difficulties in the production of its latest model, Boeing decided to abandon the original fragmented chain and repatriate key production processes to its main establishments. Other structural factors are also at work: in a future where energy is more expensive and less plentifully available there will be a natural tendency to rely more on regional supply chains.

If this trend is confirmed, the underlying deglobalisation process would hinder the possibilities of a faster recovery for international trade, provoking an L shape. More importantly, it may also prevent poorer developing countries from following the industrialisation path taken by China or Mexico, a powerful strategy for attracting foreign direct investment, creating manufacturing jobs and transfering technologies. Thus this microeconomic debate on the future of global supply chains spills over onto very critical trade and development issues.

Yet, in contrast to this pessimistic outcome, many considerations militate in favour of production networks continuing to extend their global reach. In the short run, abandoning the present global network of suppliers carries a heavy cost for the multinational firms. Off-shoring has been a central objective of many key industries, which heavily invested in their international network. Often, the new plants built offshore are more modern and efficient than the older domestic ones, and selling them to a competitor would create a comparative disadvantage (remember the dilemma of GM when selling Opel). In the longer run, the constant flow of innovations and the extension of the technological frontier are lowering the cost of communication and creating new opportunities for redesigning the international division of labour.

Moreover, from a macroeconomic perspective, the role of supply chains in amplifying trade flows will prove a kind of blessing when it comes to redressing the "global imbalances", particularly the large trade deficit of the US economy. Because the domestic value added content of trade is lower than the gross commercial value recorded in the balance of payments,[10] closing the gap will be faster and, more importantly, cheaper in terms of lost welfare. A back-of-the-envelope calculation shows that the bilateral deficit of the USA vis-à-vis China measured with conventional trade statistics overestimates the imbalances measured in value added content by about 60%.

Thus deglobalisation is probably a distant menace on objective grounds. On the other hand, the 2008-2009 crisis is a structural break, and the world economy will certainly not return to "business as usual". Old giants like General Motors have tumbled, new global players have emerged from developing countries, and the citizens' concerns about the lack of governance of the previous phase of globalisation will have to be addressed.

[10] G. Daudin, P. Monperrus-Veroni, C. Rifflart, D. Schweisguth: Who produces For Whom In The World Economy?, in : OFCE, No. 18, July 2009.

Jean-Jacques Hallaert*

Boosting the Availability of Trade Finance: A Priority in the Current Crisis?

Economists disagree on the role trade finance played in the recent collapse in world trade. In contrast, policy makers seem to have reached a consensus. In a nutshell, their reasoning is that trade finance is the lifeline of international trade. The decline in trade is larger than what would be expected given the drop in global output. So part of the fall in trade reflects a shortage of trade finance, which could amplify and extend the plunge in trade and make the current crisis worse. Hence, boosting the availability of trade finance has to be part of the international response to the crisis. In this paper, I examine the claims underpinning this storyline and highlight the uncertainties on the role trade finance played in the current crisis.

How Big Is the Trade Finance Shortfall?

International trade presents many risks that trade finance can mitigate. The risk of non-payment may be limited with the use of instruments such as letters of credit. The credit risk can be reduced with the use of export credit insurance. Trade finance also provides liquidity as some exporters, who lack sufficient liquid-

* Groupe d'Économie Mondiale de Sciences Po (GEM), Paris, France.

ity to process and acquire goods and services to fulfil export orders, may need loans. However, a large part of trade finance does not involve financial institutions, as trade partners often extend trade credit to each other.[1]

How much of international trade depends on trade finance? There is no solid statistical answer to this basic question. It is often reported that 90 per cent of world trade relies on trade finance.[2] This estimate is of questionable quality and appears too high given the sharp increase over the past two decades in intrafirm trade, which is unlikely to use external financing.[3] If the widely circulated numbers of trade finance reaching US$ 10 trillion and world trade flows US$ 14 trillion are accurate, the share is closer to 70 per cent.[4] The precise share of trade relying on trade finance does not matter much because, indisputably, trade finance is essential to trade. However, the uncertainties on its importance illustrate how poor the quality of data on trade finance is.

