exposed to the credit risk of about 14% of trade receivables have also been impacted by the pandemic. Finally, the international dimension is likely to be particularly important given the relatively higher exposures of banks and other intermediaries to trade finance, and the prevalence of the US dollar in trade financing. Governments have already moved to fill trade financing gaps in the current crisis. Their measures include increasing the capacity of export credit agencies, expanding working capital programmes, and introducing new facilities to support exporters and importers, particularly SMEs".

Trade credit insurers have warned that potential losses on trade credit and insurance claims on these losses have been simply delayed, thanks to government programmes. In its report on the activity in 2020, the Berne Union President commented that "the fact that we have not yet seen a significant increase in claims payments is in large part due to protection afforded by various forms on fiscal support from governments as well as by the quick reaction of lenders and insurers in restructuring deals when necessary. The consensus

amongst the industry is that we can expect to see a more obvious change in claims trends towards the end of year 2020".

4.3 Continuing to work with a view to strengthen in the long-run market infrastructure and trade finance supply in many countries

While developments in trade finance in 2020 have been largely driven by the impact of the COVID-19 pandemic, the “starting point” had been one in which structural trade finance gaps were already high, in the order of $1.5 trillion globally, with gaps being the highest in proportion of demand in the least-developed countries. With the global economy being deeply affected by the pandemic, it was not surprising that the perception of risk of payments in international trade, including that of non-repayment of trade loans, was at its highest.

In the medium run, actions aimed at improving trade finance supply infrastructures in developing countries must be continued, as they will help build "resilience" during periods of crisis and improve the trade potential of the countries concerned.

Such actions include, inter alia, (a) strengthening the capacity of financial institutions to distribute trade finance instruments with the support of international financial institutions (b) improving the capacity of recipients to use trade finance instruments, and of financial institutions and borrowers (c) promoting various forms of trade finance that may not exist (credit insurance, factoring, forfaiting) in countries with significant trade finance gaps (d) discussing measures needed to improve the regulatory and business environment for trade finance provision. Improving the conditions of supply yields results overtime as institutional and human capacity is built. Moreover, there are many other factors that may influence trade finance supply at any particular point in time: monetary policy (hence interest rates), financial sector stability, prudential and capitalization rules, which require inter-institutional cooperation at the local and international level for the trade finance supply capacity to be acknowledged and strengthened. Efforts described in Section 2.2, and in Section III of this paper will continue.

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