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**TRADE FINANCING AND THE ROLE OF REGIONAL  
FINANCING INSTITUTIONS IN PROMOTING SOUTH-  
SOUTH TRADE & INVESTMENT**

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The views expressed are those of the author and do not necessarily reflect the views of UNCTAD

# TRADE FINANCING AND THE ROLE OF REGIONAL FINANCING INSTITUTIONS IN PROMOTING SOUTH-SOUTH TRADE & INVESTMENT



By

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*The Trade Finance Bank for Africa*



## Outline

1. Introduction
2. Recent Trends in Africa – South Trade
3. Inhibitions to Access of African Counterparties to Trade Finance
4. Afreximbank's Support for Africa – South Trade
5. Conclusions/Recommendations



# 1. Introduction

## 1.1 Preamble

We (at Afreximbank) are pleased to participate in this Expert Meeting to share our thoughts on the role and contribution of regional development banks to the financing of South - South trade within the framework of South - South Cooperation.

## 1.2 In this Presentation, I will:

1. provide an overview of recent trends in Africa - South trade and its increasing role as a major driver of growth in Section 2;
2. highlight key inhibitions to access of African counterparties to trade finance in Section 3;
3. Elaborate on Afreximbank's support for Africa - South trade in Section 4; and
4. Conclude with some recommendations in Section 5.



## 2. Recent Trends in Africa – South Trade

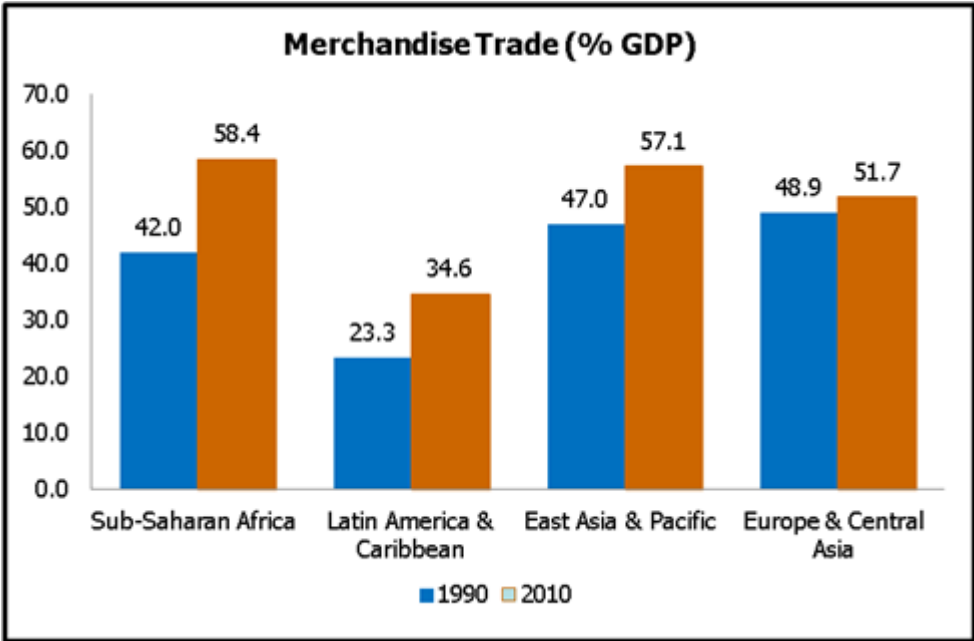
### 2.1 Trade as Driver of Growth Across Developing Regions

- Trade continues to be a principal driver of output growth in many economies across the “South”, particularly in Developing Asia and Africa;
- The well-documented contribution of trade to economic growth evidenced by the economic success of the Newly Industrialized Economies of Asia (NIEs)<sup>1</sup> led many countries in the developing world to adopt an export led growth strategy starting from the late 1980s.
- For almost all the NIEs, the adoption of export-led growth strategy led to:
  - accumulation of trade-supporting capital investment/infrastructure;
  - growth in trade-led FDI and other forms of capital inflows which contributed in closing domestic savings/investment gaps;
  -

Include Hong Kong, Singapore, Taiwan, and South Korea.