If it is so hard to measure total trade finance, needless to say estimating any shortfall cannot be more than a best guess. At the WTO's meeting of experts in November 2008, markets participants' "broad" estimate of the shortfall in trade finance amounted to US$ 25 billion.[5] Four months later, in March 2009, at another WTO meeting, the estimate was revised to US$ 100-300 billion but it seems that there was no consensus: "On the current market situation, *most* participants agreed that although trade flows were decreasing sharply, constraints to trade finance still existed" (emphasis added).[6]

Jumping the Gun or Jumping on the Bandwagon?

Despite the lack of reliable data and the fact that the then estimated shortfall accounted for only 0.25 per cent of trade finance and less than 0.2 per cent of world trade, the WTO succeeded in putting trade finance immediately in the spotlight and in marshalling, as early as end 2008, strong support for trade finance.

Initiatives mushroomed. International and government-backed institutions were mobilised and responded quickly. The capacity of export credit agencies as well as regional and multilateral development banks was increased; new products were launched; co-financing with the private sector was encouraged etc.[7] Moreover, several countries used their official reserves to supply banks and importers with foreign currencies. The international effort to support trade finance culminated in April 2009 when the G20 pledged to "ensure availability of US$ 250 billion over the next two years to support trade finance" and the World Bank announced the Global Trade Liquidity Program, which could support up to US$ 50 billion of trade.

The response was unusual not only in its strength but also in its speed. It started as early as October 2008 (and it could be argued even before), i.e. when the magnitude of the collapse in trade was not even known! Initially there were concerns that the financial crisis (more precisely the credit crunch) that started in 2007 could spread to trade finance. However, at least until the first half of 2008, trade finance was "stable with volumes and rates at normal levels".[8] Signs of possible tension appeared only when the financial crisis morphed into a full-blown economic crisis.

At that time, the political economy was ripe to boost the availability of trade finance. Long before the crisis, many countries had been lobbying at the WTO to find ways to increase the availability of trade finance for developing countries. The Aid for Trade Initiative was seen as providing leverage.[9] The 50 per cent increase in the ceiling of the International Finance Corporation's (World Bank Group) trade finance guarantee in October 2008 was welcomed by the head of the

[1] The various instruments are described by J. Chauffour, T. Farole: Trade Finance in Crisis: Market Adjustment or Market Failure, World Bank Policy Research Working Paper 5003, 2009. Inter-firm credit is discussed in Mitchell A. Petersen, Raghuram G. Rajan: Trade Credit: Theories and Evidence, in: The Review of Financial Studies, Vo. 10, No. 3, 1997, pp. 661-669.

[2] For example see the WTO document WT/AFT/W/24.

[3] See http://crisistalk.worldbank.org/2009/03/assessin-the-trade-finance-situation.html for a more detailed discussion.

[4] According to Marc Auboin: Boosting the availability of trade finance in the current crisis, CEPR Policy Insight 35, 2009, in 2008 trade finance reached US$ 10 to 12 trillion and trade flows US$ 15 trillion. These numbers imply a share ranging from 67 to 80 per cent.

[5] It is interesting to note the precise nature of this estimate: "Market participants gave a broad estimate of the gap in the trade finance market of $25 billion, which was the amount of trade finance that banks kept on their books but could not off-load on the secondary market." (WTO document WT/WGTDF/W/44).

[6] WTO document WT/WGTDF/W/44. A caveat to this estimate was: "... this being roll-over finance, the gap would nevertheless need to be *divided* in terms of net flows by the average maturity of letters of credit, which could vary widely across areas of operation" (emphasis added).

[7] Jean-Pierre Chauffour, Thomas Farole, op. cit. list the initiatives.

[8] Lamy's report to the WTO's Trade Negotiations Committee in October 2008 (WTO document WT/GC/M/116). The new ceiling will be doubled one month later to reach US$ 3 billion.

[9] Marc Auboin: Boosting trade finance in developing countries: What link with the WTO?, WTO Staff Working paper ERSD-2007-04, 2007.

WTO as "Aid for Trade in action".[10] The economic crisis provided extra leverage. Boosting the availability of trade finance was seen not only as an answer to the concerns of developing countries but also as a means to address the global crisis. Lessons from the Great Depression as well as the role played by trade finance in recent financial crises (such as the Asian, Argentinean, and Brazilian crises) were evoked.[11] Supporting trade finance was also branded as part of the international fiscal stimulus. With a high political profile and no strong interest to oppose it, the policy response could only be strong and swift. [12]

Is the Problem with Trade Finance Overestimated?

