COMESA

The Role of Trade Finance in Advancing the ACFTA and T FTA

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Role of Trade Finance in Advancing the ACfTA and TFTA

Outline

1. Introduction
2. The Importance of Trade Finance
3. Challenges for Trade Finance
4. Current Efforts to Address Trade Finance Issues in Developing Countries
5. Recommendations

Introduction

- The 39th Meeting of the Bureau of the COMESA Committee of Governors of Central Banks, which was held on 4th December, 2018, noted that the African Continental Free Trade Area (AfCFTA) agreement ushered in a new era of deeper collaboration in trade among African countries. Once fully implemented, the AfCFTA is expected to cover all 55 African countries, with an estimated combined current GDP of US$2.5 trillion, and a population of over one billion, 60 percent of whom are below the age of 25 years.
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Introduction

- The AfCFTA builds on level of integration attained by regional economic communities (RECs), the Tripartite Free Trade Area (TFTA), composed of the Southern African Development Community (SADC), the Common Market for Eastern and Southern Africa (COMESA), and the East African Community (EAC).
- Governors agreed that lack of trade finance can limit the full trade potential of ACfTA and TFTA and therefore chose the topic of this presentation as one of the Sub-themes of the Symposium
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Trade Finance in Brief

- Today up to 80 percent of global trade is supported by so me sort of financing or credit insurance
- A lack of Trade Finance is therefore a significant non-tariff barrier to trade, particularly for developing countries.
- The key aspect of trade finance is that it helps mitigate the risk of cashless trade transaction through two channels , n amely inter-company credit and Bank intermediated Finan ce.

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- While the commercial risks involved in an international trade seem in principle to be larger than in a domestic trade transaction- trade finance is considered to be a particularly safe form of finance since it is underwritten by strong collateral and documented credit operations
- Research suggests that, an absence of, or weak access to trade finance by SMEs limit their level of involvement in international trade- Market failures, notably in financial markets(be they financial crisis or “information asymmetry”, fall disproportionately on SMEs, resulting in more credit rationing , higher costs of screening and higher interest rates from banks than larger enterprises

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- Other Surveys indicate that credit constraint on SME’s were found to be much higher than those placed on larger firms, to the point of leading the SMEs to stop exporting altogether.
- A survey conducted by the WTO and OECD in 2013 as a background for the Fourth Global Review of AID for Trade concluded that lack of access to trade finance was a key obstacle to low income-countries participating in global value chain

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– Local banks are even more conservative about supporting developing countries exporters and importers, since they lack the capacity, knowledge, regulatory environment, international network and/or foreign currency to supply import and export related finance.

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- Equally traders may not be aware of the available products, or of how to use them efficiently
- The African Development Bank has estimated that Africa has an unmet demand for trade finance of more than USD90 bn annually

Challenges for Financing Trade

The following are some of the key challenges for trade finance in developing countries:

- Reduced capacity for the local banking sector to support the trade sector;
- Weak client creditworthiness and insufficient collateral

Challenges Financing Trade

- Insufficient information about trade finance products offered by the local banking sector,
- Lack of awareness by regulators(Central Banks) about appropriate regulation for trade finance products . For example in some countries(e.g Myanmar) outdated regulations prohibiting importers for paying for foreign goods with cash in advance, or local exports

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From being paid after export.

- The possibility of limited interest of many foreign ban ks in penetrating the domestic market in some countri es in part due to resizing of their global network;

The following are some of the Efforts

- Multilateral development banks are exerting more effort to support a global network of trade finance facilitation programmes. For example AfDB has established the first trade finance initiative in 2009 with a size of USD 1 billion.

- A 2014 WTO –OECD survey found that the lack of integration of low income countries into the global value chains is a major obstacle to development. In such countries , the local financial sectors ability to provide for supply chain finance arrangements is limited. SMEs are largely excluded from the private supply chain financing systems. To address this challenge , Multilateral Development Banks are extending receivable financing arrangements through local banks to help integrate small manufacturers from promising countries into international supply chain.

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- Private markets are also innovating to make trade finance more readily available to SMEs. Factoring is the fastest growing source of short-term financing for SME suppliers. It allows suppliers with weak credit ratings to access funding based on the value of their receivables (confirmed invoices), different from traditional lending relationships.

Continuation

- Avoiding the unintended consequences of Basel III in trade finance, particularly from developing countries . Traditionally trade finance – mainly letter of credit and other self liquidating instruments of payment for trade received preferential treatment from national and international regulators on grounds that it is one of the safest ,most collateralized and self liquidating form of finance. The Basel III guidelines on liquidity proved to be favourable to short term self liquidating trade finance instruments.
- Enhancing the capacity of the local banking sector to support trade

Recommendations

- Policies geared towards facilitating more financing to SMEs and those in need should focus on meas ures intended to de-risk trade finance transactions and improve credit information systems.
- Financial sector reforms should include measures geared towards revisiting banks' underwriting proc ess, as well as their lending approach, to make the mmore relevant to customers in need, particularly SMEs to which a high risk perception is attached.

Recommendations

- Encourage reforms and Policies that reduce infor mation asymmetry and facilitate credit information sharing through creation of credit information Bure aus and setting up of national collateral registry.

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- Implemetation of regulatory reforms, aimed at promoting trade facilitation as well as better designed and implemented regional trade agreements, and other trade facilitation policy measures to ensure that FTA's are well functioning and facilitate access to trade finance for the benefit of intra-Africa trade.
- Know your customer (KYC) and regulatory compliance challenges faced by international banks with respect to their African correspondent banks need to be tackled more vigorously to avert any withdrawal of these institutions from Africa or any meltdown or correspondent banking relationships

Questions & Answers

THANK YOU