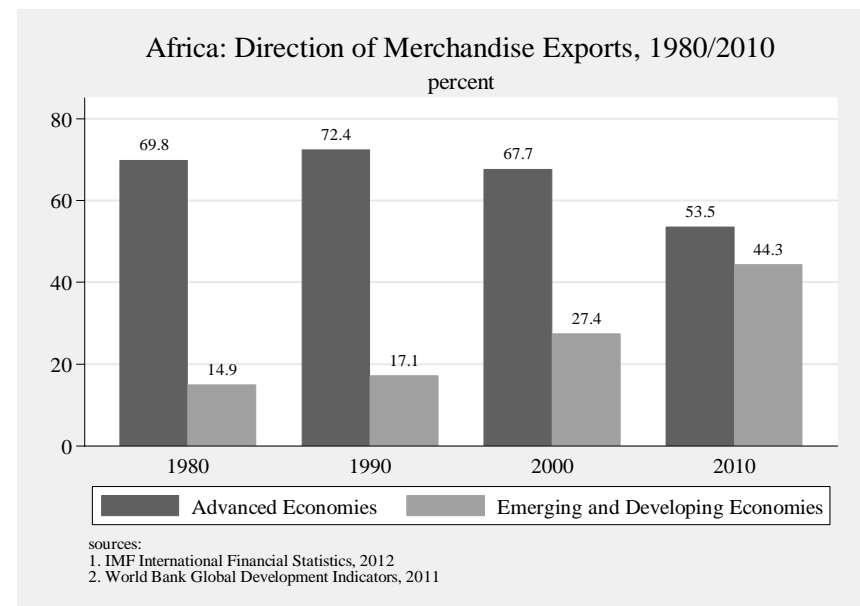
- sustained improvement in factor productivity and efficient use of resource;
  - rapid industrial development due in part to technological advancements achieved through “learning by doing”; and
  - development of state-sponsored trade (especially export) promotion institutions.
- The remarkable success of the NIEs led many economies in the South to adopt export-led growth strategy during the last two decades;
- For almost all these developing regions, trade currently accounts for more than 50% of GDP (World Bank, 2012):
- ✓ Africa (58%);
  - ✓ East Asia and Pacific (57%); and
  - ✓ Europe and Central Asia (52%) in 2010.



Source: World Bank, *World Development Indicators*, 2012

## 2.2 Recent Surge in Africa – South Trade

- Another important recent development in international trade is the growing volume of trade among developing regions, particularly Africa – South trade. For instance:
  - during the 1990s and 2000s, South – South trade grew twice as fast as North – South Trade;
  - during 2000-10, South – South trade grew at an average annual rate of about 14% compared to 5% for global trade;
  - the share of developing regions in Africa’s total trade also grew sharply from about 17% in 1990 to more than 44% in 2010; and
  - Developing Asia accounted for the largest share of the trade between Africa and the South.



### 3. Inhibitions to Access of African Counterparties to Trade Finance

- ❑ One of the principal inhibitions to the development of trade in the South is limited access to trade finance, and the very prohibitive/expensive terms of credit whenever it is available.
- ❑ In sub-Saharan Africa, where capital markets are underdeveloped, in-availability of trade finance has been singled out as the major constraint to trade development.
- ❑ The volume of South – South trade could be raised significantly if financial institutions in the South could evolve more innovative programmes and instruments to finance the trade.
- ❑ Several factors constrain availability of trade finance in Africa, including:

#### ***A. Old Inhibitions:***

- ❖ Underdeveloped financial sectors across Africa;
- ❖ Limited capacity of banks in structuring bankable trade and project finance deals;
- ❖ Low capitalization of banks due to low income and savings. This limits the capacity of banks to finance viable trade and project transactions;