A precautionary action against anticipated problems has some merit. Nonetheless, the problem with trade finance may have been overestimated. Robert Zoellick claimed that the shortage in trade finance could account for 10-15 per cent of the decline in trade.[13] However, available econometric estimates suggest that the shortfall would need to be much larger than the one reported to contribute that much to the drop in trade flows.[14] Moreover, during the period October 2008-January 2009, when the collapse in trade took place, trade volume declined much more (possibly four times more)[15] than trade finance suggesting that the drop in demand explains the contraction in trade finance. If trade finance contributed to the collapse of trade, its role was limited.

The perception that the supply of trade finance played a significant role in the crisis stems from the fact that the collapse in trade has been so sharp and so much larger than the contraction in global output that it left the impression that something other than the drop in demand must have hampered trade. Because financial problems triggered the crisis, disruption in trade finance was seen as a possible culprit. However, there is no need to invoke a trade finance shortfall to explain the recent plunge in trade.

First, the rise in the fragmentation of production increased the elasticity of trade to income from under 2 in the 1960s and 1970s to about 3.5 in recent years.[16] As a result, trade flows react more in the current crisis than in past crises to changes in global output. Supporting this view is the fact that East Asia, the region most involved in the international supply chains (and thus the region which exhibits the largest elasticity of trade to income), is the region that suffered from the largest fall in trade.

Second, the collapse in trade in goods, which attracts attention, is larger than the drop in total trade because trade in services has been much more resilient than trade in goods. This supports the idea that the initial drop in trade in goods was amplified by a destocking effect (which cannot affect trade in services because services cannot be stored.) Firms, anticipating a slowdown in growth, drew down inventories magnifying the drop in trade. A close analysis of the timing as well as the sectoral and regional pattern of trade flows supports this interpretation.[17]

Third, the plunge in trade is often calculated in nominal terms on a year-on-year basis. This calculation overestimates the decline in *real* trade because the fall in commodity prices has been dramatic since their historically high level of mid-2008.

All these points do not negate the potential role of a trade finance shortage in the plunge in world trade. Rather, they highlight that the decline in trade is not necessarily much larger than the slowdown in global output would suggest. Thus, the importance of the collapse in trade does not suggest that "something else", like a disruption in trade finance, has *necessarily* played a *significant* role.

In sum, the lack of reliable data is so dire that there is no certainty that the decline in trade finance contributed significantly to the decline in trade. It prevents us from solving the familiar causality problem: did the drop in trade cause a contraction of trade finance (a demand shock) or did a shortfall in trade finance contribute to the drop in trade (a supply shock)?

[10] Lamy's report to the WTO General Council in November 2008.

[11] Problems with trade finance are sometimes pointed to as one of the main risks for trade looking forward. For example, in his address at the 2nd global review on Aid for Trade in July 2009, Waleed Al Wohaib of the Islamic Development Bank claimed that international trade is facing "the twin risks of rising protectionism and dwindling trade finance."

[12] On the political economy of boosting trade finance, see also Richard Baldwin: Trade and the London summit outcome, 2009, www.voxeu.org.

[13] Zoellick urges global response, in: Financial Times, 19 February 2009.

[14] Cf. Alun Thomas: Financial crisis and Emerging Market Trade, IMF Staff Position note SPN/09/04, 2009); Marcio Ronci: Trade Finance and Trade Flows: Panel Data Evidence from 10 Crises, IMF Working Paper WP/04/225, 2004.

[15] Jean-Pierre Chauffour, Thomas Farole, op. cit.

[16] Cf. Caroline Freund: Demystifying the collapse in trade, 2009, www.voxeu.org; Douglas A. Irwin: Long-Run Trends in World Trade and Income, in: World Trade Review, Vol. 1, No. 1, 2002, pp. 89-100.

[17] Unpredictable tides , in: The Economist, 23 July 2009.