- ❖ Limited national institutional support for the financing of trade. For instance, of the 54 African countries:
  - ✓ 15 have no Export Finance Institutions;
  - ✓ 11 have no Export Finance Institutions but have some state credit for domestic and export production;
  - ✓ 12 have some Institutional Facilities being administered by some government agencies;
  - ✓ 4 have broad institutional coverage including *Pre-Shipment Ex-port Finance, Pre-Shipment Short-Term and Medium Term and Long Term Finance*, and an *Export Credit Insurance/Guarantee*; and
  - ✓ **ONLY 4** have full-fledged trade finance institutions and support mechanisms.

## **B. New Inhibitions:**

### **➤ Impact of Global Financial/Eurozone Debt Crisis On Africa:**

- Cuts in trade finance lines to African counterparties – banks and traders;
- Higher cost of borrowing: pricing is higher in many markets with spreads exceeding 500 basis points over LIBOR;
- Shorter tenors: less than 180 days during 2009/11 versus 270 to 360 days in 2007;
- Stringent collateral requirements, including cash collaterals are again becoming important requirements for confirmation of Letters of Credit (LC) issued by African banks;
- International commercial banks that have historically provided LC confirmation lines for the trade are presently risk averse as a result of regulatory pressures to improve the quality of their loan assets and/or shore up their balance sheets; and
- Reduction in capital inflows (FDI, Worker Remittances, etc.) as a result of the economic challenges in OECD countries.



## 4. Afreximbank Support for Africa – South Trade

### 4.1 Supporting African Trade Through Partnership

#### *A.Cooperation Between DFIs & Exim Banks In Support of South – South Trade*

➤ In 2006, the Bank, in collaboration with UNCTAD and 4 Southern Exim Banks/DFIs, launched the “*Global Network of Exim and Development Finance Institutions (“GNEXID” or NETWORK)*”, to “pool” financial and technical resources to support trade and investment flows between economies in the South.

➤ Since its creation, GNEXID members have actively collaborated to support South – South trade, especially during the global financial and economic crises of 2008/09 by offering bilateral Lines of Credit (LOCs) to support trade between member countries.

## Specifically:

- A Line of Credit in an amount of USD 100 million was extended by Export-Import Bank of India to ECOWAS Bank for Investment and Development (EBID), both members of the Network;
- Afreximbank received from a partner of the Network, the International Financial Corporation (IFC), a Line of Credit in an amount of USD 200 Million; and a USD 100 Million Line of Credit from China Development Bank (CDB), China, a member of the Network;
- IFC offered JSC State Export-Import Bank of Ukraine (Ukreximbank), an Enhanced Guarantee Facility to enable it (i.e., Ukreximbank) finance capital good imports from Ukraine;
- PTA Bank (the Trade and Investment Finance Bank for the COMESA region) received from Exim Bank of India approximately USD 200 million to fund essential imports of goods and services from India in favour of its member countries during 2009/11;

- The Development Bank of Southern Africa offered Afreximbank a trade finance line of USD 50 million to enable the Bank address critical import finance needs of some member countries in the Southern African region that were affected by the global financial and economic crises;
- The PTA Bank secured a USD50 million Line of Credit from China Development Bank. The proceeds of the credit line was used to support projects in the telecommunications, mining, infrastructure and other key sectors identified by PTA Bank Member States; and
- In November 2011, the Export-Import Bank of India extended a Line of Credit of USD 20 million to the Nigerian Export-Import Bank for the financing of essential imports of goods and services from India to Nigeria.



### ***B. Afreximbank: Partnering to Support African Trade***

- ❖ Afreximbank, at the height of the global financial crisis, deepened its partnership with ECAs (in both North and South) and DFIs in order to ensure that African trade does not decline as a result of lack of trade finance;
- ❖ Through partnership, the Bank successfully raised about US\$2 billion from a pool of DFIs and exim banks, including Exim China, China Development Bank, Exim India, Exim Korea, JBIC, SACE, EDC, IFC, DBSA, US-GSM Programme and EKN.