Filling the Gap with Surveys

To remedy the lack of data, surveys were called to the rescue. The International Chamber of Commerce (ICC) surveyed 122 banks in 59 countries.[18] The IMF and the Bankers' Association for Finance and Trade (BAFT) surveyed 44 banks from 23 countries.[19] The Institute of Development Studies (IDS) surveyed 31 medium and large-scale export-oriented sub-Saharan African firms.[20] The OECD surveyed its members on the measures taken at the national level regarding officially supported export credit.[21] All these surveys were conducted in early 2009 so it is important to bear in mind that the situation may have changed.

According to these surveys, the problem with trade finance is not with its availability but with its cost. Trade finance is somewhat more difficult to get in some regions of the world (mostly in emerging markets), in some sectors (some are perceived as more risky than others), and for some firms. Nonetheless, surveys do not depict an overly dark picture. Very few of the African firms surveyed by IDS face any problems with respect to the availability of trade finance. The Australian government reported to the OECD that it holds regular consultations with market practitioners and that "anecdotal evidence to-date suggest to us that the slowdown or contraction in international trade is leading the slowdown in trade finance and export credit insurance uptake rather than a financial crisis-induced tightening of trade credit and credit insurance preventing willing buyers and willing sellers from doing international trade deals." 47 per cent of banks surveyed by ICC report a drop in the volume of letters of credit while 32 per cent report an increase and 21 per cent no change. In the IMF-BAFT survey, "banks in advanced countries reported roughly the same number of trade finance transactions in the final months of 2008 as occurred at the end of 2007. But emerging market banks report on average a 6 percent decline in trade finance transactions."[22]

[18] https://www.thebenche.com/forum/benche-news/4108-rethinking-trade-finance-2009-icc-global-survey.html.

[19] http://www.aba.com/aba/documents/press/IMFBAFTSurveyResults20090331.ppt.

[20] Cf. John Humphrey: Are Exporters in Africa Facing Reduced Availability of Trade Finance?, Brighton 2009.

[21] http://www.olis.oecd.org/olis/2009doc.nsf/LinkTo/NT00000EEE/$FILE/JT03261582.PDF.

[22] Cf. Thomas Dorsey: Trade Finance Stumbles, in: Finance and Development, 2009, Vol. 46, No. 1, 2009, p. 18 f. There are signs that the situation somewhat deteriorated during the period October 2008 - January 2009.

This limited decline in transactions may reflect several factors and not necessarily a shortage. Tighter guidelines by banks in light of reassessment of the risks have played a role, but the drop in transactions may also reflect an increase in the cost of trade financing and a drop in the aggregate demand for trade financing due to the contraction of trade.[23] Although 57 per cent of banks surveyed by the IMF-BAFT explain the drop in the value of trade finance transactions that took place between October 2008 and January 2009 by less credit availability, 73 per cent mention a fall in the demand as a reason and 43 per cent the fall in price of transactions, which is likely to reflect the drop in commodity prices.

For some exporters trade finance may be available but unaffordable. Surveys clearly show that that the price of trade financing shot up. The main reasons for this price increase appear to be a perceived increase in the risks of default, a rise in banks' cost of funds, higher capital requirements, and a decline in the value of collateral (e.g. linked to the drop in commodity prices).

In this context, a policy that only targets the quantity of trade finance would most likely fail. If banks are reluctant to lend because of perceived risks, boosting availability of trade finance is unlikely to result in lending. As Malcolm Stephens, a former Secretary General of the Berne Union, pointed out in his analysis of trade finance during the Asian crisis, "the traditional role of export credit agencies is to support trade and to facilitate trade. They are less effective in, somehow, trying to create or initiate trade, especially, in circumstances where neither importers nor exporters are really willing (or able) to trade with each other."[24]

A policy that targets the risks would have more impact. According to Robert Zoellick, under the Global Trade Liquidity Program, the "World Bank would underwrite the riskiest part of the lending, while private banks would provide the bulk of the less risky elements."[25] Although likely to be more successful, this kind of initiative raises the potential issue of moral hazard.

[23] It is difficult to untangle the reasons for the decline in demand for trade financing. The drop in demand due to lower trade flows can be offset by the increase in demand for the protection offered by trade finance in light of increased risks. Banks report such an increase in demand for protection in the ICC survey.