### ***C. Other Initiatives for Promoting Africa – South Trade***

- ❖ The Bank is currently working with UNCTAD as well as CAF and BLADEX, the regional development and trade finance banks respectively for Latin America to pool financial and technical resources to boost trade and investment flows between Africa and Latin America;

- ❖ Working with Exim China, the Bank held a Trade and Investment Exhibition in China in July 2012, on the sidelines of the Bank's 19<sup>th</sup> Annual General Meeting, to showcase trade and investment opportunities in Africa and China to African and Chinese investors and traders; and
- ❖ Further, on that occasion, the Bank worked with Exim China to canvas for the creation of Africa–China Business Association to deepen trade and economic relations between Africa and China.

#### ***D. Afreximbank's Near Term Goal of Facilitating Africa – South Trade***

- ❖ Going forward, the Bank will continue to facilitate Africa – South trade and investment flows by:
  - ✓ Actively exchanging Lines of Credit with Southern development banks, such as Exim India, Exim China, CDB, CAF and BLADEX, among others, to facilitate Africa – South trade;
  - ✓ Encouraging Southern investors and businesses to invest in Africa by providing them with Afreximbank's Country Risk and Investment Guarantee Facilities;

- ✓ Working with its partner DFIs and Exim banks to organise *Trade and Investment Exhibitions* to educate the international investor communities of the trade and investment opportunities in the South; and
- ✓ Collaborating with its partners (DFIs, ECAs etc.) to organise annually, an Economic Forum to identify and showcase “existing and emerging business opportunities” for which constructive partnerships and joint-ventureships between Southern entrepreneurs and businesses as well as regional DFIs may be required to fully exploit.
- ❖ In furtherance of this goal, Afreximbank is currently working with CAF and BLADEX as well as UNCTAD to organise in early 2013 a Seminar on trade and investment opportunities in Africa and Latin America for the benefit of the banking and business communities in the two regions.



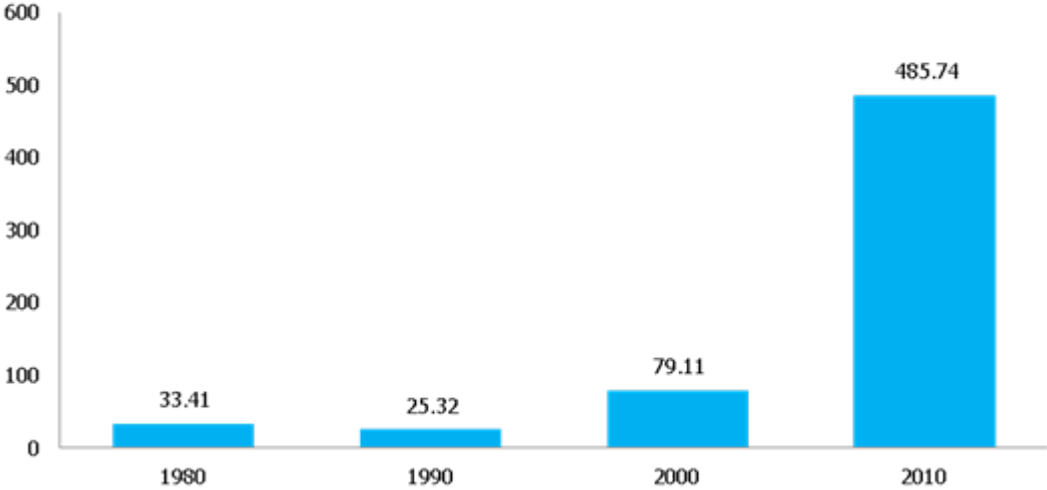


## 4.2 Mobilizing Domestic Resource for Trade and Investment

- It has been suggested that Africa and other developing economies would be better off by mobilizing part of their growing external reserves to finance viable trade and project ventures in the South;
- For example, total external reserve holdings of African countries, as a group, with OECD banks grew at an average annual rate of 17% between 1990 and 2010 to US\$485 billion.
- It has been argued that Africa could close part of its huge trade and infrastructure financing gaps by using part of its reserve to fund its trade and infrastructure development.

- This is important given the fact that Africa’s external reserves held with OECD banks presently yield paltry or no significant financial return as a result of the current “near-zero” rate of interest in global markets.

Africa’s Total Reserves Excluding Gold, 1980-2010 (US\$ Billion)



Source: World Bank World Development Indicators, 2012



## ❑ *Afreximbank's Central Bank Deposit/Investment Programme (CBDI)*

- This issue of how to optimize the benefits from Africa's growing external reserves was extensively debated at Afreximbank's 15<sup>th</sup> Advisory Group Meeting that held in July 2009 in Gaborone, Botswana.
- At that meeting, a consensus emerged that the Bank should consider the possibility of introducing a product that would enable it to attract part of this growing reserves holdings of the Continent to fund Africa's trade development.
- In response to those suggestions, Afreximbank in 2010/11 introduced the *Central Bank Deposit/Investment Programme*.



- The CDBI is a financial programme intended to mobilise part of the growing foreign exchange reserve of African central banks to fund viable trade and project ventures in Africa as part of on-going efforts at making Africa's growing external reserves more supportive of the continent's trade and economic development.
- The CDBI Programme has three facilities:
  - ***Central Bank Time Deposit Account (TDA)***

This account is intended to attract deposits from African central banks with “surplus” reserves (i.e., reserves over and above what is required to fund 4 to 8 months of imports). The TDA provides higher return than would otherwise be earned on placement elsewhere by African central banks.
  - ***National Export Support Account (NESA)***

This is a special account to be held by Central banks with surplus external reserves over and above their country's short term external financing requirements, for the purpose of pre-financing national exports into other African countries (i.e., intra-African trade).

- ***Afreximbank Investment Account (AIA)***

This is a negotiable certificate of deposit, called Afreximbank's Certificate of Deposit (ACD) with maturity of between one to three years. It is a certificate of deposit in the sense that the deposit-making central bank could on the basis of its foreign exchange needs, unexpected variations in export earnings, FDI inflows, remittance receipts, among other considerations, negotiate the terms of the deposit/investment account with a view to arriving at a mutually acceptable terms.

## 5. *Conclusions/Recommendations*

### 5.1 **Conclusions**

- ✓ Better economic fundamentals and sustained expansion of the African and many Southern economies offer enormous opportunities for higher levels of trade and investment flows among developing economies in the South;
- ✓ To address the unrelenting surge in demand for trade finance, partnerships among development finance institutions in the South need to be forged to support South – South trade and investment flows; and
- ✓ Accordingly, it is important to strengthen partnerships with ECAs and DFIs in the South to enable them play a catalytic role of financing South-South trade and investments.

### 5.2 *Recommendations*

- Such opportunities can only be harnessed with improved availability of trade finance. In this regard efforts should be made to:

- Strengthen trade and development finance institutions in the South – e.g. governments can improve the risk taking capacity of export credit agencies by making extra capital available;
  - Strengthen trade finance support agencies such as collateral management agencies, rating agencies, and political risk insurance facilities;
  - Improve the use of bilateral payment arrangements among South economies;
  - Improve the capacity of developing countries EXIM banks and DFIs to support South – South trade and investment;
  - Set up new capital market fund to invest in South – South trade and investment; and
  - Improve the capacity of commercial banks in developing countries to work together.
- Through constructive partnership with Southern development banks, including CAF, BLADEX, Exim China, CDB, and Exim India, among others, Afreximbank intends to continue to leverage financial resources to fund trade and investment flows between Africa and economies in the South.



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