[24] Malcolm Stephens: Export Credit agencies, Trade Finance, and South East Asia, IMF Working Paper WP/98/175, 1998.

[25] Financial Times, op. cit.

Is There a Need to Change the Rules of the Game?

Policymakers may also tackle the reasons for the increased risk aversion and cost of funds. According to some bankers, changes in the regulations could help. They argue that Basel II has a pro-cyclical effect on the supply of credit and affects particularly trade finance, most notably trade finance with emerging markets. This complaint is not new but, recently, it has been voiced more forcefully, notably at the WTO export meetings.[26] Moreover, it has been relayed by Robert Zoellick (who publicly complained about a regulation that tripled the amount of capital needed to back trade finance)[27] and Pascal Lamy (who wrote to the General Manager of the Bank for International Settlements and to the chairman of the Financial Stability Forum). However, only 1/3 of the 15 banks that responded to the IMF-BAFT question on the impact of Basel II on their capacity to provide trade finance indicated that it had a negative impact. 27 per cent reported it had a positive impact and the remaining banks that it had no impact.

In the current crisis, calls for changing the rules are frequent. They go beyond the G20's call for "regulators to make use of available flexibility in capital requirements for trade finance". For example, in December 2008, the European Commission introduced temporary changes in the set of Commission State Aid Guidelines on short-term export credits. It increased the flexibility of an existing "escape clause" so that official export credit agencies can cover short-term transactions in the OECD in cases where the private market fails to do so.[28] In January 2009, the participants in the OECD's Arrangement on Officially Supported Export Credits decided to adjust some of the disciplines of the Arrangement with a view to facilitating the financing of projects. These modifications allow the provision of officially supported export credit at more favourable terms and increasing the limit of the share of officially supported export credit in intra-OECD project finance. Then, in June 2009, OECD countries agreed to boost official backing for exports of renewable energy and nuclear power equipment by offering more generous terms.[29]

These changes are rather limited but a lesson from past crises is that pressures to use officially backed export credit to protect or stimulate national exports are considerable in a period of worldwide recession. This was the case during the Great Depression. The experience was bad and led to the creation of the Berne Union and "apparently convinced the GATT founders that export subsidies exacerbate international political tensions and should be eliminated".[30] During the 1970s crisis, world leaders pledged to refrain from resorting to protectionism. Today's leaders do the same. However, they do not follow their predecessors who also pledged to avoid competition in official trade credit. The concern about competition in official trade credit was so great in the 1970s that, in order to prevent it, OECD countries negotiated an Arrangement on Officially Supported Export Credit. When international trade faced another contraction in the early 1980s, export subsidies came back in the form of tied aid and mixed credit.[31]

The rules currently in place were designed to prevent the mistakes of previous crises, namely a competition in export subsidies (through favourable terms) that not only distorted international trade and domestic protection but also proved to be fiscally expensive. They act as a safeguard and no race for export subsidies has taken place in the current crisis. However, agricultural export subsidies and the lingering dispute Airbus-Boeing are a reminder that the temptation to help domestic firms' exports is not a thing of the past. Moreover, pressures on policymakers to help domestic firms may increase if the recovery is not vivid enough to reverse rapidly the rise in unemployment. The system may need more flexibility, but the lessons from history should not be forgotten.

Conclusion

Panic stemming from a sharp and sudden decline in trade flows, memories of the Great Depression and of the role of trade finance in recent financial crises,

[26] See for example the summary records of the WTO experts meetings (WTO documents WT/WGTDF/W/38 and WT/WGTDF/W/40) or Andrew Hopes: Basel II has become an obstacle to trade flows, in: Financial Times, 18 November 2008.

[27] Financial Times, 19 February 2009, op. cit.

[28] OECD survey, op. cit.

[29] http://www.oecd.org/document/40/0,3343,en_2649_34169_42168680_1_1_1_1,00.html and http://www.oecd.org/document/10/0,3343,en_2649_34169_43152266_1_1_1_37431,00.html.

[30] Richard Baldwin: The Economics of the GATT, in: Peter Oppenheimer (ed.): Issues in international Economics, Stocksfield, UK 1980; Oriel. Marc Auboin: Boosting trade finance ... , op. cit., discusses the WTO's agreement on subsidies and countervailing measures and their link with OECD rules.

[31] John E. Ray: The OECD 'Consensus' on Export Credit, in: The World Economy, Vol. 9, No. 3, 1986, pp. 295-210, provides the history of the negotiations leading to the OECD Arrangement. The intense debates on export-credit subsidies that took place in the first half of the 1980s in both the UK and France are summarised in I. C. R. Byatt: Byatt Report on Subsidies to British Export Credits, in: The World Economy, Vol. 7, No. 2, 1984, pp. 163-178, and Patrick A. Messerlin: Export-credit Mercantilism à la Française, in: The World Economy, Vol. 9, No. 3, 1986, pp. 385-408.

as well as a favourable political economy, explain why policymakers strongly and rapidly supported trade finance.

However, the trade finance shortfall and its contribution to the fall in trade flows are likely to be overestimated. Lack of reliable data is so dire that it is difficult to know if a drop in the supply of trade finance contributed to the decline in trade or is only due to the drop in demand for trade finance. Trade finance is somewhat harder to get in some parts of the world or for some firms but, on aggregate, available evidence suggests that it is unlikely to have contributed significantly to the plunge in international trade.

The cost of trade financing is more of a problem than its availability. If the rising cost is due to increased risk aversion, boosting the supply in trade finance is likely to be ineffective. Rather than trying to increase the supply of trade finance in particular, policymakers should help credit flows in general to come back to normal. Two main reasons support this strategy. First, the access to intermediated trade finance appears to be less a constraint for exporters than pre-export financing, which is very similar to a working capital loan.[34] Second, firms constrained in their access to institutional credit are likely to face difficulties in extending trade credit. Fixing the financial system will ease the credit constraint and help boost inter-firm trade credit that accounts for a large share of trade finance.[35]

Moreover, boosting the supply of trade finance is risky. Relaxing the rules limiting the competition of government-backed exports credit on the ground that more flexibility is needed to provide more trade financing could make resisting pressures to help domestic exporters more difficult. Moreover, in many countries, the recession and large fiscal stimulus packages are leading to ballooning fiscal deficits and public debts. In this context, boosting the availability of trade finance is probably not the best use of scarce public resources and encouraging export credit agencies to take more risks could result in fiscal contingent liabilities.

[34] Cf. John Humphrey, op. cit., Jean-Pierre Chauffour, Thomas Farole, op.cit.

[35] For analyses of this mechanism, see Mitchell A. Petersen, Raghuram G. Rajan, op. cit.; Inessa Love, Lorenzo A. Preve, Virginia Sarria-Allende: Trade Credit and Bank Credit: Evidence from Recent Financial Crises, in: Journal of Financial Economics, Vol. 83, No. 2, 2007, pp. 453-469..

Claude Barfield*

Protectionism and the Global Economic Crisis

The impact of protectionism – both outright and "murky" – on world trade will be highly dependent on the future course of the economic crisis. If the "green shoots" of an economic recovery blossom and bear fruit, then the (thus-far) moderate upsurge of protectionist government actions is likely to fade; if on the other hand, the world should plunge back into a "double dip" recession then all bets would be off.

Certainly, the absolute numbers chronicling the world economy from 2007 through 2009 are stark. World output slowed appreciably from 3.5 percent growth in 2007 to 1.7 percent in 2008. Then, for the first time since World War II, the World Bank predicts that in 2009 world GDP will decline (2.9 percent in the latest projection). Similarly, a decline in foreign direct investment flows began in 2008 and is projected to deepen in 2009, dropping some 30 percent in year-over-year numbers.

Trade figures were no exception to the negative trends. World trade by volume grew 6 percent in 2007, then by only 2 percent in 2008. For 2009, the projection is for an unprecedented decline of 11 percent.[1]

As noted above, what is important is what happens next to the world economy and world trade. And on this question, economists differ. In a widely cited succession of analyses starting in April 2009, Barry Eichengreen and Kevin O'Rourke set out to demonstrate that "globally we are tracking or doing even worse than the

* American Enterprise Institute, Washington DC, USA.

[1] The trade and economic numbers are taken from the following sources: World Bank: Global Economic Development, Washington DC 2009; World Trade Organization, World Trade Report, Geneva, Switzerland 2009.